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Trust Accounting 101

Ensure compliance for trust accounts with proper maintenance, record-keeping

IN BUSINESS, GOOD, CLEAN RECORD-keeping is critical. This is especially true for mortgage brokers who handle money on behalf of clients to pay third-party service providers, such as credit-reporting agencies. These funds are called trust funds, and many states have trust-accounting regulations that also dictate how to document deposits to and withdrawals from these accounts.

Mortgage companies that hold funds for borrowers or investors often have specified trust accounts at a bank. Brokers often manage these accounts for single or multiple transactions. A number of accounting-software programs can help manage these business books. Many of these programs are ill-suited for meeting the accounting and legal requirements of businesses that must track funds for their clients, however.

It is important for brokers to understand what these accounts are used for, as well as the best method for tracking funds in and out of a trust account.

Trust accounts often can be opened with \$100 to \$200. These funds should belong to the broker's subsidiary ledger and always remain in the account to cover any bank fees.

Some states require that brokers deposit clients' funds in a trust account. Brokers should check with their state regulatory agencies for local requirements and ensure compliance. The account should be in their name or in their company's name, with the broker as a trustee.

Trust accounts can serve multiple functions, including the following:

- **Escrow-funding trust account.** Brokers who fund a loan using their own line of credit or private investors' funds can

use a trust account. Brokers who collect credit-report fees can use it, too. These funds should be deposited in a trust account and tracked in subsidiary ledgers for each loan and borrower.

- **Commercial or construction-loan trust account.** A trust account may hold construction funds that are disbursed to pay contractors upon completion of each phase of the project. All funds for all loans are in one bank account. But subsidiary ledgers for each borrower and contractor or payable account will account for funds received and disbursed.
- **Loan-servicing trust account.** Some state regulatory agencies mandate a separate trust account designated solely for loan collections. California, for instance, requires quarterly reporting for trust funds collected and disbursed. In addition, the state requires an annual report for the total of loans and dollar amount of loans originated and serviced.
- **Escrow or impound trust account.** Payments to a loan servicer for taxes, insurance, association fees for common areas of office or industrial buildings, and other miscellaneous impound charges must be maintained in a trust account and disbursed to the payable accounts when due. This account often can be in conjunction with the loan-servicing trust account or it can be a stand-alone bank account.
- **Property-management trust account.** Property-managers who collect rents and disburse payments to landlords should track those transactions in a trust account.
- **Payroll trust account.** Trust accounts also can track employees' federal and state taxes.

- **Living-trust trust account.** If a living trust includes properties and other assets, setting up a trust account at the bank and maintaining subsidiary ledgers for each asset may be necessary. Thus, the trustee can easily track income and expenses for and from each asset.

Finding the correct method of tracking trust accounts and automating it to best serve your business's requirements for managing these funds is critical to your success as a broker.

Should you track the money via a spreadsheet program, a basic general-ledger accounting system or trust-accounting software with subsidiary ledgers? Understand which method is optimal for managing your clients' funds and why it is different from managing your own company books.

Further, some state regulatory agencies have preferred methods of record-keeping for companies that manage client funds.

Spreadsheet programs have many uses, but they are not designed to meet the needs of any one industry or sector. Rather, users often customize the software for their own purposes.

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Timi Pereira, president and CEO of Goldenomega.net, consults clients about trust accounting, loan servicing and mortgage-fund accounting. Goldenomega.net has been providing software for the mortgage industry since 1988. It offers a variety of modules for small- to large-volume companies for loan origination for private-money loans, trust accounting, loan servicing and mortgage-fund accounting software. Reach Pereira at (916) 939-7083 or timi@goldenomega.net, or visit www.goldenomega.net for software product information.

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General-ledger software programs are widely used for bookkeeping. A general ledger is the core accounting for any business. Although businesses need a general-ledger system to manage their checking accounts, accounts receivables and accounts payables, it is not designed to manage client trust accounts.

To manage client trust accounts appropriately, mortgage brokers must maintain those accounts according to trust-accounting principles. One principle of trust accounting is to avoid comingling personal or company funds with clients' funds. This can have unwanted legal repercussions if rules are not followed.

For example, California requires that brokers withdraw any personal funds owed to them out of the trust account every 25 days. As such, issuing checks or deducting funds

out of the trust account and paying them to the broker's general business account at least twice a month is recommended to meet this requirement.

Spreadsheet and general-ledger software programs are not well-suited to ensure that you avoid comingling funds. For best results in maintaining trust-accounting records, brokers should look for trust-accounting software that manages subsidiary-ledger balances individually, with reports that explicitly state those individual balances. With this software, daily transactions should result in positive balances for each day and for each subsidiary ledger. If not, the software should be able to report the information and to transfer funds between ledgers — for example, from the broker's ledger to a client's ledger to cover the overdrawn client account.

Further, monthly bank-account reconciliation is required to balance the bank statement with the software's entries. Trust-accounting software is specifically designed to maintain a strict audit trail of all transactions to meet regulatory audit requirements. Also, annual-review reporting through the software can ensure proper maintenance. ●