BASICS OF ESCROW ACCOUNTING

1.   **Definitions**

Escrow Transactions - The American Land Title Association states: "An escrow is a transaction in which an impartial third party acts in a fiduciary capacity as an agent for the seller, buyer, borrow/lender in carrying out any or all of the following:

- preparing instructions,
- preparing/delivering papers and documents; and
- receiving and disbursing funds.

The escrow holders have fiduciary responsibility for prudent processing, safeguarding, and accounting for funds entrusted to them by escrow customers. Accordingly, this responsibility results in significant exposure to losses from inadvertent or intentional failure to execute their duties properly."

Cash Disbursement Journal - The accounting subsidiary ledger on which are listed all checks disbursed from the escrow trust account in sequential order.

Cash Receipt Journal - The accounting subsidiary ledger on which are listed all funds deposited to the escrow bank account.

Collected Funds - Cash items that have been cleared through the Federal Reserve Bank, local clearinghouse, or two or more bank accounts within the same bank.

Deposit in Transit - A deposit which is reflected on the books of the agency but, because of timing difference, is not yet reflected on the current bank statement. A true deposit in transit will be shown as a credit early in the period covered by the subsequent bank statement.

These two can be one and the same. Sometimes they are different but, when considered together, display all the information called for in minimum requirement #15 (disbursement sheets).

File Disbursement Sheet - An accounting sheet which is part of the individual guaranty file for a particular real estate transaction. It reflects all monetary transactions for the file and is used as a control to assure that receipts equal disbursements.

Individual Escrow Ledger Record - Record maintained for accounting purposes to show actual receipts and disbursements on a daily basis and determine the funds available in a specific file at any given time.

Good Funds - Those funds identified in Procedural Rule P-27 adopted by the State Board of Insurance and required to be received and deposited before any disbursement may be made from the related file.

Check Register - A listing in sequential order of all checks issued during the month.

Outstanding Checks - Checks issued but not yet cleared through the bank.

Escrow Trial Balance - A list of all open individual escrow ledger record balances at the end of the month.

II.   Escrow Accounting Formula

Assets = Liabilities. There is no equity as in the normal accounting formula.

III.   Basic Rules of Escrow Accounting

A.   All escrow transactions must be accounted for separately.

B.   Escrow funds must not be commingled with operating funds.

C.   A shortage in an escrow account creates an escrow receivable (a situation prohibited by state law).

D.   Escrow accounts must be reconciled monthly using a three-way reconciliation process.

E.   An important element in a system of internal control is the concept of segregation of duties. There are four general types of segregation of duty controls:

1.   Authorization of transactions,

2.   Escrow activity,

3.   Custody of assets, and

4.   Financial record keeping.

If there is not sufficient staff for complete segregation of these duties, there should be adequate daily supervision by management.

IV.   Types of Escrow Accounts

A.   General escrow accounts: These accounts consist of monies deposited to a file pending satisfaction of the accompanying instructions. These funds belong to the parties to the transaction and are held by the title company subject to the parties' direction. The title company is not entitled to any benefit deriving from the custody of these funds.

B.   Interest-bearing accounts: An interest-bearing account may be opened by the title company when so instructed in writing by the relevant party to the transaction. The interest accrues strictly for the benefit of the party or parties to the transaction.