

STATE OF CALIFORNIA
DEPARTMENT OF BUSINESS OVERSIGHT

SECOND INVITATION FOR COMMENTS
TEXT OF PROPOSED CHANGES UNDER THE
ESCROW LAW

(Additions shown by underline and deletions shown by strikethrough)

1. Section 1732.2 is amended to read:

§ 1732.2. Escrow Books

(a) An escrow agent shall establish and maintain currently the following books with reference to its escrow accounts:

(1) Escrow ledger containing a separate ledger sheet for each escrow;

(2) Escrow liability controlling account, which must be maintained separate from any accounting software used by the escrow agent to record account activity;

(3) Cash receipt and disbursement journal or a file containing copies of all receipts and checks and/or check stubs of checks issued by the escrow agent ~~as a medium of posting to the records referred to in subsections (1) and (2) in which case adding machine tapes of totals of receipts and checks shall be retained.~~

~~(b)~~ The records referred to in subsections ~~(a)~~(1) and ~~(a)~~(2) shall be reconciled at least once each month with the bank statements of the "trust" or "escrow" account. The records referred to in subsection ~~(a)~~(1) shall be reconciled ~~at least once each week~~ daily with the escrow liability controlling account referred to in subsection ~~(a)~~(2).

~~(b)~~(c) An escrow agent engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision (c) ~~of Section 17312 of the Financial Code~~ and of the types of transactions not specified

therein shall maintain separate escrow books and separate escrow trust accounts for each type of escrow business in the same manner as provided for in subsection (a).

(ed) An escrow agent that is located outside this state shall, in addition to the books and records required in subsections (a) and ~~(b)-(c)~~, maintain separate books and records and separate escrow trust bank accounts for the escrow activity that occurs within this state as defined in ~~Section~~ Financial Code section 17005.5 ~~of the Financial Code~~.

2. Section 1737.3 is amended to read:

§ 1737.3. Records to Be Preserved

(a) An escrow agent shall preserve for at least five years from the close of escrow:

(1) All bank statements of the "trust" or "escrow" account;

(2) All canceled checks, or their images including the back of the check, drawn upon the "trust" or "escrow" account;

(3) Copies of bank deposit slips with reference to the "trust" or "escrow" account;

(4) All additional records reflecting banking transactions with reference to the "trust" or "escrow" account, including copies of all receipts for funds transferred from interest-bearing accounts into the "trust" or "escrow" account;

(5) The Statement of Account;

(6) Escrow instructions and amendments thereto;

(7) All additional records pertinent to the escrow transaction.

(b) The records referred to in ~~paragraph~~ subsection (a) may be retained and provided to the Commissioner in electronic format provided that:

(1) The electronic records are maintained and provided in a format that allows the Commissioner or his or her authorized representatives complete access to all of the books, accounts and records. The electronic records must be provided to the Commissioner in a software format that is acceptable to the Commissioner and that the Commissioner has in his or her possession. The escrow agent shall ensure that the Commissioner and his or her authorized representatives have the ability to download and print any or all of the records that are stored and maintained electronically. Electronic records transmitted by email must be sent using encryption or other secure manner.

(2) The escrow agent shall provide any or all of the records maintained in electronic format in printed form if the electronic records are not in a format that enables the Commissioner or his or her authorized representatives to determine if the licensee is complying with the Escrow Law or rules, or upon the request of the Commissioner or his or her authorized representatives. The escrow agent must maintain printed copies of any records required to be maintained by this rule when the escrow agent changes its software and past records are no longer accessible electronically through the escrow agent's current software.

(3) The electronic records shall be maintained in a media that is (A) non-erasable "write once, read many" ("WORM") that does not allow changes to the stored document, (B) consistent with the minimum standards of quality approved by either the National Institute of Standards and Technology or the Association for Information and Image Management, and (C) contain written authentication identifying the electronic record as an exact unaltered copy of the document.

3. Section 1741.5 is amended to read:

§ 1741.5. Preparation of the Independent Annual Audit Report.

~~(a) Set forth below are the Instructions for preparing the Independent Annual Audit Report required by Section 17406 of the Escrow Law.~~

~~STATE OF CALIFORNIA
DEPARTMENT OF CORPORATIONS
INSTRUCTIONS FOR INDEPENDENT AUDIT PURSUANT TO
THE CALIFORNIA ESCROW LAW~~

~~(1) The Independent Annual Audit Report shall be prepared in accordance with the provisions of Section 17406 of the Escrow Law, and as provided in the paragraphs of this subsection. For the purpose of determining independence, the regulations of the California State Board of Accountancy (Chapter 1, Sections 1 through 99.1, Title 16, California Code of Regulations) shall apply.~~

~~(2) The following items shall be considered in preparation of the report and in examining the financial statements included in the annual report:~~

~~(A) If the licensee is engaged in other businesses, in addition to the escrow business, the financial statements of the licensee shall include the assets and liabilities employed in such other businesses and the results of the operations thereof.~~

~~(B) The income statement shall state, separately from other salaries, the amount of salaries and bonuses paid to officers.~~

~~(C) If the liabilities include long term notes or mortgages, the amount of monthly payments, name of payee, due date, and other terms and conditions, including any subordination agreement which may exist with respect thereto in the financial statements or a footnote thereto, shall be stated.~~

~~(D) Quoted market values, if available, shall be stated parenthetically on the balance sheet or in a supporting schedule for items as marketable securities, including obligations of the United States Government, bonds of state and municipal governmental units, etc. A schedule of all securities shall be included in the annual report.~~

~~(E) The report shall contain a statement as to whether or not the licensee met the liquid asset and tangible net worth requirement of Section 17210 of the Financial Code on the balance sheet date. The report shall include:~~

~~(i) A schedule showing the computation of both the licensee's liquidity and tangible net worth for measuring compliance with Section 17210 of the Financial Code.~~

~~(ii) An itemized schedule listing each item included in the computations.~~

~~(iii) If marketable investments are included as liquid assets, the following information must be shown: company name; market value at balance sheet date; cost; the name of the exchange it is listed on; and the stock symbol.~~

~~(iv) If fees receivable are to be considered a liquid asset, a copy of the fee ledger at the balance sheet date must be included with the report.~~

~~(F) The report shall include copies of the trust bank account reconciliations for each location as of the balance sheet date, including all interest bearing and dormant accounts. The report shall contain an outstanding checklist which includes check and escrow numbers, dates and amounts for each check and an explanation for all adjustments and~~

reconciling items including the date of adjustment. This explanation shall include an affirmative statement if any reconciling items were not adjusted as of the report date and whether or not the adjustments cause debit balances (shortages). The outstanding checklists submitted with the audit report shall be maintained in the confidential section of the Department of Corporations' records.

(G) The report shall include an escrow trial balance as at the reconciliation date.

(H) The report shall disclose if the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in subdivision (c) of Section 17312 of the Financial Code and if the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions not specified therein, or both. If applicable, the report shall include:

(i) A trial balance for the types of transactions specified in subdivision (c) of Section 17312 of the Financial Code and a separate trial balance for the types of transactions not specified therein. The trial balances submitted with the audit report shall be maintained in the confidential section of the Department of Corporations' records.

(ii) A statement whether or not escrow books and escrow trust accounts are maintained for those transactions specified in subdivision (c) of Section 17312 of the Financial Code separate from those transactions not specified therein.

(iii) If the escrow agent is engaged in the business of receiving escrows for deposit or delivery of the types of transactions not specified in subdivision (c) of Section 17312 of the Financial Code, a statement shall be made whether or not the licensee has fidelity bond coverage as required by Section 1723 of these rules.

~~(iv) If the escrow agent is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in subdivision (c) of Section 17312 of the Financial Code, a statement shall be made whether or not the licensee is a member of Escrow Agents' Fidelity Corporation as required by Section 17312 of the Financial Code.~~

~~(3) The report shall include a statement indicating:~~

~~(A) That the individual escrow liability accounts and the controlling account have been reconciled to the escrow trust account as at the balance sheet date. If debit balances exist in the escrow liability, a full explanation of the nature and cause of the debit balances must be included in the auditor's comments along with a full explanation of the resolution of the item. If the debit balance has not been resolved as of the date of the auditor's report, then the auditor shall include a positive statement stating that the debit balance has not been resolved as of the auditor's report date. If no debit balances were in existence at the balance sheet date, a positive statement of this fact shall be made; and~~

~~(B) That the escrow funds were independently confirmed in writing by the accountant directly with the depositories or other holders of escrow assets.~~

~~(4)(A) The schedule of the escrow liability as at the end of each month during the calendar or fiscal year as reflected in the Escrow Control Account must be included in the report.~~

~~(B) If the audit is commenced on a date other than the calendar or fiscal year-end, the accountant shall request cut-off bank statements on all bank accounts covering the period from the balance sheet date to the date the audit is commenced. The bank accounts shall be reconciled to adjusted book balances as at the cut-off date, with particular attention given to the propriety and disposition of reconciling items appearing in the bank~~

reconciliations at the balance sheet date. The report shall include and show the same information as at the cut-off date as is required by paragraph (4) of this subsection.

~~(5) The opinion or report of the independent accountant shall include a statement to the effect that the accountant has examined the financial statements with respect to the provisions of Part 3, Title 10, of the Code of Civil Procedure, and the results of such examination.~~

~~(6) The accountant shall use such additional auditing procedures and standards including extension of the minimum escrow liability confirmation required above that is considered necessary in verifying the escrow funds and the escrow liability. The escrow liability shall include all escrow funds deposited into interest-bearing accounts pursuant to Section 1737(b). The comments shall include details of the nature and extent of all additional auditing procedures used in this verification.~~

~~(7) The following additional audit procedures shall be performed and the results shall be disclosed in the report:~~

~~(A) Verify the authorization and documentation of disbursements from a selective number of escrows.~~

~~(B) Select a representative sampling of escrows closed within 60 days prior to the commencement of the audit and perform the following audit procedures:~~

~~(i) Review escrow instructions, correspondence and documents in the escrow files for authorization disbursements.~~

~~(ii) Review checks for disbursements out of escrow.~~

~~(C) Review the schedule of escrow liability as of the last audit for dormant files and outstanding checks and perform the following audit procedures:~~

~~(i) Verify that funds in dormant files that no longer are on the schedule of escrow liability were properly disbursed according to signed instructions or according to the instructions of a court of competent jurisdiction, were interpleaded to a court of competent jurisdiction, or were escheated to the State of California.~~

~~(ii) Verify that the oldest dormant outstanding checks that no longer appear on the outstanding checklist were paid, were properly canceled back into the escrow fund, were properly canceled and re-issued to the original payee, were properly canceled and re-issued to a new payee according to instructions, or were escheated to the State of California. The selection of the checks shall include those checks that were older than six months at the last audit and no longer appear on the current outstanding checklist. The procedures shall include the review of check endorsements.~~

~~(8) When a licensee has branches, a statement shall be made by the accountant that the examination included auditing of the branches, and the address of each branch so examined shall be listed.~~

~~(9) If in the opinion of the independent public accountant a departure from the requirements set forth in this section is justified, upon request, the Commissioner may grant a variance upon a proper showing of suitable alternative procedures.~~

~~(b) This section became operative March 31, 2002.~~

~~(a) (1) **Definitions.** The following definitions apply to this rule and section 1741.5.1 of these rules.~~

~~(A) “Annual report” means (i) the licensee’s audited financial statements and related disclosures required by subsection (b) of this rule; (ii) the agreed-upon procedures~~

engagement report of findings required by subsection (c) of this rule; and (iii) the additional documentation required by subsection (d) of this rule.

(B) “Cessation date” means the date the licensee stops taking new escrows with the intent to discontinue the business of receiving escrows.

(C) “Debit balance” means the balance that exists when money withdrawn, paid, or transferred out of an escrow account exceeds the amount credited to the account.

(D) “Dormant escrow balance” means the monetary balance in any escrow ledger that had no accounting activity for the six months prior to the previous fiscal year-end. “Dormant escrow balance” also means the monetary balance in any trust account that is no longer maintained by the licensee for the purpose of receiving current escrow deposits, regardless of the date of the last accounting activity in the trust account.

(E) “Escrow ledger” means an accounting record of every escrow transaction, which includes receipts and disbursements issued and adjustments made as reflected on a separate ledger sheet for each escrow, as provided in section 1732.2, subsection (a)(1) of these rules.

(F) “Escrow liability” means the reconciled book balance of the aggregate balance of each escrow ledger. Upon reconciliation the escrow liability should equal the funds held in the trust accounts and interest-bearing accounts.

(G) “Escrow liability controlling account” means the accounting of trust receipts and disbursements maintained apart from the licensee’s computer trust accounting software. The escrow liability controlling account should be reconciled to the escrow ledgers daily in accordance with section 1732.2, subsection (a)(3) of these rules.

(H) “Escrow trial balance” means a list of every escrow and the monetary balance in each corresponding escrow ledger, the total of which is the unreconciled escrow liability.

(I) “Escrow transaction” includes every receipt, disbursement, and adjustment that is created in the processing of an escrow.

(J) “List of outstanding checks” means an accounting of all checks issued against a bank account that have either not cleared the account or have not been voided or otherwise canceled.

(K) “Month-end escrow liability report” is a listing of the reconciled escrow liability as reflected on each end-of-month trust account bank reconciliation for the entire fiscal year.

(L) “Practitioner” means a certified public accountant that is independent of the licensee in accordance with California Code of Regulations, title 16, section 65, and that is licensed by the California Board of Accountancy to practice public accountancy in accordance with established professional standards.

(M) Reconciling items to be adjusted to the book balance include, but are not limited to, (i) late issuance of a receipt; (ii) late posting of an incoming wire; (iii) missing deposit; (iv) returned deposit; (v) error posting of a receipt; (vi) stopped check that cleared; (vii) erroneous cancellation of a check that cleared; (viii) late issuance of a check that cleared; (iv) late posting of an outgoing wire; or (v) un-posted interest earned from an interest bearing account.

(N) Reconciling items to be adjusted to the bank balance include, but are not limited to, (i) deposits in transit; (ii) late deposit; (iii) erroneous posting of a deposit/cleared check by bank; (iv) erroneous wire amount transferred by bank; (v) bank service charges; (vi)

trust funds deposited into the general account or any other account that is not designated as an escrow trust account.

(O) Reconciling items that cause debit balances include, but are not limited to, (i) returned deposits or correction of a receipt to a smaller amount after disbursement of trust funds; (ii) disbursements against missing deposits; (iii) erroneous cancelation of a check that cleared and was reissued or disbursed against; (iv) stopped check that cleared and was reissued or disbursed against; (v) late posting of an outgoing wire after close of escrow and after funds to cover it have been disbursed; (vi) bank service charges to the trust account; and (vii) deposit of trust funds into the general account or any other account not designated as an escrow trust account.

(P) Source documents include, but are not limited to, (i) the receipt issued, (ii) copies of deposited check and validated deposit slip, (iii) copy of canceled check, (iv) bank wire transfer confirmation, (v) wire authorization form, and (vi) bank statement.

(Q) "Trust account" or "trust bank account" means a bank account that holds deposited funds for the consummation of an escrow.

(R) "Trust account bank reconciliation" means the comparison of the net ledger entries for each escrow transaction with the funds held in the corresponding trust bank account. The reconciliation must include complete descriptions of all adjustments needed to eliminate any differences.

(S) "Trust accounting records" means all records of the licensee that pertain to the accounting for the escrow liability and corresponding trust funds.

(2) **Written Engagement.** Each licensee must enter into one or more written engagements with the same practitioner to prepare all sections of the annual report required by this rule.

(A) The engagement must include the licensee's express direction to the practitioner to report directly to the Commissioner the information required by paragraphs (c)(6)(B)(x)(V) and (c)(6)(B)(xiii) of this rule, without any additional notification of, or consent from, the licensee.

(B) The licensee is responsible for the practitioner performing all of the procedures required by this rule, conducting activities and preparing the annual report in accordance with the applicable professional standards, and submitting the annual report directly to the Commissioner within 105 days after the close of the licensee's fiscal year-end.

(b) Audit of Financial Statements.

(1) A licensee must engage a practitioner to provide directly to the Commissioner the licensee's audited financial statements expressing the practitioner's opinion whether the financial statements are fairly stated and prepared in accordance with auditing standards generally accepted in the United States.

(2) The financial statements must include the following information, presented as described.

(A) **Notes to the Financial Statements.** The notes to the financial statements must include all of the following:

(i) The net assets of the reconciled trust balance and the trust balance liabilities.

(ii) A statement that the trust balance represents funds held in trust for one or more third parties and does not represent assets available to the licensee for any purpose other than the administration of the associated escrows.

(iii) An explanation of whether the trust obligation has fidelity coverage provided by EAFC in accordance with Financial Code division 6, chapter 2.5.

(B) **Officer, Director, or Shareholder Compensation.** The income statement must state, separately from other compensation, the amount of compensation paid to any natural person who is an officer, director, or shareholder of the licensee.

(C) **Long Term Notes or Mortgages.** If the liabilities include long term notes or mortgages, the balance sheet (or a footnote) must include the following information for each note or mortgage: the monthly payment amount, the noteholder, the due date, and the terms and conditions of the long term notes or mortgages, including any subordination agreement that may exist.

(D) **Schedule of Securities.** The balance sheet must include a schedule of securities, parenthetically or in a supporting schedule, identifying investments in marketable securities, including obligations of the United States, bonds of state and municipal governmental units, and similar investments. The schedule must include the name of the investment; market value at balance sheet date; cost of acquisition; name of the exchange the investment is listed on; and stock symbol.

(c) (1) Agreed-Upon Procedures Engagement. A licensee must engage the practitioner to perform the agreed-upon procedures set forth in paragraphs (2) through

(6) of this subsection, and to directly provide the Commissioner with a report of findings in the annual report.

(A) The report of findings must identify each of the procedures required by this rule and provide the practitioner's findings derived from each procedure.

(B) For procedures related to trust accounting, the report of findings must indicate that the procedures were performed on the trust accounting records of all of the locations of the licensee.

(C) The Commissioner is a specified party of each agreed-upon procedures engagement entered into pursuant to this rule and the Commissioner acknowledges responsibility for the sufficiency of the procedures set forth in this rule.

(D) The Commissioner represents all matters set forth in AT-C Section 215, Agreed-Upon Procedures Engagements, Written Representations, section .29, American Institute of Certified Public Accountants, Inc. (2016), and this rule constitutes the letter to the practitioner expressing the representations therein.

(E) Each licensee makes the following representations:

(i) The licensee is responsible for the contents of its books and records and all assertions made regarding its records and business activities.

(ii) The licensee has provided or will provide the practitioner with access to all records relevant to the engagement.

(iii) The licensee has disclosed or will disclose to the practitioner other matters as the practitioner deems appropriate.

(iv) The licensee's minimum net worth and liquid assets are at or above the minimums set forth in Financial Code section 17210 as of the balance sheet date.

(v) The licensee has timely escheated dormant escrow funds.

(vi) Each accounting entry in each escrow account is documented and authorized.

(vii) The licensee maintains fidelity bond coverage or is a member of EAFC.

(viii) All trust accounts are reconciled to the bank statements and all reconciling items are documented.

(F) The practitioner's report of findings under the agreed-upon procedures engagement is solely for the use of the Commissioner and constitutes a public record under the California Public Records Act, except as provided herein.

(2) Minimum Tangible Net Worth and Liquid Assets. Confirm that the licensee is in compliance with the minimum tangible net worth and liquid assets required by Financial Code section 17210 as of the balance sheet date.

(A) Include a schedule showing the computation of both the licensee's net liquid assets and tangible net worth as of the balance sheet date.

(B) Include an itemized schedule listing each balance sheet item included in the computations.

(3) Dormant Escrow Funds.

(A) Inspect dormant escrow balances, as of the balance sheet date, on the escrow trial balance and on the list of outstanding checks to determine whether the licensee is timely escheating dormant escrow funds that have been outstanding for more than three years in accordance with Code of Civil Procedure section 1500 et seq.

(B) For each trust account that had a dormant escrow balance prior to an accounting entry during the current fiscal year, confirm that documentation exists to support the current year accounting entry.

(C) Inspect each current-year accounting entry and confirm that none of the following conditions exist: (i) the accounting entry is a disbursement of escrow funds other than in accordance with escrow instructions; (ii) the accounting entry or supporting documentation contains a misstatement or fails to state a material fact, or (iii) the accounting entry or supporting documentation has one or more characteristics that suggest possible theft or fraud, such as, but not limited to, an invoice from a fictitious vendor, the use of a mail drop address, an address associated with an employee or the licensee, an internal transaction, a transfer to an external account whose ownership cannot be confirmed, or supporting documentation that does not bear a reasonable relationship to the underlying escrow transaction.

(D) From the escrow trial balance at the previous fiscal year-end date, select those escrow balances that have a last activity date older than six months from the previous year-end date and that are no longer on the escrow trial balance, and select three with balances that have declined at current fiscal year end. For the selected escrow balances, inspect escrow ledgers, escrow instructions, canceled checks, and any other supporting documentation to confirm that the dormant escrow balances (i) were properly disbursed according to signed escrow instructions or according to the instructions of a court of competent jurisdiction, (ii) were interpleaded to a court of competent jurisdiction, or (iii) were escheated to the state.

(E) From the list of outstanding checks at the previous fiscal year-end date, select those checks that have a date older than six months from the previous fiscal year-end date and that are no longer on the outstanding check list at current fiscal year-end. For the selected checks, inspect the underlying escrow ledgers, escrow instructions, canceled checks, and check endorsements to confirm that the dormant outstanding checks no longer appearing on the list of outstanding checks (i) were paid in accordance with the signed escrow instructions, (ii) were canceled back into the escrow funds and are accounted for on the escrow ledger, (iii) were canceled and re-issued to the original payee, (iv) were canceled and re-issued to a new payee according to instructions, or (v) were escheated to the state. If the checks were canceled, confirm that documentation exists to support that the cancellation is authorized.

(4) Sampling of Escrow Files. Perform the following procedures on at least three escrows per licensed location at the fiscal year-end that were consummated and closed within the current fiscal year to verify the existence of authorization for disbursements.

(A) Inspect the underlying documentation for each disbursement (checks and outgoing wires) including, but not limited to, the escrow instructions, correspondence and other documentation to confirm that the disbursement was authorized.

(B) Confirm that the underlying documentation supports a finding that each disbursement was authorized. If the underlying documentation does not confirm that every disbursement was authorized, document in the report of findings management's explanation for the disbursement and resolution. If the escrow agent's management fails to provide an explanation, include a statement in the report to that effect.

(5) Types of Escrow Transactions. Inspect the trust accounting records to determine whether the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision (c), and whether the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions not specified therein, or both.

(A) Inquire of management and the escrow manager as to the types of escrows being processed by the licensee.

(B) Inquire of management whether the licensee is engaging in business activities other than escrow services.

(C) If the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision (c) and in the business of receiving escrows for deposit or delivery of the types of transactions not specified in subdivision (c), confirm that the escrow books and trust bank accounts for those transactions specified in Financial Code section 17312, subdivision (c) are maintained separately from those transactions not specified therein.

(D) If the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions not specified in Financial Code section 17312, subdivision (c), confirm with the licensee's insurance carrier that the licensee maintains sufficient fidelity bond coverage as required by section 1723 of these rules. Include in the report of findings the name of the insurance carrier, the policy number, the policy expiration date, and the policy coverage amount.

(E) If the licensee is engaged in the business of receiving escrows for deposit or delivery of the types of transactions specified in Financial Code section 17312, subdivision

(c), confirm that the licensee is a member of EAFC and confirm that the licensee's membership is in good standing.

(6) Trust Account Verification.

(A) Include a month-end escrow liability report in the report of findings and confirm that the amounts on the schedule agree to the adjusted book balance on the monthly trust account bank reconciliations for escrows that covered and a separate list for those not covered by EAFC, if any.

(B) Perform the following procedures on the trust account bank reconciliation and bank statements for all types of escrow transactions.

(i) Confirm that the escrow liability in the fiscal year-end trust account bank reconciliation agrees with the ending escrow trial balance.

(ii) Confirm that the fiscal year-end total of receipts and receipt adjustments issued, checks and check adjustments issued, and incoming and outgoing wires and wire adjustments issued as shown on the trust account bank reconciliation agree with the respective totals on the month-end receipts and adjustments register, checks and adjustments register, incoming and outgoing wires and adjustments register, and any other item that is shown on the trust account bank reconciliation that represent activity during the month.

(iii) If the balances on the escrow trial balance and escrow liability controlling account for the last day of the fiscal year, including adjustments, are not reconciled to the trust account bank balance as required by section 1732.2 of these rules, indicate in the report of findings that the licensee has failed to reconcile its trust account and indicate any subsequent corrective action taken by the licensee.

(iv) Foot the fiscal year-end escrow trial balance and confirm it agrees with the total stated amount.

(v) Inspect the escrow trial balance for debit balances at the balance sheet date. For every debit balance identified, inquire and provide in the report of findings the licensee's explanation of the nature, cause, and resolution of the debit balance. Inspect the underlying documentation supporting the applicable escrow ledger entries creating the debit balance, and confirm that the underlying documentation supports the licensee's description of the nature, cause and resolution of the debit balance. If any debit balance remains as of the annual report date, indicate in the report that the debit balance has not been resolved. If no debit balance is identified in the review of the escrow trial balance at the balance sheet date, indicate in the report of findings that the escrow trial balance was reviewed for debit balances and none was identified.

(vi) Inspect the trust account bank statements and reconciliations of all trust accounts as of the balance sheet date to confirm that the bank accounts are reconciled to adjusted book balances, and confirm that documentation supports the disposition of the reconciling items appearing in the trust account bank reconciliations. Inspect management's description of the reconciling items to confirm that that the description is not contradicted or otherwise unsupported by the underlying documentation. Indicate in the report of findings whether the disposition of the reconciling items (I) is supported by underlying documentation, and (II) results in a trust account debit balance.

(vii) Confirm that the fiscal year-end trust account bank reconciliation accurately classifies escrow liability book adjustments from bank balance adjustments in order to reflect adjusted ending escrow liability book balance and bank balance.

(I) Confirm that descriptions of all reconciling items include information regarding the escrow and escrow ledgers affected, and the date and event that created the reconciling item. Confirm that reconciling items to be adjusted to either the escrow liability book balance or bank balance include a statement indicating the reason for the adjustment.

(II) Confirm that the underlying escrow ledger and source documents of each reconciling item substantiate each reconciling item. Explain each reconciling item in the report of findings. Include in the explanation the (1) escrow number, (2) receipt number or check number, (3) cause and resolution of the reconciling item including the date the item was created, and (4) date of adjustment. Indicate whether the adjustment of the reconciling item causes a debit balance.

(III) If any reconciling item is outstanding as of the annual report date, include this information in the report of findings and provide the licensee's anticipated date of resolution.

(viii) Confirm the account balance of every trust account through either written correspondence with the depository institutions or through an online platform that allows access directly to bank records that cannot be retrospectively altered except by the depository institution. The confirmation of account balances must include all accounts containing escrow funds, including interest bearing accounts, dormant accounts, and trust accounts maintained separately by the licensee for transactions not specified in Financial Code section 17312, subdivision (c).

(ix) Compare and agree the bank name, account number, and balance at the fiscal year-end on each trust account bank statement to the trust account bank reconciliation.

(I) Confirm that every account containing trust funds is designated as a trust or escrow account.

(II) Trace each ending bank balance appearing on the respective trust account bank reconciliation to the related bank confirmation and bank statement.

(III) Indicate in the report of findings whether any differences exist.

(IV) If differences are identified, state the resolution or state the differences remain unresolved at the report date.

(x) Perform the following procedures related to checks.

(I) Foot the total on the list of outstanding checks to confirm that it agrees with the stated total on the trust account bank reconciliation.

(II) Compare the first check issued in the current month to the last check number issued in the prior month to confirm that checks were consecutively issued. Select at least ten checks issued in the last month of the fiscal year to confirm that they (1) have cleared the bank, (2) were canceled, or (3) appear on the list of outstanding checks. Compare the outstanding check amounts of at least ten checks issued in the last month of the fiscal year with those on the check register and confirm that the amounts are the same.

(III) Select at least 50 items and confirm that canceled, voided, and cleared checks for the last two months of the fiscal year-end are not included on the list of outstanding checks.

(IV) Trace a sample of at least ten cleared checks appearing on the bank statement of the first month following the fiscal year-end to the list of outstanding checks and agree the amounts and payees. Confirm that the back of the check is endorsed by the payee. Inspect at least ten outstanding checks on the trust account bank reconciliation that

do not appear on the subsequent month-end bank statement and confirm that they were properly canceled or listed as outstanding on the subsequent month's trust account bank reconciliation.

(V) Inspect the cleared check images returned with the bank statement (or available through an online banking platform) for a minimum of 50 checks issued in any month of the fiscal year for any unusual transactions, such as affiliated companies or employee payees, or endorsements other than the payee, payments to the general or other non-escrow trust accounts, or transactions not typical for the type of escrows conducted by the licensee. Inspect the underlying documentation supporting each unusual transaction for possible misappropriation or embezzlement. For each unusual transaction, confirm that the disbursement was authorized by the parties to the escrow. If checks were issued to or endorsed by officers, directors, stockholders, or employees of the escrow company, or affiliated companies, without authorization, or a misappropriation or embezzlement is found, confirm that the licensee has reported these occurrences to the Commissioner and Escrow Agents Fidelity Corporation and identify the supporting evidence in the report. If confirmation of reporting cannot be made, report these occurrences directly to the Department, in accordance with the terms of the engagement.

(xi) Confirm the date and amount of the deposits in transit at the fiscal year-end by performing the following procedures. Trace the deposits in transit on the trust account bank reconciliation to recorded receipts, the subsequent month bank statement, and source documents. Indicate in the report whether any deposits in transit were deposited more than two business days after receipt.

(xii) Trace a sample of at least 10 bank returned items appearing on the fiscal year-end month trust account statements to the source documents. Identify in the report whether a bank debit memo creates a debit balance, or a bank credit memo corrects the debit balance on the escrow ledger. If less than ten returned items appear on the fiscal year-end month trust account statements, trace all of the bank returned items on the statement and report that all returned items appearing on the bank statements were traced.

(xiii) If the licensee has more than one trust bank account, and transfers of cash between the trust accounts were made within five days of the fiscal year-end date, confirm the cash receipt and disbursement dates on the escrow ledgers to test for kiting. Identify any evidence of kiting in the report of findings and immediately report such activity to the Commissioner in accordance with the terms of the engagement.

(xiv) If the licensee maintains one set of books that includes more than one trust bank account, confirm each adjusted bank balance as of the fiscal year-end. If the accounting records do not reflect the bank statement balances and the list of outstanding checks for each trust account separately, include a description of which trust account is affected by each bank adjustment. Confirm that the total of all adjusted bank balances is equal to the adjusted escrow liability balance for the fiscal year-end month. Confirm that the licensee separately reconciles each dormant trust account.

(d) Additional Documentation. The practitioner must include the following documentation obtained from the licensee in the annual report.

(1) Copies of the trust account bank reconciliations for all trust accounts at each location as of the balance sheet date, including all interest bearing and dormant accounts and any other accounts held in trust by the licensee.

(A) The trust account bank reconciliations must include a list of outstanding checks, which must include check and escrow numbers, the names of the payees, dates and amounts for each check and an explanation for each adjustment, including the date of the adjustment.

(B) The trust account bank reconciliations are subject to public disclosure under the California Public Records Act upon redaction of account numbers, identifiable payee information, and other nonpublic information.

(2) An escrow trial balance as of the fiscal year-end trust account bank reconciliation date. If applicable, provide a separate escrow trial balance as of the fiscal year-end trust account reconciliation date for the types of transactions specified in Financial Code section 17312, subdivision (c) and the types of transactions not specified therein. The trial balances submitted with the annual report containing identifiable customer information are subject to public disclosure under the California Public Records Act upon redaction of identifiable customer information and other nonpublic information.

(3) The month-end escrow liability report, which must indicate the balance at the end of each month during the fiscal year as reflected in adjusted book balance with separate reports for escrows covered and not covered by EAFC.

(4) A list of the address of every branch location.

(5) A copy of the licensee's fee ledger at the balance sheet date, for fees receivable that are included as a liquid asset on the licensee's balance sheet.

(6) A copy of the practitioner's letter or report of internal control, if the practitioner prepares a letter or report of internal control for the licensee's individuals in charge of governance, which must be identified as a confidential document and is not subject to disclosure under the California Public Records Act.

(e) If in the opinion of the practitioner, a departure from the requirements set forth in this section is justified, upon request, the Commissioner may grant a variance upon a finding that a variance is in the public interest.

4. Section 1741.5.1 is adopted to read:

§ 1741.5.1. Closing Procedures.

(a) A licensee seeking to surrender its license must enter into an agreed-upon procedures engagement with a practitioner to perform the agreed-upon procedures in this section. The practitioner must be independent of the licensee in accordance with California Code of Regulations, title 16, section 65.

(b) The licensee must engage a practitioner to perform the following procedures.

(1) Obtain directly from the licensee's financial institution bank statements for the month prior to the cessation of business of the licensee and the month following that date. For the same two month-ends, obtain the trust account reconciliations, the list of outstanding checks, the escrow trial balances, and all other subsidiary listings such as receipts, checks, incoming and outgoing wires, and adjustments.

(2) Follow the trust account bank reconciliation procedures in section 1741.5, subsection (c)(6)(B) of these rules on the trust account bank reconciliation for the month following cessation of business. Indicate the results of each procedure in the report of findings. For the month prior to the cessation of business and the month of cessation, verify that the reconciling items are supported by the underlying documentation and that any debit balances were corrected.

(3) Examine the escrow ledgers showing all the activity for each escrow for 60 days prior to the cessation date and subsequent escrow ledgers for escrow funds that may have been disbursed without authorization or that appear to have been disbursed in an unusual manner, such as those transactions described in section 1741.5, subsection (c)(5)(B)(x)(V) of these rules, or an escrow did not close, but the balance was not transferred to another escrow company or to the depositing party. Request that the licensee explain every unauthorized or unusual disbursement. Include a statement in the report that no unauthorized disbursement of funds was found, if applicable.

(4) Determine whether any escrows were opened after the Department was notified of the licensee's cessation of business date. Indicate in the report whether any escrow was opened during this time period, and provide the status of the escrow.

(5) Identify the escrows opened during the 45 days prior to the cessation of business. Examine the dispositions of these escrows for any unusual activity (i.e., the failure to follow escrow instructions). Describe the unusual activity in the report of finding.

(6) Verify whether the licensee has escheated all remaining trust funds in accordance with Code of Civil Procedure section 1517. Describe in the report of findings whether the total of all trust funds have been escheated to the state.

(7) Include in the report of findings the name, phone number, and address of the appointed custodian of records and the location address of the escrow files and accounting records.

(c) The licensee must ensure the practitioner performs all of the procedures required by this rule and includes in the closing report of findings a description of all the above agreed-upon procedures performed and the results of each procedure.

(d) The licensee must ensure the practitioner submits the report of findings directly to the Commissioner and includes in the report a copy of the trust account bank reconciliations, bank statements, list of outstanding checks, trial balances, and proof of remittance of all remaining trust funds to the State Controller's Office.

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