

STATE OF CALIFORNIA
DEPARTMENT OF FINANCIAL PROTECTION AND INNOVATION

TEXT OF PROPOSED CHANGES UNDER THE
ESCROW LAW

(Additions shown by underline and deletions shown by strikethrough)

1. Section 1711.1 is added:

§ 1711.1. Personal property

(a) "Personal property" includes "gametic material," for the purposes of this subchapter.

Note: Authority cited: ~~17315 and~~ Section 17400, Financial Code. Reference: Section 17003, Financial Code.

2. 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, as defined in section 1741.5(a)(1)(E), containing a separate ledger sheet for each escrow;

(2) Escrow liability controlling account, which must be maintained separately from any accounting software or a manually created escrow ledger, in an electronic or non-electronic format, 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 financial institution~~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~~ trust accounts for each type of escrow business in the same manner as provided for in subsection (a).

~~(e)~~ 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 accounts for the escrow activity that occurs within this state as defined in ~~Section~~ Financial Code section 17005.5 of the Financial Code.

(e) Escrow books and records shall be maintained at a licensee's business location or main office and made available to the Commissioner and his or her representative upon request at such location. For the purposes of this section, "business location" is defined in Financial Code section 17005.2.

Note: Authority cited: ~~17315 and~~ Section 17400, Financial Code. Reference: Sections 17005.5, 17404 and 17409, Financial Code.

3. Section 1737.3 is amended to read:

§ 1737.3. Records to Be Preserved

(a) An escrow agent shall preserve all escrow documents for at least five years from the close of escrow or the last escrow activity date, or longer as required by any other applicable laws or regulations. Escrow documents include, but are not limited to:

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

(2) All canceled checks, or their images, including the front and back of the check, in a physical or electronic format, drawn upon the "trust" or "escrow" account;

(3) Copies of financial institution bank deposit slips, or copy of deposit confirmation from an online financial institution portal, with reference to the "trust" or "escrow" account;

(4) All additional records reflecting financial institution 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) Any other documents pertaining to the escrow transaction, including but not limited to, title, recording documents showing recording date and time information, title invoices and invoices from escrow service providers, purchase and user agreements and amendments, proof of liquor license transfer by California Department of Alcohol and Beverage Control, and proof of recording from California Department of Housing and Community Development for mobile home transactions. ~~additional records pertinent to the escrow transaction.~~

(b) The records referred to in ~~paragraph~~ subdivision (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, which contain confidential and/or personally identifiable information, transmitted by email must be sent using encryption or another 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 section 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.

(c) For purposes of this section, "statement of account", also referred to as a closing statement, means an escrow settlement statement report that identifies and summarizes each cash receipt, disbursement of funds and debit and credit of escrow funds for an escrow transaction. ~~a report that identifies each receipt, disbursement, and credit of escrow funds for an escrow transaction.~~

Note: Authority cited: ~~17315, and~~ Section 17400, Financial Code. Reference: Sections17403.5 and 17404, Financial Code.

4. 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 section and section 1741.5.1 of these regulations.

(A) "Annual report" means (i) the licensee's audited financial statements and related disclosures required by subdivision (b) of this section; (ii) the report of findings required by subdivision (c) of this section; and (iii) the additional documentation required by subdivision (d) of this section.

(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) (i) "Dormant escrow ledger 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. (ii) "Dormant bank trust account balance" 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 the principal’s name, property description, consideration, all 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 regulations.

(F) “Escrow liability” means the reconciled book balance of the aggregate balance of each escrow ledger. Upon reconciliation, the escrow liability should equal the reconciled funds held in all the trust accounts and interest-bearing accounts maintained by the licensee in a financial institution pursuant to Financial Code section 17409, subdivision (a).

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

(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)(I) “List of outstanding checks” means an accounting of all checks issued against a financial institution ~~bank~~ account that either have not cleared the financial institution ~~bank~~ account upon which they were drawn, or have not been voided or canceled.~~

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

~~(L)~~(K) “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. The term includes a public accounting firm, where all of the requirements for a practitioner in this section are performed under the direction and supervision of a certified public accountant who is employed by the firm.

~~(M)~~(L) 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)~~(M) Reconciling items to be adjusted to the financial institution~~bank~~ balance include, but are not limited to, (i) deposits in transit; (ii) late deposit; (iii) erroneous posting of a deposit/cleared check by financial institution~~bank~~; (iv) erroneous wire amount transferred by financial institution~~bank~~; (v) financial institution~~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)~~(N) Reconciling items that cause debit balances and/or trust account shortages 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) financial institution~~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)~~(O) 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) financial institution~~bank~~ wire transfer confirmation, (v) wire authorization form, and (vi) financial institution~~bank~~ statement.

~~(Q)~~(P) “Trust account” means a financial institution~~bank~~ account that holds deposited funds for the consummation of an escrow.

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

~~(S)~~(R) “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 letter 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)~~ (c)(2) to (d)(5) of this section, without any additional notification of, or consent from, the licensee.

(B) The licensee must engage ~~is responsible for the practitioner to performing~~ all of the procedures required by this section, ~~conducting~~ activities and ~~preparing~~ the annual report in accordance with the ~~applicable~~ professional standards applicable to certified public accountants, and ~~submitting~~ the annual report directly to the Commissioner within 105 days after the close of the licensee's fiscal year-end or within an extension approved by the Commissioner.

(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 present fairly, in all material respects, the licensee's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

(2) The financial statements must include the following additional 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 amount of the reconciled trust account bank~~ balances and the adjusted escrow liability balances.

(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) A statement of whether the trust obligation has fidelity coverage provided by the Escrow Agents Fidelity Corporation (EAFC), the amount of the trust obligation with fidelity coverage provided by EAFC, if any, and the amount of the trust obligation with fidelity coverage provided through another source, which source must be identified in the statement. The statement must indicate whether any portion of the trust obligation is not subject to fidelity coverage.

(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 identity of the person or entity who owns or holds the note, or the identity of the person or entity to whom the payments are owed on the note, if known by the licensee, or the identity of the person receiving payments on behalf of the person who owns or holds the note, 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 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)(i) In addition to the requirements of this section, the performance of the procedures and reporting under this subsection must be in accordance with national attestation engagement standards applicable to certified public accountants. ..

(ii) 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 the specified party of each engagement entered into pursuant to this subsection 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 accordance with national attestation engagement standards applicable to certified public accountants, and this section constitutes the letter to the practitioner expressing the representations therein.

(E) Each licensee shall make the following representations to the Department:

(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) Whether 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) Whether the licensee has timely escheated dormant escrow funds.

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

(vii) The licensee is a member of EAFC for all transactions listed in Financial Code section 17312, subdivision (c) and, if applicable, maintains fidelity bond coverage for all transactions not covered by EAFC, pursuant to section 1723.

(viii) Whether all trust accounts are reconciled to the ~~financial institution~~ bank statements and all reconciling items are documented.

(F) The practitioner's report of findings under the engagement is intended 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 whether 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 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, or such other time as required by law in accordance with Code of Civil Procedure section 1500 et seq.

(B) If a licensee has a dormant trust account as defined in (a)(1)(D)(ii), using the financial institution~~bank~~ statement, inspect all current-year disbursements of funds if less than three disbursements, or inspect at least three disbursements if there are more than three disbursements total from all escrow ~~bank~~ trust accounts that, prior to the current fiscal year, had a dormant ~~bank~~ financial institution account balance, i.e., was not being actively used as the current trust account, and review the corresponding escrow files to confirm that none of the following conditions exist: (i) the disbursement of funds was not in accordance with escrow instructions; (ii) the supporting documentation contains a misstatement or fails to state a material fact necessary to establish that the disbursement was for an authorized reason, or (iii) the financial institution ~~bank~~ entry lacks supporting documentation or the supporting documentation from the escrow file has one or more characteristics that suggests possible theft or fraud, such as, but not limited to, lack of documentation, 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 does not relate to the underlying escrow transaction.

(C) From the escrow trial balance at the previous fiscal year-end date, select three escrows or 5 percent, whichever is greater, of the escrow balances that have a last activity date older than six months from the previous fiscal year-end date and that are no longer on the escrow trial balance, or from balances that have declined at current fiscal year end. For the selected escrows, inspect escrow ledgers, escrow instructions, canceled checks, and any other supporting documentation to confirm that the reason for the removal of the escrow balance from the trial balance, or the reason for the decrease of the escrow balance on the trial balance, is one of the following:

(i) The funds no longer reported in the escrow balance were disbursed according to signed escrow instructions or according to the instructions of a court of competent jurisdiction; or

~~(ii) The supporting documentation does not contain evidence of irregular activities, such as, but not limited to, lack of documentation, 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; or~~

(iii) The funds no longer reported in the escrow balance were interpleaded to a court of competent jurisdiction; or

(iii*) The funds no longer reported in the escrow balance were escheated to the state, or;

(iv*) The supporting documentation does not contain evidence of irregular activities, such as, but not limited to, lack of documentation, 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 relate ~~does not bear a reasonable relationship~~ to the underlying escrow transaction.

(D) From the list of outstanding checks at the previous fiscal year-end date, select 5 percent, or all checks if fewer than five, of the 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 2 percent of, but not fewer than 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. At least half of the escrows sampled must be escrows consummated and closed within the 60 days prior to the selection of the sampling, unless an insufficient number of escrows were consummated and closed during this time period.

(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 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 whether the licensee's fidelity bond coverage provider is licensed by the Department of Insurance of the State of California to provide fidelity policies, and confirm with the licensee's insurance carrier that the licensee maintains sufficient fidelity bond coverage as required by section 1723 of these regulations. Include in the report of findings the policy coverage amount, the deductible amount, and expiration date. If the fidelity bond policy has a deductible amount greater than zero, include in the report of findings whether the licensee maintains a surety bond, or cash in lieu of the surety bond, in the amount of fidelity deductible pursuant to section 1723, separate from the surety bond as required pursuant to section 17202 of the Financial Code.

(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 list for the 12 months of the fiscal year in the report of findings and confirm that the amounts on the schedule agree to the adjusted book balances on the monthly trust account bank reconciliations for escrows that are covered by EAFC, and a separate list of transactions not covered by EAFC, if any.

(B) Perform the following procedures on the trust account ~~bank~~ reconciliation and ~~bank~~ financial institution 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 reconciled 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 balance as required by section 1732.2 of these regulations, 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) Verify the accuracy of the total stated amounts of escrows with balances shown on the fiscal year-end escrow trial balance.

(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~~ financial institution 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~~ financial institution balance adjustments in order to reflect adjusted ending escrow liability book balance and ~~bank~~ financial institution 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 ~~financial institution~~ ~~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~~ financial institution 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~~ financial institution name, account number, and balance at the fiscal year-end on each trust account 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 financial institution balance appearing on the respective trust account bank reconciliation to the related bank financial institution confirmation and bank financial institution 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) Add the amount of each check included on the list of outstanding checks and confirm that the sum equals 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. 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) Using the licensees monthly check registers, select at least 25 checks issued during the last two months of the fiscal year-end and confirm that canceled, voided, and cleared checks are not included on the list of outstanding checks. If less than 25 checks were issued during this time period, select all of the checks issued.

(IV) Trace a random sample of at least 25 cleared checks appearing on the financial institution bank statement of the first month following the fiscal year-end that were issued before the fiscal year end to the check registers and agree the amounts and payees. If less than 25 checks cleared during this time, select all of the cleared checks. Confirm by reviewing the backs of the checks that are endorsed that the endorsements match the names of the payees with either a signature, or a restrictive endorsement identifying that

the check be paid to an account. Identify in the report of findings whether any check sampled contains an endorsement that does not match the payee on the check. Inspect at least ten outstanding checks on the trust account ~~financial institution~~~~bank~~ reconciliation of the first month following the fiscal year-end that do not appear on the subsequent month-end ~~financial institution~~~~bank~~ statement and confirm that they were properly canceled or listed as outstanding on the subsequent month's trust account ~~bank~~ reconciliation. If less than ten outstanding checks appear on the trust account ~~bank~~ reconciliation the first month following the fiscal year-end, then sample all of the outstanding checks during this period.

(V) Inspect the cleared check images returned with the ~~financial institution~~~~bank~~ statement (or available through an online ~~financial institution~~~~banking~~ platform) for a minimum of 50 checks issued in any month of the fiscal year for any ~~irregular~~~~unusual~~ transactions, ~~which include~~ such as checks issued to affiliated companies or employee payees, or endorsements other than the payee, payments to the general account, other than for earned escrow fees, 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~~~~irregular~~ transaction. For disbursements to affiliated companies or employee payees, or endorsements other than the payee, payments to the general account, other than for earned escrow fees, or other non-escrow trust accounts, underlying documentation includes written authorization from the principals, supporting invoices and disclosure on the settlement statements. For transactions not typical to the escrow company, obtain a letter from a corporate officer of the escrow company explaining the transaction and review source documents that confirm the explanation. For each

irregular~~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 whether 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. If no ~~unusual~~ irregular transactions are found, include a statement in the report that the procedures were performed, and any ~~unusual~~ irregular items noted were supported with instructions and disclosure to the principals.

(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~~ financial institution 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 ten ~~bank~~ financial institution-returned deposits appearing on the fiscal year-end month trust account statements to the source documents. Identify in the report whether a financial institution ~~bank~~ debit memo creates a debit balance, or a ~~bank~~ financial institution credit memo corrects the debit balance on the escrow ledger. If less than ten ~~bank~~ financial institution-returned deposits appear on the fiscal year-end month trust account statements, trace all of the ~~bank~~ financial institution-returned deposits on the statement and report that all ~~bank~~ financial institution-returned deposits appearing on the ~~bank~~ financial institution statements were traced. For purposes

of this paragraph, a financial institution~~bank~~-returned deposit is an intended transaction, either check, wire or other deposited item, in a trust account that is not honored or is reversed by a financial institution~~bank~~.

(xiii) If the licensee has more than one trust 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 report such activity to the Commissioner in accordance with the terms of the engagement, no more than 3 business days after discovery. For purposes of this paragraph, kiting means the process whereby cash is recorded in more than one ~~bank~~ financial institution account, but in reality, the cash is either nonexistent or is in transit. An example of kiting is the issuance or transfer of a check or other negotiable instrument from one trust account into another trust account or multiple ~~bank~~ financial institution accounts, where the disbursement is not recorded in the books for the initial account, to give the appearance that the balances of the combined accounts are greater than the actual total funds in the affected accounts.

(xiv) If the licensee maintains one set of books that includes more than one trust account, confirm each adjusted ~~bank~~ financial institution balance as of the fiscal year-end. If the accounting records do not reflect the financial institution~~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 financial institution~~bank~~ adjustment. Confirm that the total of all adjusted financial institution~~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 an explanation for each adjustment, including the date of the adjustment, and a list of outstanding checks, which must include check and escrow numbers, the names of the payees, dates and amounts for each check.

~~(B) The trust account bank reconciliations are subject to public disclosure under the California Public Records Act upon the Department's 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 ~~bank~~ 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 the Department's 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 the 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.

(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.

Note: Authority cited: Sections 17400 and 17406, Financial Code. Reference: Section 17406, Financial Code.

5. 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 engagement with a practitioner to perform the procedures in this section. The practitioner must be independent of the licensee in accordance with California Code of Regulations, title 16, section 65. The performance of the procedures and reporting requirements must be in accordance with national attestation engagement standards applicable to certified public accountants.

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

(1) Obtain directly from the licensee's financial institution three complete calendar months of bank financial institution statements: the month prior to the cessation of business of the licensee, the month of cessation of business, and the month following that date. For the same three months, obtain the trust account bank 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 regulations on the trust account ~~bank~~ reconciliation for the calendar month following the month that business ceased. Indicate the results of each procedure in the report of findings. For the calendar month prior to the month that business ceased, and the calendar month during which business ceased, verify that the reconciling items are supported by the underlying documentation and that any debit balances were corrected.

(3) Inspect the escrow ledgers of each escrow that includes an entry for 60 days prior to the cessation date of business, and inspect the escrow ledgers with entries after the date of cessation of business, to confirm that no escrow funds have been disbursed without authorization. Identify escrow funds that appear to have been disbursed in an ~~unusual~~ irregular manner, such as those transactions described in section 1741.5, subsection (c)(6)(B)(x)(V) of these regulations. For purposes of this paragraph, any escrow where the escrow did not close, and the balance was not transferred to another escrow company, escheated to the State Controller's Office or disbursed to the depositing party, constitutes escrow funds that appear to have been disbursed in an ~~unusual~~ irregular manner. Request that the licensee explain every unauthorized or ~~unusual~~ irregular disbursement, and identify each unauthorized or ~~unusual~~ irregular disbursement, and the licensee's explanation for the disbursement, in the report. 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~~ irregular activity (i.e., the failure to follow escrow instructions, incorrect or non-disclosure on settlement statement(s)). Describe the ~~unusual~~ irregular 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, email and mailing address of the licensee's 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 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~~ financial institution statements, list of outstanding checks, trial balances, and proof of remittance of all remaining trust funds to the State Controller's Office, for the following months: the month prior to the cessation of business of the licensee, the month of cessation, and the month following the cessation of business.

Note: Authority cited: ~~17315~~, Sections 17400 and 17406, Financial Code. Reference: Sections 17403.5, 17404, 17406 and 17409, Financial Code.

6. Section 1741.7 is added to read:

§ 1741.7. Prohibited Compensation

(a) The following activities, constitute consideration, whether performed directly or indirectly, are deemed a commission, fee, or other consideration as compensation as compensation for an escrow agent referring, soliciting, handling or servicing escrow customers or accounts, in violation of Financial Code section 17420 and are prohibited:

(1) Paying or offering to pay, furnishing or offering to furnish, or providing or offering to provide assistance with the business expenses of any person, including, but not limited to, rent, employee salaries, furniture, copiers, facsimile machines, automobiles, training, marketing expenses, insurance coverage, office space, accounting services, telephone services, or other services, equipment, or computers.

(2) Advertising or paying for an advertisement, the advertising in any newspaper, newsletter, magazine, publication, broadcast television, the Internet, or podcast, online video or online media, or application which enable users to create and share content or to participate in social networking on behalf of any person.

(3) Sharing content generated by or on behalf of another person on the Internet or an application which enables users to create and share content or to participate in social networking.

(34) Expenditures for foods, beverages and entertainment for a person or catering events.

(45) Furnishing or offering to furnish all or any part of the time or productive effort of any employee of the escrow agent to any person for any service unrelated to the escrow business.

(56) Offering free escrow services to one or more parties to the escrow.

(67) Offering escrow services at rates below the escrow agent's fee schedule, unless the discount meets the following conditions:

(A) The discount is available to all principals in the same transaction meeting the conditions or status for the discount;

(B) The discount from the fee schedule is mutually agreed upon by all parties to the escrow and substantiated by written escrow amendments and the amount of fees are explicitly disclosed on the written instruction;

(C) The discount does not contravene the distribution of escrow fees agreed upon by the parties to the escrow in a purchase or other agreement;

~~(D) The discount is not of a size or nature that will affect the independence of the escrow agent in the transaction; and~~

~~(DE) The discount does not result in one or more parties to an escrow covering the cost of escrow services for another party to the escrow, unless this allocation of escrow fees was made between the parties to the escrow without regard to the discount.~~

(8) Offering a discounted rate to clients of a broker without making the discount available to clients of all brokers.

(9) Offering a discounted rate to a broker, where the broker is the principal to the transaction.

(b) An arrangement of an escrow agent paying over to any other person any commission, fee, or other consideration as compensation for referring, soliciting, handling, or servicing escrow customers or accounts need not be written or verbalized but may be established by practice, pattern or course of conduct.

Note: Authority cited: ~~17315, Section 17400 and 17406~~; Financial Code. Reference:
Section 17420, Financial Code.

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