

## AUDITS AND EXAMINATIONS

Because of the importance of trust fund handling, the Commissioner has an ongoing program of examining brokers' records. As necessary, audited licensees are made aware of deficiencies in trust fund handling and record keeping. If an audit discloses actual trust fund imbalances or money handling procedures which may cause monetary loss, appropriate disciplinary proceedings may be initiated.

Section 10148 of the Business and Professions Code provides that a real estate broker shall retain for three years copies of all listings, deposit receipts, canceled checks, trust records, and other documents executed by or obtained by the broker in connection with any transaction for which a real estate broker license is required. The retention period shall run from the date of the closing of the transaction or from the date of the listing if the transaction is not consummated. After notice, such books, accounts and records shall be made available for examination, inspection and copying by the Commissioner or a designated representative during regular business hours, and shall, upon the appearance of sufficient cause, be subject to audit without further notice, except that such audit shall not be harassing in nature.

## SAMPLE TRANSACTIONS

To demonstrate the record keeping requirements discussed above, we have simulated trust account records for typical real estate transactions occurring over a thirty-day period. To set the stage, let us assume that James Adams, a real estate broker, owns and operates a one-man real estate office specializing in residential sales and property management. Broker Adams has one trust fund bank account. We will look at the trust account activity for this office for the month of May, **2013**.

The use of columnar records to record these transactions is illustrated in Exhibits 1 - 10 at the end of this publication. As previously discussed, a broker may use other types of records as long as they meet generally accepted accounting standards.

### 2013 TRANSACTIONS

May 1 Opened a trust account with First County Bank, and deposited \$100 of his own money to cover bank service charges.

May 1 Entered into agreements to manage the following rental properties:

<i>Address</i>	<i>Owner's Name</i>
a) 1538 South Ave. Anycity, CA	T. Eddie
b) 3490 Tower St. Anycity, CA	L. Stewart
c) 9152 High Way Anycity, CA	W. Allen
d) 2351-2353 Kingstone Way Anycity, CA	S. Manly
e) 7365 Meadow Circle Anycity, CA	J. Bird

May 3 Deposited the following rents received from tenants of managed properties:

<i>Property.</i>	<i>Tenant's Name</i>	<i>Rent Received</i>
a) 1538 South Ave.	B. Hamms	\$1,700
b) 3490 Tower St., Unit 1	R. Robertson	\$700
c) 2351 Kingston Way	I. Warren	<u>\$1,250</u>
	TOTAL	<u>\$3,650</u>

May 6 Received a \$5,000 check payable to broker from Mr. and Mrs. Dennis White as deposit for their offer to buy a house at 615 Lake Drive, Anycity, owned by Mr. and Mrs. Richard J. Jensen. Buyers' offer instructed broker to hold the check uncashed until their offer was accepted by the Jensens.

May 6 Received and deposited \$2,250 from T. Sundance representing rent of \$1,250 for May 5 to 30, and \$1,000 security deposit for 7365 Meadow Circle.

May 6 Was notified by the Jensens that they accepted the offer on their property.

May 6 Deposited the \$5,000 check from Mr. and Mrs. White.

May 8 Obtained an exclusive listing to sell a six-plex at 915 Galaxy St., Anycity, owned by R. Jays.

May 9 Received \$1,000 from W. Allen, owner of 9152 High Way, to cover anticipated expenses for the property. Amount was deposited the same day.

May 10 Issued the following checks to pay for various expenses connected with the managed properties:

<i>Check No.</i>	<i>Payee</i>	<i>Purpose</i>	<i>Amount</i>
1001	ABC Mortgage Co.	Mortgage payment for 1538 South Ave.	\$1,300
1002	Anycity Treasury	Utilities for 1538 South Ave.	135
1003	Professional Cleaners	Cleaning for 3490 Tower St.	125
1004	Mr. Handyman	Minor repairs on 2351 Kingston	95
		TOTAL	<u>\$1,655</u>

May 14 Received a \$4,000 check from B. Sun, payable to Title Escrow Company, with an offer to buy the 915 Galaxy property.

May 15 Received R. Jays' acceptance of the buyer's offer on 915 Galaxy Street.

May 16 Delivered the \$4,000 check from B. Sun to Title Escrow Company.

May 20 Issued check number 1005 for \$5,000 to First Title Co. for account of Mr. and Mrs. White, buyers of the 615 Lake Drive property.

May 22 Received an offer and a \$3,000 check as deposit from R. Olive to buy a single family house at 31009 Technology Street owned by T. Evans.

May 24 Returned R. Olive's check after seller rejected the offer.

May 31 Charged property management fees to the following accounts and issued check number 1006 for \$590 payable to himself:

<i>Property Owner</i>	<i>Management Fee</i>
T. Eddie	\$170
L. Stewart	70
W. Allen	100
S. Manly	125
J. Bird	<u>125</u>
Total	<u>\$590</u>

May 31 Sent statement of account to each owner of the managed properties.

**Background Information**

James Adams keeps four types of columnar records:

1. Record of all Trust Funds Received and Paid Out - Trust Fund Bank Account (hereinafter referred to as “Bank Account Record”). This record is required under Commissioner’s Regulation 2831 for each trust account a broker has.
2. Record of all Trust Funds Received - Not Placed in Broker’s Trust Account (hereinafter referred to as “Record of Undeposited Receipts”). This is required under Commissioner’s Regulation 2831.
3. Separate Record For Each Beneficiary or Transaction (hereinafter referred to as “Separate Beneficiary Record”). This is required under Commissioner’s Regulation 2831.1.
4. Separate Record For Each Property Managed (hereinafter referred to as “Separate Property Record”). This serves the same purpose as the Separate Beneficiary Record.

To illustrate the recording process, listed below are the entries made on the books by James Adams as well as the documents prepared or obtained as support for each transaction. The actual entries are shown on the forms/exhibits at the end of this publication.

Note that:

- Each entry to any record shows all the pertinent information of the transaction, such as the date, name of payee, name of payor, amount, check number, etc.
- The daily *bank balance* is computed and posted on the Account Record after recording the transactions.
- The balance owing to the client is computed and posted on the Beneficiary Record or Separate Property Record, after posting transactions.
- Any entry made on the Bank Account Record has a corresponding entry on a Beneficiary Record or a Separate Property Record, and vice versa.
- All records except the Record of Undeposited Receipts show entries in chronological sequence regardless of transaction type. The Record of Undeposited Receipts shows the disposition of a trust fund in the same line as the receipt is entered, rather than in chronological sequence.

**Step-By-Step Narrative of Trust Account Entries**

(Actual recording shown in Exhibits 1 - 10)

<i>Transaction Date</i>	<i>Documentation</i>	<i>Entries</i>
May 1	Deposit slip prepared by broker.	Record the deposit on: 1. The Bank Account Record. Balance is \$100. <b>(Exh. 1)</b> 2. A newly prepared Separate Beneficiary for James Adams. Balance is \$100. <b>(Exh. 2)</b>
May 1	Management agreements signed by property owners and broker.	No entries needed since there was no receipt nor disbursement of trust funds.
May 3	Collection receipts Nos. 2, 3 and 4 issued to B. Hamns, R. Robertson, and I. Warren, respectively.	Record the \$3,650 receipt on: 1. The Bank Account Record. New balance is \$3,750. <b>(Exh. 1)</b> 2. Newly prepared Separate Beneficiary Records for: T. Eddie - balance is \$1,700 <b>(Exh. 4)</b> L. Stewart – bal. is \$700 <b>(Exh. 5)</b> S. Manly - balance is \$1,250 <b>(Exh. 6)</b>
May 6	Real Estate Purchase Contract and Receipt for Deposit signed by Mr. and Mrs. White. Collection receipt No. 1 issued to the Whites.	Enter transaction on the Record of Undeposited Receipts. <b>(Exh. 3)</b>  No Separate Beneficiary Record is necessary since the check was not deposited.

<i>Transaction Date</i>	<i>Documentation</i>	<i>Entries</i>
May 6	Collection receipt No. 5 issued to T. Sundance. Receipt showed that \$1,250 of the \$2,250 was for rent and the other \$1,000 was for security deposit.	Record the \$2,250 deposit on: 1. The Bank Account Record. <b>(Exh. 1)</b> 2. Separate Beneficiary Records for: J. Bird - Sundance's Security Deposit, bal. is \$1,000. <b>(Exh. 7)</b> J. Bird - balance is \$1,000. <b>(Exh. 8)</b> (Since security deposits will be accounted to the tenant in the future, James Adams keeps a separate record for deposits. Total liability to the owner is the sum of the two records - one for security deposits, another for rents and other transactions.)
May 6	Real Estate Contract and Receipt for trust funds were received for Deposit signed by Mr. and Mrs. Jensen.	No entries were made since no trust funds were received or disbursed.
May 6	Deposit receipt prepared by broker.	Record \$5,000 deposit on: 1. Bank Account record. New balance is \$11,000. <b>(Exh. 1)</b> 2. A newly prepared Separate Beneficiary Record - Mr. and Mrs. White/Mr. and Mrs. Jensen. Account balance is \$5,000. <b>(Exh. 9)</b> 3. Record of Undeposited Receipts. <b>(Exh. 3)</b> Shows disposition of check previously entered on the record.
May 8	Exclusive Listing Agreement signed by sellers and broker.	
May 9	Collection receipt No. 6 issued to W. Allen.	Record receipt on: 1. The Bank Account Record. New balance is \$12,000. <b>(Exh. 1)</b> 2. A newly prepared Separate Beneficiary Record - W. Allen. Balance is \$1,000. <b>(Exh. 10)</b>
May 10	Checks issued by broker. Supporting papers for each check.	Record disbursements on: 1. Bank Account Record. New Balance is \$10,345. <b>(Exh. 1)</b> 2. Separate Beneficiary Records for: T. Eddie - New balance is \$265. <b>(Exh. 4)</b> L. Stewart - New balance is \$575. <b>(Exh. 5)</b> S. Manly - New balance is \$1,155. <b>(Exh. 6)</b>
May 14	Real Estate Purchase Contract and Receipt for Deposit signed by B. Sun.	Record receipt on the Record of Undeposited Receipts. <b>(Exh. 3)</b>
May 15	Real Estate Purchase Contract and Receipt for Deposit signed by R. Jays.	No entry was needed since there was no receipt or disbursement of funds.
May 16	Receipt issued by Title Escrow Company.	Note disposition of check on the Record of Undeposited Receipts. <b>(Exh. 3)</b>
May 20	Check issued by broker. Receipt issued by First Title Company.	Record disbursements on the: 1. Bank Account Record. New balance is \$8,345. <b>(Exh. 1)</b> 2. Separate Beneficiary Record - Mr. and Mrs. White/Mr. and Mrs. Jensen. New balance is \$0. <b>(Exh. 9)</b>
May 22	Real Estate Purchase Contract and receipt for Deposit signed by R. Olive.	

<i>Transaction Date</i>	<i>Documentation</i>	<i>Entries</i>
May 24	Real Estate Purchase Contract and Receipt for Deposit rejected by T. Evans.	Post the return of check on the Record of Undeposited Receipts. <b>(Exh. 3)</b>
May 31	List showing the breakdown of the check amount, showing the charge to each owner.  (NOTE: A list is necessary as support for a check disbursement chargeable to a number of beneficiaries. Posting the entries on the separate records without such a list is not sufficient.)	Record disbursements on the: 1. Bank Account Record. New balance is \$7,755. <b>(Exh. 1)</b> 2. Separate Beneficiary Records for: New Owners      Balance  T. Eddie     \$95 L. Stewart   \$505 W. Allen     \$900 S. Manly     \$1,030 J. Bird       \$1,125

After recording the daily transactions, the next step in the trust fund accounting process is the reconciling of records at the end of the month. James Adams prepared reconciliation schedules by comparing the bank balance on the Bank Account Record with the bank statement balance (the bank reconciliation) and also with the total of the Separate Beneficiary Records balances (the reconciliation report).

The bank statement and reconciliations are shown on the next two pages.

**FIRST COUNTY BANK**

**STATEMENT**

MAIN BRANCH  
5 Main Avenue  
ANYCITY, CA 90002

PAGE 1 of 1

DATE OF THIS STATEMENT: 05/31/13

JAMES ADAMS  
TRUST ACCOUNT  
8310 ORANGE AVENUE  
ANYCITY, CA 90002  
CUSTOMER SINCE 1995

CHECKING ACCT. 123456

SUMMARY: PREVIOUS STATEMENT BALANCE ON 04/30/13	00.00
TOTAL OF 5 DEPOSITS FOR.....	12,000.00
TOTAL OF 4 CHECKS FOR.....	6,560.00
TOTAL OF 1 OTHER DEBIT FOR .....	7.00
STATEMENT BALANCE ON 05/31/13.....	5,433.00

CHECKS/ OTHER DEBITS	CHECKS CHECK NUMBER	DATE POSTED	AMOUNT
	1001	5/14	1,300.00
	1002	5/16	135.00
	1003	5/16	125.00
	1005	5/21	5,000.00

OTHER DEBITS			
DATE POSTED			AMOUNT

05/31	SERVICE CHARGE	7.00
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DEPOSITS/ OTHER CREDITS	DEPOSITS	DATE POSTED	AMOUNT
		5/1	100.00
		5/6	3,650.00
		5/6	2,250.00
		5/6	5,000.00
		5/9	1,000.00

DAILY BALANCE	DATE	AMOUNT	DATE	AMOUNT
	5/1	100.00	5/16	10,440.00
	5/6	11,000.00	5/21	5,440.00
	5/9	12,000.00	5/31	5,433.00
	5/14	10,700.00		

**James Adams**  
**Bank Reconciliation**  
 First County Bank  
 May 31, 2013

Balance per bank statement, 5/31/13 .....		\$5,433.00
Add deposits in transit .....		-0-
<i>Less outstanding checks:</i>		
check #1004.....	\$95.00	
#1006.....	<u>590.00</u>	<u>&lt;685.00&gt;</u>
Adjusted bank balance, 5/31/13.....		<u>\$4,748.00</u>
Balance per books, 5/31/13.....		\$4,755.00
Less May bank service charge.....		<u>&lt;7.00&gt;</u>
Adjusted balance, 5/31/13 .....		<u>\$4,748.00</u>

**James Adams**  
**Reconciliation Report**  
 First County Bank  
 Account No. 123456  
 May 31, 2013

<i>Beneficiary</i>	<i>Balance</i>
James Adams (Broker) .....	\$93.00
W. Allen .....	900.00
J. Bird .....	1,000.00
J. Bird .....	1,125.00
T. Eddie .....	95.00
S. Manly .....	1,030.00
L. Stewart .....	<u>505.00</u>
Total per subsidiary records.....	<u>\$4,748.00</u>
(Agrees with bank account record balance.)	