

THREE WAY ESCROW ACCOUNT RECONCILIATION: **WHAT IS IT AND HOW DO I DO IT?**

By definition, an escrow agent is a disinterested, impartial third party acting in a fiduciary capacity as agent for seller, buyer, borrower, and lender. When we assume this fiduciary capacity, we also assume the risk associated with this responsibility. Mainly, we must prudently process, adequately safeguard and accurately account for all funds entrusted to us by the escrow customer. By performing the reconciliations process we adequately prove and absolutely assure funds entrusted to us were handled properly.

As escrow agents, closers, managers and owners of title agencies, we all know the importance of maintaining a complete and accurate closing files. We all remember that cliché: “Money In = Money Out”. What a lot of us don’t understand is how to prove Money In = Money Out. That’s what the reconciliation process is all about!

So what does this process entail? Simply put, as agent, you must perform, on a monthly basis a three-way reconciliation of book balance, bank balance and escrow trial balance. Let’s go through each “balance” in detail:

Book Balance:

This is a summary of what is going on in the "check book". Just like your personal checking account, the escrow or trust account should have a register listing the transactions. When you write a check, you enter the date, the payee and the amount into your register. You subtract that amount from your balance and that gives you a new balance. Likewise, when you make a deposit, you enter the amount and add it to the previous balance to arrive at the new balance. The same thing happens in your escrow account. Your bookkeeper (or computer) should keep a checkbook register of all deposits and disbursements for the month.

Bank Balance:

As we know from our personal checking account, the balance on the bank statement is never the same as what our check book says it should be. The reconciliation of “book” to “bank” will prove the accuracy of our records. (we will get into the ‘how to’ later)

Escrow Trial Balance:

Simply put, the trial balance is a list of open files and their balances. When we reconcile our personal account, we know the ending balance is our money. Whereas, in escrow accounting any remaining funds belong to some one. The trial balance tells us which file(s) the money belongs.

The important thing to remember here is: *all three balances must agree!* The purpose of this requirement is to locate any errors and to discover any shortages. So, how do we do this? The attached exhibit "A" is a book to bank reconciliation for March 2004. Let 's go over it in detail:

BEGINNING BOOK BALANCE:

This is the amount shown as the balance in the "check book" on March 1, 2004.

ADD:

CURRENT PERIOD DEPOSITS:

WIRE TRANSFER DEPOSITS:

You are adding to the beginning check book balance all of your deposits for the month. Some people like to segregate wires from other deposits, but it isn't mandatory to do so.

LESS:

CURRENT PERIOD CHECKS:

You are subtracting all the checks (and wires if you do those) that have been written for the month.

BOOK BALANCE AS OF 3/31/04:

That's your total!

For those of you that are computerized, this information is automatically retained in your program. All you need to do is print your deposits register and the disbursement register. You should also be able to print a summary report similar to my exhibit A.

ENDING BANK STATEMENT BALANCE (3/31/04):

This number is found on your bank statement. The statement should say beginning balance, total of deposits, total of disbursements, and ending balance.

ADD:

DEPOSITS-IN-TRANSIT:

These are any deposits your checkbook says you have made, but, do not show on the bank statement. A common mistake made on most bank reconciliations is to account for file shortages as “deposits in transit”. A true DIT will clear the bank in the first few days of the following month. Anything that stays as a deposit in transit for more than a few days is a file shortage.

LESS:

OUTSTANDING CHECKS:

Outstanding checks are checks you have written, but have not cleared the bank. You arrive at this number the same way as with your personal account. Take the canceled checks that you received with the bank statement. Place them in numerical order. Then mark them off the register if they have cleared the bank. Those that have not cleared become part of the outstanding checklist. **NOTE:** It is a good idea to review the actual check against the bank statement and the check register...banks do made mistakes.

BOOK BALANCE AS OF 3/31/04:

This is your total! Unless you have made a mistake, it should be the same figure as you check book balance.

Ok, one more step to go! Remember, in escrow account management, we must know what file(s) constitute the ending balance. That’s where the trial balance comes in. Exhibit B is a copy of the trial balance for March 2004. Let’s take a look:

Trial balance:

Remember, this is the most basic of all requirements: it’s a listing of all files with open balances. It proves which files have/need what money.

Our exhibit shows positive and negative balances and both are important to management. Positive balances reflect files that haven’t been fully disbursed. Reasons for this occurrence are:

- recording fees being held for releases/satisfactions

- checks were voided and a replacement hasn't been issued
- funds being held for post closing contingencies
- minor mistakes in check writing

Negative balances will also be shown on your trial balance. Reasons for their occurrence are:

- deposits made, but not posted
- deposits posted to the wrong file
- file was double disbursed
- a check was not voided
- file was purposely overdrawn

A common mistake, is to allow these files shortages to remain on the trial balance. Each of these items should be researched immediately. Acceptable accounting practices require file shortages to be reimbursed by the appropriate parties or from the agent's operating account immediately upon discovery. Simply put: If the file is short, you must place money from your operating account, into the escrow account. When you receive salvage or recovery, you must place these funds into the escrow account, prior to reimbursing your operation account. This provides a complete and accurate accounting trail that would make any auditor proud!

This reconciliation for March 2004 is in balance, but needs some help. In this particular instance, the agent needs to place operating funds in file 04-097. Do they need to reimburse 04-252? What about 04-304? What should be done on 04-289? These are the types of questions you as "fiduciary agent" should be asking .

Remember, your escrow account is dynamic entity, constantly in motion. Think of the reconciliation as a "snap-shot" of the escrow account on any given day. It tells you if the world could stand still and all things were equal, you would have X amount of money (or in our example NEED) in the account. And most importantly, which file needs or has money.

The total listed on this **trial balance** equals the **book balance** and the **bank balance**. We have now successfully completed a **three-way reconciliation!**

This process must be completely monthly. We recommend it be performed within 10 after receipt of your bank statement. Someone not responsible for escrow disbursement should prepare the reconciliation. (This person shouldn't be an authorized signatory on the escrow account) Since the owner or manager of the agency will be ultimately responsible for any improprieties, it is strongly recommended that someone in authority critically review and formally approve each reconciliation. Accepted accounting procedures suggest the preparer and the reviewer sign and date the document.

EXHIBIT A

BANK RECONCILIATION STATEMENT:

FOR THE PERIOD BEGINNING 3/1/04 AND ENDING 3/31/04:

Bank Account 08603701

BOOK BALANCE COMPUTATION:

Beginning Book Balance (3/1/04)	\$56,656.93
Add:	
Current period deposits	93,752.84
Wire transfer deposits	318,709.52
Less:	
Current period checks	<u>475,599.67</u>
BOOK BALANCE AS OF 3/31/04	<u>\$ 6,480.38-</u>

BANK STATEMENT RECONCILIATION:

Ending Bank Statement Balance (3/31/04)	\$261,468.91
Add:	
Deposits-In-Transit (outstanding deposits)	-0-
Less:	
Outstanding Checks	<u>267,949.29-</u>
BOOK BALANCE AS OF 3/31/04	<u>\$ 6,480.38-</u>

This reconciliation statement is only valid if the **TRIAL BALANCE** (EOM) or ledger report for the period ending 3/31/04 matches the **BOOK BALANCE** shown above.

EXHIBIT B

ESCROW ACCOUNT MANAGEMENT:

Trial Balance as of 3/31/04 (EOM)

<u>File</u>	<u>Buyer</u>	<u>Last Activity</u>	<u>Balance</u>
04-097	Claire Andrews	1/15/04	3,047.79-
04-104	Dean Weeks	1/31/04	25.04
04-136	Rick Matta	1/19/04	25.04
04-143	Kim Francis	2/01/04	75.04
04-209	V.J. Parkee	2/23/04	125.04
04-252	Nick Scott	3/19/04	75.04-
04-268	Suzanne Ramey	3/23/04	330.04
04-289	Charles Sanchez	3/23/04	.27
04-304	John Bellows	3/31/04	<u>3,957.86-</u>
			6,480.38-

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NOTES ON TRIAL BALANCE

File #04-097- Claire Andrews

This file closed on January 15, 2004 and as of the end of March, 2004, the file is \$3,047.79 short. It is immaterial if this shortage was caused by a closing error or failure to receive a deposit from one of the parties involved in the transaction. As mentioned previously, all file shortages must be funded *immediately upon discovery!* In this instance, \$3,047.79 in operating funds should have been deposited into the escrow account when the shortage was discovered. The agent should then determine which party owes the monies that caused the shortage and then try to effect collection from the responsible party. Should the agent receive these monies, they can then be deposited into the operating account to replace those funds advanced to balance the escrow.

File #04-252- Nick Scott

This file should be handled the same as the previous example. Operating funds should be deposited into the escrow account to cover the shortage.

File #04-289 - Charles Sanchez

This file contains an overage of \$.27. Although the natural inclination would be to deposit this small sum into the operating account to offset funds advanced for file shortages, federal statutes dictate that this overage be returned to the rightful party.

File #04-304 - John Bellows

Since the date of this file is the last day of the accounting period for this trial balance, it is highly likely that this closing did not actually close until the day following the end of the month. While checks have been written in preparation of the closing, the actual closing has not occurred as of the date of this trial balance. Assuming this to be the case, this shortage will be received at closing and the escrow will balance. The subsequent bank statement should show a deposit in the amount of this file shortage within the first two days of the month following this report.