Accountings in Fiduciary Law

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The Uniform Trust Code employs the term "report" instead of "accounting" in order to negate any inference that the report must be prepared in ***any particular format*** or with a ***high degree of formality***. The reporting requirement ***might even be satisfied*** by providing the beneficiaries with copies of the trust's income tax returns and monthly brokerage statements if the information on those returns and statements is complete and sufficiently clear. The key factor is not the format chosen but whether the report provides the beneficiaries with the ***information necessary to protect their interests***. (Emphasis added.) [1]

Introduction

Accountings are a common event in fiduciary law. Accountings are also a frequent source of litigation. So what is an accounting? How are they attacked and defended?

It is commonly understood that a trustee is a fiduciary and must provide accountings to the beneficiary. It is less commonly understood what standards govern whether a particular accounting fulfills the duty of the trustee to the beneficiary. This article will attempt to answer that question.

"Accounting" is a word of art. The format of the accounting will vary depending upon the nature of the assets and the nature of the asset management by the fiduciary. Litigation can arise over various issues such as whether the fiduciary has a duty to provide an accounting at some particular time, whether the accounting is adequate, and what remedy is appropriate if the accounting fails in some regard.

There is also a degree of mystery that comes with the word "accounting." As quoted above, the Comment to Section 813 of the Uniform Trust Code substitutes the word "report" for the word "accounting." The UTC authors' comment seeks to eliminate the confusion that surrounds the concept of an "accounting."

Authority

Accountings represent an intersection between accountants and lawyers. To an accountant, the governing authority arises from the Washington Trust Act (RCW Chapter 11.98), Washington Uniform Principal and Income Act (RCW Chapter 11.104A), the Trustee's Accounting Act (RCW Chapter 11.106), the standards supported by the Generally Accepted Accounting Principles (GAAP) promulgated by the American Institute of Certified Public Accountants (AICPA), and the application of the Internal Revenue Code. For lawyers and judges, governing authority arises from case law, statutes and – in King County – the King County Probate Manual. When the court requires further guidance, we may also look to uniform codes, the policies of relevant professional groups, and the scholarly community (although these sources are not authority).

As a practical matter, we should start with the statutes and then turn to the case law to learn how the statutes are applied. Unfortunately, the statutes governing the topics of fiduciary duties and accountings are not organized into one convenient title or chapter. The statutes governing trust accountings and notifications are located in Title 11 in Chapter 96A (generally), Chapter 98 (generally), Chapter 100 (nonroutine notice), Chapter 106 (Trustee's Accounting Act), and perhaps other chapter references.

In addition, specific sources of authority for trustees, personal representatives, and guardians include:

Trustees. *In re Estate of Ehlers*, 80 Wn. App. 751, 761, 911 P.2d 1017 (1996); *Fred Hutchinson Cancer Research Ctr. v. Holman*, 107 Wn.2d 693, 716, 732 P.2d 974 (1987); *Porter v. Porter*, 107 Wn.2d 43, 726 P.2d 459 (1986); *In re Estate of Cooper*, 81 Wn. App. 79, 94, 913 P.2d 393 (1996).

Personal Representatives. RCW 11.68.065 and RCW 11.28.290; *In re Estate of Jones*, 152 Wn.2d 1, 93 P.3d 1247 (2004); *In re Estate of Livingston*, 7 Wn. App. 841, 502 P.2d 1247 (1972); *In re Estate of Aaberg*, 25 Wn. App. 336, 607 P.2d 1227 (1980).

Guardians. RCW 11.92.040, RCW 11.92.050, and RCW 11.92.053; *In re Guardianship of Deming*, 192 Wash. 190, 73 P.2d 764 (1937); *In re Montgomery's Estate*, 140 Wash. 51, 248 P. 64 (1921).

1. Other Fiduciaries. Other fiduciaries would include partners, attorneys-in-fact, corporate directors, and LLC managing members. The issue of who qualifies as a fiduciary is not always clear. Guidance on this issue was recently provided in *Alexander v. Sanford*:[2]

On the other hand, a fiduciary relationship arises in fact when there is "something in the particular circumstances which approximates a business agency, a professional relationship, or a family tie, something which itself impels or induces the trusting party to relax the care and vigilance which he otherwise should, and ordinarily would, exercise.

Practice Tip: The guidance provided in *Alexander* could be applied to many persons who have a close or confidential relationship with the person whose benefit is intended by the relationship. This could impose the requirements of fiduciary duties on many persons who, if asked, would not otherwise have chosen to accept those duties. Whether a confidential relationship exists is a common issue in will contests. Under *Alexander*, any person who occupies a close relationship may be held to the strict liability standard of a fiduciary.

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Community Standards

The common law standard of an acceptable accounting is whether that accounting meets "community standards." This is typically established by the opinion testimony of someone who can be qualified by the court as an expert. Typically, these experts are accountants, employees of professional guardianship services or trust companies, or other professional fiduciaries.

Case law offers little guidance on the adequacy of accountings. Although there are many reported cases that involve an accounting, those cases hold, generally, that a fiduciary has a duty to account, has a duty of loyalty, and a duty "to make a full, fair, and timely disclosure to the principal of all facts within the knowledge or coming to the attention of the fiduciary."[3] Such general statements do not provide any specific guidelines as to the form and content of an acceptable accounting. So, how do we ascertain and apply a "community standard" to those general statements?

The difficulty of defining a community standard is illustrated by *Cook v. Brateng*.[4] The court in *Cook* held that former RCW 11.106.020 required an accounting to disclose only cash receipts and disbursements, without requiring disclosure of substantial changes in net worth that occurred during the accounting period. In *Cook*, the daughter of a decedent claimed unpaid back compensation for providing care services to her father. Her claim was disputed by her brother, who argued that she had breached her duty, as their father's attorney-in-fact, to account during their father's lifetime. During their father's life, the sister did provide an accounting to her brother. However, the accounting did not disclose any indebtedness of the father to the daughter for any of her claimed compensation. The brother argued that his sister had a duty to disclose in her accounting that she was incurring a large indebtedness against the assets of their father; he further argued that she had breached that duty by not disclosing the indebtedness in the accounting. The court held that the accounting was in strict compliance with the prior statute because the accounting provided a listing of receipts and disbursements, noting that the statute required nothing more. An accounting under the prior statute, therefore, would not require disclosure of massive debt accumulation nor, impliedly, of any assets that were not producing income (for example, artwork, intellectual property rights, etc.). The court observed that the common law duty requires a trustee must inform all parties of any trust matters that would affect their interests.[5] The court in *Cook*, however, held that if a party (the brother) could "reasonably expect" that debts would be incurred, then the trustee did not breach her duty to disclose. Accordingly, "reasonable expectations" seems to trump actual disclosure. The premise of the court's reasoning was that the brother's interest was not prejudiced, because he knew his father needed the care services and he should have known that those services would have to be paid for.[6] This reasoning however, clearly would not apply to the accounting of any business entity such as a partnership, corporation, or LLC. For this reason, *Cook* provides little in the way of practical value in seeking to advise our fiduciary clients.

The court in *Cook* would also leave the CPA retained to prepare an accounting in a quandary. The CPA may wonder: Who are all of the persons with an interest? What nondisclosures might prejudice their interest? What activities by the fiduciary could fall within the court's anticipation of what an interested party may "reasonably expect?" Does the accounting need to disclose more information than compliance with a minimal standard of only "receipts and disbursements?"

Practice Tip: Notwithstanding that *Cook* arose prior to the current statute, the court's opinion provides an illustration of why it is important to discuss the purposes of an accounting with the client. It is primarily the lawyer's job to characterize the "interests" of a person and to ascertain whether that person's interests have been prejudiced. Consequently, it is important to define the scope of the accounting with the client and to discuss with the CPA how to address the reporting of assets such as artwork or intellectual property rights and their respective valuations.

Recent Statutes and the Community Standard

Trustee's Accounting Act – Chapter 11.106 RCW

Chapter 11.106 of the Revised Code of Washington provides for an annual statement and for intermediate and final accounts.[7] The annual statement shall include "a written itemized statement of all current receipts and disbursements made by the trustee of the funds of the trust" and, if requested by a beneficiary, "an itemized statement of all property then held by the trustee."[8]

An intermediate account must show the period covered and the principal carried forward from the last accounting or inventory, an itemized statement of all principal funds received and disbursed, an itemized statement of all income received and disbursed, the balance remaining, and how it is invested.

Query: Do the above elements replace the concept of a community standard? If the trust accounting contains each of the above elements, then argument by counsel (without an expert) that the statutory standard was met could be presented to the court.

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1. RCW 11.96A.070

RCW 11.96A.070 (1)(a) and (b) provide in relevant part:

> (1)(a) A beneficiary of an express trust may not commence a proceeding against a trustee for breach of trust more than three years after the date a report was delivered in the manner provided in RCW 11.96A.110 to the beneficiary or to a representative of the beneficiary ***if the report adequately disclosed the existence of a potential claim for breach of trust*** and informed the beneficiary of the time allowed for commencing a proceeding.
>
> (b) ***A report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows or should have known of the potential claim.*** A report that includes all of the items described in this subsection [(1)](b) that are relevant for the reporting period is presumed to have provided such sufficient information regarding the existence of potential claims for breach of trust for such period:
>
> (i) A statement of receipts and disbursements of principal and income that have occurred during the accounting period;
>
> (ii) A statement of the assets and liabilities of the trust and their values at the beginning and end of the period;
>
> (iii) The trustee's compensation for the period...

(Emphasis added.)

RCW 11.96A.070 defines the role of "sufficient information" in the context of a statute of limitations. The section provides that the provision of certain information creates a presumption of having provided "sufficient information" to the beneficiary. Although RCW 11.96A.070(1) applies only to the determination of when the statute of limitations on a claim for breach of fiduciary duty begins to run, the provision is important because it specifies just what information is presumed "sufficient" to inform the beneficiary of a potential claim. Although the beneficiary could rebut this presumption, this definition of a presumption based upon "sufficient information" clearly suggests a standard for what constitutes an adequate accounting.

However, it can also be argued that RCW 11.96A.070 does not even apply to the standards of an acceptable accounting. The provision mentions only a "report" and does not use the word "accounting." Obviously, however, a report could include an accounting.[9] The larger issue is that the various statutory provisions address differing public policy concerns. It is an open question as to whether the public policy concern of providing sufficient information to trigger the running of a statute of limitations, for example, is the same public policy concern for the sufficiency of an accounting. Both the presumption described in RCW 11.96A.070 and the Comment to section 813 of the Uniform Trust Code are significant in that they may specify what information is sufficient in an accounting by providing a minimum standard. If the minimum information is provided, then the fiduciary has the benefit of a presumption in his or her favor. Prior to these statutory provisions, the fiduciary had the burden of proving the adequacy of the accounting. Now, with the statutory presumptions that favor the fiduciary, the beneficiary must come forward with reasons as to why the presumption should be rebutted. Whether RCW 11.96A.070 defines a new standard for an "acceptable" accounting is likely to remain an open issue until the ambiguity is resolved by a published opinion from an appellate court.

2. RCW 11.98.072

RCW 11.98.072(1) provides, in part: "A trustee must keep all qualified beneficiaries of a trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests." This provision does not mention either an "accounting" or a "report"; however, it echoes the language of "necessary to protect their interests" from both the Comment to section 813 of the Uniform Trust Code and RCW 11.96A.070(1).

Consequently, Washington still has no definitive format for an acceptable accounting. This is appropriate, however, given the need to accommodate different trust purposes, the varying complexity of assets in different trusts, the differing events in any particular trust administration, and the purpose of any particular accounting. In a general sense, an accounting is basically a tool to provide information to a beneficiary and to the court, in order that the administration and finances of a trust can be understood. The accounting should provide transparency so that anyone with a financial interest in the trust can be protected. The accounting must be reliable and must make a full disclosure of all relevant information, both favorable and unfavorable to the fiduciary. As a tool, it must be adaptable to the unique circumstances of any particular trust and to the different financial assets that might comprise different trusts. Because it is an informational tool, the requirements of an acceptable accounting must encompass more flexibility than any fixed format can provide.

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Burden of Proof When an Accounting is Contested

Unlike the general rule in most civil cases, the petitioner who is attacking the accounting does not bear the burden of proving that the accounting is inadequate. Instead, it is the defendant fiduciary who must prove that the accounting is adequate. In *In re Tembreull's Estate*, the Washington Supreme Court held:

> "It is the universal rule that … where an accounting is had, **it is the duty of a partner who manages**, conducts, or operates a partnership business, **to render complete and accurate accounts of all of the partnership business**, and … when a managing partner who keeps the books is sued for settlement, he must sustain the burden of proof of the correctness of the account. In so doing, he will be held to strict proof of the items of his account. This proof must be by way of the books of the firm, showing the income and expenses, together with the necessary vouchers and checks and the amounts of the various items.[10]

The negligent breach of the duty to account is "tantamount to constructive fraud." [11] Further, if the books and records are unintelligible, every presumption will be made against those to whose negligence or misconduct the non-production of proper accounts is due. [12]

Practice Tip: Prepare your client's attack on the accounting by switching the burden to the fiduciary.

Remedies on a Disallowed Accounting

The remedies available to the court are equitable and are very broad. For example, equity has the power to compel the return of converted property, to set aside gifts, to disgorge fees, to disgorge the profit obtained from any self-dealing, to impose a constructive trust or an equitable lien, to impose monetary damages, and to award attorney fees and other costs of the challenger.

Breach of a fiduciary duty imposes liability in tort. [13] Both statute and common law principles provide damages as a remedy to such breach. First, RCW 7.21.030(3), the statute that authorizes remedies for contempt, provides that "in addition to the remedial sanctions set forth" in the statute, the court may "order a person found in contempt of court to pay a party for any losses suffered by the party as a result of the contempt," including costs and attorney fees.[14] Also, RCW 11.28.300 gives a successor personal representative a cause of action against "any delinquent former personal representative." Under RCW 11.28.300, the court may in its discretion enter judgment for damages, including reasonable attorneys' fees and statutory costs.[15] Finally, common law imposes liability in damages upon a fiduciary who fails to account for property and funds that come into his possession.[16]

The measure of damages against the wrong-doing former fiduciary will be the difference between the value of the assets inventoried (or last accounted for) and the value of the assets received by the successor fiduciary. The assets identified in the inventory or, alternatively, in the last periodic accounting are always a convenient starting point. Of course, the reliability of the inventory or of the last accounting may be called into question.

The measurement of damages is problematic in those cases where no inventory was ever filed and no previous accounting was provided. In those cases, you have no starting point from which to calculate damages. Without such a starting point, a challenger will have a serious conceptual issue as to how to enter a judgment that meets the requirement of being supported by evidence. In these cases, the challenger must present the best evidence available of the loss and then ask the court to shift the burden to the former fiduciary to rebut the claim. This satisfies any concerns for fundamental fairness because the former personal representative is the person who actually had the assets. Consequently, the only alternative for the innocent heirs is to reconstruct the reasonable value of the estate from whatever facts are known to the parties and then ask the court to make reasonable inferences from those facts. By shifting the burden, the court imposes the liability upon the person having possession rather than upon the innocent heirs.

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1 Uniform Trust Code § 813 cmt. (amended 2004).
2 181 Wn. App. 135, 173, 325 P.3d 341 (2014).
3 Cogan v. Kidder, Mathews & Segner, Inc., 97 Wn.2d 658, 662, 648 P.2d 875 (1982).
4 158 Wn. App. 777, 262 P.3d 1228 (2010).
5 *Id.*
6 *Id.*
7 RCW 11.106.020; RCW 11.106.030.
8 RCW 11.106.020.
9 *See* Comment to section 813 of the Uniform Trust Code, *supra*.
10 37 Wn.2d 93,102, 221 P.2d 821 (1950) (citing *Simich v. Culjak*, 27 Wn.2d 403, 178 P.2d 336, 339 (1947)) (*emphasis added*).
11 Hsu Ying Li v. Tang, 87 Wn.2d 796, 800-01; 557 P.2d 342 (1976).
12 Cederlund v. Cederlund, 7 Wn. App. 320, 321; 499 P.2d 14 (1972).
13 Micro Enhancement International, Inc., v. Coopers & Lybrand, LLP, 110 Wn. App. 412, 433-34, 40 P.3d 1206 (2002).
14 McFerran v. McFerran, 55 Wn. 2d 471, 476, 348 P.2d 222 (1960).
15 RCW 11.76.070.
16 Restatement (Second) Trusts, § 172 cmt. b (1959).