Trust Funds
2nd Edition

First 15 pages only.

3 D.R.E. Approved Credit Hours
Disclaimers

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DRE Course Evaluation

An online evaluation form for this course is available on DRE’s website (www.dre.ca.gov). To access it, select the hyperlink Course & Instructor Evaluation in the lower right portion of DRE’s homepage. After completing the evaluation, you may electronically submit it to the DRE by clicking Send Your Evaluation to the DRE!
PREFACE:

This is the textbook for our course, *Trust Funds, 2nd Edition*. It is one of the five, three-hour courses required by the California Department of Real Estate (DRE). We call these the “Five Mandatory Courses”:

1. **Ethics**: Describes the real estate license law enforced by the DRE and the *Code of Ethics and Professional Conduct* as practiced by members of the National Association of REALTORS®

2. **Agency**: Explains the common law of agency as applied to California real estate brokerage.

3. **Trust Funds**: Details the fiduciary responsibilities of brokers when acting as escrows for their clients’ real estate transactions.

4. **Fair Housing**: Describes the federal and California fair housing and lending laws.

5. **Risk Management**: Provides licensees with the knowledge needed to avoid costly disputes with their clients arising from professional errors and omissions in the performance of their duties.

The DRE requires each licensee to take the Five Mandatory Courses before renewing their licenses for the **first time**. When renewing for the **first time**, salespersons who received their original (i.e., first) license between October 1st 2001 and September 30th 2007 need only these five courses to fulfill their entire continuing education requirement while all other licensees renewing for the **first time** (brokers, corporations, officers, and salespersons who were awarded their first license on or after October 1st, 2007) need these five courses and an additional 30 hours of CE. Any licensee renewing **after the first time**, may take any or all of the Five Mandatory Courses again and receive full credit towards their 45-hour CE requirement.

To save space and make the text more readable, we use the following abbreviations and terms:

- **BPC** The Business and Professional Code of California.
- **CC** The Civil Code of California

You can find the complete California codes at [www.leginfo.ca.gov/calaw.html](http://www.leginfo.ca.gov/calaw.html). Unless otherwise stated, all cases are California cases. In citing cases, we specify only the names of the litigants and the year of the decision.

The forms cited in this course are from the California Association of REALTORS®. We are aware that not all brokerage firms use these forms but we believe they are representative of the forms used in the industry.

In addition to the above terms and abbreviations, we also follow a few typographic conventions.

We use margin notes to provide definitions and short footnotes. We use the symbol ⟨⟩ to direct your attention to an adjacent margin note.

Side bars like this one are used for long notes. Content in the margin notes, side bars, and in the appendices is not tested in the final exam.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Editor's Preface</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>General Information</td>
<td>2</td>
</tr>
<tr>
<td>2.1</td>
<td>Trust Funds and Non-Trust Funds</td>
<td>2</td>
</tr>
<tr>
<td>2.2</td>
<td>Why a Trust Account?</td>
<td>2</td>
</tr>
<tr>
<td>2.3</td>
<td>Trust Fund Handling Requirements</td>
<td>3</td>
</tr>
<tr>
<td>2.4</td>
<td>Identifying Owners of Trust Funds</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>Trust Fund Bank Accounts</td>
<td>4</td>
</tr>
<tr>
<td>3.1</td>
<td>General Requirements</td>
<td>4</td>
</tr>
<tr>
<td>3.2</td>
<td>Trust Account Withdrawals</td>
<td>5</td>
</tr>
<tr>
<td>3.3</td>
<td>Interest-Bearing Accounts</td>
<td>5</td>
</tr>
<tr>
<td>3.4</td>
<td>Commingling Prohibited</td>
<td>7</td>
</tr>
<tr>
<td>3.5</td>
<td>Trust Fund Liability</td>
<td>8</td>
</tr>
<tr>
<td>3.6</td>
<td>Summary</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>Accounting Records</td>
<td>10</td>
</tr>
<tr>
<td>4.1</td>
<td>General Requirements</td>
<td>10</td>
</tr>
<tr>
<td>4.2</td>
<td>Columnar Records</td>
<td>11</td>
</tr>
<tr>
<td>4.3</td>
<td>Bank Account Record [#4522]</td>
<td>11</td>
</tr>
<tr>
<td>4.4</td>
<td>Separate Beneficiary Record [#4523]</td>
<td>12</td>
</tr>
<tr>
<td>4.5</td>
<td>Record of Undeposited Receipts [#4524]</td>
<td>12</td>
</tr>
<tr>
<td>4.6</td>
<td>Separate Property Record [#4525]</td>
<td>13</td>
</tr>
<tr>
<td>5</td>
<td>Other Accounting Systems</td>
<td>13</td>
</tr>
<tr>
<td>5.1</td>
<td>Journal</td>
<td>14</td>
</tr>
<tr>
<td>5.2</td>
<td>Cash Ledger</td>
<td>14</td>
</tr>
<tr>
<td>5.3</td>
<td>Beneficiary Ledger</td>
<td>15</td>
</tr>
<tr>
<td>6</td>
<td>Recording Process</td>
<td>15</td>
</tr>
<tr>
<td>7</td>
<td>Reconciliation</td>
<td>15</td>
</tr>
<tr>
<td>7.1</td>
<td>Purpose</td>
<td>15</td>
</tr>
<tr>
<td>7.2</td>
<td>With Bank Statement</td>
<td>16</td>
</tr>
<tr>
<td>7.3</td>
<td>Bank Account Record [#4522] With Each Separate Beneficiary Record [#4523]</td>
<td>16</td>
</tr>
<tr>
<td>7.4</td>
<td>Overages</td>
<td>16</td>
</tr>
<tr>
<td>7.5</td>
<td>Suggestions for Reconciliation</td>
<td>17</td>
</tr>
<tr>
<td>8</td>
<td>Document Requirements</td>
<td>18</td>
</tr>
<tr>
<td>Section</td>
<td>Page</td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td>------</td>
<td></td>
</tr>
<tr>
<td>8.1 Activities and Related Documents</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>9 Additional Requirements</td>
<td>19</td>
<td></td>
</tr>
<tr>
<td>9.1 Signers to be Given Copy</td>
<td>19</td>
<td></td>
</tr>
<tr>
<td>10 Audits and Examinations</td>
<td>19</td>
<td></td>
</tr>
<tr>
<td>11 Consequences of Conversion</td>
<td>19</td>
<td></td>
</tr>
<tr>
<td>12 Sample Transactions</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>13 Background Information</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>14 Step-By-Step Narrative</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>15 Questions and Answers</td>
<td>27</td>
<td></td>
</tr>
<tr>
<td>16 Summary</td>
<td>28</td>
<td></td>
</tr>
</tbody>
</table>
Editor's Note

The majority of this course’s content is from the chapter “Trust” in the DRE’s Reference Book (http://www.dre.ca.gov/pdf_docs/ref23.pdf).

The course makes many references to the California Code and the DRE Regulations which you can find online at these websites:

- California Codes (Business & Professional, Labor, Probate, Civil Procedure, etc.): http://www.leginfo.ca.gov/calaw.html

To reduce the text, we abbreviate “Business and Professional Code” to “BP”.

We have inserted margin notes to provide definitions of legal terms with which you may be unfamiliar. We distinguish our comments and notes from DRE’s using sidebars such as this one.

Course Introduction

Real estate brokers and salespersons receive trust funds in the normal course of doing business. They receive these funds on behalf of others, thereby creating a fiduciary responsibility to the funds’ owners. Brokers and salespersons must handle, control and account for these trust funds according to established legal standards. While compliance with these standards may not necessarily have a direct bearing on the financial success of a real estate business, non-compliance can result in unfavorable business consequences. Improper handling of trust funds is cause for revocation or suspension of a real estate license, not to mention the possibility of being held financially liable for damages incurred by clients.

This course discusses the legal requirements for receiving and handling trust funds in real estate transactions as set forth in the Real Estate Law and the Regulations of the Real Estate Commissioner. It describes the requisites for maintaining a trust fund bank account and the precautions a licensee should take to ensure the integrity of the account. It explains and illustrates the trust fund record keeping requirements under the BP and the DRE Regulations.

The discussions and examples in this course involve real property sales and property management trust account transactions. Other types of real estate activities involving trust funds, although subject to the same laws and regulations, may also have to comply with additional legal and regulatory requirements. While these other types of transactions may require records significantly different from those illustrated, the record keeping fundamentals still apply.
2 GENERAL INFORMATION

2.1 TRUST FUNDS AND NON-TRUST FUNDS

Since trust funds must be handled in a special manner, a licensee must be able to distinguish trust funds from non-trust funds. Trust funds are money or other things of value that are received by a broker or salesperson on behalf of a principal or any other person and which are held for the benefit of others in the performance of any acts for which a real estate license is required. Trust funds may be cash or non-cash items. Some examples are: cash; a check used as a purchase deposit (whether made payable to the broker or to an escrow or title company); a personal note made payable to the seller; or even an automobile’s “pink slip” given as a deposit.

The discussions in this course pertain to real estate trust funds received by licensees, and not to non-trust funds such as real estate commissions, general operating funds, and rents and deposits from broker-owned real estate. These other types of funds, as long as not commingled with trust funds, are not subject to the Real Estate Law and DRE Regulations. It should be noted, however, that under certain circumstances the Department of Real Estate does have the jurisdiction to look into transactions involving non-trust funds.

2.2 WHY A TRUST ACCOUNT?

A trust account is set up as a means to separate trust funds from non-trust funds. Although it can certainly be argued that keeping trust funds in a trust account will not prevent a dishonest broker from misusing the funds, separating client’s funds from the broker’s own funds provides a better physical and accounting control over the trust funds.

An important reason for designating a trust fund depository as a trust account is the protection afforded principals’ funds in situations where legal action is taken against the broker or if the broker becomes incapacitated or dies. Trust funds held in a true trust account cannot be “frozen” pending litigation against the broker or during probate.

Trust funds also have better insurance protection if deposited into a trust account. The general counsel of the FDIC, in an opinion in 1965, held that funds of various owners which are placed in a custodial deposit (trust account) in an insured bank will be recognized for insurance purposes to the same extent as if the owners’ names and interests in the account are individually disclosed on the records of the bank, provided the trust account is specifically designated as custodial and the name and interest of each owner of funds in the account are disclosed on the depositor’s records. Each client with funds deposited in a trust account maintained with a federally insured bank is insured by the FDIC up to $250,000, as opposed to just $250,000 for the entire account, as long as the regulatory requirements are met.
2.3 TRUST FUND HANDLING REQUIREMENTS

A typical trust fund transaction begins with the broker or salesperson receiving trust funds from a principal in connection with the purchase or lease of real property. According to BPC §10145, trust funds received must be placed into the hands of the owner(s) of the funds, into a neutral escrow depository, or into a trust account maintained pursuant to DRE Reg 2832 not later than three business days following receipt of the funds by the broker or by the broker’s salesperson.

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 DRE Reg. 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 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 BPC §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.

2.4 IDENTIFYING OWNERS 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.

Typically the offeror is the buyer
and the offeree is the seller

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
  (DRE Reg. 2832(d)).

- The offeror’s check may be given to the offeree only if the offeror
  and offeree expressly so provide in writing (DRE Reg. 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.

3

TRUST FUND BANK ACCOUNTS

3.1 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 (BPC §10145).

BPC §10145 and DRE Reg. 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 (see 3.3 below for a detailed discussion 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 BPC
§10145(a)(2).
In other words, the broker may only use a bank outside of the State if he services (i.e., collects payments) on first mortgages on behalf of banks, corporations, trusts, and several other types of substantial investors detailed in BPC § 10145(a)(2).

### 3.2 TRUST ACCOUNT WITHDRAWALS

According to DRE Reg. 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; 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.

### 3.3 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 BPC §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 DRE Reg, 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 §2954.8 of the Civil Code, as long as the following requirements are met:

These are better known as “escrow impound accounts” – accounts which lenders set up to collect “up-front” money from the borrower when he takes out a mortgage to cover future expenses such as property taxes and insurance.

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 BPC §10176(e).

Commingling occurs when:

1. Personal or company funds are deposited into the trust fund bank account. *Except for what is provided in §2835 of the DRE 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 BPC §10145. It is also grounds for suspension or revocation of a license under BPC §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 own 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.

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. DRE Reg. 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.

3.5 **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 DRE Reg. 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 BPC §10176(e) for commingling.

**Editors Note**

The forms referenced below are available from the DRE’s website ([http://www.dre.ca.gov/frm_audit.html](http://www.dre.ca.gov/frm_audit.html)): In the below table, the “Short Name” column is the name by which the form is referenced in this course; “Complete Name” is the actual name of the form’s title. We have modified the text of this chapter to use the short names for the various forms followed by the form number (e.g., “Bank Account Record (#4522)”).

<table>
<thead>
<tr>
<th>Form</th>
<th>Short Name/Description</th>
<th>Complete Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>#4521</td>
<td>Bank Account Record: One line for each deposit or withdrawal from the account.</td>
<td>Trust Fund Record Keeping Information Columnar Record of all Trust Funds Received and Paid Out -- Trust Fund Bank Account</td>
</tr>
<tr>
<td>#4522</td>
<td><strong>Separate Beneficiary Record:</strong> One record for each beneficiary. Each line records a deposit or withdrawal affecting the beneficiary’s balance.</td>
<td>Separate Record for each Beneficiary or Transaction For Client's Funds Placed in Trust Funds Placed in Trust Fund Bank Account</td>
</tr>
<tr>
<td>#4523</td>
<td><strong>Record of Undeposited Receipts:</strong> Funds received in trust but not deposited to the trust fund account (e.g., undeposited checks).</td>
<td>Record for All Trust Funds Received -- Not Placed in Broker's Trust Account</td>
</tr>
<tr>
<td>#4524</td>
<td><strong>Separate Property Record:</strong> One record for each property (similar to #4523 but based on a property instead of a beneficiary). Each line records a deposit or withdrawal affecting the property.</td>
<td>Separate Record for each Property Managed.</td>
</tr>
</tbody>
</table>
Examples of these forms are given in Exhibits 1-10 at the end of this chapter.

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 DRE Reg. 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 [#4522] and the Separate Beneficiary Record [#4523]. 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 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.