

It's Not Easy to Act as a Trustee If You Want to do it Right A Short Case Study!

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Few of us have any idea of the role of trustee yet many of us are asked at one time or another to assume that role. And, because the requestor is typically a friend, a relative, or some other acquaintance, we acquiesce and say yes. That can be a huge mistake.

In 2013 a client asked me to consider taking on the role of trustee for three trusts, trusts set up by the owners of the company for their three children. The trusts had been created and funded in prior years when the company was extremely profitable. The parents, concerned that their offspring may not be particularly wise with any money they may receive from the parents desired that an independent trustee manage the assets in the trusts and manage distributions.

Because the parents had been wonderful clients and good friends as well, I consented to take on the role. And for the same reasons I decided to take on the role, that the parents had been wonderful clients and good friends as well, it's possible, in fact it's certain, that my accountant antennae may not have extended with regard to potential problems. Another fact that should have raised concerns, but unfortunately did not, was that the client was no longer my client but remained the client of the large firm from which I had resigned in 2011. After 2011 my only contact with the client had been audit workpaper preparation assistance, bookkeeping assistance, internal control recommendations, coffee breaks in their kitchen, and now, trustee of their children's trusts.

But, in any event, all trust documents were amended, at a cost to the client, to name me the trustee. I met with the bank, ordered new checks, and set up the trust accounting records on Quickbooks on my server, the server used in my sole practitioner CPA practice.

All went well closing the 2013 fiscal year as there was really not much to do. The trusts were shareholders in an S-Corp and my previous employer furnished me with K-1s, I prepared all bookkeeping, reconciled all bank accounts, and passed the trial balance back to the other CPA firm who prepared the tax returns. In fact, my

relationship with the client was easy, and therefore good, throughout 2013 and 2014. But all was not as it appeared.

For a period of about five years, the parent's company had been in turmoil, losing money year after year. As the company was a construction company, as the company lost money, working capital depleted and the company found itself not able to bid on jobs that may have helped it climb out of its hole. So, working capital was paramount. But since no bank would lend the company the necessary funds, there was no way to obtain those funds except, as a last resort, to borrow the funds, virtually the entire balances, from the children's trusts.

In 2015 I received a call from the company's CPA informing me that the company intended to borrow virtually all the money in the trusts. It was at this time that my accountant antennae rose quickly. Why now? In a nutshell, if a company is deemed non-creditworthy by virtually every bank in a city the size of El Paso, Texas, can a trustee, any trustee, really deem himself to have acted in the best interests of the trusts if he complies with the request and lends the company money from the trusts? Of course not! That would compare to investing in junk bonds, bonds that pay a much higher rate of interest than United States Treasuries but also carry a much higher risk of loss.

Having not seen the financial statements for the company for a few years, I asked the parents for a copy of the company's latest audited or reviewed financial statements. Although I already knew the answer, I wanted to at least attempt to gain some comfort that the loans would be repaid as scheduled. Or perhaps I wanted to justify my refusal to make the loans. I suspected that one primary reason for the company's inability to borrow funds from any bank would be a "going concern" paragraph in the Auditor's/Independent Accountant's report letter stating that the auditor or independent accountant had concerns that the company could continue as a going concern. I was also well aware that the company's CPA would love, while helping the client survive one more year (and possibly more), to push the risk onto me. The client was scheduled for an interim review and if that review could have been issued WITHOUT a going concern paragraph as a result of the loan from the trusts, the CPA would have effectively

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pushed all the risk for failure to survive onto the trusts and thus, onto me. The company's CPA responded by emailing me the balance sheet as of the previous interim period. I knew the year end work had been completed and asked for the complete audited or reviewed statements and the CPA refused to send them.

I knew that if the trusts lent the requested funds to the company and the company was unable to continue as a going concern and thus was unable to repay the loans, or even if the company was able to continue as a going concern but was unable to repay the trusts, that I would be, or could be, if the children chose to do so, held financially liable for the losses. And the children would have been absolutely right to do so since I would have failed in my fiduciary responsibility to the trusts.

I requested that a release of liability be drafted by the company's attorney, absolving me of any liability for any losses incurred by the trusts as a result of having lent the company the working capital funds. I asked that each of the children sign the release of liability. The attorney balked, as he probably should have since he was the company's attorney and not mine, and in the final analysis, the company's CPA suggested to the parents that they remove me as trustee and appoint a sister of one of the parents, a woman who would be more amenable to the idea of the working capital loan. And that is what was done to solve our dilemma.

Being a trustee is nothing about which to be cavalier. It is not without risks to the trustee.

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