

2010-2011 BROKER-IN-CHARGE ANNUAL REVIEW

SECTION ONE

TRUST ACCOUNT MANAGEMENT

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Learning Objective: This Section will provide an overview of the rules applicable to trust account maintenance, record-keeping requirements, and the biggest pitfalls brokers-in-charge encounter in fulfilling their responsibility to oversee and account for all trust monies received by the office.

INTRODUCTION

All licensees may be subject to disciplinary proceedings for:

- “failing, within a reasonable time, to account for or to remit any moneys coming into his or her possession which belong to others” [G.S. 93A-6(a)(7)]
or
- “commingling the money or other property of his or her principals with his or her own or *failure to maintain* and deposit in a trust or *escrow account in an insured bank* or savings and loan association *in North Carolina* all money received by him or her as a real estate licensee acting in that capacity...” [G.S. 93A-6(a)(12)].

While all licensees have accountability, responsibility for ensuring the safe-keeping of trust monies is expressly vested in the broker-in-charge. **Rule A.0110(a)** of the Broker-in-Charge rule states in pertinent part: “The broker-in-charge *shall* ... assume the responsibility at his or her office for: (4) the proper maintenance at such office of the trust or escrow account of the firm and the records pertaining thereto.” As most brokers are aware, the surest way to incur disciplinary action and have one’s name appear in the back of the *Real Estate Bulletin* is to have substantial shortages (or overages) in one’s trust account. This section will provide a general overview of the requirements imposed by the trust account rule, **Rule A.0107, Handling and**

Accounting of Funds, which licensees should read if they have any questions. [Reprinted at the end of this Section.]

TRUST MONIES AND TRUST ACCOUNTS

Before one can determine who must have a trust or escrow account, one must first understand what is meant by “trust money.”

What is “Trust Money?”

The easiest definition of “trust money” is money belonging to others. However, in the context of real estate transactions, the definition of **trust money** has two parts, namely:

- 1) *money belonging to others*
- 2) *received by a real estate broker who is acting in a fiduciary capacity (i.e., as an agent) in a real estate transaction.*

It is also any money held by a licensee who acts as the temporary custodian or manager of funds belonging to others related to or concerning the person’s or entity’s interest or investment in real property. Such money must be held in trust even if the circumstances are only collateral to the licensee’s role as an agent in a real estate related matter, e.g., a listing agent receives monies from his out of town seller for yard maintenance while the property is being marketed. The most common examples of trust money are:

- Earnest money deposits
- Down payments
- Tenant security deposits
- Rents
- Homeowner association dues and assessments, and
- Money received from final settlements

In the case of resort and other short-term rentals, trust money also includes advance reservation deposits and state (and local, if applicable) sales taxes on the gross receipts from such rentals.

Thus, any real estate brokerage company or sole proprietorship that receives monies belonging to others related to real property while acting as a licensee in a fiduciary capacity in a real estate transaction must maintain a trust or escrow account. *A brokerage company or sole proprietorship that never receives monies belonging to others while acting as a licensee does not need to have a trust or escrow account.* While it may be possible for brokers who only represent buyers or tenants to avoid receiving or holding trust monies by requesting that the listing company or the buyer’s closing attorney hold any earnest money deposit or other deposits or monies, it is highly unlikely that a brokerage company or sole proprietorship that engages in property management or lists real property for sale for others can avoid having a trust/escrow account. *To the extent that a broker must have a trust account, it must be maintained in accordance with the requirements of Rule A.0107.*

What Constitutes a “Trust Account?”

A “trust account” or “escrow account” (the terms are synonymous for Commission purposes) is simply a bank account into which trust money (and *only* trust money) is deposited. The three primary features of a trust or escrow account are that it is:

- 1) **separate**, containing *only* monies belonging to others,
- 2) **custodial**, that is, titled or held in the name of the licensee or real estate company (e.g., Jones Realty, Escrow Account), thereby preventing access by those whose money is in the account, *and*
- 3) **available on demand**, that is, the funds may be withdrawn without prior notice.

Brokers must ensure that the bank properly designates the account as a trust or escrow account and that *the words “trust account” or “escrow account” appear on all signature cards, bank statements, deposit tickets and checks.* [See **Rule A.0107(d).**] Even though the account is in the name of the company or broker, so long as the broker properly designates the account as a “trust” or “escrow” account and *keeps accurate records* that identify each owner of the funds and/or depositor (buyer, seller, lessor, lessee, etc.), the depositors are protected from the funds being “frozen” or attached if the broker/trustee becomes insolvent, incapacitated, dies, has tax liens, becomes involved in a lawsuit, etc. *Failure to properly designate the account as a trust or escrow account may result in attachment of the account by others or denial of FDIC insurance coverage as to each individual’s interest in the account.*

Deposits now are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 *per individual* for whom funds are held. For example, a broker’s trust account may contain \$500,000.00 total, but all funds are fully insured so long as no one individual’s interest in the account exceeds \$250,000.00. *Congress just recently passed legislation making the increased \$250,000.00 per individual depositor insurance coverage permanent, retroactive to January 1, 2008.* (Originally, the increased \$250,000.00 limit was to expire and revert back to the former \$100,000.00 per individual maximum after December 31, 2013.) Note, however, that an individual still may be under-insured if the individual maintains accounts in his/her individual name at the same financial institution as the broker’s trust/escrow account.

Opening the Account

Trust accounts must be opened and maintained in an insured bank or savings and loan association *located in North Carolina*, so the bank’s records may be subpoenaed by the Commission, if necessary. (Note that trust/escrow accounts may *not* be maintained at a credit union, as credit unions typically are not FDIC insured.) Once opened in a North Carolina branch office, subsequent transactions may be conducted from any branch office, whether within or outside of North Carolina. A broker who is inactive or otherwise not using his/her real estate license is not required to open or maintain a trust account as s/he should not be receiving any trust monies. As previously mentioned, *if an active practicing broker does not collect or otherwise handle the funds of others, no trust account is required.* Only when the broker/company or an affiliated licensee takes possession of trust money must the broker open and properly maintain a trust account.

[**Editor's Note:** as of January 1, 2012 G.S. 93A-6 will be revised to eliminate the requirement that a broker's trust account be opened in a bank or savings and loan in North Carolina. The law will require that the trust account be a demand deposit account maintained in a federally insured depository institution authorized to do business in North Carolina that agrees to make its records available to the Commission. See the 2011-2012 *Real Estate Update Course* materials, Section Five, "License Law Changes."]

How Many Accounts?

Except for brokers who are managing homeowner or property owner association funds, a broker holding trust money is *only required to have one trust account*. All earnest money deposits, tenant security deposits, rents, and other trust monies may be deposited into this one common trust account. However, brokers who are active in both sales and property management often find it helpful to use more than one trust account. For example, they may wish to keep a "general sales trust account" for earnest money deposits, settlement proceeds, etc., and a "rental trust account" for tenant security deposits, rents, and related receipts. Although it is not required, some brokers involved in property management and leasing elect to maintain an additional "security deposit trust account" to keep tenant security deposits separate from rents and other related receipts. Often this separate security deposit trust account may be an interest-bearing account with the interest earned being paid to the brokerage company. Interest-bearing trust accounts will be discussed shortly.

Homeowner Association Funds

Since September 1, 2002, Rule **A.0107(i)** has required brokers who handle homeowner or property owner association funds to maintain a *separate trust account for each property owner association or homeowner association they manage*. The funds of one homeowner association are not to be commingled with funds from any other association nor with any general trust monies. While all the accounts may be at the same financial institution, each account would be designated as a trust account and have its own account number and separate records. Preferably the ***account should be in the name of the broker or brokerage company, not the owners' association***, for it to be a true escrow or trust account, e.g., XYZ Realty, Inc, Escrow Account for Happy Valley Owners Assoc.; XYZ Realty, LLC, Escrow Account for Carolina Sunshine Owners Assoc., or merely XYZ Realty, LLC Escrow Acc't.

[**Editor's Note:** The original materials stated that the trust/escrow account "must" be in the broker's name. Subsequent to the publication of the final BICAR course materials, it was decided that if the owners' association insists on having the account in its name, the account might still comply as a trust account ***so long as the account is custodial***, i.e., only the broker and perhaps selected employees of the broker have access to the account. This can be determined from the signature cards for the account. *No one in the association may have access to any funds the broker controls and the broker may not have access to funds under the control of the association.*]

The broker also must provide the association with periodic written statements not less than once each quarter (i.e., every 90 days) reporting all monies received, disbursed, and due but

unpaid (i.e., delinquent), as well as the balance of funds in the account. Additionally, since April 1, 2004, every agreement for services connected with the management of a property owners association or its funds must be in writing from the inception of the relationship under Rule A.0104, "Agency Agreements and Disclosure."

Bank Service Charges

Trust accounts are subject to the same service charges as regular checking accounts. Whenever possible, brokers should arrange for the depository/bank either to bill the broker for these expenses or charge these expenses to the broker's personal or general operating account. However, if such arrangements cannot be made, the broker may deposit and maintain in his trust account a *maximum of \$100.00 of his personal funds* (or such other amount as may be required) *to cover* (not avoid or prevent) *such charges*.

If a broker's monthly service charges and other fees typically are \$175 to \$220, then the broker may deposit \$250 to \$300 of his/her own money into the trust account to *cover* these charges. *A broker who deposits any of his/her own money in the trust account to cover bank charges must be careful to properly enter and identify personal funds on the deposit ticket and on a personal funds ledger sheet in his/her trust account records.* Thereafter, the broker must deduct any bank charges as they occur from his/her trust account journal or check stub running balance *as well as* from his/her personal funds ledger sheet running balance and may replenish these funds within permissible limits as necessary to cover these bank service charges. While this technically constitutes commingling, it is permissible commingling to avoid the greater evil of using other peoples' money to pay these bank service charges.

COMMISSION RULE A.0107

Basic Requirements

As mentioned in the Introduction, in addition to the *statutory* mandates concerning a broker's obligations regarding other peoples' money, there also is a *Commission rule*, **Rule A.0107: Handling and Accounting of Funds**, that enumerates all the details a licensee must follow in maintaining a brokerage trust or escrow account. When in doubt as to what is required, a licensee should *read Rule A.0107*. The opening paragraph states:

(a) Except as provided herein, *all monies received by a licensee acting in his or her fiduciary capacity shall be deposited in a trust or escrow account maintained by a broker not later than three banking days following receipt of such monies except that* earnest money deposits paid by means *other than currency* which are received on offers to purchase real estate and tenant security deposits paid by means *other than currency* which are received in connection with real estate leases shall be deposited in a trust or escrow account not later than *three banking days following acceptance* of such offer to purchase or lease; the date of acceptance of such offer to purchase or lease shall be set forth in the purchase or lease agreement. All monies received by a provisional broker shall be delivered

immediately to the broker by whom he or she is employed, except that all monies received by nonresident commercial licensees shall be delivered as required by Rule .1808 of this Subchapter.

[Emphasis added.]

Three Banking Days

The *general rule* is that all trust monies received by a licensee must be deposited in a trust account within three banking days of receipt subject to one exception. That exception applies to *checks or other negotiable instruments* received as earnest money deposits with offers to purchase or as tenant security deposits in connection with leases. These must be deposited in a trust account *not later than three banking days following acceptance of the offer to purchase or lease agreement unless* the deposit is tendered in *cash* in which event it must be deposited within *three banking days following receipt, even if the contract or lease has not been accepted*. In part, this is because cash is immediately available and may be refunded within a day of deposit, unlike checks which may require a few days to clear.

Note, however, that a broker may choose to immediately deposit a check received for an earnest money deposit or tenant security deposit and is not *required* to wait until contract acceptance unless so instructed by the buyer/tenant. Of course, early deposit may cause problems if the offer to purchase or lease is not accepted and the prospective buyer or tenant understandably wants their deposit returned, as they are entitled. The date of acceptance must be shown in the purchase or lease agreement to determine when the three banking days begins. Rents, settlement proceeds, and all other trust money must be deposited in a trust or escrow account not later than *three banking days following receipt* of the funds. Handling option monies under Alternative 2 is discussed below. (Presumably, “due diligence fees” under the new residential Offer to Purchase and Contract form will be treated in the same manner as “option money.”)

Holding Trust Monies

All trust money received by a provisional broker must be delivered immediately to the provisional broker’s broker-in-charge. In other words, provisional brokers may not handle money! Trust monies received by a nonresident *limited commercial licensee* are to be delivered immediately to and held by the affiliated resident North Carolina broker who has agreed to supervise the nonresident commercial licensee.

A broker may transfer possession of trust money to a bookkeeper, secretary, or some other clerical employee to record and deposit the funds in a trust account; however, the broker remains responsible for the care and custody of such funds. Brokers should closely and diligently supervise the acts of these persons, as final accountability rests with the broker-in-charge. **Access to trust money should be limited and carefully controlled.**

Due Diligence Fee/Alternative Two Option Money

The second half of **A.0107(a)** was added effective July 1, 2005 and states:

... A licensee may accept custody of a check or other negotiable instrument *made payable to the seller* of real property as option money only for the purpose of delivering the instrument to the optionor-seller. While the instrument is in the custody of the licensee, the licensee shall, *according to the instructions of the buyer-optionee*, either deliver it to the seller-optionor or return it to the buyer-optionee. The licensee shall safeguard the instrument and shall be responsible to the parties on the instrument for its prompt and safe delivery. In no event shall a licensee retain such an instrument for more than three business days after the acceptance of the option contract.

[Italics added.]

This provision was added following the July 2004 amendment to the standard residential Offer to Purchase and Contract form promulgated by the North Carolina Association of REALTORS® and the North Carolina Bar Association that added “Alternative 2,” allowing the buyer to unilaterally terminate the contract by a stated date in exchange for paying the seller a specified sum of money. Notwithstanding the rule’s reference to “option money” and “optionor” and “optionee,” *it is anticipated that the same procedure will govern a broker’s receipt of a check or negotiable instrument made payable to the seller intended as a “due diligence fee”* under the standard NCAR/NCBA Offer to Purchase and Contract form to become effective January 1, 2011, as the purpose of the fee remains the same, even though the label has changed. Thus, after January 1, 2011, one may substitute “due diligence fee” for the term “option money” in the discussion below.

In the rule, “custody” means possession. Since the check is written by the buyer, it may be retained by the agent working with the buyer until negotiations are completed and a contract formed, at which point it should be delivered to the seller or listing agent, as applicable. **Note**, however, that the rule requires agents to *follow the buyer’s instructions concerning delivery of an “instrument,” i.e., a check, money order, etc., regardless of which agent is holding the option money check*. Thus, if the buyer instructs either broker, whether listing agent or buyer agent (or seller subagent), who is holding the option money check to return the option money check to the buyer, then the broker is to comply with the buyer’s directive so long as the option money check is still in the broker’s possession. If the buyer’s directive occurs after contract formation, but prior to delivery of the check to the seller, then the buyer may be in breach of contract, but the broker by rule is to follow the buyer’s instructions. Recall that option money is paid directly to the seller, to whom the check is written as payee, and it is not anticipated that licensees will be depositing these checks into their trust accounts, as the check is not payable to the licensee or real estate company.

However, if a buyer for some reason gives a broker *cash* for the option money, then the broker must *immediately deposit the cash into his/her trust account* (no later than three banking days from receipt) and then following contract formation, write a check from the trust account payable to the seller, noting in the memo section that it is for the “option money fee” from the buyer. If, however, a dispute erupts over cash option money prior to the broker disbursing it from his/her trust account, then the *broker must retain the option money in his/her trust account pursuant to A.0107(g), the disputed funds rule*. Brokers who wish to avoid this potential

headache may decide as part of their office policy that they will not accept cash for the due diligence fee/option money; rather, the due diligence fee/option money must be a negotiable instrument payable to the seller, e.g., certified check, money order, cashier's check, personal check, etc.

Interest-Bearing Trust Accounts

Rule A.0107(b) allows brokers to maintain interest-bearing trust accounts under the following conditions:

(b) In the event monies received by a licensee while acting in a fiduciary capacity are deposited in a trust or escrow account which bears interest, the licensee having custody over such monies shall first secure from all parties having an interest in the monies written authorization for the deposit of the monies in an interest-bearing account. Such authorization shall specify how and to whom the interest will be disbursed, and, if contained in an offer, contract, lease, or other transaction instrument, such authorization shall be set forth in a conspicuous manner which shall distinguish it from other provisions of the instrument.

Thus, **trust money may be deposited in an interest-bearing trust account *only if*:**

(1) the broker first obtains *written authorization* from the persons for whom he holds the funds to deposit the funds into an interest-bearing account;

(2) the authorization must clearly specify *how and to whom the interest will be disbursed*; and

(3) if the authorization is contained in an offer, contract, lease or other transaction instrument, it must be printed in a manner that will draw attention to the authorization and distinguish it from other provisions of the instrument (for example, *italics*, **boldface type**, underlining, a blank _____ to be filled in with the name of the party to whom the interest will be paid, or some similar means).

Typically, the authorization provides that the interest earned on the trust account is payable to the brokerage company, not to the people who own funds in the account. If the interest belongs to the brokerage company, what must it do periodically and how often? Where would the amount of interest earned and the amount withdrawn be recorded? ***

Inasmuch as trust money must be deposited in a ***demand account in an insured bank or savings and loan association***, the investment of such funds in any type of security, including government bonds, is prohibited. The investment of trust money in most certificates of deposit also is prohibited. Trust money may be maintained in a certificate of deposit with an *insured bank or savings and loan association* ***only if*** the certificate of deposit: 1) is insured, 2) permits withdrawal of the trust money on demand, 3) without any penalty that would reduce the principal amount of the trust money invested. Trust monies may not be deposited in sweep accounts or invested in repurchase agreements.

*** Each month when the broker or brokerage company receives its bank statement, it must first note on both the journal and its personal funds ledger the amount of interest earned on the account that month. It must then write a check to itself from the trust account in whatever amount is necessary to reduce the amount of personal funds to within the permissible maximum and transfer that excess into its operating account. The check must also be recorded in the journal and on the personal funds ledger. Failure to transfer the earned interest each month will quickly result in broker-owned funds exceeding the permissible maximum, causing illegal commingling.

RECORD-KEEPING

Section **93A-6(d)** of the License Law requires that :

(d) Each broker shall maintain complete records showing the deposit, maintenance, and withdrawal of money or other property owned by his or her principals or held in escrow or in trust for his or her principals. The Commission may inspect these records periodically, *without prior notice* and may also inspect these records whenever the Commission determines that they are pertinent to an investigation of any specific complaint against a licensee. [Italics added.]

Trust Account Records

Commission Rule A.0107 is extremely detailed as to what and how trust account records are maintained. A broker not familiar with the rule's requirements risks at least a record-keeping violation, if not missing funds. Any broker who feels uncertain as to whether s/he is maintaining records properly and in compliance with the rule should seriously consider taking the Commission's Basic Trust Account Procedures course. Brokers who are doing resort vacation rentals or short-term rentals should also be aware that the Commission has a Resort Trust Account Procedures course that basically is now offered upon request so long as there is a guarantee of 20 attendees. Both courses are taught by the Commission's auditors and count for four hours of elective continuing education credit. [**Note:** brokers-in-charge and brokers who have "broker-in-charge eligible" status may take the trust account courses if they wish and receive continuing education credit for those courses, but they *still must take the annual BICAR and mandatory Update course each year to retain broker-in-charge eligible status.*]

Briefly, what the law and rule require is a **clear audit trail** from the deposit tickets and canceled checks to the check stubs or journal to the ledger sheets. What are these things??

Journal: The journal is merely a *record in chronological sequence of all monies going into or out of the trust account*, including both deposits of monies the broker holds on behalf of others and interest earned on the account, as well as all disbursements/deductions from the account, whether by check or automatic debit by the bank, e.g., service charges, NSF charges, etc. The journal is the "whole pie;" it shows *all activity in to or out of the account and the total monies in the account at any given*

moment, but it does *not* reflect the share of those monies owned by each person who has an interest in the account. That information is contained in the ledger sheets.

Ledgers: Ledger sheets typically are maintained by property address with a separate ledger for each property. *Each ledger records only money in and money out of the trust account pertaining to that specific property. The balance on a ledger sheet indicates the amount of monies in the trust account belonging to that particular person or property.* If the journal is the whole pie, ledgers may be thought of as the “pieces of the pie.” The importance of accurately maintaining the ledgers can not be over-emphasized. It is the ledgers that reflect who is owed how much of the funds in the account in the event the broker dies, files bankruptcy, is audited, or if the bank fails and the FDIC must make depositors whole.

Understand that **for every entry on the journal, there must ALWAYS be a corresponding entry on a (one) ledger sheet.** Every check and every deposit ticket must contain certain information to facilitate the maintenance of a “clear audit trail” to the ledgers and journal. The five required notations on each check or deposit ticket are:

- *date* of deposit or check
- *amount* of deposit or check
- *purpose* for which monies are received or disbursed
- *property* address to which monies relate, and
- *payor* (of monies received by broker) or *payee* (for checks written by broker)

NOTE: By rule, in addition to the payor’s name (buyer), the *seller’s name also must appear on deposit slips for earnest money deposits*, but the owner’s name need *not* appear on deposit slips reflecting lease transaction payments.

If there is insufficient room on the deposit ticket or check to note all of the foregoing information for multiple transactions, e.g., a deposit ticket totaling \$8200 representing monies received/held for five different transactions, the broker may write “**SDW**” or “**SCW**” on the deposit ticket or check, indicating that there is a “Supplemental Deposit Worksheet” or a “Supplemental Check Worksheet” to provide the required information explaining from whom the monies were received or to whom paid, why, how much, and to which property it related. **Subparagraph (e)** of the trust account rule (**A.0107**) provides **extremely detailed instructions** as to the information that must appear on checks and deposit tickets, and what one’s journal and ledgers must contain. A broker-in-charge who remains confused after reading the rule might be wise to take the Commission’s Basic Trust Account Procedures course or order the current *Broker-in-Charge Guide* and study Section One or consult the *Trust Account Guidelines* referenced below.

Examples of how deposit slips, checks, ledger sheets and journals should look, as well as a sample reconciliation, are published at pages 67-74 of the “*Trust Account Guidelines*” found in the *North Carolina Real Estate License Law & Commission Rules* booklet published by the Commission and sold for \$3.00 per copy, or access the publication online at the Commission’s website. These pages also **are reprinted at the end of this Section One.**

Required Information on Deposit Tickets and Checks

In a nutshell, **deposit tickets** reference the journal entry by the date and the amount of the deposit and the deposit ticket number, if numbered. Then on the deposit ticket itself (or supplemental worksheet) one would write the payor's name, the amount, the purpose for which paid, and the subject property address for each and every amount being deposited. If the monies are received in a sales transaction, both buyer's and seller's surnames should appear on the deposit ticket. The cross-reference to the ledger sheet is the property address or an internal case number that has been assigned to that particular file.

The cross-reference to the journal on a **check** is merely the date and check number. The payee's name appears on the check, as does the amount; thus, the only missing information is the purpose for which the trust funds are being disbursed and the property address to which the payment pertains, both of which can be indicated on the "memo" line on the lower left of most checks. Again, the reference to the appropriate ledger sheet is the property address (or internal case number).

Journal Entries

The *journal* is where all deposits into and all disbursements from the trust account are recorded. Any and all money going into or being paid out of the trust account is reflected on the journal. The **journal entry of a deposit** will indicate the date and the amount, but may merely refer to it as "Deposit," hopefully with some reference to the specific deposit slip, and then the running balance. The journal reference for checks written out of the trust account is the date and check number. The **journal entry for checks** also must indicate the *payee*, the *purpose* of each disbursement, the *amount*, and the running balance. It need not include the property address, as that is indicated on the check itself (or SCW). All these requirements are part of the paper trail that must be created and supervised by brokers-in-charge.

Ledger Sheets

Recall that for every entry in the Journal, there must be a corresponding entry on *a* ledger sheet. Most ledger sheets are maintained by property address, and identify the parties by name, whether seller/buyer or lessor/lessee. *The only monies recorded on any individual ledger are those received or disbursed on behalf of that property.* The ledger entry must state the date of the check or deposit, the payor or payee, the purpose of the deposit or disbursement, the check number (or deposit ticket number, if applicable), the amount of the deposit or check, and the running balance. Ledger sheets for sales transactions frequently will only have two entries — EMD received and deposited; check to closing attorney for EMD transfer not more than ten days prior to closing [see **Rule A.0107(h)**] (or in some areas, payment to the real estate company as partial commission *post-closing*, which is not as favored by the Commission).

Monthly Reconciliation

The final paragraph of the lengthy **Rule A.0107(e)** states:

... Records of all receipts and disbursements of trust or escrow monies shall be maintained in such a manner as to create an audit trail from deposit tickets and canceled checks to check stubs or journals and to the ledger sheets. *Ledger sheets and journals or check stubs must be reconciled to the trust or escrow account*

*bank statements on a **monthly basis**. To be sufficient, records of trust or escrow monies must include a worksheet for each such monthly reconciliation showing the ledger sheets, journals or check stubs, and bank statements to be in agreement and balance. [Italics added.]*

Brokers are required to maintain complete records of all trust account receipts and disbursements, with an explanation as to what was received or spent, from whom and why. **Rule A.0107(e)** lists all the *records brokers must retain* related to their trust account, and includes, among others:

- Bank statements
- Canceled checks
- Deposit tickets
- Closing statements
- Property management reports and agreements
- Copies of *all* offers (both accepted and rejected)
- Copies of contracts, leases and management agreements
- Invoices
- Bills, and
- Other transaction records.

Brokers must maintain copies of these documents as well as other detailed books and records. The use and maintenance of separate ledger sheets (individual transaction ledgers) and payment record sheets for association management are required. In the event a branch office maintains a separate trust account, a separate bookkeeping system should be maintained in such office.

The rule requires brokers to report all receipts and disbursements of trust monies in such a manner as to create a **clear audit trail from deposit tickets and canceled checks to check stubs or journals and to the ledger sheets**. *A broker must reconcile ledger sheets and journal or check stubs to the trust account bank statements on a monthly basis. The broker must create a worksheet (Trial Balance) for each such monthly reconciliation and must retain the worksheet (Trial Balance) as part of his/her trust account records.*

A “**trial balance**” is merely where a broker adds together all the balances on the individual ledger sheets and derives a total. The trial balance must list each ledger (e.g. buyer and seller, property address, or owner) and show each ledger balance as of the date of the trial balance. A trial balance shows a breakdown of all funds in the trust or escrow account and who owns what share of those funds.

IMPORTANT: In a “**monthly reconciliation**” the monthly ending bank statement balance must be reconciled to the checkbook and/or journal balance (i.e., running balance of funds on deposit) taking into consideration outstanding checks and deposits. The checkbook and/or journal balance should equal the sum of all the individual transaction ledgers (i.e., the trial balance). *It is the ledger sheets, not the journal, that represent the Company’s total outstanding liability to those for whom the Company is holding trust monies.*

The first thing a broker should do if s/he fears a problem with a trust account is **perform a trial balance and compare that total to the journal balance**. If they don't match, start looking for an explanation, because the trial balance should *always* equal the journal balance. After all, if the ledgers are the pieces of the pie, and you add all the pieces together, they should equal the whole pie (i.e., the journal balance).

Record Retention

Brokers must keep all trust account records pertaining to any given transaction, as well as other records under **Rule A.0108**, for three years from the successful or unsuccessful conclusion of the transaction or the disbursement of all monies related to that transaction from the broker's trust account, *whichever is later*. The trick is recognizing when the three year clock begins; if a transaction died eight months ago and the parties signed a written termination of contract *without* release of EMD, one of the two brokers' clock has begun (probably the buyer agent), whereas the clock for the listing company's record retention period won't begin until the EMD is out of the broker's trust account.

Note the rule does not require that brokers retain a hard copy of these records; the only requirement is that the broker be able to generate a hard copy, if requested. Brokers interested in keeping these records electronically should visit the Commission website to review various software programs found by Commission auditors to be capable of meeting the rule's requirements.

It must be emphasized that *all receipts and disbursements must be recorded in the journal and posted to the applicable ledger sheet in a timely manner*, whether records are maintained in hard copy or using computer software. Also, reconciliation worksheets should be prepared within a reasonable time following receipt of the trust account bank statement. **A broker's failure to follow these accounting and bookkeeping principles increases the risk of both errors and the misapplication of trust money.**

The broker-in-charge need not handle the book-keeping functions personally. Rather, s/he may authorize a secretary, a bookkeeper, or some other person to have signatory authority on the trust checking account, thereby affording that person the ability to withdraw money from the account. If ability is coupled with opportunity, the broker-in-charge ultimately may have a problem. Even though someone else actually takes the money, the broker-in-charge may not escape liability or responsibility for the misuse of the funds by such persons. **Brokers are advised to closely supervise these persons and periodic record audits and bonding of such persons is recommended**, as well as a two signature policy, i.e., all checks must be signed by at least two authorized individuals, perhaps the broker-in-charge and the bookkeeper. The more supervision there is of people handling money, the less the perceived opportunity to successfully embezzle.

Imaged Checks

Prior to September 1, 2002, licensees were required to obtain and retain the *original canceled checks* from the bank for all broker *trust accounts*. While the rule still requires

canceled checks to be retained, it now affords more leeway and allows a licensee to retain “digitally imaged copies of the canceled checks” **SO LONG AS:**

- no individual image is smaller than 1.1875” x 3”;
- the images are *legible* reproductions of the ***front and back of the check***; **and**
- the licensee’s *bank must retain the original canceled checks or “substitute checks” (the legal equivalent) or the capacity to provide substitute checks for six years.*

If **all** of the foregoing requirements are met, then licensees may retain *imaged* canceled checks for their trust account records, rather than the actual paper canceled checks. If the **financial institution cannot meet these criteria, a licensee MUST receive and retain the original canceled checks.**

NOTE: Brokers who receive their trust account statements online, **must either** print a hard copy each month or download the file to their computer and retain the records for the three years required by Rules A.0107 and A.0108.

Safeguarding/Nonconversion

While it should be patently obvious that licensees may not use funds belonging to others for their own purposes, **Rule A.0107(j)** eliminates any doubt by mandating preservation and forbidding conversion of funds. It supplements License Law stating:

(j) Every licensee shall safeguard the money or property of others coming into his or her possession in a manner consistent with the requirements of the Real Estate License Law and the rules adopted by the Commission. A licensee shall not convert the money or property of others to his or her own use, apply such money or property to a purpose other than that for which it was paid or entrusted to him or her, or permit or assist any other person in the conversion or misapplication of such money or property.

Examples

The following are two true stories based on former disciplinary cases from the past 12 years to illustrate the points mentioned above. In each case, a broker-in-charge was disciplined, even though s/he had not personally misappropriated trust funds.

Case #1

The first is the story of a sweet, grandmotherly woman in her mid-to-late sixties who agreed to be the broker-in-charge and qualifying broker of a real estate company owned by a general contractor who did not have a broker license. He created the company primarily to sell properties he purchased and improved through his general contracting company. Times got

tough and money tight and the general contractor/owner began “borrowing” monies from the real estate brokerage trust account to shore up his general contracting company. The broker-in-charge knew the owner was misappropriating (stealing) trust monies, but did nothing about it. She didn’t quit or make an anonymous report or anything.

By the time it came to the Commission’s attention, the owner had pilfered tens of thousands of dollars. The broker-in-charge’s license was revoked for taking no action, thereby permitting the owner to continue to misappropriate funds belonging to others. Her attempted defenses that she was not the actual thief and what was she to do since the owner was her employer were to no avail. As broker-in-charge she was charged with the responsibility to oversee the trust account records and monies and she failed to safeguard those monies. While quitting may have been difficult and deprived her of an income temporarily, at least she would have avoided complicity and may have retained her broker license and been able to work for a different company.

Case #2

The second case illustrates two points: 1) the pitfalls of trusting someone implicitly to manage your trust records and failing to supervise them closely in that record keeping, and 2) that it often is the people you trust the most, and thus tend to supervise less, who will betray you and embezzle from your trust account, rather than strangers you hire. In this case, the broker-in-charge was a very successful, honest, well-respected broker-owner-developer who primarily developed and managed or sold retail and mixed use commercial properties. One of his business partners was his dearest friend of thirty years who also had been a CPA. The friend was a financial officer in the company and the trust account record keeping duties were delegated to him. Because he knew he could rely on this trusted friend, the broker-owner rarely reviewed the trust account records or ensured that the requirements and safeguards established by the trust account rule were implemented.

Finally, there came a time when trust account checks started to bounce. When the owner-BIC had the account records investigated, he learned that his best friend had embezzled/diverted over a seven year period somewhere between one million to 1.3 million dollars from the trust account. The owner-BIC immediately severed all business relationships with his former friend and *made the trust account whole*. When the situation later came to the Commission’s attention, the broker-owner’s license ultimately was suspended for two years, with six months active and the remainder stayed for the balance of the period, due to his failure to properly supervise the trust account maintenance, even though many recognized that he had been a victim. He accepted the responsibility, suffered the consequences honorably, reactivated his license, redeclared as broker-in-charge, and continued to be a very prosperous commercial broker. When the story finally broke in the press, he had limited comments to the media, other than to say that he was surprised and that he had lost his best friend.

RED FLAGS & INTERNAL CONTROLS

Red Flags

A *red flag* is a set of circumstances that are unusual in nature or vary from the normal activity. It is a warning sign that something is out of the ordinary and *should be further investigated*.

Common red flags in real estate trust accounts

(A) Checks can be a source of many different red flags, including:

- NSF notices on checks drawn on the trust account.
- Canceled checks missing from bank statements.
- Excessive voided checks or entries to correct errors (a.k.a. “cooking the books.”)
- Checks (and deposits) for large, round figures.
- Checks written to the bookkeeper. (S/he is paid from the operating account!)
- Checks written to an unknown vendor. (Do they really exist?)
- Checks held and not mailed. (Why write the check, but not mail it?)

(B) Likewise, missing trust account records are a red flag. If any of the following are missing, follow-up is a must, both to avoid record-keeping violations and to find out what someone might be trying to hide:

- Cash receipts
- Bank statements, including canceled checks and deposit tickets
- Trust account reconciliations

(C) Similarly, discrepancies between different types of trust account records constitute red flags. Look for:

- Discrepancies between cash receipts and deposit amounts, e.g., cash receipts show \$2,250, yet the deposit ticket from the following day is for only \$2,000.
- Discrepancies between amounts on bank statements and amounts on trust account records, e.g., journal shows 3 voided checks, yet 2 cleared the bank.

The broker-in-charge must discover the explanation for the discrepancies and document it.

(D) Also, look for vendors with P.O. boxes and no physical address. This may be a red flag that the vendor is not real and is simply a conduit through which a bookkeeper, associate or employee is passing money to him/herself or for his/her benefit.

(E) If you see large transfers of funds between various trust accounts, you may also have a problem. Why is the transfer being made? Does it make sense? Do your files include the proper documentation?

So long as each trust account has check writing privileges, there really is no reason to have transfers between trust accounts. However, if for example, the tenant security deposit account is an interest bearing money market account with no check-writing ability, then when the time comes to disburse the tenant security deposit, the broker must transfer the deposit from

the money market account into the general trust checking account and then disburse the funds. Other than that, transfers between trust accounts may indicate a shortage; someone is stealing from the more active account and is trying to subsidize it by borrowing funds from the more stable, unused trust account.

(F) Property owner complaints of late rent proceeds or no rent proceeds or insufficient or low proceeds should be a *huge* red flag for brokers-in-charge. If the rent was received by the broker, then why is it that the owner hasn't received the net rent proceeds two months later? It's amazing how patient some owners are, waiting 4-6 months before contacting the Real Estate Commission. Such complaints garner the attention of the Commission's auditors *quickly*.

(G) Finally, employees themselves can be red flags. Look for:

- Employee lifestyle changes. (New car/jewelry/trips, i.e., "why is your bookkeeper living better than you?")
- Bookkeeper/employee who is obsessed with the mail. (Seeks to intercept and "screen" the mail to remove NSF notices, owner complaints, etc.)
- Bookkeeper/employee who never takes time off. (Why not?)

A broker-in-charge may authorize a secretary, bookkeeper or other employee to collect trust money, make deposits, sign trust account checks, make bookkeeping entries and reconcile trust account bank statements to the journal and ledgers. However, it is the responsibility of the broker-in-charge to make sure the trust account and related records are properly maintained. If an employee misappropriates trust funds, the broker-in-charge may well be held responsible.

In many cases, after it is discovered that an employee has misappropriated trust funds, it becomes clear that red flags were present. Had the broker-in-charge recognized these red flags, the loss might not have occurred or at least would have been substantially reduced. ***A broker-in-charge should be able to discover most trust account abuses quickly (no later than a month or two) if he or she reviews the records regularly and watches for the red flags described above.*** If a broker-in-charge realizes in relatively short order that there may be a problem with the trust account and investigates it and documents what happened and makes it right, then chances are s/he may not be disciplined. The longer the embezzlement persists and the larger the sum of misappropriated funds grows, the more likely the broker-in-charge may lose his/her license for some period, because s/he was not fulfilling his/her supervisory duties to monitor the trust account.

Internal Controls

Internal controls are policies and procedures designed to safeguard the assets of a business and ensure the accuracy of its financial records.

Recommended Internal Controls

- Separate the handling of cash from bookkeeping. This helps avoid a situation where a bookkeeper is hiding cash receipts. If someone else knows monies were received and makes a record of receipt, the bookkeeper is less able to take the cash.
- Each employee handling cash should have his or her own cash drawer and account for cash daily.
- Use sequentially numbered cash receipts and compare cash receipts to deposit tickets daily.
- Employees handling cash should be bonded. A bond is like insurance. If an employee does take money improperly, the bond provides coverage. Understand that E&O coverage will not pay one cent for trust account misappropriation as that is an intentional act. Thus, absent bonding, the owners of the company and/or the broker-in-charge may be obligated to personally restore all missing trust funds if the company wants to continue in business.
- Any mail bearing the bank's return address is delivered to the broker-in-charge's desk unopened and is opened first by the broker-in-charge. Compare this month's balance to last, and to prior months' balances. Is the balance significantly lower or steadily declining? Should it be? Have "voided" checks cleared the bank?
- Review checks for unusual amounts or unknown payees. Consider requiring at least two signatures on every trust account check with only two or three people having authority to sign.
- Examine monthly reconciliations and the entire trial balance for accuracy, even if it is pages long.
- Maintain an approved vendor list. The bookkeeper may write checks to anyone on the list, but if a vendor is used who is not on the list, then only the broker-in-charge may sign that check.
- Adequately screen job applicants who will have access to cash, e.g., criminal record check, contact previous employers, etc.
- Actively supervise the bookkeeper and others handling cash.
- Have the books audited periodically by a C. P. A., particularly one experienced in detecting fraud, rather than one who primarily prepares tax returns, or occasionally hire a certified fraud examiner (CFE) to review your records.

In evaluating internal controls, focus on the areas in your practice that are most susceptible to fraud and abuse. Identify what procedures should be in place and then actively supervise the employees to make sure those procedures are being followed on a regular basis.

INVESTIGATORY PROCEDURES

An auditor/investigator is most likely to knock on your office door, or telephone you with some questions, either because they are investigating a complaint referred from Legal Services, *or* because you were one of the lucky names randomly drawn from the hat for purposes of a spot audit. While investigations mostly involve trust account or loan fraud issues, A&I staff also investigate factual matters in the field, gathering information to report back to the Legal staff person assigned to that case. In both cases the procedure will be similar, as are the broker's obligations. [Note: hereafter the term "auditor" will be used as more concise, but understand it includes "investigator" where appropriate.]

Typically, the auditor will not telephone in advance to make an appointment. All field personnel carry official identification cards bearing their photo. The auditor will identify him/herself and ask to speak to the broker-in-charge. If the BIC is not in the office, the auditor may request a cell phone or other number to contact the broker-in-charge. The auditor will explain that s/he is there to review either particular files or trust account records in general and to what records s/he needs access. It is the broker's obligation to afford that access. Note that the broker-in-charge is not required to be present, so long as access to the files and records is provided. If explanations are desired, then the broker-in-charge and/or broker-associates will be contacted.

How quickly must access to the trust account records and transaction files be allowed?

Basically, immediately; if the records are onsite, what possible reason could there be for delay? Note that Rule A.0107(f) provides that all trust/escrow account records shall be made available to Commission representatives in accordance with Rule A.0108, the last sentence of which states: "... all such records ***shall*** be made available for inspection *and reproduction* by the Commission or its authorized representatives *without prior notice.*" While financial records typically will be kept in the office, transaction files may be stored off-site. If such is the case, the broker may be given a day to provide access to the requested files. For those real estate companies that are becoming "paperless" by maintaining all records electronically, an audit/investigation should be able to commence immediately since all records can be accessed by computer. Again, the only requirement for digital records is that the broker be able to print a hard copy of any requested document.

An investigation may be brief, or fairly prolonged, depending on the facts. Some of the more complex mortgage and loan fraud cases may take months, if not years to investigate. However, it is doubtful that an auditor would visit as long with a broker who maintains trust account records in compliance with the rule, reconciles all records monthly and actively supervises the bookkeeper, as s/he might with a broker who fails to maintain accurate records and reconciles quarterly. If the broker's records show that the journal balance routinely matches

the trial balance which matches the reconciled bank statements, then life is good. Auditors often find non-compliance with some of the more technical, detailed record-keeping and notation requirements of the rule, but generally will just advise the broker where s/he is out of compliance and how to remedy that for the future.

Obviously, more serious problems arise when there is either too little or too much money. Overages are not necessarily any better than shortages, particularly if the broker can't explain who owns what portions of the overage. If part of the overage resulted from interest paid on the account that the company failed to withdraw for eighteen months, then the company is guilty of commingling and seriously jeopardized the integrity of the trust account. To the extent the surplus funds belong to others, then why weren't they disbursed and what happened to the ledger sheets on which this information was to be recorded? So long as there was money in the trust account related to that property, even if the transaction was ten years ago, that ledger sheet should still be in the monthly trial balance — a huge reminder that the broker was still sitting on these monies and his/her three year record retention clock had not yet started to tick.

What if an auditor appears at a broker's office requesting to see the trust account records, but the broker doesn't have a trust account because s/he never holds monies for others? Then the broker tells the auditor "I never receive or hold monies for others when acting as a broker and therefore I don't have a trust account." Will the auditor say, "O.K., thanks" and go away? Maybe - but more likely s/he will first ask to randomly pull several transaction files just to ensure that the broker/company isn't engaged in any leasing/property management activities or has not signed as an escrow agent in any of the sales files. If the transaction files support this conclusion, then the auditor will depart after a relatively short visit.

CONCLUSION

Bottom line is: either refuse to ever hold monies on behalf of others while acting as a broker thereby eliminating the need for a trust account, or pay meticulous attention to its maintenance. Rule A.0107, subparagraph (e) in particular, leaves no doubt regarding the information that must appear on checks, deposit tickets, journals or check stubs, ledger sheets, bank statements, trial balance and monthly reconciliations. ***Read the rule, know and understand it, and make sure you, or your bookkeeper, follow its instructions. Document everything!*** If something goes wrong (and invariably it will), document for the file what happened and why, including any substantiating physical evidence, explain what you did to make it right, and any other remedial action you took, including additional education for you, your associated agents and/or your bookkeeper, or implementing a new internal control as part of office policy to hopefully prevent a reoccurrence in the future.

Commission Rule 58A.0107: Handling and Accounting of Funds (as of July 1, 2010.)

(a) Except as provided herein, all monies received by a licensee acting in his or her fiduciary capacity shall be deposited in a trust or escrow account maintained by a broker not later than three banking days following receipt of such monies except that earnest money deposits paid by means other than currency which are received on offers to purchase real estate and tenant security deposits paid by means other than currency which are received in connection with real estate leases shall be deposited in a trust or escrow account not later than three banking days following acceptance of such offer to purchase or lease; the date of acceptance of such offer to purchase or lease shall be set forth in the purchase or lease agreement. All monies received by a provisional broker shall be delivered immediately to the broker by whom he or she is employed, except that all monies received by nonresident commercial licensees shall be delivered as required by Rule .1808 of this Subchapter. A licensee may accept custody of a check or other negotiable instrument made payable to the seller of real property as option money only for the purpose of delivering the instrument to the optionor-seller. While the instrument is in the custody of the licensee, the licensee shall, according to the instructions of the buyer-optionee, either deliver it to the seller-optionor or return it to the buyer-optionee. The licensee shall safeguard the instrument and shall be responsible to the parties on the instrument for its prompt and safe delivery. In no event shall a licensee retain such an instrument for more than three business days after the acceptance of the option contract.

(b) In the event monies received by a licensee while acting in a fiduciary capacity are deposited in a trust or escrow account which bears interest, the licensee having custody over such monies shall first secure from all parties having an interest in the monies written authorization for the deposit of the monies in an interest-bearing account. Such authorization shall specify how and to whom the interest will be disbursed, and, if contained in an offer, contract, lease, or other transaction instrument, such authorization shall be set forth in a conspicuous manner which shall distinguish it from other provisions of the instrument.

(c) Closing statements shall be furnished to the buyer and the seller in the transaction not more than five days after closing.

(d) Trust or escrow accounts shall be so designated by the bank or savings and loan association in which the account is located, and all deposit tickets and checks drawn on said account as well as the monthly bank statement for the account shall bear the words "Trust Account" or "Escrow Account."

(e) A licensee shall maintain and retain records sufficient to identify the ownership of all funds belonging to others. Such records shall be sufficient to show proper deposit of such funds in a trust or escrow account and to verify the accuracy and proper use of the trust or escrow account. The required records shall include:

(1) bank statements.

(2) canceled checks which shall be referenced to the corresponding journal entry or check stub entries and to the corresponding sales transaction ledger sheets or for rental transactions, the corresponding property or owner ledger sheets. Checks shall conspicuously identify the payee and shall bear a notation identifying the purpose of the disbursement. When a check is used to disburse funds for more than one sales transaction, owner, or property, the check shall bear a notation identifying each sales transaction, owner, or property for which disbursement is made, including the amount disbursed for each, and the corresponding sales transaction, property, or owner ledger entries. When necessary, the check notation may refer to the required information recorded on a supplemental disbursement worksheet which shall be cross-referenced to the corresponding check. In lieu of retaining canceled checks, a licensee may retain digitally imaged copies of the canceled checks or substitute checks provided that such images are legible

reproductions of the front and back of such instruments with no smaller images than 1.1875 x 3.0 inches and provided that the licensee's bank retains for a period of at least six years the original checks, "substitute checks" as described in 12 C.F.R. 229.51 or the capacity to provide substitute checks as described in 12 C.F.R. 229.51 and makes the original or substitute checks available to the licensee and the Commission upon request.

(3) deposit tickets. For a sales transaction, the deposit ticket shall identify the purpose and remitter of the funds deposited, the property, the parties involved, and a reference to the corresponding sales transaction ledger entry. For a rental transaction, the deposit ticket shall identify the purpose and remitter of the funds deposited, the tenant, and the corresponding property or owner ledger entry. For deposits of funds belonging to or collected on behalf of a property owner association, the deposit ticket shall identify the property or property interest for which the payment is made, the property or interest owner, the remitter, and the purpose of the payment. When a single deposit ticket is used to deposit funds collected for more than one sales transaction, property owner, or property, the required information shall be recorded on the ticket for each sales transaction, owner, or property, or the ticket may refer to the same information recorded on a supplemental deposit worksheet which shall be cross-referenced to the corresponding deposit ticket.

(4) a payment record sheet for each property or interest for which funds are collected and deposited into a property owner association trust account as required by Subsection (I) of this Rule. Payment record sheets shall identify the amount, date, remitter, and purpose of payments received, the amount and nature of the obligation for which payments are made, and the amount of any balance due or delinquency.

(5) a separate ledger sheet for each sales transaction and for each property or owner of property managed by the licensee identifying the property, the parties to the transaction, the amount, date, and purpose of the deposits and from whom received, the amount, date, check number, and purpose of disbursements and to whom paid, and the running balance of funds on deposit for the particular sales transaction or, in a rental transaction, the particular property or owner of property. Monies held as tenant security deposits in connection with rental transactions may be accounted for on a separate tenant security deposit ledger for each property or owner of property managed by the licensee. For each security deposit the tenant security deposit ledger shall identify the remitter, the date the deposit was paid, the amount, the tenant, landlord, and subject property. For each disbursement of tenant security deposit monies, the ledger shall identify the check number, amount, payee, date, and purpose of the disbursement. The ledger shall also show a running balance. When tenant security deposit monies are accounted for on a separate ledger as provided herein, deposit tickets, canceled checks and supplemental worksheets shall reference the corresponding tenant security deposit ledger entries when appropriate.

(6) a journal or check stubs identifying in chronological sequence each bank deposit and disbursement of monies to and from the trust or escrow account, including the amount and date of each deposit and a reference to the corresponding deposit ticket and any supplemental deposit worksheet, and the amount, date, check number, and purpose of disbursements and to whom paid. The journal or check stubs shall also show a running balance for all funds in the account.

(7) copies of contracts, leases and management agreements.

(8) closing statements and property management statements.

(9) covenants, bylaws, minutes, management agreements and periodic statements relating to the management of a property owner association.

(10) invoices, bills, and contracts paid from the trust account, and any documents not otherwise described herein necessary and sufficient to verify and explain record entries.

Records of all receipts and disbursements of trust or escrow monies shall be maintained in such a manner as to create an audit trail from deposit tickets and canceled checks to check stubs or journals and to the ledger sheets. Ledger sheets and journals or check stubs must be reconciled to the trust or escrow account

bank statements on a monthly basis. To be sufficient, records of trust or escrow monies must include a worksheet for each such monthly reconciliation showing the ledger sheets, journals or check stubs, and bank statements to be in agreement and balance.

(f) All trust or escrow account records shall be made available for inspection by the Commission or its authorized representatives in accordance with Rule 58A.0108.

(g) In the event of a dispute between the seller and buyer or landlord and tenant over the return or forfeiture of any deposit other than a residential tenant security deposit held by a licensee, the licensee shall retain said deposit in a trust or escrow account until the licensee has obtained a written release from the parties consenting to its disposition or until disbursement is ordered by a court of competent jurisdiction. Alternatively, the licensee may deposit the disputed monies with the appropriate clerk of court in accordance with the provision of G.S. 93A-12. If it appears to a licensee holding a disputed deposit that a party has abandoned his or her claim, the licensee may disburse the money to the other claiming parties according to their written agreement provided that the licensee first makes a reasonable effort to notify the party who has apparently abandoned his or her claim and provides that party with an opportunity to renew his or her claim to the disputed funds. Tenant security deposit monies shall be disposed of in accordance with the requirements of N.C.G.S. 42-50 through 56 and N.C.G.S. 42A-18.

(h) A licensee may transfer earnest money deposits in his or her possession collected in connection with a sales transaction from his or her trust account to the closing attorney or other settlement agent not more than ten days prior to the anticipated settlement date. A licensee shall not disburse prior to settlement any earnest money in his or her possession for any other purpose without the written consent of the parties.

(i) The funds of a property owner association, when collected, maintained, disbursed or otherwise controlled by a licensee, are trust monies and shall be treated as such in the manner required by this Rule. Such funds must be deposited into and maintained in a trust or escrow account dedicated exclusively for funds belonging to a single property owners association and may not be commingled with funds belonging to other property owner associations or other persons or parties. A licensee who undertakes to act as manager of a property owner association or as the custodian of funds belonging to a property owner association shall provide the association with periodic statements which report the balance of association funds in the licensee's possession or control and which account for the funds the licensee has received and disbursed on behalf of the association. Such statements must be made in accordance with the licensee's agreement with the association, but in no event shall the statements be made less frequently than every 90 days.

(j) Every licensee shall safeguard the money or property of others coming into his or her possession in a manner consistent with the requirements of the Real Estate License Law and the rules adopted by the Commission. A licensee shall not convert the money or property of others to his or her own use, apply such money or property to a purpose other than that for which it was paid or entrusted to him or her, or permit or assist any other person in the conversion or misapplication of such money or property.

(k) In addition to the records required by paragraph (e) of this rule, a licensee acting as agent for the landlord of a residential property used for vacation rentals shall create and maintain a subsidiary ledger sheet for each property or owner of such properties onto which all funds collected and disbursed are identified in categories by purpose. On a monthly basis, the licensee shall reconcile the subsidiary ledger sheets to the corresponding property or property owner ledger sheet.

(l) In lieu of maintaining a subsidiary ledger sheet, the licensee may maintain an accounts payable ledger sheet for each owner or property and each vendor to whom trust monies are due for monies collected on

behalf of the owner or property identifying the date of receipt of the trust monies, from whom the monies were received, rental dates, and the corresponding property or owner ledger sheet entry including the amount to be disbursed for each and the purpose of the disbursement. The licensee may also maintain an accounts payable ledger sheet in the format described in paragraph (k) above for vacation rental tenant security deposit monies and vacation rental advance payments.

YOUR REALTY COMPANY, INC.

TRUST ACCOUNT JOURNAL

NC Insured Bank A/C# 123-456-7890

| DATE | DESCRIPTION | NUM | | DEPOSITS | CHECKS | BALANCE |
|---------|--|-------------|---|------------|------------|------------|
| 1/03/1X | DEPOSIT | 1X-1 (A) | √ | \$3,600.00 | | \$3,600.00 |
| 1/04/1X | DEPOSIT | 1X-2 | √ | \$2,300.00 | | \$5,900.00 |
| 1/11/1X | Ajax Plumbing - 143 N. Blvd - Repairs | 101 | √ | | \$75.00 | \$5,825.00 |
| 1/20/1X | Gerald Howard - 143 N. Blvd Net Jan Rent to Owner | 102 | | | \$465.00 | \$5,360.00 |
| 1/21/1X | Your Realty Company, Inc. 1/1X Mgt Fees | 103 | √ | | \$115.00 | \$5,245.00 |
| 1/22/1X | Jack Thomas - NSF - 1362 Main St | DM (B) | √ | | \$2,500.00 | \$2,745.00 |
| 1/30/1X | Perry Mason, Attorney 119 Maple Closing | 104 | | | \$1,000.00 | \$1,745.00 |
| 1/31/1X | DEPOSIT | 1X-3 | | \$2,500.00 | | \$4,245.00 |
| 1/31/1X | NC Insured Bank Check Printing Charges | DM | √ | | \$25.00 | \$4,220.00 |
| | | | | | | |

(A) - Referenced to sequentially numbered deposit tickets

(B) - Debit Memo

√ - Cleared Bank

DEPOSIT TICKET

| YOUR REALTY COMPANY, INC. TRUST ACCOUNT DATE <u>1/3/1X</u> # 0X-1 | | |
|--|---------|-------|
| | DOLLARS | CENTS |
| CURRENCY | | |
| COINS | | |
| CHECKS | | |
| 1. <i>Your Realty Co, Inc.</i> | \$100 | 00 |
| 2. <i>Personal Funds</i> | | |
| 3. | | |
| 4. <i>Jones to Wood - EMD</i> | \$1,000 | 00 |
| 5. <i>119 Maple St</i> | | |
| 6. | | |
| 7. <i>Clay to Thomas</i> | \$2,500 | 00 |
| 8. <i>EMD - 1362 Main</i> | | |
| 9. <i>Street</i> | | |
| TOTAL | \$3,600 | 00 |

DEPOSIT TICKET

| YOUR REALTY COMPANY, INC. TRUST ACCOUNT DATE <u>1/31/1X</u> # 0X-3 | | |
|---|---------|-------|
| | DOLLARS | CENTS |
| CURRENCY | | |
| COINS | | |
| CHECKS | | |
| 1. <i>Thomas - 1362 Main</i> | \$2,500 | 00 |
| 2. <i>Street - Redeposit</i> | | |
| 3. <i>EMD - NSF Check</i> | | |
| 4. <i>Clay, Seller</i> | | |
| 5. | | |
| 6. | | |
| 7. | | |
| 8. | | |
| 9. | | |
| TOTAL | \$2,500 | 00 |

DEPOSIT TICKET

| | | |
|--|---------|-------|
| YOUR REALTY COMPANY, INC. TRUST ACCOUNT DATE <u>1/4/1X</u> (C) # 0X-2 | | |
| | DOLLARS | CENTS |
| CURRENCY <i>SDW</i> (C) | \$2,300 | 00 |
| COINS | | |
| CHECKS | | |
| 1. | | |
| 2. | | |
| 3. | | |
| 4. | | |
| TOTAL | \$2,300 | 00 |

(C) - Referenced to supplemental deposit worksheet for deposit ticket #2.

SUPPLEMENTAL DEPOSIT WORKSHEET
Deposit Ticket #2 (D)
1/4/1X

| REMITTER/BUYER/TENANT | PROPERTY | PURPOSE | AMOUNT |
|-----------------------|----------------------------|-------------------------|-------------------|
| <i>Clark</i> | <i>143 North Boulevard</i> | <i>Security Deposit</i> | <i>\$600.00</i> |
| <i>Clark</i> | <i>143 North Boulevard</i> | <i>Jan Rent</i> | <i>\$600.00</i> |
| <i>Stephens</i> | <i>2500 Johnson Street</i> | <i>Security Deposit</i> | <i>\$550.00</i> |
| <i>Stephens</i> | <i>2500 Johnson Street</i> | <i>Jan Rent</i> | <i>\$550.00</i> |
| | TOTAL | | \$2,300.00 |

(D)-Supplemental deposit worksheet cross-referenced back to deposit ticket #2.

LEDGERS

| NAME: <i>Your Realty Company, Inc. - Personal Funds</i> | | | | | ACCOUNT NO. | |
|---|----|--|------|----------|-------------|----------|
| ADDRESS: | | | | | SHEET NO. | |
| DATE | | ITEMS | | DEPOSITS | CHECKS | BALANCE |
| 1/03 | 1X | <i>Your Realty Company Inc. Personal Funds</i> | 1X-1 | \$100.00 | | \$100.00 |
| 1/31 | 1X | <i>NC Insured Bank Check Printing Charges</i> | DM | | \$25.00 | \$75.00 |
| | | | | | | |

| NAME: <i>Jones (Seller) to Wood (Buyer)</i> | | | | | ACCOUNT NO. | |
|---|----|--|------|------------|-------------|------------|
| ADDRESS: <i>119 Maple St</i> | | | | | SHEET NO. | |
| DATE | | ITEMS | | DEPOSITS | CHECKS | BALANCE |
| 1/03 | 1X | <i>John Wood EMD</i> | 1X-1 | \$1,000.00 | | \$1,000.00 |
| 1/30 | 1X | <i>Perry Mason, Attorney Closing</i> | 104 | | \$1,000.00 | \$0.00 |
| | | | | | | |

| NAME: <i>Clay (Seller) to Thomas (Buyer)</i> | | | | | ACCOUNT NO. | |
|--|----|--|------|------------|-------------|------------|
| ADDRESS: <i>1362 Main Street</i> | | | | | SHEET NO. | |
| DATE | | ITEMS | | DEPOSITS | CHECKS | BALANCE |
| 1/03 | 1X | <i>Jack Thomas EMD</i> | 1X-1 | \$2,500.00 | | \$2,500.00 |
| 1/22 | 1X | <i>Jack Thomas NSF</i> | DM | | \$2500.00 | \$0.00 |
| 1/31 | 1X | <i>Jack Thomas Redeposit NSF EMD Check</i> | 1X-3 | \$2,500.00 | | \$2,500.00 |
| | | | | | | |

LEDGERS

| NAME: <i>Gerald Howard, Owner - - Clark, Tenant</i> | | | | | ACCOUNT NO. | |
|---|----|---|------|----------|-------------|------------|
| ADDRESS: <i>143 North Boulevard</i> | | | | | SHEET NO. | |
| DATE | | ITEMS | | DEPOSITS | CHECKS | BALANCE |
| 1/04 | 1X | <i>Charles Clark Security Deposit</i> | 1X-2 | \$600.00 | | \$600.00 |
| 1/04 | 1X | <i>Charles Clark Jan Rent</i> | 1X-2 | \$600.00 | | \$1,200.00 |
| 1/11 | 1X | <i>Ajax Plumbing Repairs</i> | 101 | | \$75.00 | \$1,125.00 |
| 1/20 | 1X | <i>Gerald Howard Net Jan Rent To Owner</i> | 102 | | \$465.00 | \$660.00 |
| 1/21 | 1X | <i>Your Realty Co., Inc. Jan Management Fee</i> | 103 | | \$60.00 | \$600.00 |
| | | | | | | |

| NAME: <i>Allan Ward, Owner - - Stephens, Tenant</i> | | | | | ACCOUNT NO. | |
|---|----|---|------|----------|-------------|------------|
| ADDRESS: <i>2500 Johnson Street</i> | | | | | SHEET NO. | |
| DATE | | ITEMS | | DEPOSITS | CHECKS | BALANCE |
| 1/04 | 1X | <i>Blake Stephens Security Deposit</i> | 1X-2 | \$550.00 | | \$550.00 |
| 1/04 | 1X | <i>Blake Stephens Jan Rent</i> | 1X-2 | \$550.00 | | \$1,100.00 |
| 1/21 | 1X | <i>Your Realty Co., Inc. Jan Management Fee</i> | 103 | | \$55.00 | \$1,045.00 |
| | | | | | | |
| | | | | | | |

Your Realty Company
Trust Account
Anytown, NC 12345

103

1/21/1X

Your Realty Company, Inc.

\$ 115.⁰⁰

One hundred fifteen and ⁰⁰/100 -----Dollars

1/1X Mgt Fees - SCW

John Broker

⑈⑈⑈ || =⑈⑈⑈⑈=⑈⑈⑈⑈⑈⑈ || ⑈⑈⑈= ⑈⑈⑈=|| ⑈⑈⑈⑈⑈⑈⑈

SUPPLEMENTAL CHECK WORKSHEET
1/21/1X - CHECK #103 - YOUR REALTY CO., INC. (E)

| PROPERTY | PURPOSE | AMOUNT |
|----------------------------|-----------------------------|-----------------|
| <i>143 North Boulevard</i> | <i>1/1X Management Fees</i> | <i>\$60.00</i> |
| <i>2500 Johnson Street</i> | <i>1/1X Management Fees</i> | <i>\$55.00</i> |
| | | <i>\$115.00</i> |

(E) - Date and check number provide cross-reference to corresponding check.

Bank Account Reconciliation
Your Realty Company, Inc.

Period Ending 1/31/1X

Ending Balance from Bank Statement A. \$ 3,185.00

List Deposits in Transit \$ 2,500.00
(Deposits posted to the journal
that have not cleared the bank)

Total Deposits in Transit + B. \$ 2,500.00

List Outstanding Checks
(Checks posted to the journal that
have not cleared the bank)

| Check | Date | Amount |
|---------------|----------------|--------------------|
| <u>102</u> | <u>1/20/1X</u> | <u>\$ 465.00</u> |
| <u>104</u> | <u>1/30/1X</u> | <u>\$ 1,000.00</u> |
| <u> </u> | <u> </u> | <u>\$</u> |

Total Outstanding Checks - C. \$ 1,465.00

Reconciled Bank Balance D. \$ 4,220.00

YOUR REALTY COMPANY, INC.
TRIAL BALANCE

NC INSURED BANK A/C# 123-456-789

DATE: 1/31/1X

| OWNER | PROPERTY | AMOUNT |
|----------------------------------|----------------------------|------------|
| <i>Your Realty Company, Inc.</i> | | \$75.00 |
| <i>Clay</i> | <i>1362 Main Street</i> | \$2,500.00 |
| <i>Howard</i> | <i>143 North Boulevard</i> | \$600.00 |
| <i>Ward</i> | <i>2500 Johnson Street</i> | \$1,045.00 |
| | | |
| | | |
| TOTAL | | \$4,220.00 |

NOTE

The total on the trial balance equals the reconciled bank balance on the bank reconciliation and the journal running balance as of 1/31/0X.