

THE CALIFORNIA CORPORATIONS COMMISSIONER HEREBY ADOPTS
THE FOLLOWING CHANGES IN THE REGULATIONS UNDER THE
ESCROW LAW AND
CALIFORNIA RESIDENTIAL MORTGAGE LENDING ACT
AS SET FORTH IN CHAPTER 3, TITLE 10,
CALIFORNIA CODE OF REGULATIONS
EFFECTIVE: August 20, 2002

1. Adopt Section 1729 to Article 4 to read:

1729. Inspection and Examination by Commissioner.

The Commissioner may consider the following factors in determining how often an examination required under subdivision (c) of Section 17405 of the Financial Code shall be conducted:

(a) Past and current violations of the Escrow Law and the regulations promulgated thereunder, taking into consideration the nature and severity of the violations and the number of violations.

(b) The number of years the escrow agent has been licensed under the Escrow Law.

NOTE: Authority cited: Section 17400, Financial Code. Reference: Section 17405, Financial Code.

2. Amend Section 1741.5 to read:

1741.5. Preparation of Independent 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

~~(a)~~ (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 ~~subsections~~ paragraphs of this ~~section~~ 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.

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

~~(1)~~ (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.

~~(2)~~ (B) The income statement shall state, separately from other salaries, the amount of salaries and bonuses paid to officers.

~~(3)~~ (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.

~~(4)~~ (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.

~~(5)~~ (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.

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

~~(4)~~ (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. If no debit balances were in existence at the balance sheet date, a positive statement of this fact must be made; and

~~(2)~~ (B) That the escrow funds were independently confirmed in writing by the accountant directly with the depositaries or other holders of escrow assets.

~~(d)(1)~~ (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.

~~(2)~~ (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 ~~subsection (d)~~ paragraph (4) of this section ~~subsection~~.

~~(e)~~ (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.

~~(f)~~ (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.

~~(g)~~ (7) The following additional audit procedures shall be performed:

~~(1)~~ (A) Verify the authorization and documentation of disbursements from a selective number of escrows.

~~(2)~~ (B) Select a representative sampling of escrows closed within 60 days prior to the commencement of the audit and perform the following audit procedures:

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

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

~~(h)~~ (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.

(i) (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 shall remain in effect only until March 31, 2002, and as of that date is repealed.

NOTE: Authority cited: Sections 17400 and ~~17401~~, Financial Code.

Reference: Section 17406, Financial Code.

3. Adopt Section 1741.5 to read:

1741.5. Preparation of Independent 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 depositaries 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 of 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 the oldest 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. The selection of dormant files shall include those that were older than six months at the last audit and no longer appear on the current schedule of escrow liability.

(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 shall become operative March 31, 2002.

NOTE: Authority cited: Section 17400, Financial Code. Reference: Section 17406, Financial Code.

4. Adopt Section 1950.302 to Article 9 to read:

1950.302. Examination by Commissioner.

The Commissioner may consider the following factors in determining how often an examination required under subdivision (a) of Section 50302 of the Financial Code shall be conducted:

(a) Past and current violations of the California Residential Mortgage Lending Act and the regulations promulgated thereunder, taking into consideration the nature and severity of the violations and the number of violations.

(b) The number of years the licensee has been licensed under the California Residential Mortgage Lending Act.

NOTE: Authority cited: Section 50304, Financial Code. Reference: Section 50302, Financial Code.