

An exception to this rule is *when* a check is received from an offeror in connection with an offer to purchase or lease real property. As provided under Commissioner's Regulation 2832, a deposit check may be held uncashed by the broker until acceptance of the offer if the following conditions are met:

1. the check by its terms is not negotiable by the broker, or the offeror has given written instructions that the check shall not be deposited or cashed until acceptance of the offer; and
2. the offeree is informed, before or at the time the offer is presented for acceptance, that the check is being held.

If the offer is later accepted, the broker may continue to hold the check undeposited only if the broker receives written authorization from the offeree to do so. Otherwise, the check must be placed, not later than three business days after acceptance, into a neutral escrow depository or into the trust fund bank account or into the hands of the offeree if both the offeror and offeree expressly so provide in writing.

According to Business and Professions Code Section 10145, a real estate salesperson who accepts trust funds on behalf of the broker under whom he or she is licensed must immediately deliver the funds to the broker or, if directed *to do so* by the broker, place the funds into the hands of the broker's principal or into a neutral escrow depository or deposit the funds into the broker's trust fund bank account.

A *neutral escrow depository*, as used in Business and Professions Code Section 10145, means an escrow business conducted by a person licensed under Division 6 (commencing with Section 17000) of the Financial Code or by any person described in subdivisions (a)(1) and (a)(3) of Section 17006 of the Financial Code.

Identifying the Owner(s) of Trust Funds

A broker must be able to identify who owns the trust funds and who is entitled to receive them, since these funds can be disposed of only upon the authorization of that person. The person entitled to the funds may or may not be the person who originally gave the funds to the broker or the salesperson. In some instances the party entitled to the funds will change upon the occurrence of certain events in the transaction. For example, in a transaction involving an offer to buy or lease real property or a business opportunity, the party entitled to the funds received from the offeror (prospective buyer or lessor) will depend upon whether or not the offer has been accepted by the offeree (seller or landlord).

Prior to the acceptance of the offer, the funds received from the offeror belong to that person and must be handled according to his/her instructions. If the funds are deposited in a trust fund bank account, they must be maintained there for the benefit of the offeror until acceptance of the offer. Or, as discussed in the previous section, if the offeror wishes, his/her check may be held uncashed by the broker as long as he/she gives written instructions to the broker to do so and the offeree is informed before or at the time the offer is presented for acceptance that the check is being so held.

After acceptance of the offer, the funds shall be handled according to instructions from the offeror and the offeree as follows:

- An offeror's check held uncashed by the broker before acceptance of the offer may continue to be held uncashed after acceptance of the offer, only upon written authorization from the offeree. [Commissioner's Regulation 2832(d)]
- The offeror's check may be given to the offeree only if the offeror and offeree expressly so provide in writing. [Commissioner's Regulation 2832(d)]
- All or part of an offeror's purchase money deposit in a real estate sales transaction shall not be refunded by an agent or subagent of the seller without the *express written permission* of the offeree to make the refund.

TRUST FUND BANK ACCOUNTS

General Requirements

Trust funds, such as a purchase money deposit check, received by a licensee that are not forwarded directly to the broker's principal or to a neutral escrow depository or for which the broker does not have authorization to hold uncashed must be deposited to the broker's trust fund bank account. (Business and Professions Code Section 10145)

Business and Professions Code Section 10145 and Commissioner's Regulation 2832 require that a trust account meet the following criteria:

1. designated as a trust account in the name of the broker as trustee;
2. maintained with a bank or recognized depository located in California; and
3. not an interest-bearing account for which prior written notice can, by law or regulation, be required by the financial institution as a condition to withdrawal (except as noted in the discussion below of "Interest-Bearing Accounts").

A broker may have an out-of-state trust account if the account is insured by the Federal Deposit Insurance Corporation (FDIC) and is used to service first loans for the types of note owners/investors specified in Section 10145(a)(2) of the Business and Professions Code.

Trust Account Withdrawals

According to Commissioner's Regulation 2834, withdrawals from the trust account may be made only upon the signature of one or more of the following:

1. the broker in whose name the account is maintained;
2. the designated broker-officer if the account is in the name of a corporate broker;
3. if specifically authorized in writing by the broker, a salesperson licensed to the broker, who has entered into a written agreement pursuant to Section 2726; or
4. if specifically authorized in writing by the broker who is a signatory of the trust account, an unlicensed employee of the broker covered by a fidelity bond at least equal to the maximum amount of trust funds to which the employee has access at any time.

No arrangement under which a person named in items 3 or 4 is authorized to make withdrawals from a broker's trust fund relieves an individual broker or the broker-officer of a corporate broker licensee from responsibility or liability as provided by law in handling trust funds in the broker's custody.

Interest-Bearing Accounts

A trust fund bank account normally may not be interest-bearing. A broker may, however, at the request of the owner of trust funds, or of the principals to a transaction or series of transactions from whom the broker has received trust funds, deposit the funds into an interest-bearing account in a bank or savings and loan association if all of the following requirements of Business and Professions Code Section 10145(d) are met:

1. The account is in the name of the broker as trustee for a specified beneficiary or specified principal of a transaction or series of transactions.
2. All of the funds in the account are covered by insurance provided by an agency of the federal government.
3. The funds in the account are kept separate, distinct, and apart from funds belonging to the broker or to any other person for whom the broker holds funds in trust.
4. The broker discloses the following information to the person from whom the trust funds are received and to any beneficiary whose identity is known to the broker at the time of establishing the account:
 - the nature of the account;
 - how the interest will be calculated and paid under various circumstances;
 - whether service charges will be paid to the depository and by whom; and
 - possible notice requirements or penalties for withdrawal of funds from the account.
5. No interest earned on funds in the account shall inure directly or indirectly to the benefit of the broker or to any person licensed to the broker, even if the funds' owners would permit such an arrangement.
6. In an executory sale, lease, or loan transaction in which the broker accepts funds in trust to be applied to the purchase, lease, or loan, the parties to the contract shall have specified in the contract or by collateral written agreement the person to whom interest earned on the funds is to be paid or credited.

The only other situation where a real estate broker is allowed to deposit trust funds into an interest-bearing account occurs when the broker is acting as an agent for a financial institution which is the beneficiary of a loan. In this case the broker may, pursuant to Commissioner's Regulation 2830.1, deposit and maintain funds received from or for the account of an obligor (borrower) into an interest-bearing trust account in a bank or savings and loan association in order to pay interest on an impound account to the obligor in accordance with Section 2954.8 of the Civil Code, as long as the following requirements are met:

1. The funds received from or for the account of the obligor are for the future payment of property taxes, assessments or insurance relating only to a property containing a one-to-four family residence.
2. The account is in the name of the broker as trustee.
3. All of the funds in the account are covered by insurance provided by an agency of the federal government.
4. All of the funds in the account are funds held in trust by the broker for others.

5. The broker discloses to the obligor how interest will be calculated and paid.
6. No interest earned on the trust funds shall inure directly or indirectly to the benefit of the broker or to any person licensed to the broker.

Commingling Prohibited

Funds belonging to a licensee may not be commingled with trust funds. Commingling is strictly prohibited by the Real Estate Law. It is grounds for the revocation or suspension of a real estate license pursuant to Business and Professions Code Section 10176(e).

Commingling occurs when:

1. Personal or company funds are deposited into the trust fund bank account. ***Except for what is provided in Section 2835 of the Commissioner's Regulations as noted below, this*** is a violation of the law even if separate records are kept.
2. Trust funds are deposited into the licensee's general or personal bank account rather than into the trust fund account. In this case the violation is not only commingling, but also handling trust funds contrary to Business and Professions Code Section 10145. It is also grounds for suspension or revocation of a license under Business and Professions Code Section 10177(d).
3. Commissions, fees, or other income earned by the broker and collectible from the trust account are left in the trust account for more than 25 days from the date they were earned.

A common example of commingling is depositing rents and security deposits on broker-owned properties into the trust account. As these funds relate to the broker's properties, they are not trust funds and, therefore, may not be deposited into the trust fund bank account. Likewise, the broker may not make mortgage payments and other payments on broker-owned properties from the trust account even if the broker reimburses the account for such payments. Conducting personal business through the trust account is strictly prohibited and is a violation of the Real Estate Law.

Commissioner's Regulation 2835 provides that the following situations do not constitute "commingling" for purposes of Business and Professions Code Section 10176(e):

- (a) The deposit into a trust account of reasonably sufficient funds, not to exceed \$200, to pay service charges or fees levied or assessed against the account by the bank or financial institution where the account is maintained.
- (b) The deposit into a trust account maintained in compliance with item (d) below of funds belonging in part to the broker's principal and in part to the broker when it is not reasonably practicable to separate such funds, provided the part of the funds belonging to the broker is disbursed not later than 25 days after the deposit and there is no dispute between the broker and the broker's principal as to the broker's portion of the funds. When the right of a broker to receive a portion of trust funds is disputed by the broker's principal, the disputed portion shall not be withdrawn until the dispute is settled.
- (c) The deposit into a trust account of broker-owned funds in connection with mortgage loan activities as defined in subdivision (d) or (e) of Section 10131 of the Business and Professions Code or when making, collecting payments on, or servicing a loan which is subject to the provisions of Section 10240 of the Business and Professions Code provided:
 - (1) The broker meets the criteria of Section 10232 of the Business and Professions Code.
 - (2) All funds in the account which are owned by the broker are identified at all times in a separate record which is distinct from any separate record maintained for a beneficiary.
 - (3) All broker-owned funds deposited into the account are disbursed from the account not later than 25 days after their deposit.
 - (4) The funds are deposited and maintained in compliance with item (d) below.
 - (5) For this purpose, a broker shall be deemed to be subject to the provisions of Section 10240 of the Business and Professions Code if the broker delivers the statement to the borrower required by Section 10240.
- (d) The trust fund account into which the funds are deposited is maintained in accordance with the provisions of Section 10145 of the Business and Professions Code and the Commissioner's Regulations.

To summarize, a real estate broker's personal funds may be in the trust account in the following two specific instances:

1. Up to \$200 to cover checking account service fees and other bank charges such as check printing charges and service fees on returned checks. Trust funds may not be used to pay for these expenses. (The preferred practice, however, is for the broker to have the bank debit his/her own *personal* account for any trust account fees and charges.)
2. Commissions, fees, and other income earned by a broker and collectible from trust funds may remain in the trust account for a period not to exceed 25 days. Regulation 2835 recognizes that it may not always be practical to disburse the earned income immediately upon receipt. For instance, a property management company may find it too burdensome to collect its management

fee every time a rent check is received and deposited to the trust account. Therefore, as long as the broker disburses the fee from the trust account within 25 days after deposit there is no commingling violation. Note, however, that income earned *shall not* be taken from trust funds received *before* depositing such funds into the trust bank account. Also, under no circumstances may the broker pay personal obligations from the trust fund bank account even if such payments are a draw against commissions or other income. The broker must issue a trust account check to himself/herself for the total amount of the income earned, adequately documenting such payment, and then pay personal obligations from the proceeds of that check.

Trust Fund Liability

Trust fund liability arises when funds are received from or for the benefit of a principal. The aggregate trust fund liability at any one time for a trust account with multiple beneficiaries is equal to the total *positive* balances due to all beneficiaries of the account at the time. Note that beneficiary accounts with negative balances are not deducted from other accounts when calculating the aggregate trust fund liability.

Funds on deposit in the trust account must always equal the broker's aggregate trust fund liability. If the trust account balance is *less* than the total liability a *trust fund shortage* results. Such a shortage is in violation of Commissioner's Regulation 2832.1, which states that the written consent of every principal who is an owner of the funds in the account shall be obtained by a real estate broker prior to each disbursement if such a disbursement will reduce the balance of the funds in the account to an amount less than the existing aggregate trust fund liability of the broker to all owners of the funds. Conversely, if the trust account balance is *greater* than the total liability, there is a *trust fund overage* and the broker may be in violation of Business and Professions Code Section 10176(e) for commingling.

A trust fund discrepancy of any kind is a serious violation of the Real Estate Law. Many real estate licenses have been revoked after a DRE audit disclosed a trust account shortage. To ensure that the balance of the trust account always equals the trust fund liabilities, a broker should implement the following procedures:

1. Deposit intact and in a timely manner to the trust account all funds that are not forwarded to escrow or to the funds' owner(s) or which are not held uncashed as authorized. This practice, required under Commissioner's Regulation 2832, lessens the risk of the funds being lost, misplaced, or otherwise not deposited to the trust account. A licensee is accountable for all trust funds received whether or not they are deposited. DRE auditors have seen numerous cases where trust funds received were properly recorded on the books but were never deposited to the trust account.
2. Maintain adequate supporting papers for any disbursement from the trust account. Record the disbursement accurately in both the Bank Account Record and the Separate Beneficiary Record. The broker must be able to account for all disbursements of trust funds. Any unidentified disbursement will cause a shortage.
3. Disburse funds from a beneficiary's account only when the disbursement will not result in a negative or deficit balance (negative accountability) in the account. Many trust fund shortages are caused by disbursements to a beneficiary in excess of funds received from or for account of that beneficiary. The excess disbursements are, in effect, paid out of funds belonging to other beneficiaries. A shortage occurs because the balance of the trust fund bank account, even if it is a positive balance, is less than the broker's liability to the other beneficiaries.
4. Ensure that a check deposited to the trust fund account has cleared before disbursing funds against that check. This applies, for example, when a broker who has deposited an earnest money check for a purchase transaction has to return the funds to the buyer because the offer is rejected by the seller. A trust fund shortage will result if the broker issues the buyer a trust account check and the buyer's deposit check bounces or for some reason fails to clear the bank.
5. Keep accurate, current and complete records of the trust account and the separate record for each beneficiary. These records are essential to ensure that disbursements are correct.
6. On a monthly basis, reconcile the cash record with the bank statement and with the separate record for each beneficiary or transaction.

Summary - Maintaining Trust Account Integrity

In summary, to maintain the integrity of the trust fund bank account, a broker must ensure that:

1. his/her personal or general operating funds are not commingled with trust funds;
2. the balance of the trust fund account is equal to the broker's trust fund liability to all owners of the funds; and
3. the trust fund records are in an acceptable form and are current, complete and accurate.

ACCOUNTING RECORDS

General Requirements

An important aspect of the broker's fiduciary responsibility to the client is the maintenance of adequate records to account for trust funds received and disbursed. This is true whether the funds are deposited to the trust fund bank account, sent to escrow, held uncashed as authorized under Commissioner's Regulation 2832, or released to the owner(s) of the funds. These records:

1. provide a basis upon which the broker can prepare an accurate accounting for clients.
2. state the amount of money the broker owes the account beneficiaries at any one time. (This is especially important when there are a large number of transactions.)
3. prove whether or not there is an imbalance in the trust account. Some brokers audited by DRE have disagreed that their trust accounts had a shortage or an overage in the amount disclosed by the audit, but could not provide documentation to support their position.
4. guarantee that beneficiary funds deposited in the trust account will be insured up to the maximum FDIC/NCUSIF, etc. insurance coverage.

There are two types of accounting records that may be used for trust funds: columnar records in the formats prescribed by Commissioner's Regulations 2831 and 2831.1; and records other than columnar that are in accordance with generally accepted accounting practices *which include details specified in subdivision (a) of the Regulations and are in a format that will readily enable tracing and reconciliation in accordance with Section 2831.2.* Regardless of the type of records used, they must include the following information:

1. all trust fund receipts and disbursements, with pertinent details, presented in chronological sequence;
2. the balance of the trust fund account, based on recorded transactions;
3. all receipts and disbursements affecting each beneficiary's balance, presented in chronological sequence; and
4. the balance owing to each beneficiary or for each transaction.

Either manually produced or computerized accounting records are acceptable. The type and form of records appropriate to a particular real estate operation as well as the means of processing transactions will depend on factors such as the nature of the business, the number of clients, the volume of transactions, and the types of reports needed. For example, manual recording on columnar records might be satisfactory for a broker handling a small number of transactions, while a computerized system might be more appropriate and practical for a large property management operation.

Columnar Records

A broker may decide to use the columnar records prescribed by Commissioner's Regulations 2831 and 2831.1. The records required will depend on whether the trust funds received are deposited to the trust account or are forwarded to an escrow depository or to the owner of the funds. These records are:

1. Columnar Record of All Trust Funds Received and Paid Out - Trust Fund Bank Account (DRE form RE 4522);
2. Separate Record for Each Beneficiary or Transaction (DRE form RE 4523); and
3. Record of All Trust Funds Received - Not Placed in Broker's Trust Account (DRE form RE 4524).

The first two records are required when trust funds are received and deposited to the trust fund bank account.

The third record is required when trust funds received are not deposited to the trust account, but are instead forwarded to the authorized person(s).

If the trust fund account involves clients' funds from rental properties managed by the broker, the Separate Record for Each Property Managed (DRE form RE 4525) may be used in lieu of the Separate Record for Each Beneficiary or Transaction.

A broker who has an escrow division pursuant to Financial Code Section 17006(a)(4) must keep the above mentioned records for escrow funds. (Commissioner's Regulation 2951)

Record of All Trust Funds Received and Paid Out - Trust Fund Bank Account

This record is used to journalize all trust funds deposited to and disbursed from the trust fund bank account. At a minimum, it must show the following information in columnar form: date funds were received; name of payee or payor; amount received; date of deposit; amount paid out; check number and date; and the daily balance of the trust account.