ACCOUNTING

Rachelle Pelkman, Trust Accountants Ltd

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Lindsay: I'm pleased to introduce Rachelle Pelkman, the owner of Trust Accountants Ltd in Auckland. Rachelle's a Chartered Accountant with an extensive background in trust accounting, specialising in family and charitable trusts. She's also Convener of the Trust Special Interest Group of the New Zealand Institute of Chartered Accountants in Auckland which meets every few weeks to discuss topical trust issues.

Rachelle, we're talking about managing trust accounting and why that's important. When should trustees start thinking about their trust accounting?

Rachelle Pelkman: It needs to be part of the preliminary considerations well before a trust is set up. The first step is to consider why you are setting up the trust, who will benefit and then look at what assets are to be brought into the trust.

Part of that initial set up process involves looking at the value of those assets and considering any tax implications that may be associated with bringing those assets into trust. For instance, if you're transferring shares held in a private company to a trust, there is the potential to lose imputation credits and accumulated tax losses. A sale of a rental property to a trust can trigger a depreciation recovery so it is important to talk to your accountant and get some good advice first.

I would recommend that anyone who is looking at setting up a trust, who has a trust, or is a trustee of a trust, read about trusts to increase their knowledge. It will help give them a good grasp of what a trust is, what assets should be managed by the trust and how a trust should be properly run.

The trustees should also look to get a good team of professional advisers behind them, for example, an accountant, a lawyer and an investment advisor.

Lindsay: So you need to be thinking about getting good accounting advice right from the outset when you start thinking about setting up a trust and I also like your recommendation of putting together a team of professional advisers who can support the trustees. Let's take a look at the annual financial statements of a trust. Why are they important?

Rachelle: The financial statements show trustees what assets are held by the trust and what liabilities are owed by the trust. They also provide details of income received, distributions made to beneficiaries, payments made and tax liabilities, so in my view, they're important.

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The financial statements provide a good starting point at the annual trustee meeting for the trustees to discuss what has happened in the trust and for reporting to the beneficiaries. While there really is no requirement to prepare financial statements in any particular format, a trustee is required to be able to account to the beneficiaries.

The financial statements provide transparency of the financial transactions and finances of the trust. They assist the trustees to tell the beneficiaries what has happened within the trust which is important as it is the beneficiaries who can enforce a trust and hold trustees to account.

Finally, good financial records are part of good trustee record keeping and I'd recommend trustees keep all their supporting invoices, receipts, bank statements and other documents together to make it easy to prepare the annual financial statements and tax returns for the trust.

Lindsay: So, the annual financial statements are an important part of having good checks and balances in place as trustees – as a mechanism to initiate the annual trustee review, for reporting to beneficiaries on what's been happening and as part of ensuring proper record keeping is in place.

Your point about transparency to beneficiaries is an important one. I've seen some real problems arise when the day to day management of a trust lapses – annual meetings stop, financial statements don't get prepared and the paper work ends up in a shambles. While I sense some trustees are reluctant to issue financial statements to beneficiaries, the issuing of financial statements does help trustees demonstrate their accountability to beneficiaries and show a trust is being properly run.

Rachelle: Absolutely. Financial statements are a good way to help trustees meet their obligation to account to the beneficiaries of a trust.

Lindsay: What are some of the problems you're seeing trustees making around managing their trust accounting? What are some of the things that trustees need to be watching out for?

Rachelle: The first problem would be in situations where no financial statements have been prepared by the trustees. If a beneficiary ever asks the trustees questions about what has happened within the trust, it is actually very hard for the trustees to backtrack at a later stage and reconstitute the financial statements for previous years, particularly if the trustees end up in a legal dispute with the beneficiary.

Another problem would be poor record keeping and the intermingling of transactions which is a frequent issue. The intermingling of transactions occurs where the financial transactions for the trust are

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not kept separate from personal transactions. A trust needs to have its own bank account.

I've also found that the ownership of assets has not always been properly completed into the trustees' names. For example, shares are still registered in the settlor's name instead of the trustees' names. It's also important as part of the transfer of any assets into trust that the insurance company or broker is asked to change the insurance policies for the trust assets into the trustees' names. It is something that can easily be missed.

I've seen trustees run into problems when they haven't recognised the need to prepare tax returns for their trust. The trust is set up and income is received on the trust assets. At some point of time in the future, the Inland Revenue Department comes along and asks the trustees to file tax returns, which until that time the trustees hadn't realised were needed.

GST, is another area where trustees can easily get caught, especially where GST is payable and the GST returns haven't been filed.

Lindsay: There have been recent cases where Inland Revenue has chased trustees personally for outstanding tax or GST owed by a trust. Have you got an example of where that's happened?

Rachelle: Yes. I had a situation where the GST returns hadn't been filed by the trustees; in fact many of the trust records had been lost. The independent trustee was asked by Inland Revenue to file the GST returns and told by Inland Revenue that they would be held personally liable as a trustee for the GST owing. The GST in that trust went back several years and in the end, the independent trustee was responsible for paying the outstanding GST.

So, it can be a real risk to any trustees who are not taking responsibility for checking to make sure that any tax or GST obligations of the trust are being met and paid.

Lindsay: Those examples really show how important it is for a trust to be managed properly and for all trustees to know what's going on. You mentioned the intermingling of trust and personal financial transactions in bank accounts. Presumably that's where it would be important for all trustees to keep an eye on what's happening with the trust cheque book and bank account?

Rachelle: Yes. Setting up a separate bank account is really quite vital in a trust and I think it is a good way of demonstrating that the trust is a totally separate arrangement. I'd recommend there is a separate bank account for the trust and that trust transactions are not being intermingled with personal transactions.

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All trust expenses and payments should be paid through the trust bank account and all trust receipts like interest or dividends should be received through the trust bank account. That way all trust transactions will be kept totally separate from private transactions.

Lindsay: I think that just reinforces the point you made earlier about the importance of trustees getting good accounting advice and ensuring everything is set up right from the outset. Rachelle, what would you then suggest are some good practices for trustees to manage their trust accounting?

Rachelle: There are a few good practices I'd recommend for trustees for both their trust accounting and their trust administration. While we've covered some of them already, I'd summarise them as:

- Get good trust accounting advice – especially when the trustees are receiving any new assets into trust and well before anything is actually put into trust.
- Prepare a financial statement annually – even it's just a simple "one pager" for a trust with a few assets (for example, in a trust where there is just a family home and a bank account).
- Set up a separate bank account for the trust. Make sure all trust receipts and payments are made through it and that all trustees keep close control and oversight of the trust cheque book and bank account.
- Keep good trust records. Keep a Trust File with all correspondence, invoices, receipts, bank statements and other legal documents in one place where they are easily accessible.
- Meet as trustees at least once a year. I'd encourage trustees to get their "adviser team" involved in trustee meetings – the accountant, lawyer and investment advisor as well.
- Record decisions properly. Take minutes or notes of what takes place and is agreed at trustee meetings; have resolutions signed by all trustees for decisions as they are made.
- Complete regular reviews of the trust. Use the annual financial statement as a basis for a trust review; as trustees discuss what has happened in the past year, what will be happening in the year ahead; consider what income has been received, who is entitled to it and when and how it should be distributed. These are questions trustees should be asking.
- Review investment performance annually – check the trust has the right investment strategy and asset mix to achieve the trust's investment objectives.

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- Review annually that trust assets are properly protected, maintained and insured.

So yes, the annual review is a good opportunity to sit and look at the Trust, how it has performed and where it is going in the future. It is the time to plan.

Lindsay: Rachelle, those are really good suggestions for better trustee practice and not only for why accounting is important for Trustees! Thank you for your recommendations for better trust accounting and better trustee practice. I know if people wish to make contact then they can do so through your website www.trustaccountants.co.nz.

Rachelle: Thanks Lindsay.