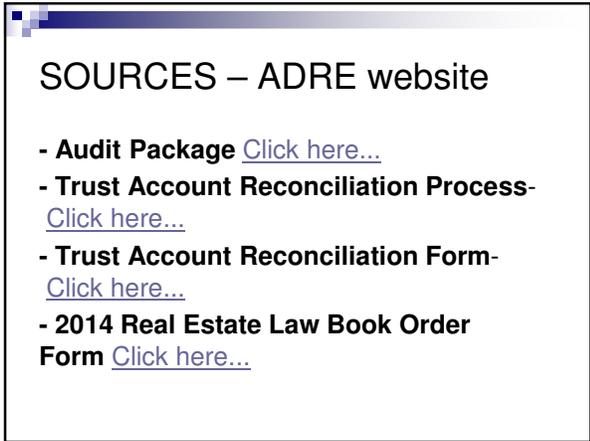


Property Management
Trust Accounting

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SOURCES – ADRE website

- **Audit Package** [Click here...](#)
- **Trust Account Reconciliation Process-**
[Click here...](#)
- **Trust Account Reconciliation Form-**
[Click here...](#)
- **2014 Real Estate Law Book Order Form** [Click here...](#)



ADRE Property Management Accounting Requirements

- For Property Management, is a Trust Account Required and why?
- Trust account set up
- Authorized signers

Trust Account Defined:

Trust funds are funds that are received in the course of performing real estate activity on behalf of another person by a Broker, Licensee, or Property Manager (Agent). These funds do not belong to the agent but are being held for the benefit of others. A "Trust Account" is a bank account into which trust funds (and only trust funds) are deposited.

Trust Account Defined:

By depositing funds into a trust account, the funds are protected should the Agent become involved in a legal action, become incapacitated or die. The funds are also FDIC insured up to the federal limit for each depositor.

Trust Account Set Up & Usage

- Setting up your Accounts
- Allowable signers
- Proper Trust Account usage

AZ State A.R.S. (32-2174):

A. All property management accounts shall be designated as trust accounts and shall include descriptive wording, substantially similar to one of the following, in the trust account title:

- 1. "Trust account".
- 2. "Fiduciary account".
- 3. "In trust for (individual or entity name)".
- 4. "Trustee for (individual or entity name)".
- 5. "Fiduciary for (individual or entity name)".

"Real Estate Brokerage Trust Account"

B. A broker's trust account is required for all of the owner's monies, except if the owner directs the broker to deposit the monies directly into the owner's account. The broker shall not have access to the owner's account.

Banks often have trouble setting up property management trust accounts

http://red.state.nv.us/publications/bulletins/ib26_trustaccountbanktitle061412.pdf

F.D.I.C.

ADRE requires that all trust accounts be Federally Insured or Guaranteed, including Security Deposit, CD's, Savings, Sweep Accounts, etc.

Accounts may be interest bearing but Broker must disclose how interest is distributed.

Account Signers:

Who may be a signer on the Brokerage 1 Trust Accounts?

ACTIVE LICENSEES	UNLICENSED PERSONS
The Designated Broker for the brokerage An Associate Broker licensed with the brokerage A Salesperson licensed with the brokerage	An unlicensed bookkeeper or other party employed by the brokerage An unlicensed officer, member, or principal of the entity.

Digital Signatures & Stamps

- A.R.S. (32-2174 C.): ... The broker may require dual signatures on checks and may use a facsimile signature according to the broker's business policies and procedures. The designation of a licensed or unlicensed person to transfer monies or to be a signatory on trust accounts does not lessen the broker's responsibility or liability for any monies handled.
- ADRE Commissioner and Auditors discourage this practice. Difficult to insure supervision.

Broker/Agent Owned Properties

ADRE Rules for Broker and licensee owned rentals:

- Funds must be held in a trust account – Security deposit funds are Tenant funds.
- Licensees can NOT be a signer on Account where they are property Owner.
- Rules apply to immediate family – “persons related by blood, marriage, or adoption, including spouse, sibling, parents, grandparents, children and grandchildren.”

A.R.S 32-2153:

Grounds for denial, suspension or revocation of licenses; letters of concern; provisional license; retention of jurisdiction by commissioner; definitions:

16. Commingled the money or other property of the licensee's principal or client with the licensee's own or converted that money or property to the licensee or another.

Rental properties owned by the Broker, Agent employed by Broker, or immediate family is considered by the department to be "personal monies" and running the funds thru the main trust account is considered commingling.

Also see the attached Property Management Audit Packet from the department - page 7 covers this specifically.

Proper Trust Fund Usage

- Owner's Funds
- Tenant's Funds
- Brokerage Funds

Commingling Funds

- Definition: The act of combining the Broker's personal funds with Clients funds or using one Client's funds to pay for another Client's obligation.

- Legal vs. illegal

Brokerage Funds:

- When establishing a trust account, the broker may deposit no more than \$3000 of the broker's monies to keep a trust account open or to avoid charges for an insufficient minimum balance
- Brokerage Funds must be removed at least Monthly and Interest must be removed at least Yearly

ADRE Accounting Records Rules

- Monies shall be used only for the purpose for which the monies were deposited.
- A complete record of all monies received in connection with a real estate transaction
- The broker's records shall be kept according to generally accepted accounting principles (GAAP) and shall include a properly descriptive receipts and disbursement journal and client ledger.

ADRE Accounting Records Rules

- The broker shall maintain a trust account bank reconciliation AND client ledger balance monthly
- A broker shall not permit advance payment of monies belonging to others to be deposited in the broker's personal account or to be commingled with the broker's personal monies (ARS 32-2151.2)

General Trust Accounting Rules:

- No commingling
Owner A's money has nothing to do with Owner B's money. Although they are keep in the same account, each owner's funds are considered completely separate from those of all your other owners. In other words, you are not allowed to use one owner's money to pay another owner's or your own obligations.

General Trust Accounting Rules:

- Commingling continued
You may have \$100,000.00 total in the trust account, but if owner A only has \$100 then you can not write a check for \$200 with out using some other owner's money.

General Trust Accounting Rules:

- No negative balances:
If you are following proper accounting policies, you no owner should ever have a negative balance.

General Trust Accounting Rules:

- Inactive clients
As long as funds remain in your trust account, all the rules still apply. Clear up inactive accounts in a timely manner. Until they have a “zero” balance, they are not closed out.

Reconciliations

- Required Monthly by ADRE. Must reconcile to the client ledgers (3 Way)
- 3 way reconciliations only way to prove there is no illegal commingling.

Required Record Retention

- Banking record retention
 - Deposit slips
 - Cancelled Checks
 - Voided Checks
 - Invoices
 - Bank Statements and reconciliations
 - 3 Way reconciliation records
 - Other

Examples / Case studies

Questions / Discussion

Reconciliations

What is the difference between a normal bank reconciliation and a "3 Way" reconciliation?

Is a 3 Way reconciliation required?

Three Way Reconciliations

BANK STATEMENT
=
CHECK REGISTER
=
CLIENT LEDGERS

The first step in any three way reconciliation is to balance your bank statement to your accounting software. After you have balanced your statement, you will need to calculate the adjusted bank balance. This is the "cleared" balance plus any uncleared deposits and minus any uncleared checks

Your software should provide this number.

Bank Account Reconciliation

Bank Statement Balance	A. _____
Less: Outstanding Checks / withdrawals	B. _____
Plus: Outstanding Deposits / additions	C. _____
Adjusted Balance: (D = A - B + C)	D. _____
Check Book (Software) Balance:	E. _____
Difference: (F = D - E)	F. _____

The next step is to prove that the total of all individual ledgers (Owner, Tenant, and Broker) equals the same amount. None of the ledgers should have a negative balance.

Trust Account Reconciliation

Client / Tenant Liabilities:	
Owner Funds	G. _____
Tenant Funds	H. _____
Other Trust funds	I. _____
Total Client / Tenant Liabilities: (J = G + H + I)	J. _____
Bank Account Balance: (adjusted = D from above)	D. _____
Difference: (K = D - J)	K. _____

Owners Funds:

- Cash
- Liability accounts (set asides, reserve accounts, etc.)
- Tenant Deposits are not Owner's funds.

Tenant Funds:

- Security deposits
- Other refundable deposits
- Advanced payments, over payments, open credits, etc.

Management & Other Trust Funds:

- Fees collected waiting to be paid out
- Cash reserve (up to \$3000)
- Tax Liability Accounts
- Other Liability accounts for management funds are not a normal (GAAP) practice.

3 Way Reconciliation Examples

- Refer to software help for instructions
- You will need reports showing Owner, Tenant and other ledger totals.
- These should be run as of the Bank reconciliation date (usually last day of month)

Following is an example of a 3 way reconciliation. The numbers used assume you have balanced the bank statement to your software and have an adjusted bank balance of \$21,177.81

OWNER FUNDS	Available Cash	Liability (escrow)	* Balances on hand after distributions
Adams	\$200.00		
Bush	\$200.00		
Carter	\$500.00		owns 5 homes
Hayes	\$200.00		
Jackson	\$200.00		
Kennedy	\$200.00		
Lincoln	\$200.00	\$400.00	set aside for Termite Warranty
Reagan	\$200.00		
Roosevelt	\$200.00		
Washington	\$500.00		owns a fourplex
	\$2,600.00	\$400.00	

Owner	Tenant	Security Deposit	Over Payments	Notes
Adams	Andrea	\$1,000.00		
Bush	Betsy	\$1,000.00		
Carter House# 1	VACANT	\$0.00		
Carter House# 2	Chris	\$800.00		
Carter House# 3	Dave	\$900.00		
Carter House# 4	Donna	\$900.00		
Carter House# 5	Fred	\$750.00		
Hayes	James	\$995.00	\$40.00	Rent is \$995 but pays \$1000
Jackson	Jayci	\$850.00		
Kennedy	Kit	\$1,500.00		
Lincoln	Mark	\$800.00		
Reagan	Melissa	\$1,000.00		
Roosevelt	Ray	\$1,100.00		
Washington Unit# 1	Rose	\$500.00		
Washington Unit# 2	Steve	\$500.00		
Washington Unit# 3	Tony	\$500.00	\$3,000.00	Prepaid 6 months rent in advance
Washington Unit# 4	Vicky	\$500.00		
		\$13,595.00	\$3,040.00	

Other Trust Funds	
Management ledger	\$500.00
Chandler Tax	\$17.19
Mesa Tax	\$179.56
Phoenix Tax	\$789.65
Peoria Tax	\$56.41
	\$1,542.81

Trust Account Reconciliation

Client / Tenant Liabilities:	
Owner Funds	G. <u>3,000.00</u>
Tenant Funds	H. <u>16,635.00</u>
Other Trust funds	I. <u>1,542.81</u>
Total Client / Tenant Liabilities: (J = G + H + I)	J. <u>21,177.81</u>
Bank Account Balance: (adjusted = D from above)	D. <u>21,177.81</u>
Difference: (K = D - J)	K. <u>0.00</u>

Errors and Deficiencies

- Bank errors
- Posting errors
- Unintended shortages

Looking at ledgers individually will help identify posting errors (liability accounts, security deposits, etc.) or any negative balances.

Examples of posting errors:

- Tenant receipt posting errors (date issues)
- Invoice paid by owner using wrong code
- Liability Account Issues

Rental tax Overview

- Who owes?
- What is taxable?
- How can it be paid?

General Overview

- Approximately 94 cities charge privilege tax on rent - rates vary between 1.5% & 3.0%.
- Some counties charge on commercial rents.
- ADOR was collecting for most cities while a few cities collected and required separate reporting. Starting soon (1/1/16), all reporting and collecting will be done by ADOR.

Who?

- Each city varies for Owner managed units and has exemptions for “casual” activity
- Per code: “a Broker acting for a lessor deriving gross (rental) income shall be liable for such tax even if his principal would not be subject to the tax if he conducted such activity on his own behalf.”

What?

- Gross income from the “business” activity is taxable.
- Specifically included are:
pet fees, utilities, property taxes, repairs, improvements, maintenance, released security deposits, vending and laundry income, any reimbursements (damages, keys, etc.) received from the tenants, non-refundable deposits

How? PMC vs Owner

- Option 1: PMC (master license) – ADOR is allowing PMC to have and pay under 1 (or more) master license. Owners still required to obtain licenses.
- PMC can bulk apply, remove, report and pay under master license.
- POA & MOU are not required
- PMC & Owner are responsible

How? PMC vs Owner

- Option 2: PMC does not get a master license but collects tax and reports for Owner under Owner's license.
- POA & MOU are required
- PMC would file separate returns for each owner's license.
- Owner is responsible

How? PMC vs Owner

- Option 3: PMC does not report or pay. They collect tax and send it to the Owner.
- POA & MOU are not required – PMC can not discuss or help with tax issues.
- Owner is responsible and would file all returns.

How? Cash vs Liability

- LIABILTY METHOD – payments made by tenant are put into a separate ledger. Payments to the tax authority are paid out of this ledger.
- Positive – funds can not be used for other purposes
- Negative – multiple other ledgers must be reconciled every month.
- For master license, this is a good option.

How? Cash vs Liability

- CASH METHOD – Funds received from tenant are posted to the owner’s ledger. Tax payments are made from owner’s cash funds.
- Positive – no other ledgers to reconcile
- Negative – funds might not be available to pay tax when due

Owner’s paying rental tax

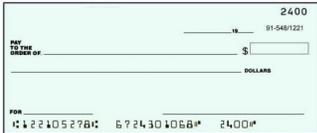
■ **Model City Tax Code says:**
 “For the purposes of proper administration of this chapter and to prevent evasion of taxes imposed, Brokers shall be wherever necessary treated as tax payers for all purposes, and shall file a return and remit the tax imposed on the activity on behalf of the principal. No deduction shall be allowed for any commissions or fees retained by such Broker, except as provided ... relating to advertising.”

“The liability of the Broker does not relieve the principal... except upon proof of payment of the tax and only to the extent of the correct payment. The Broker shall be relieved of the responsibility to file and pay taxes upon the filing and correct payment of such taxes by the principal.”

Question & Answer Session

Accounts Payable Requirements

- Trust account distributions – what is allowed and is not allowed
- Record keeping
- Best Practices



Commissions and Fees

- Which of the following payments are allowed to be paid directly out of the Trust account?
 - A. Commissions to Licensees
 - B. Reimbursements to agents (keys, etc.)
 - C. Referral fees to other Brokers/Agents
 - D. None of the above

Accounts Payable

- Minimum details for all payments
- Accounting practices follow G.A.A.P.
- Cannot exceed Owner's available cash
- Mortgage, Tax and Insurance payments

Details, Details, Details

All disbursements (checks, debits, ACH, etc.) need to have the following details:

- Date, amount, form (check, debit, etc.), ledger (payor), payee, invoice#, and details regarding transaction

Owner reserve usage

- Funds can only be used for the purpose for which they were deposited. Make sure your PMA defines any owner reserve funds being held and what they can be used for.

Accounts Receivable Requirements

- Minimum Details
- Forms of Payment
- Best Practices



Accounts Receivable:

- How soon must funds be deposited?
 - A. Immediately
 - B. 1 Business day
 - C. 3 Business days
 - D. 1 Week

Any Exceptions???

Forms of payment

- Cash, personal checks, money orders, cashier's checks, traveler's checks
- When are funds "Good"?
- Company receipt policies

General Trust Accounting Rules:

- Timing matters:

It may take 5 to 10 days after depositing funds before they are "available". You should not write checks out of the trust account until you know the funds have cleared.

Bank Float

Ways to reduce the bank float

- A. Online payments
- B. Scheduled Automatic debits
- C. Credit and Debit card payments
- D. Check Scanning /Digital deposits

Accounts Receivable

- Deposits must be made using descriptive deposits slips
- Lease must disclose where Security Deposits will be held and must match terms in PMA

Question & Answer Session

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