

WHEN FIDUCIARIES FAIL

WHAT CPAS NEED TO KNOW ABOUT TRUSTEE MISMANAGEMENT

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TRUSTS ARE ESSENTIAL TOOLS IN ESTATE PLANNING, HELPING people manage and pass on assets while avoiding probate. But even the best plans can fall apart if the trustee does not do their job properly. Poor trust management can reduce the value of a trust, create family conflict, and lead to expensive legal battles. As a CPA, understanding a trustee's duties, recognizing warning signs, and advising clients proactively can help prevent these issues.

WHAT IS A TRUSTEE?

A trustee is the individual or entity appointed to manage trust assets for the benefit of the beneficiaries. Trustees hold legal title to the assets but must act solely in the beneficiaries' best interests. This fiduciary role carries significant legal and financial responsibilities, and failure to meet them can result in personal liability.

WHAT ARE THE DUTIES OF A TRUSTEE?

Trustees must follow these core duties:

1. **Loyalty** – The trustee must always act in the best interest of the beneficiaries and avoid personal gain.
2. **Impartiality** – The trustee must treat all beneficiaries equally, especially when the beneficiaries' interests may differ.
3. **Prudence** – The trustee must administer the trust with care, skill, and caution.
4. **Inform and Report** – Trustees must keep beneficiaries reasonably informed about the administration of the trust and provide regular, accurate annual reports. These reports should include a clear summary of trust assets, liabilities, income, and expenses.

To help prevent trustee mismanagement and reduce the risk of disputes, it's essential to build strong safeguards into the trust from the start.

WHAT IS TRUSTEE MISMANAGEMENT?

Trustee mismanagement occurs when the foregoing duties are breached. Common examples include:

1. **Self-dealing** – This can occur when a trustee sells property to themselves or their business at below-market prices, uses trust funds to pay personal expenses, or otherwise personally gains at the trust's expense.
2. **Lack of Communication** – This can occur when a trustee withholds accountings, delays distribution decisions, or fails to consult beneficiaries about significant actions. Missing or incomplete accountings can mask improper withdrawals or unexplained expenses. When involved with the accountings, CPAs should verify that all financial reports are timely, accurate, and reconciled with the trust bank statements.
3. **Improper Investment of Trust Assets** – This occurs if a trustee invests heavily in speculative ventures, fails to diversify, or holds illiquid assets without justification. Poor investment choices often lead to diminished principal or liquidity issues. CPAs should review investment allocations for compliance with the Prudent Investor Rule and confirm that risk levels align with the trust's objectives.
4. **Excessive Fees** – This can occur when a trustee charges unreasonable trustee commissions, hires overpriced advisors, or bills for unnecessary services. Inflated fees erode trust value and may indicate self-dealing. CPAs should compare trustee and advisor fees against industry standards and ensure they match the trust agreement's terms.

These actions can lead to legal consequences, including removal of the trustee and surcharge actions.

HOW TO PREVENT MISMANAGEMENT & AVOID DISPUTES

To help prevent trustee mismanagement and reduce the risk of disputes, it's essential to build strong safeguards into the trust from the start. When a client is preparing to serve as a trustee and seeks your guidance, recommend that the trust document include clear financial guidelines, i.e., how investments should be managed, approval processes for major transactions, and distribution standards. These details reduce ambiguity and protect against fiduciary errors. Recommend oversight mechanisms, such as co-trustees or a trust protector with authority to remove or replace a trustee, to strengthen accountability. Establish reporting

requirements and response timelines to promote transparency and allow early detection of issues. Finally, confirm that trustee compensation is well-defined, either capped or tied to the trust's size and complexity, to prevent excessive fees and preserve trust assets.

HOW TO ADDRESS TRUSTEE MISMANAGEMENT

If a client suspects trustee mismanagement, advise them that beneficiaries have several remedies. The first step is often requesting a formal accounting to review trust transactions and financial activity. If the trustee fails to provide this, court intervention may be required. In serious cases, such as clear breaches of duty or ongoing mismanagement, beneficiaries can petition for trustee removal. Courts may also compel compliance, prevent further violations, or recover misused assets through a constructive trust or surcharge action against the trustee. In appropriate circumstances, courts may also appoint a neutral third-party fiduciary, known as a special administrator, to serve in the role of trustee for some or all purposes of the trust's administration. Throughout this process, stress the importance of engaging experienced legal counsel to protect interests and navigate complex trust litigation.

CONCLUSION

Trustees carry significant fiduciary responsibilities, and failure to meet those obligations can jeopardize the trust's integrity and the beneficiaries' financial security, as well as open the trustee to significant liability. By promoting transparency, prudent management, and proper oversight, CPAs can help safeguard trust assets and reduce the risk of disputes. ◀



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