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# **Audit Guide**

  

## **For**

  

# **Cemetery Trust and Funeral Trust**

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## **Introduction – About This Guide**

This guide has been developed by the California Department of Consumer Affairs, Cemetery and Funeral Bureau's Audit Unit. The Cemetery and Funeral Bureau's Audit Unit is comprised of the Supervising Auditor and three general auditors.

The purpose of the audit guide is to provide a tool that can be used by individuals and public accounting firms that perform audits of cemetery and funeral establishments. The primary focus of the guide is auditing and reporting on the cemetery's endowment care fund and special care fund as well as the preneed funeral trust funds.

The standardized procedures and suggested methods that are provided in the guide should help auditors apply auditing and evaluation techniques. However, since conditions vary and all situations cannot be anticipated, auditors should also use independent judgment in planning and conducting audits and engagements.

Some sections of the guide include broad policies and procedures, while others are intended to provide narrowly focused instructions to financial and/or compliance auditors needed to satisfy statutory authorities.

An electronic version of this guide will soon be found on the Bureau's home page:  
[www.cfb.ca.gov](http://www.cfb.ca.gov)

This guide is not intended to be an auditing procedures manual but rather a guide that will assist individuals in understanding policies, audit techniques and sources for laws and regulations and specific audit procedures.

### **Background – Cemetery and Funeral Bureau**

The Cemetery and Funeral Bureau (Bureau) has statutory authority for licensing and regulating licensees in the funeral, cemetery, and crematory industries in California. Additionally, the Bureau has responsibility for overseeing the fiduciary and operational activities of the industries it regulates. The responsibilities include issuing and renewing licenses; overseeing funeral and cemetery trust funds; responding to various complaints; conducting inspections and investigations; disciplining violators; and providing consumer information to the public.

The Bureau has statutory authority to enforce the licensing and practice acts in the Business and Professions (B&P) Code relating to the funeral, cemetery and crematory industries. The Bureau also has jurisdiction over specific sections of the Health and Safety (H&S) Code dealing with human remains, cemetery and cremation provisions. In addition to the B&P Codes and H&S Codes, the California Code of Regulations (CCR) also provides general regulatory requirements.

The Bureau is comprised of 22 full-time staff, lead by a Bureau Chief and a Deputy Bureau Chief and is divided into three distinctive units and functions:

- Licensing unit (three full-time staff)
- Enforcement unit (four full-time staff in Sacramento and nine full-time field inspectors throughout the state)
- Audit unit (four full-time staff)

The Bureau regulates nearly every aspect of the licensed cemetery and funeral industries, with approximately 195 cemetery licensees and 970 funeral establishment licensees in California.

On the financial side, the Bureau oversees preneed funeral trust funds, cemetery endowment care trust funds and cemetery special care trust funds. The Bureau may audit trust funds to ensure compliance with the laws, verify accounting and investing practices, and identify funding shortages. Audits may be initiated based upon the review of an annual trust report, failure to file a trust report, consumer complaints, or for any reason if the funds appear to be at risk of possible abuse or noncompliance.

## Background – Cemetery Laws & Regulations

### Certificate of Authority (COA)

A cemetery means either of the following, used or intended to be used and dedicated for cemetery purposes:

1. A burial park, for earth interments.
2. A mausoleum, for crypt or vault interments.
3. A crematory and columbarium, for cinerary interments.
4. A place where six or more human bodies is buried.

The Cemetery Act constitutes the laws and regulations that govern the cemetery authorities. This Act does not apply to any of the following:

- (a) A religious corporation, church, religious society or denomination, a corporation sole administering temporalities of any church or religious society or denomination, or any cemetery organized, controlled, and operated by any of them.
- (b) A public cemetery.
- (c) Any private or fraternal burial park not exceeding 10 acres in area, established prior to September 19, 1939; **however**, (1) such cemeteries shall be subject to the cemetery brokerage provisions of this act, and (2) any such cemetery shall be subject to all of the provisions of this act if it collects a care, maintenance or embellishment deposit (an endowment care fund deposit) or sets up a trust for burial purposes pursuant to Section 8775 of the Health and Safety Code, including funeral services such as mortuary, cremation or other commodities or services furnished at the time of and in connection with such funeral or cremation.

Applicable laws and regulations:

The Business and Professions Code (BPC), Chapter 19 provides the authority for regulating licensed cemeteries and crematories, as follows:

Article 1	General Provisions	9600-9610
Article 2	Administration	9625-9631
Article 3	Regulations of Cemeteries	9650-9663
Article 4	Cemetery Brokerage Regulations	9675-9686
Article 5	Licenses and Certificate of Authority	9700-9723.2
Article 6	Disciplinary Proceedings	9725-9737
Article 6.5	Cremated Remains Disposer	9740-9749.5
Article 7	Fees	9750-9770
Article 8	Crematories	9780-9789

Health and Safety Code (H&S), Division 8 Part 3 provides authority for regulating licensed cemeteries and crematories, as follows:

Chapter 1	General Provisions	8250-8253
Chapter 2	Operation and Management	8275-8362
Chapter 3	Acquisition, Dedication, and Sale	8500-8585
Chapter 4	Property Rights	8600-8680
Chapter 5	Endowment and Special Care	8700-8785
Chapter 7	Abandonment	8825-8829

In addition, California Code of Regulations (CCR), Title 16 provides regulations for cemeteries, as follows:

Article 1	General	2300-2304
Article 2	Fees	2310-2324
Article 3	Applications and Licenses	2326-2332
Article 4	Signs, Contracts, Literature, Etc.	2336-2340
Article 5	Annual Reports	2350-2351
Article 6	Special Care Funds	2370-2380
Article 7	Disciplinary Proceedings	2381
Article 7.5	Citation and Fines	2382-2388
Article 9	Private Mausoleums and Columbariums	2390

Each cemetery is required to file the Endowment Care Fund and Special Care Fund Report (Annual Report). It is also required that an audit report upon the general purpose financial statements of the endowment care fund and special care fund accompany the Annual Report and be signed by the certified public accountant or public accountant that performed the audit in accordance with B&P Code Section §9650.

Section §9650. *(a) Each cemetery authority shall file with the bureau annually, on or before June 1, or within five months after close of their fiscal year provided approval has been granted by the bureau as provided for in Section 9650.1, a written report in a form prescribed by the bureau setting forth the following:*

*(1) The number of square feet of grave space and the number of crypts and niches sold or disposed of under endowment care by specific periods as set forth in the form prescribed.*

*(2) The amount collected and deposited in both the general and special endowment care funds segregated as to the amounts for crypts, niches and grave space by specific periods as set forth either on the accrual or cash basis at the option of the cemetery authority.*

(3) A statement showing separately the total amount of the general and special endowment care funds invested in each of the investments authorized by law and the amount of cash on hand not invested, which statement shall actually show the financial condition of the funds.

(4) A statement showing separately the location, description, and character of the investments in which the special endowment care funds are invested. The statement shall show the valuations of any securities held in the endowment care fund as valued pursuant to Section 9659.

(5) A statement showing the transactions entered into between the corporation or any officer, employee or stockholder thereof and the trustees of the endowment care funds with respect to those endowment care funds. The statement shall show the dates, amounts of the transactions, and shall contain a statement of the reasons for those transactions.

(b) The report shall be verified by the president or vice president and one other officer of the cemetery corporation. The information submitted pursuant to paragraphs (2), (3), (4), and (5) shall be accompanied by an annual audit report of the endowment care fund and special care fund signed by a certified public accountant or public accountant. The scope of the audit shall include the inspection, review, and audit of the general purpose financial statements of the endowment care fund and special care fund, which shall include the balance sheet, the statement of revenues, expenditures, and changes in fund balance.

(c) If a cemetery authority files a written request prior to the date the report is due, the bureau may, in its discretion, grant an additional 30 days within which to file the report.

A financial statement audit is primarily concerned with providing reasonable assurance about whether financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP), or with a comprehensive basis of accounting other than GAAP. Other objectives of financial audits, which provide for different levels of assurance and entail various scopes of work, may include:

- a. providing special reports for specified elements, accounts, or items of a financial statement;
- b. reviewing interim financial information;
- c. issuing letters for underwriters and certain other requesting parties;
- d. reporting on the processing of transactions by service organizations; and
- e. auditing compliance with regulations relating to federal award expenditures and other governmental financial assistance in conjunction with or as a by-product of a financial statement audit.

The audit is performed to ensure that each licensed cemetery is in compliance with applicable laws and regulations governing the administration of endowment care funds (ECF) and special care funds (SCF).

### **Transfer of Cemetery Ownership – See H & S Code Section 8585**

If the sales agreement/contract for the sale of the cemetery and transfer of the cemetery license (certificate of authority) does not indicate who is responsible for fulfilling the Cemetery and Funeral Bureau's annual report and CPA audit report requirements, then it is the current owner of the cemetery at fiscal year-end or at December 31, whichever is the reporting year of the cemetery, that is responsible for completing the annual reporting requirements. Any shortages in the trust funds shall be funded by the current owner of the cemetery license at fiscal year end or December 31, if it is not indicated on the sales agreement/contract.

### **Annual Reporting Requirement – See B&P Code Section 9650 and CCR Code Section 2883**

Each cemetery authority shall file with the Bureau annually, on or before June 1, or within five months after the close of their fiscal year, provided approval has been granted by the Bureau, a written report in a form prescribed by the Bureau. This report is commonly called the *Endowment Care Fund and Special Care Fund Report* or Annual Report. Accompanying the Bureau's Annual Report shall be an audit report of the endowment care fund and special care fund signed by a certified public accountant or public accountant.

Any cemetery authority that does not file the Annual Report within the time prescribed in B&P Code Section 9650 shall be assessed a fine in the amount of four hundred dollars (\$400) per month for a maximum of five months (\$2,000).

A cemetery authority may request a waiver or reduction of a fine by making a written request to the Bureau. The request shall be postmarked within 15 calendar days after receipt of written notification of the assessment.



## Background – Funeral Laws & Regulations

### Funeral Establishment

A licensed funeral establishment is a place of business conducted in a building or separate portion of a building having a specific street address or location and devoted exclusively to those activities as are incident, convenient, or related to the preparation and arrangements, financial and otherwise, for the funeral, transportation, burial or other disposition of human remains and including, but not limited to either of the following:

- (1) A suitable room for the storage of human remains.
- (2) A preparation room equipped with a sanitary flooring and necessary drainage and ventilation and containing necessary instruments and supplies for the preparation, sanitation, or embalming of human remains for burial or transportation.

A licensed funeral establishment shall at all times employ a licensed funeral director to manage, direct, or control its business or profession. The business of a licensed funeral establishment shall be conducted in a fixed place or facility.

### Applicable Laws and Regulations

The Business and Professions (B&P) Code provides the authority for regulating Funeral Directors and Embalmers. Chapter 12 – Funeral Directors and Embalmers, includes the following Sections:

Article 1	Administration	7600-7612
Article 2	Funeral Directors	7615-7635
Article 3	Embalmers	7640-7650
Article 4	Apprentices	7660-7671
Article 5	Licenses	7680
Article 5.5	Funeral Practices	7685-7685.5
Article 6	Disciplinary Proceedings	7686-7711
Article 7	Penal Provisions	7715-7719
Article 8	Revenue	7725-7729
<b>Article 9</b>	<b>Preneed Funeral Arrangements</b>	<b>7735-7746</b>

In addition, California Code of Regulations (CCR), Title 16, Division 12, provides regulations for State Board of Funeral Directors and Embalmers, as follows:

Article 1	General Provisions	1200-1203
Article 1.5	Funeral Directors	1204-1205
Article 2	Funeral Establishments	1208-1213
Article 3	Embalming	1214-1224
Article 4	Apprentices	1225-1230

Article 5	Embalmer's License	1234-1239
Article 5.5	Citations, Fines and Order of Abatement	1240-1246
Article 6	Procedure before Board	1248-1253.6
Article 7	Miscellaneous	1254-1259
<b>Article 8</b>	<b>Reporting of Preneed</b>	<b>1261-1276</b>
Article 9	Continuing Education Requirements	1280-1291

Each licensed funeral establishment and licensed funeral director who enter into any preneed arrangements, contracts or plans shall file with the Board annually on or before May 1 of each year and upon transfer of license or cessation of business, a written, verified or audited report, on form 21P-4A prescribed and furnished by the Bureau, pertaining to funds received and held under such arrangements, contracts or plans.

Firms utilizing a fiscal year accounting system may request permission, in writing to the Bureau Chief to file said report on a fiscal year basis. If permission is granted said report shall then be filed with the Bureau no later than 120 days from the date of the close of said fiscal year.

### **Funeral License Assignment or Transfer – See B&P Code Section 7630**

The CPA audit report required shall accompany the forms of assignment or transfer of a funeral establishment license. The CPA audit report required upon cessation of business as a licensed funeral establishment shall be submitted thirty (30) days prior to such cessation of business. The audit report shall include an unqualified opinion on the accuracy of the trust fund balances and a separate report of compliance with the applicable Funeral laws. Any shortages in the trust funds shall be funded by the seller or assignor of the license.

### **Annual Reporting Requirement – See B&P Code Section 7737.3 and CCR Code Section 1261**

In cases where the trust corpus is deposited in individual savings accounts and not commingled for investment purposes, the Bureau requires a verified report, but no independent CPA audit report. This means that the individual savings accounts are listed and recorded in the customers' name and not the funeral establishment. The verification shall be deemed complied with by a verification under penalty of perjury by the owner, partners, or, in the case of a corporation, by the president or vice-president and one other officer.

In cases where trust funds have been **commingled** for purposes of investment, the Bureau requires in addition to the required verified report, an independent audit report prepared and signed by a Certified Public Accountant or Public Accountant currently licensed in the State of California, which certifies compliance with the provisions of Article 9, Chapter 12, Division 3 of the Business and Professions Code.

All written reports required under this section shall include, but are not limited to, a statement setting forth:

- (1) Amounts collected pursuant to preneed arrangements, contracts or plans, or any agreements collateral thereto;
- (2) Amounts deposited with the trustee and held in trust;
- (3) Amounts of authorized expenditures of income allocable to individual accounts, itemized as to the nature of expenditures;
- (4) Amount of authorized expenditures of income paid, itemized as to the nature of expenditure; and
- (5) Separately, the total amount of such trust funds invested in each of the investments authorized by law and the amount of cash on hand not invested which statement actually show the financial condition of the trust funds.

Two or more funeral establishments who utilize a common trust fund to hold and administer payments received under preneed contracts may cause the trustee of that common trust fund to file one combined annual report regarding all such preneed contracts, provided each funeral establishment's information is disclosed separately.

### **Declaration of Non-Reporting Status Form – See B&P Code Section 7746**

A preneed arrangement, contract or plan subject to the provisions of Business and Professions Code Division 3, Chapter 12, Article 9 does not include an arrangement when:

- (a) The funeral establishment's client directly deposits his or her own money in a bank or savings institution trust account in the name of the client as trustee for the funeral establishment, provided that, until death, the client retains the exclusive power to hold, manage, pledge, and invest the funds in the account and may revoke the tentative trust and withdraw the funds, in whole or in part, at any time; and

(b) There is no delivery whatsoever to the funeral establishment of money to pay for the services or merchandise, until such services or merchandise has been provided. Delivery of money to a funeral establishment within the meaning of this rule and Business and Professions Code Section 7735 includes direct or indirect delivery to the funeral establishment, or to any of the funeral establishment's agents or employees.

A funeral establishment that is otherwise exempt from the requirement of filing an annual preneed trust report or whose preneed trust funds are reported in a combined preneed annual preneed trust report, shall annually file a declaration of non-reporting status form with the bureau.

(a) The declaration shall be filed on or before May 1 of each year and shall also be filed upon the transfer of ownership or the cessation of business.

(b) The declaration shall be filed on a form provided by the bureau and shall include, but shall not be limited to, both of the following:

(1) The basis upon which the funeral establishment is exempt from the annual trust reporting requirement.

(2) The specific kind and nature of the exempt preneed arrangements, if any, in which the funeral establishment engages.

(c) The declaration shall be verified by the funeral establishment's owner, a partner, or in the case of a corporation, by the president or vice president.

### **Endowment Care Fund and Special Care Fund**

Every cemetery authority which now or hereafter maintains a cemetery will place its cemetery under endowment care and establish, maintain, and operate an endowment care fund in a "Trust". Endowment care and special care funds consisting of trust funds created by irrevocable trust agreements may be commingled for investment and the income shall be divided between the endowment care and special care funds in the proportion that each fund contributed to the principal sum invested.

Special care funds derived from trusts created by a revocable agreement shall not be commingled for investment and shall be accounted for separately from all other funds. The funds may be held in the name of the cemetery authority or its directors or in the name of the trustees appointed by the cemetery authority.

### **Distinction between Endowment Care and Special Care**

Endowment care fund monies must be placed in a trust account and charged on the sale of cemetery property and land, for the perpetual care and maintenance of the cemetery, including plots, graves, crypts, niches, tablets, headstones, markers, and the structures that may house these.

Special care fund monies must be placed in a trust account and is for the preneed and prepayment of services and merchandise relating to the cemetery operation. Services include, but not limited to the opening and closing of a casket, placing death notices in newspapers, cemetery counseling and consultation of the beneficiary, etc. Merchandise could be for flowers, caskets, urns, markers, headstones, death certificates, notices, or any other tangible object sold, but not delivered, in connection with a funeral and/or cemetery operation.

There is no provision in law that allows monies for endowment care and special care to be held outside of trust, such as in the general operating account of the cemetery. The Bureau enforces this requirement as making deposits within 30 calendar days of receipt.

### **Members of the Board of Trustees – Health & Safety Code Section §8731**

The cemetery authority may appoint a board of trustees of not less than three in number as trustees of its endowment care fund. The members of the board of trustees shall hold office subject to the direction of the cemetery authority.

Each individual trustee of an endowment care fund shall be a resident of this State, and a corporate trustee shall be qualified to do business in this State and not more than one member of the board of trustees of an endowment care fund may have a proprietary (ownership) interest in the cemetery authority.

In lieu of the appointment of a board of trustees of its endowment care fund, any cemetery authority may appoint as sole trustee of its endowment care fund any bank or trust company qualified under the provisions of the Banking Law, Division 1, (commencing with Section 99) of the Financial Code to engage in the trust business.

### **Compensation of the Board of Trustee Members – Health & Safety Code §8733**

No sum in excess of 5 percent of the net income (excluding unrealized capital gains) derived from an endowment care fund, or special care fund, or both, in any year can be paid as compensation to the board of trustees for its services as trustee. This amount shall be the total compensation from the fund to be paid to a trustee for services. For purposes of this section, "net income" means the amount of income remaining after reasonable administrative expenses, including bookkeeping, postage, taxes, and other costs directly related to generating income to the trust fund, have been deducted from the gross income derived from the fund. Unrealized capital gains and losses are ignored and not included in the definition and reporting of net income.

If a cemetery authority appoints a bank or trust company, the sum paid to the bank or trust company may exceed 5 percent of the net income.

### **Board Trustee Signed Acknowledgment – Health & Safety Code Section §8731**

Each member of the board of trustees shall provide signatory acknowledgment of understanding of the role of a trustee in managing trust funds in the following areas:

- (a) Trustee duties, powers, and liabilities as contained in Part 4 (commencing with Section 16000) of Division 9 of the Probate Code.
- (b) Reporting and regulatory requirements contained in Article 3 (commencing with Section 9650) of Chapter 19 of Division 3 of the Business and Professions Code.

(c) Provisions related to the care of active cemeteries contained in Chapter 5 (commencing with Section 8700) of Part 3 of Division 8.

The signatory acknowledgment shall be retained by the cemetery authority during the duration of the trustee's term of office.

### **Fidelity Bond Coverage – Health & Safety Code Section §8734**

The board of trustees or corporate trustee of an endowment care fund of one or more special care funds shall file a fidelity bond executed by an admitted surety insurer with the Cemetery and Funeral Bureau in the amount of fifty thousand dollars (\$50,000), guaranteeing payment to each such fund of any monetary loss incurred by the fund occasioned by acts of fraud or dishonesty by the trustees or trustee. The board of trustees or corporate trustee of both an endowment care fund and one or more special care funds need file only one such bond.

If moneys in the endowment care fund and special care funds administered by the board of trustees or corporate trustee are substantially less than fifty thousand dollars (\$50,000), the Cemetery and Funeral Bureau upon application may reduce the amount of the bond required.

Any state or national bank authorized to engage in the trust business pursuant to Division 1 (commencing with Section 99) of the Financial Code shall be exempt from the requirements of this section.

### **Endowment Contributions – Health & Safety Code Section §8738**

Endowment contributions or deposits from grave, plot, crypt or niche sales have minimum rates required by law.

Endowment contributions shall be deposited immediately into the endowment care fund, and no later than 30 calendar days. The minimum required rates are listed below:

- a) \$2.25 a square foot per each grave
- b) \$35 for each niche
- c) \$110 for each crypt or first crypt, and \$55 for each additional crypt from the same sale

### **Special Care Contributions – Health & Safety Code Section §8775**

A cemetery authority which has established an endowment care fund may also take and hold any property bequeathed, granted, or given to a special care trust. The principal, or proceeds, or income of the special care trust may be applied to either or all of the following purposes:

- (a) Improvement or embellishment of all or any part of the cemetery or any lot in it.
- (b) Erection, renewal, repair, or preservation of any monument, fence, building, or other structure in the cemetery.
- (c) Planting or cultivation of trees, shrubs, or plants in or around any part of the cemetery.
- (d) Special care or ornamenting of any part of any plot, section, or building in the cemetery.
- (e) Any purpose or use not inconsistent with the purpose for which the cemetery was established or is maintained.

The above law allows cemetery licensees to sell “preneed” cemetery services and/or merchandise and have the customer prepay for it, bequeath it, or grant it, as opposed to selling “at-need” contracts only. If there is an amount prepaid, bequeathed or granted for preneed cemetery services and/or merchandise then it **must** be 100% trusted. The above law does not make it “optional” to trust money for special care, representing preneed cemetery services and/or merchandise.

All money or property received by a cemetery authority for deposit in a special care fund shall be placed in the custody of the trustee or trustees within 30 days after receipt by the cemetery authority. The corpus of special care trusts shall be invested and reinvested and kept invested as authorized by Health and Safety Code Section 8777.

### **Separation of the Trust Funds**

In accordance with Business and Professions Code Section 8738.2, the endowment care fund shall be kept separate and apart from all other cemetery funds, including the special care fund. Separate records, books, accounts and financial reports shall be kept of the endowment care fund. The amount to be deposited in the endowment care fund shall be separately shown on the original purchase agreement (customer) or sales agreement (seller) and a copy delivered to the purchaser (customer). In the sale of cemetery property, no commission shall be paid to a broker or salesperson on the amount deposited by the purchaser in the fund.



## Accumulated Capital Gains Realized

Current net realized capital gains not set aside in the reserve for future maintenance is a part of the principal of the endowment care fund and shall be added to the accumulated capital gains. Net capital gain means the amount by which cumulative capital gains exceed the sum of cumulative capital losses.

If the trust incurs a net realized capital loss, the loss shall be applied first to the reserve for losses. Excess losses not absorb by the reserve for losses may be applied to the balance of the accumulated realized capital gains, provided the balance of the accumulated capital gains would not be less than zero. In no instance should the accumulated realized capital gains have a negative balance. A negative balance in accumulated capital gains realized is an expenditure of the corpus of the trust and is a violation of the Cemetery Law.

## Reserve for Future Maintenance

Health and Safety Code Section 8726.1 allows the trustee to set aside out of income or 50 percent of current net capital gains from investment in the reserve for future maintenance. The total amount of the reserve for maintenance shall not at any time exceed 10 percent of the endowment care fund. Any capital gains not set aside in reserve shall be a part of the principal of the endowment care fund.

The reserve for future maintenance is set aside for future repair or restoration, or embellishments in the cemetery which are necessary as a result of wear, deterioration, accident, damage or destruction.

Example:

Current year realized capital gains	\$1,500
Current year realized capital losses	<u>\$ 500</u>

Net capital gains	\$1,000
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\$500 can be set aside in the reserve for future maintenance  
\$500 shall be added to the principal of the endowment care fund

Endowment Care Fund Balance		\$100,000
Multiplied by 10%		<u>X 10%</u>
Statutory limit on reserve for future maintenance		\$10,000
	(a)	(b)
Beginning balance – reserve for future maintenance	\$8,500	\$ 9,700
50% of net capital gains set aside	<u>\$ 500</u>	<u>\$ 500</u>
Ending balance – reserve for future maintenance	\$9,000	\$10,200

In sample (a), the \$9,000 ending balance in the reserve for future maintenance is within the statutory limit of \$10,000. However, in sample (b), the \$10,200 ending balance in the reserve for future maintenance exceeds the statutory limit of \$10,000. In such case, sample (b) can only set aside \$300 of the net capital gains to the reserve for future maintenance and \$700 of the net capital gains shall be added to the principal of the endowment care fund.

**Reserve for Losses**

Health and Safety Code Section 8726.1, allows for the trustee of the endowment care fund to create a reserve by setting aside a reasonable percentage of the income from the fund. The reserve for losses is set aside to replace realized capital losses incurred from the investment of the trust fund. This reserve is optional and not required.

**Investments Allowed**

Endowment care funds and special care funds created by irrevocable trust agreements may be commingled for investment purposes. Special care funds derived from trusts created by a revocable agreement shall not be commingled for investment and shall be accounted for separately from all other funds. The principal of the endowment care fund shall not be used for any purpose and shall be invested in perpetuity.

Eligible investments of the endowment care trusts:

- (a) Bonds of the United States or this state, or of any county, city and county, or city in this state.
- (b) Bonds legal for investment for savings banks in this state.
- (c) First mortgages or first trust deeds on improved real estate.
- (d) Income producing improved real estate in any city or city and county in this state.

- (e) Investment certificates in any savings and loan association organized, existing and doing business under the laws of this state.
- (f) Investments of the type enumerated for domestic incorporated insurers in Article 3, Chapter 2, Part 2, of Division 1 of the Insurance Code of this state.
- (g) By deposit in a bank which is insured by the Federal Deposit Insurance Corporation.
- (h) Shares of a duly chartered and insured federal savings and loan association.

In addition, the funds may be invested and reinvested and kept invested in investments of the type and in the manner as provided in Part 4 (commencing with Section 16000) of Division 9 of the Probate Code.

Essentially under Probate Code Sections §15001 et.seq, types of investments allowable are ones where trustees have made a sound financial prudent decision, while considering investment risk and general economic conditions, and not to use or deal with trust property for the trustee's own profit. Additionally, the trustee should not take part in any transaction having an adverse interest to the beneficiary.

The Bureau strictly prohibits investments that have the appearance of a conflict of interest, lack of independence, and/or lack of an unrelated party relationship between the cemetery establishment owners, partners, stockholders, shareholders, officers, employees, or trustees, and with the people related to marketing, selling or owning the investment.

Therefore, under the above Probate Code sections, an investment in equity investments, such as, stocks and stock mutual funds, and investments in improved real estate generating rental income is allowable.

Eligible investments for all special care trusts are:

- (1) Bonds of the United States or this state, or of any county, city or city and county in this state.
- (2) Bonds which are legal investments for commercial banks in this state.
- (3) Certificates of deposit or other interest-bearing accounts in any bank in this state insured by the Federal Deposit Insurance Corporation.
- (4) Investment certificates or shares in any state or federally chartered savings and loan association insured by the Federal Savings and Loan Insurance Corporation.
- (5) Investments in first trust deeds on improved real estate, provided such loans require monthly amortization of principal and interest and are fully

amortized within 30 years or the term of the loan, whichever comes first. No loan shall be made to the cemetery authority; director, officer, or stockholder of a cemetery authority, or trustees of the special care funds; or partners, relatives, agents, or employees thereof.

With respect only to special care trusts created by irrevocable agreement, any investment which is lawful for endowment care funds shall also be a lawful investment for such special care trusts.

### **Unrealized Capital Gains and Losses**

Investments in debt and equity securities classified as trading and available-for-sale are required to be carried at fair value in the statement of financial position per FASB 115. Unrealized gains and losses represent the net change in fair value of a security.

For reporting purposes with the Bureau, the Bureau requires that the Annual report shall be prepared under the cost basis method. The difference between cost basis and fair market value basis of investments shall be reported on the Schedule of Reconciliation of the Annual Report as a reconciling item.

As a result, unrealized capital gains and losses are also not recognized and not presented on the Statement of Activities or Statement of Income.

### **Trust Fund Income**

Health and Safety Code 8726 allows the income of the endowment care fund to be used for the care, maintenance, and embellishments of the cemetery in accordance with the provisions of the law and for no other purpose. Any excess of income over the allowable expenses shall remain a part of the endowment care fund and cannot be distributed to the cemetery authority. The excess income should be reported as unexpended income in the Annual Report.

The cemetery authority and/or trustees shall maintain a record of the specific expenditures upon which the income from the endowment care funds has been expended.

### **Preneed Funeral Trust Fund**

A preneed arrangement is a written instruction regarding goods or services or both, for the final disposition of human remains when the goods or services are not provided until the time of death, and may be either unfunded or paid for in advance of need.

Any such prepayment of moneys is to be placed into a trust account and separate from the funeral establishment's general operating account. However, the funeral establishment's preneed sales consisting entirely of life insurance contracts are exempt from the annual trust reporting requirements.

### **Members of the Board of Trustees – B&P Code Section §7736**

The term "trustee" shall mean any banking institution or trust company legally authorized and empowered by the State of California to act as trustee in the handling of trust funds or not less than three persons, one of whom may be an employee of the funeral establishment.

### **Other Important Terms – B&P Code Section §7736**

The word "trustor" shall mean any person who pays the money or deposits the securities used for those preneed arrangements. The term "beneficiary" shall be the person for whom the funeral services are arranged. The words "corpus of the trust" shall include all moneys paid and securities delivered by the trustor and will commonly be referred as the principal of the trust.

### **Trust Agreements**

There are many types of preneed funeral agreements/contracts with customers. The moneys for some of these preneed funeral agreements will be required to be placed into a trust account. Other types of preneed funeral agreements are exempt from the trust requirements. Types of preneed funeral agreements **exempt** from the trust requirements are listed below:

1. The consumer deposits money directly into a savings account and the consumer is the trustee of the money held in the savings account. The funeral establishment does not receive any money directly or indirectly from the consumer for deposit into the savings account.

2. The consumer purchases an insurance policy for preneed funeral services and/or merchandise. The payments are made directly by the consumer to the insurance company. The funeral establishment does not receive any money directly or indirectly from the consumer for payments on the insurance policies.

Types of preneed funeral agreements that require trust requirements are listed below:

1. The consumer purchases a preneed funeral agreement directly with the funeral establishment and the funeral establishment directly receives the money.
2. The consumer purchase is made through a trust company with deposits made by the consumer directly to the trust company. The funeral establishment does not directly or indirectly receive any money from the consumer for deposit with the trust company.

Examples of trust companies with this arrangement are California Master Trust (CMT), Forethought Trust, and American Funeral and Cemetery Trust Services (AFCTS).

3. The preneed funeral trust is administered under a common trust fund containing two or more funeral establishments, pursuant to California Code of Regulations Section 1269(f). Accordingly, the trustee of the common trust fund files one combined report, which discloses each funeral establishment's information separately.

This situation occurs when the consumer purchases a preneed funeral agreement directly with the funeral establishment and the funeral establishment directly receives the money. The owner or company owns two or more separate funeral establishments, each having separate funeral establishment licensees (FD#'s) with the Bureau. The preneed moneys are commingled in one pool for investment purposes among all of the commonly owned funeral establishments. The trustee of the common trust may file one combined report. The combined report must disclose each funeral establishment's preneed funeral trust summary separate.

### **Annual Bureau Reports to be Filed – B&P Code Sections §7737.3 and §7746**

Annual Reports to be submitted to the Bureau from funeral establishment licensees are either:

- Preneed Funeral Trust Report (11 pages or long form) for funeral establishments who receive preneed funeral agreement money from the customer directly. The money is held in trust and controlled, recorded and reported by the funeral establishment. There are individual members of the funeral establishment that are declared “trustees” (administrators) of the preneed funeral trust fund.
- Preneed Funeral Trust Fund Declaration of Non-Reporting Status (1 page) for funeral establishments who are exempt from filing an annual preneed trust report or whose preneed trust funds are reported in a combined preneed trust report.

One of the above forms must be filed annually to the Bureau.

In cases where trust funds have been commingled for investment purposes, the Bureau requires in addition to the written reports mentioned above, an independent audit report prepared and signed by a Certified Public Accountant or Public Accountant, currently licensed in the State of California who certifies that the funeral establishment is in compliance with the California Funeral laws and regulations.

### **Investments Allowed – California Code of Regulations Section §1263**

The trust funds shall be invested and reinvested, and kept invested in:

- 1) Bonds of, or securities guaranteed by the United States or an Agency thereof or the State of California, or of any County, City, or City and County in California.
- 2) Bonds that are legal investments for commercial banks in this State (see Financial Code).
- 3) Certificates of deposit or other interest-bearing accounts in any bank in California insured by the Federal Deposit Insurance Corporation.
- 4) Investment certificates or shares in any state or federally chartered savings institution insured by the Federal Savings and Loan Insurance Corporation.

- 5) Investments of the type and in the manner as provided in Section §15001 et.seq. of the Probate Code.
- 6) No loan shall be made to any licensed funeral establishment; or to any owner, director, officer, partner or stockholder of any licensed funeral establishment; or to trustees of the trust funds; or to partners, relatives, agents, or employees of any licensed funeral establishment or of such trustees.

Under Probate Code Sections §15001 et.seq., types of investments allowable are ones where trustees have made a sound financial prudent decision, while considering investment risk and general economic conditions, and not to use or deal with trust property for the trustee's own profit. Additionally, the trustee should not take part in any transaction having an adverse interest to the beneficiary.

The Bureau strictly prohibits investments that have the appearance of a conflict of interest, lack of independence, and/or lack of an unrelated party relationship between the funeral establishment owners, partners, stockholders, shareholders, officers, employees, or trustees, and with the people related to marketing, selling or owning the investment.

Therefore, under the above Probate Code sections, an investment in equity investments, such as, stocks and stock mutual funds, and investments in improved real estate generating rental income is allowable.

### **Use of Trust Income – B&P Code Section §7735**

The income from the trust may be used to pay for a reasonable annual fee for administering the trust, including a trustee fee to be determined by the Bureau, and to establish a reserve of not to exceed ten percent (10%) of the corpus (principal) of the trust as a revocation fee in the event of cancellation on the part of the beneficiary. The annual fee for trust administration may be recovered by withdrawals from accumulated trust income, provided that total withdrawals for this purpose shall not exceed the amount determined by the Bureau.

Currently, the Bureau allows a maximum annual administration fee of 4% or current year earned trust income, whichever is **lower** for the fiscal year. For instructions on how to calculate the 4% maximum annual administration fee, see page 10 of 11, Line 9 – “Annual Administration Fees,” instructions on the Preneed Funeral Trust Fund Report.

Income earned from the trust does **not** include unrealized capital gains and losses. Only realized capital gains and losses are included in the calculation of current year earned trust income and the annual administration fee.



In no case shall the total amount withdrawn in a year for trust administration exceed the total amount of posted trust income for the immediate 12 preceding months. In addition to annual administration fees and reserves authorized, a trustee may pay taxes on the earnings on any trust. In no event, however, shall taxes paid on the earnings of any trust be considered part of the fees or reserves authorized by B&P Code Section §7735. All remaining income shall be accumulated in trust.

None of the corpus (principal) of the trust shall be used for payment of any commission nor shall any of the corpus of the trust be used for other expenses of trust administration, or for the payment of taxes on the earnings of the trust.

## **Audit Procedures**

The standardized procedures provided in this chapter can be used by individuals and public accounting firms in developing an audit program. The procedures presented should not be used in lieu of an audit program, but as a tool to assist auditors in conducting cemetery and funeral audit engagements. The primary focus of these procedures is mainly on internal control and substantive testing.

### **Cemetery Audit - Endowment Care Fund (ECF) and Special Care Fund (SCF)**

Review and document the issues noted in the ECF and SCF Reports (Annual Reports) with the accompanying audited financial statements filed by the cemetery authority (B&P Code Section §9650). Follow up on any deficiencies from the prior year's report.

#### Internal Control Structure

- A. Review and evaluate the cemetery authority's internal control structure.
  1. Develop an internal control questionnaire to obtain an understanding of the internal control structure over the ECF and/or SCF.
  2. Obtain and review a current organizational chart, chart of accounts, relevant flowcharts, and documented policies and procedures.
    - a) Determine if the cemetery authority has adapted rules and regulations for the use, care, control, management, restriction, and protection of all or any part of the cemetery.
  3. Interview appropriate staff to obtain an understanding of relevant policies and procedures pertaining to the cemetery authority's ability to record, process, summarize and report ECF and SCF financial information and to ensure compliance with applicable laws and regulations.
- B. Determine if the ECF and/or SCF are maintained separate and distinct from all other cemetery funds.
  1. Review the general ledger, working trial balance, and adjusting journal entries.
  2. Review and follow-up on any discrepancy noted in the preliminary analysis relating to the record keeping of the trust funds.
- C. Determine if the cemetery authority has established a board of trustees (not less than three members) or has appointed a qualified bank or trust company (H&S Code Sections §8732 & §8733.5)

1. If the cemetery has a board of trustees, determine:
  - a) That not more than one of the members have a propriety interest in the cemetery authority (H&S Code Section §8732)
    - All board members have a signed acknowledgment form for responsibilities as trustees on file (H&S Code Section 8731)
  - b) If the trustee is a bank or trust company:
    - i) Obtain the bank charter and review it to determine if the bank is authorized to engage in trust business in California (H&S Code Section §8733.5) or is a federally chartered national bank.
- D. Determine if the trustees of the endowment care fund has obtained a fidelity bond in the amount of \$50,000 guaranteeing payment to each such fund of any monetary loss incurred by the fund by acts of fraud or dishonesty by the trustee or trustees). (H&S Code Section §8734)
  - a) Review the fidelity bond insurance documents to determine:
    - That the policy is current.
    - That the annual premium was paid.
    - The minimum amount of coverage is in compliance with the applicable regulations.
    - If the policy is blanket dishonesty insurance, determine if the coverage includes the trustees of the funds.
- E. Prepare a written narrative or flowchart, describing the internal control structure over the ECF and/or SCF. Consider the five components of internal control: control environment, control activities, risk assessment, information and communication, and monitoring.
- F. Perform a risk analysis and identify the audit procedures for fieldwork.

### Substantive Testing

- A. Cemetery Contracts:
  1. Obtain the outstanding contracts used by the cemetery authority for the sale of interment plots, or any service or merchandise.
    - a) Select a representative sample and determine if the contracts include the following attributes as required by H&S Code Section §8277:
      - i) Total contract price
      - ii) Terms of payment, including any promissory notes or other evidence of indebtedness

- iii) Any itemized statement of charges including, as applicable, the following:
    - Charges for an interment plot
    - Charges for performing burial, entombment, or inurnment
    - Charges for a monument or marker
    - Charges for any services to be rendered in connection with any religious or other observance at the site of interment or in any facility maintained by the cemetery
    - Amounts to be deposited in any endowment care or SCF
    - Charges for any insurance to be provided in connection with the contract
    - Any other charges which shall be particularized.
  - b) Document the specific contracts selected and summarize the results of the testing in the working papers.
  - c) Determine if additional sample testing is needed.
2. Determine if any contract revocation occurred within 5 calendar days after purchaser signed the agreement.
- Document any instances where a revocation fee was charged (H&S Code Section §8278)
- B. Deposits (Contributions) to the ECF/SCF:
1. Endowment Care Fund:
    - a) Verify ECF deposits reported on the Annual Reports to source documents.
      - i) Trace to general ledger details, bank statements, and other pertinent source documents.
      - ii) Obtain a listing of interment space sold and the contribution rates for sale.
      - iii) Select a sample of interment space sold and test transactions to determine if:
        - Amounts to be deposited were adequately disclosed in the cemetery contract pursuant to H&S Code Section §8277.
        - ECF contributions are properly collected and trusted in accordance with H&S Code Section §8738,
          - minimum required rates deposited
          - deposits made at the time of or not later than the completion of the initial sale, within 30 days.

- b) Determine if the number of burials, entombments, or inurnments reported on the Quarterly Reports were reasonable. ( B&P Code Section §9765 and CCR Section §2310)
  - i) Obtain and review quarterly reports relevant to audit period(s).
  - ii) Confirmed reported number burials, entombments, or inurnments to the cemetery authority's records.
  - iii) Document any variances noted.

### 2. Special Care Fund:

- a) Determine if the cemetery authority is collecting fees for preneed services (future burial) for which service has not been provided.
  - i) If so, this amount represents the corpus of the money collected and should be maintained in the SCF.
  - ii) Inquire about preneed service fees collected
- b) Review preneed service contracts.
- c) Verify that SCF contributions collected were in the custody of the trustee(s) within 30 days after the receipt by the cemetery authority, and properly recorded.

### c. Trust Revenues

- 1. Review and verify the total amount of ECF trust income from investment during the audit period.
  - a) Trace income to supporting documents such as bank statements, year end investment summary statements, etc.
  - b) Identify total ECF income available for expenditures.
- 2. Review and determine the total amount of SCF trust income from investments during the audit period.
  - a) Trace income to supporting document such as bank statements, year end investment summary statements, etc.
  - b) Determine if the SCF income is accounted for in accordance with the SCF trust agreement.
- 3. Determine if the principal of the ECF and SCF have been commingled for investment purposes. If so:
  - a) Determine if the income from commingled investment have been dividend between the ECF and SCF in proportion to the principal sum invested for each respective trust fund.

### D. Reserve for Principal Losses:

1. Determine if the trustee has created a reserve from which principal losses can be replaced by setting aside a reasonable percentage of the income from the fund.
  - i) Verify that charges to the reserve for losses are for realized losses from ECF investments, not from unrealized losses.
  - ii) Verify that capital losses charged to the reserve are used to arrive at net capital gains.
  - iii) Verify that additions to the Reserve for Losses were not from capital gains, but only from income.

### E. Reserve for Future Maintenance:

1. Determine if the trustee has set up a reserve for future maintenance by setting aside income or net capital gains from investments. (H&S Code Section §8726.1)
  - a) Determine if the reserve for future maintenance is less than 10% of the endowment care fund.
  - b) Determine if the additions to the reserve for future maintenance in any given year do not exceed one-half the difference between the capital gains and capital losses in the respective year.
  - c) Determine if the expenditures charged to the reserve for future maintenance are allowable charges.

### F. ECF/SCF Expenses:

1. Determine the allowability of ECF expenses/distributions. The principal of the ECF shall be invested and only income can be used for care, maintenance and embellishment of the cemetery (H&S Code Section §8726), or for expenses directly related to generating income of the trust (H&S Code Section §8733):
  - a) Review general ledger details and test transactions.
    - i) Trace to source documents such as vendor invoices, timesheets, canceled checks, etc.
  - b) Document questionable/unallowable expenses charged to the ECF.
  - c) Determine if the total ECF expenses exceed total available ECF income.
  - d) Document any expenses in excess of income. This amount represents expenditure of principal. (H&S Code Sections §8726, 8750, 8751 requires that principal be kept invested and only income can be used for cemetery care and maintenance).

2. Determine the allowability of SCF disbursements during the periods.
    - a) Disbursements made from the SCF should be in accordance with the SCF trust agreement and H&S Code Sections §8775.
  3. Determine if a director or officer of the cemetery authority has directly or indirectly borrowed any funds of the corporation or association. (H&S Code Sections §8360 and §8778).
    - a) Review annual audit reports to determine if there were any accounts receivable that are due from any officer of the corporation or association.
    - b) Review the cemetery authority's general ledger to determine the presence of any loan made to any officers of the association.
    - c) Inquire with the cemetery authority about any account receivable of the cemetery from any officers.
  4. Determine if the amount paid in any year as compensation to the board of trustees for its services as trustee do not exceed 5 percent of the income derived from the endowment fund (trustee fee limitation does not apply to a bank or trust company). (H&S Code Sections §8733)
    - i) Review the general ledger for payments to the Board of trustee for services as trustee.
    - ii) Inquire with the cemetery authority regarding compensation of trustees for the ECF and SCF.
- G. ECF/SCF Investments:
1. Determine if all ECF and SCF trust investments are kept separate from all other property that is not subject to the trust, and determine if all trust property is designated as property of the respective trust funds (Probate Code Section §16009).
  2. Determine if the SCF principal commingled for investment is only from irrevocable agreements. (Revocable agreements shall not be commingled) (H&S Code Section §8725).
  3. Determine if the principal of the ECF (and commingled irrevocable SCF fund) has been invested, reinvested, and kept invested. (H&S Code Section §8726)
  4. If the cemetery authority has created a special care trust fund which is not irrevocable, determine if the special care trust funds are deposited into one of the following investments:

- Bonds of the United States or this state, or of any county, city or city and county in this state.
  - Bonds which are legal investments for commercial banks in this state.
  - Certificates of deposit or other interest-bearing accounts in any bank in this state insured by the Federal Deposit Insurance Corporation.
  - Investment certificates or shares in any state or federally chartered savings and loan association insured by the Federal Savings and Loan Insurance Corporation.
  - Investments in first trust deeds on improved real estate, provided such loans require monthly amortization of principal and interest and are fully amortized within 30 years or the term of the loan, whichever comes first.
  - No loan shall be made to the cemetery authority; director, officer, or stockholder of a cemetery authority, or trustees of the special care funds; or partners, relatives, agents, or employees thereof.
5. Determine if any net capital gains from the ECF investments not set aside in reserve have become a part of the corpus of the ECF.

Details of the reporting section of the Cemetery and Funeral audit is discussed in Chapter 8 of this audit guide.



## **Funeral Audit - Preneed Funeral Trust Fund**

Review the Annual Preneed Report and CPA Audit Report from the prior year. Determine areas of concern and noncompliance. Follow up on any deficiencies from the prior year's report.

### Internal Control Structure

- A. Review and evaluate the funeral establishment's internal control structure.
  - 1. Obtain and review a current organizational chart, chart of accounts, relevant flowcharts, and documented policies and procedures.
    - a) Determine if the funeral establishment has adapted rules and regulations in compliance with all the provisions of the Funeral Laws.
    - b) Review the trust agreement for compliance with CCR §1275.
  - 2. Interview appropriate staff to obtain an understanding of relevant policies and procedures pertaining to the funeral establishment's ability to record, process, summarize and report the Preneed trust financial information and to ensure compliance with applicable laws and regulations.
  
- B. Determine if the Preneed trusts are maintained separate and not commingled with the special endowment care fund (B&P Code §7738)
  - 1. Review the general ledger, working trial balance, and adjusting journal entries.
  - 2. Review and follow-up on any discrepancy noted in the preliminary analysis relating to the record keeping of the trust funds.
  
- C. Determine if the funeral establishment has established a board of trustees (not less than three members) or has appointed a qualified bank or trust company (B&P Code Section §7736)
  - 1. Regarding the board of trustees, determine:
    - a) That not more than one board of trustees is an employee of the funeral establishment
    - b) If trustee is a bank or trust company:

Obtain the bank charter and review it to determine if the bank is authorized to engage in trust business in California.

- D. Prepare a written narrative or flowcharts, describing the internal control structure over the Preneed trust. Consider the five components of internal control: control environment, control activities, risk assessment, information and communication, and monitoring.

- E. Perform a risk analysis and identify the audit procedures for fieldwork.

### Substantive Testing

#### A. Preneed Trust Account:

1. Verify that the licensee has maintained records as required by CCR §1267.
2. Verify that administrative fees are not in excess of the law (CCR §1265). Administrative fees cannot exceed 4% of total ending balance of corpus plus all prior years' accumulated income. Also, administrative fees are limited to current year earned income. Any remaining income (current year) cannot be used for administrative fees in future periods.
3. Review the portfolio of investments to verify that investments are in compliance with CCR §1263.
4. Test the following from the cash receipts journals/records:
  - a. Trust moneys placed in trust within 30 days of receipt (B&P Code Section §7737)
  - b. Verify that monthly postings from the general ledger to the cash journal are performed (CCR §1267)
  - c. Verify that income is allocated properly. Trace a sample of cash receipts to individual trustor ledger cards.
  - d. Review the deposit entries in the cash receipts journal, general ledger & bank statements to verify if preneed trust funds are not commingled with any other firm, person or corporation, except for the purpose of investment (CCR §1268)
5. Test the following from the cash disbursement journal/records:
  - a. Determine if none of the trust corpus was used for payments for any commissions or other expenses of trust administration other than the allowable annual fee (B&P Code Section §7735)
  - b. Determine if loans were made from funds to the funeral director or trustees or to any employees, stockholders, partners, relatives, etc. of the funeral establishment (CCR §1263)
  - c. Verify that monthly postings from the general ledger to the cash disbursements journal are performed (CCR §1267)
  - d. Verify that signatures of a majority of trustees before payment of trust corpus to the funeral director upon evidence of the death of the beneficiary and furnishing of agreed-upon services (B&P Code §7737)

- e. If checking account is used for the trust, verify that the account is reconciled on a monthly basis. Review monthly reconciliation.

### B. Test of Serviced Accounts:

1. Verify if the required service records are maintained (CCR §1267).  
Serviced records include, but not limited to:
  - a. Death certificate, final (itemized) arrangements, and copy of final statements to family
  - b. All monies received from trust; all monies received from family; and all monies received from Veterans Affairs or Social Security
  - c. A record showing credit for each of the above
  - d. A copy of the completed Disclosure of Preneed Funeral Agreement form (B&P Code Sections §7685.6 & §7745)
2. For guaranteed plans, verify that the plans were fully paid and any billings for at-need were not overcharges. For exceptions, obtain an explanation.
3. Compare trust agreements for evidence of services received to determine if goods and services received were proper. If listed on statement, verify that the merchandise agrees with the preneed agreement.

### C. Test of Cancelled Accounts:

1. Verify if the required cancelled records are maintained (CCR §1267).  
Cancelled records include, but not limited to:
  - a. A record of income and expenses, including revocation fee
  - b. A copy of final accounting to the family along with proof of payment.
2. Verify that all written requests for revocation were honored within 15 days of receipt (CCR §1264).
3. For accounts cancelled by the trustor, verify that a revocation fee does not exceed 10% of paid-in corpus and is chargeable against earned income only (B&P Code Sections §7735 & 7737).
4. For accounts cancelled by the funeral establishment due to inability to perform, verify that all trust corpus and net income is refunded back to the trustor or beneficiary without a revocation fee (CCR §1274).

5. If a refund was given to the family, verify that the trust was not irrevocable (may be in violation of Welfare and Institutions Code, refer to B&P Code Section §7737). If so, obtain explanation from management.

Details of the reporting section of the Cemetery and Funeral audit is discussed in Chapter 8 of this audit guide.

## Reporting

### A. BASIS OF ACCOUNTING ALLOWED TO BE PRESENTED

Basis of accounting methods allowable for cemetery licensees are:

- 1) Comprehensive Basis of Accounting other than Generally Accepted Accounting Principles
  - a) Cash basis or modified cash basis
  - b) Modified accrual basis
  - c) Income tax basis
  - d) Regulatory basis
- 2) Generally Accepted Accounting Principles (GAAP)

For funeral licensees, generally accepted accounting principles must be followed by the funeral licensee and presented in an audit report.

### B. AUDIT OPINIONS ALLOWED TO BE ISSUED

- 1) Unqualified opinion
- 2) Qualified opinion, “except for” due to using a comprehensive basis of accounting other than GAAP, under the four above examples, a) – d).
- 3) For the transfer or change in ownership of a cemetery or funeral establishment during a fiscal year, a CPA may have to qualify an audit opinion for a period of time under the previous ownership, and issue an unqualified opinion for the period under the new ownership if there was a change in cemetery’s CPA due to the change in ownership.

### C. FINANCIAL STATEMENTS

Financial statements in the CPA’s audit report can be presented on the following basis:

- 1) On a for-profit basis under GAAP for a for-profit establishment
- 2) On a for-profit basis under a comprehensive basis of accounting other than GAAP

- 3) On a not-for-profit basis under FASB 117 – Financial Statements of Not-for-Profit Organizations for an establishment that is not-for-profit under Internal Revenue Service definition
- 4) On a specialized industry or regulatory compliance basis

The Bureau's Endowment Care Fund and Special Care Fund Report for cemetery licensees is commonly referred to as the "Annual Report."

The Bureau's Preneed Funeral Trust Report for funeral licensees is also commonly referred to as the "Annual Report."

The CPA's audit report is a different document and is referred as "CPA Audit Report."

### **D. STATEMENT OF ASSETS, LIABILITIES AND TRUST CORPUS (BALANCE SHEET OR STATEMENT OF FINANCIAL POSITION)**

A majority of the endowment care funds held by cemetery licensees prepare their financial statements on a comprehensive basis of accounting other than GAAP. Accordingly, the Statement of Assets, Liabilities and Trust Corpus is titled and presented for the balance sheet.

If reporting under Financial Accounting Standards Board (FASB) #117 as a not-for-profit cemetery, a Statement of Financial Position should be prepared and only reflect the endowment care fund and special care fund, if applicable, and not the general operating account of the cemetery. You may wish to have two separate financial statements and two separate audit reports, one for the endowment care fund, and another for the special care fund. You may also present both funds in different columns in the same audit report.

Unrealized gains and losses are not recognized under California Cemetery and Funeral Law in presenting the valuation of investments and other assets. Under GAAP and in the "audit report", investments will be presented at fair market value. However, in the Bureau's "Annual Report" investments will be based at cost, not fair market value and a reconciling difference between cost and fair market value will be calculated.

Under the Bureau's regulatory basis of accounting, the corpus or principle of the trust cannot be violated. This means that if a cemetery licensee has deposited \$1,000,000 in endowment care fund contributions throughout its licensing existence and currently has an endowment care fund balance of

only \$900,000 due to current-year realized capital losses, it has violated the corpus of the trust. Therefore, prudent investing of trust fund assets is necessary.

### **E. STATEMENT OF REVENUE COLLECTED AND EXPENSES PAID (INCOME STATEMENT OR STATEMENT OF ACTIVITIES) AND CHANGES IN TRUST CORPUS**

As stated above in **D. Statement of Assets, Liabilities and Trust Corpus**, unless reporting under GAAP or under FASB 117 as a not-for-profit cemetery, the Statement of Revenue Collected and Expenses Paid (Income Statement under GAAP or Statement of Activities, under FASB 117) should only reflect the endowment care fund and special care fund, if there is one, and not the general operating account of the cemetery. You may wish to have two separate financial statements and two separate audit reports, one for the endowment care fund, and another for the special care fund. You may also present both funds in different columns in the same audit report.

Repeated again from above, unrealized gains and losses are not recognized under California Cemetery and Funeral Law in presenting the valuation of investments and other assets. See **D. Statement of Assets and Trust Corpus** above for the treatment of net capital gains and losses realized.

#### **Revenue Collected**

Unless presented in accordance with FASB 117, revenue presented on the Statement of Revenues Collected and Expenses Paid should reflect only revenue earned and realized from the investments in the endowment care fund and special care fund. That revenue generally consists of interest income, dividend income, net capital realized gains, and rental income.

Unrealized capital gains and losses are not recognized and presented for regulatory purposes. However, for GAAP purposes you may include unrealized capital gains and losses in your presentation, but **do not** use or apply those gains and losses towards expenses or as a withdrawal from the trust corpus.

Based on Health and Safety (H & S) Code Section §8726.1, allowable uses of revenue are illustrated below.

“Income” as interpreted by the Bureau under H & S Code Section §8726.1 is interest income, dividend income and rental income.

Additions to the Reserve for Losses can only be made when there is sufficient and available income.

“Net capital gains” as interpreted by the Bureau is the difference between realized capital gains and realized capital losses for the reporting year.

Do not include “contributions” or “deposits” to the endowment care fund and special care fund as revenue or income. This should be treated as additions to the Changes in Trust Balance section.

### **Expenses Paid**

Expenses recognized and presented on the Statement of Revenue Collected and Expenses Paid should be only for administrative costs to manage the endowment care and special care funds and for the care and maintenance of the cemetery (allowable expenses). It should not include administrative expenses for the general operation of the cemetery.

Generally, administrative costs that are allowed to be deducted from both the Endowment Care Fund and Special Care Fund include the following:

- Accounting and auditing fees
- Trustee fees
- Investment advisor fees
- Banking fees
- Legal fees

Cemetery care and maintenance expenses are allowed to be deducted from interest, dividend, and rental income only. The amount of net capital gains realized cannot be used and deducted for the care and maintenance of the cemetery, and only up to 50% may be applied to the Reserve for Future Maintenance.

In most instances, the amount of care and maintenance expenses for the cemetery will significantly exceed the amount of available income. Therefore, you can only deduct and expense an amount for the cemetery’s care and maintenance up to the amount available from income. This may be a plug figure.

**However, you may not expense an amount for care and maintenance of the cemetery that exceeds the actual amount.** This would apply to the largest cemetery establishments with very large endowment care funds.

On the following page is a typical example of a Statement of Revenues Collected and Expenses Paid and Changes in Trust Corpus.



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**JOHN AND JANE DOE CEMETERY  
ENDOWMENT CARE FUND (ECF)  
STATEMENT OF REVENUES COLLECTED AND EXPENSES PAID  
AND CHANGES IN TRUST CORPUS**

**REVENUES COLLECTED**

Interest income	\$ 10,000
Dividend income	5,000
Rental income	<u>20,000</u>
Total income	35,000
Net realized capital gains	<u>100,000</u>
Total Revenues	135,000

**EXPENSES PAID**

Care and maintenance of the cemetery (plug figure)	24,750
Accounting and auditing fees	5,000
Bank and investment fees	2,500
Trustee fees	<u>1,000</u>
Total Expenses	<u>33,250</u>
Excess of Revenues Collected over Expenses Paid	101,750
Additions (1) - Reserve for Future Maintenance (50% cap. gains)	50,000
Additions (2) - Reserve for Losses (5% of total income)	<u>1,750</u>
Revenues added to Accumulated Capital Gains Realized (3)	50,000

**CHANGES IN TRUST CORPUS**

Beginning year Trust balance (4)	5,000,000
Contributions/deposits from sales	200,000
Withdrawals from contract cancellations	(1,500)
Revenues added to Accumulated Capital Gains Realized	50,000
Ending Balance – Reserve for Losses	15,500
Ending Balance – Reserve for Future Maintenance	<u>250,000</u>
Ending year Trust balance	<u><u>5,514,000</u></u>

(1) Reserve for Future Maintenance – subject to maximum annual addition of 50% of net realized capital gains, and subject to maximum of 10% of total endowment care ending year fund balance.

(2) Reserve for Losses – annual addition is based on reasonable percentage of income.

(3) Net income of \$50,000 resulted from net realized capital gains; thus, any left over and not allocated to the Reserve for Future Maintenance shall become a part of the principal of the ECF.

(4) Includes beginning balance of Accumulated Capital Gains Realized since ECF inception.

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**JOHN AND JANE DOE CEMETERY  
SPECIAL CARE FUND (SCF)  
STATEMENT OF REVENUES COLLECTED AND EXPENSES PAID  
AND CHANGES IN TRUST CORPUS**

**REVENUES COLLECTED**

Interest income	\$ 10,000
Dividend income	5,000
Rental income	<u>20,000</u>
	35,000
Net realized capital gains	<u>100,000</u>
Total Revenues	135,000

**EXPENSES PAID**

Care and maintenance of the cemetery (plug figure)	126,500
Accounting and auditing fees	5,000
Bank and investment fees	2,500
Trustee fees	<u>1,000</u>
Total Expenses	<u>135,000</u>
Excess of Revenue Collected over Expenses Paid	0

**CHANGES IN TRUST CORPUS**

Beginning year Trust balance	5,000,000
Remaining available excess revenue	0
Contributions/deposits from sales	200,000
Withdrawals for serviced contracts (market value)	(375,000)
Withdrawals for contract cancellations	<u>(5,000)</u>
Ending year Trust balance	<u><u>4,820,000</u></u>

The Statement of Changes in Trust Corpus for cemetery and funeral establishment licensees should present the beginning balance, additions to the trust balance, withdrawals from the fund balance, and the ending balance. In rare instances, prior year adjustments or one-time adjustments may be required. Adjustment items should be presented separately as a line item and not combined or netted in the line item for additions and/or withdrawals. Adjustment line items should additionally be disclosed in the Notes to the Financial Statements.

### Additions

Additions to the trust balance generally result as contributions from sales activity that represents trust fund deposits. Because the trust balance should never be violated for the endowment care fund, the Bureau regards these contributions as direct transfers to fund balance, and not income or revenue.

Contributions to a special care fund or to a funeral establishment's preneed trust fund usually represent sales activity where services, merchandise or both will be delivered in the future. Due to California's strict 100% trusting requirements, any prepaid amount is trusted and therefore not treated as income or revenue until the service is rendered or the merchandise is delivered. Therefore, revenue recognition for the special care fund may be different than for the general operating account of the cemetery.

### Withdrawals

Endowment care fund and special care fund balance withdrawals should not frequently occur and would only result from a contract cancellation.

For cemetery special care funds and funeral preneed trust funds, when revenue recognition has been met, the prepaid amount is withdrawn from the fund balance. Revenue recognition generally is met when the service is performed and/or the merchandise has been delivered.

Also, withdrawals from fund balance can result from cancelled funeral contracts, including an amount representing a cancellation fee withheld from the customer. However, there is no provision in law for a cancellation fee on cancelled cemetery contracts.

## **F. NOTES TO THE FINANCIAL STATEMENTS**

Notes to the financial statements should be comprehensive and descriptive. The Bureau focuses on areas that can indicate noncompliance with laws and regulations, specifically in the type of assets, liabilities, and expenses listed.

For example, accounts receivables and Due to the endowment care fund are types of assets that require comprehensive note disclosure because it could indicate that the cemetery licensee is not depositing trust money in a timely manner, within 30 calendar days, and using the float to benefit the general operating account of the cemetery. Moreover, it could indicate improper loan activity from the trust fund to the cemetery's general operating account.

Liabilities, such as, "Due to the cemetery authority" also need to be disclosed why the trust fund owes money to the cemetery's general operating account and how did the liability occur or result from. Accounts payables also draw scrutiny from Bureau auditors.

Investments should have adequate disclosure to determine if any investments like a notes receivable is behind in making interest payments to the trust funds or in default. Bureau auditors are concerned if the notes receivables are from loans made to related-parties, owners or shareholders of the cemetery. Also of concern is whether the investment was made at arms-length or was it self-serving to benefit a relative or friend, and whether any conflict of interest was involved.

CPA auditors may want to consider also issuing a separate audit opinion on whether the cemetery or funeral establishment is in compliance with applicable California laws and regulations governing the cemetery and funeral trust funds. This would provide an added service to the client and a benefit to the Bureau.

### **G. ENDOWMENT CARE FUND AND SPECIAL CARE FUND REPORT**

The annual Endowment Care Fund and Special Care Fund Report is a sixteen page document that the Bureau commonly refers to as the "Annual Report." This report is a mandatory annual filing for cemetery licensees.

#### **IMPORTANT HINTS PAGE BY PAGE**

##### Page 8 of 16 of Annual Report – Grave Space Deposit Rates

The endowment care deposit rate for "Grave Space" must be per square foot. If you have the deposit rate per grave, convert the rate into per square foot.

##### Page 9 of 16 of Annual Report – Schedule A

The "Accumulated balance forward from prior year" for grave space contributions, crypt space contributions, niche space contributions, and

other contributions should be a carry-forward from the prior year Annual Report (Line 2, 5, 8, and 11).

The “Accumulated Capital Gains Realized” (Line 15) should be a carry-forward from the prior year Annual Report under “Total fund corpus from net capital gains/(losses)” (Line 20).

The amount added to the Reserve for Losses (Line 17) should agree with the CPA audit report. Also, the amount added to the Reserve for Future Maintenance (Line 19) on page 9 of 16 should agree with the amount added on page 11 of 16 (Line 2), and on the CPA audit report.

The “Unexpended trust income” (Line 25) balance is the accumulated amount since the inception of the endowment care fund of left over income (not realized capital gains), that is not used and expensed. Generally, most cemetery authorities will not have any unexpended trust income due to expensing any remaining income (as a plug figure) to the care and maintenance of the cemetery and/or the Reserve for Losses.

### Page 11 of 16 of Annual Report – Schedule C1 & C2

The beginning balance of the Reserve for Losses (Line 1) and the Reserve for Future Maintenance (Line 1) should be a carry-forward from the ending balance in the prior year’s Annual Report.

The additions to the Reserve for Future Maintenance should agree with the amount deducted on page 9 of 16 from the capital gains for the current reporting year. Additions to both Reserves should agree to the CPA audit report.

Capital losses realized applied to the Reserve for Losses and additions to the Reserve for Losses should both agree to the CPA audit report.

The “Current year reserve expended for maintenance” amount (Line 4) in the Reserve for Future Maintenance is different and in addition to the amount expensed on the Statement of Activities under Expenses for the care and maintenance of the cemetery. This is due to the Reserve for Future Maintenance being a part of the fund balance or corpus of the trust.

### Page 12 of 16 of Annual Report – Schedule D2

In regards to the Special Care Fund – Reserve for Losses, additions to the reserve for the current year (Line 2) and decreases due to capital losses realized (Line 4) should agree with the CPA audit report.

### Page 13 of 16 of Annual Report – Schedule E

It is acceptable to use a supplemental spreadsheet to provide details to the “Investments” page. However, if a supplemental spreadsheet page is provided, page 13 of 16 still needs to be completed using summary totals.

If investments are not commingled between the endowment care fund and special care fund, then a separate Schedule E should be prepared for each fund (two Schedule E’s).

### Page 15 of 16 of Annual Report – Schedule G

It is acceptable to use a supplemental spreadsheet to provide details to the “Schedule of Realized Capital Gains and Losses” page. However, if a supplemental spreadsheet page is provided, page 15 of 16 still needs to be completed using summary totals.

If investments are not commingled between the endowment care fund and special care fund, then a separate Schedule G should be prepared for each fund (two Schedule G’s).

### Page 16 of 16 of Annual Report

Two signatures from two different officers are required on the Annual Report.

### H. PRENEED FUNERAL TRUST FUND REPORT

The Preneed Funeral Trust Fund Report is an 11-page report (long form) that is required only when there are reportable preneeds. Reportable preneeds are preneeds that are **not** exempt from reporting. Generally, reportable preneeds are when the customer submits money representing payments directly or indirectly to the funeral establishment, in the name of the funeral establishment. The funeral establishment has direct control over the processing and investing of the preneed payments, and not invested in individual passbooks under the customers' name. See the Declaration of Non-Reporting Status form for examples of exemptions from reporting the 11-page report.

#### Page 2 of 10 of Preneed Funeral Trust Report

Question #5 relates to whether a funeral establishment must also submit a certified public accountant (CPA) audit report on the funeral establishment's funeral preneed trust fund. If the funeral establishment's preneed trust fund has commingled investments or commingled savings then such a CPA audit report is also required. If the preneed trust fund money is put in individual passbook savings accounts under the customers' individual name, then a CPA audit report is **not** required, and only the 11-page report is required.

#### Page 5 of 10 of Preneed Funeral Trust Report

Line #9 – Administration Fees is calculated using the lesser of two different sum totals. See page 10 of 11 for instructions on its calculation. Generally, if the lesser is a negative loss, then no administration fees are allowed to be deducted for the reporting year.

Line #11 – Ending Cost Balance should agree to the CPA audit report after adjusting for any unrealized capital gains and losses.

Line #12 – Market Valuation should agree to the CPA audit report.

### I. DECLARATION OF NON-REPORTING STATUS

The Declaration of Non-Reporting Status form is a one-page form used to inform the Bureau on an annual basis that the funeral establishment does not have any reportable preneeds that require the completion of the 11-page long form report listed above. **Even though there may be no changes from the previous year, this form must be submitted annually, if it still applies.** Always attach a separate list for insurance companies used and trust companies used.

Common life insurance companies used are:

- Homesteaders
- Forethought
- American Funeral and Cemetery Trust Services (AFCTS)
- National Guardian
- CNA
- American Founders Life
- Valley Forge

Common trust companies, referred to as “Master Trust” companies are:

- California Master Trust (CMT)
- Forethought Trust
- AFCTS

### **J. ANNUAL REPORT FILING DEADLINES**

#### Cemetery Licensees

The filing deadline to file the annual Endowment Care Fund and Special Care Fund Report for cemetery licensees depends on the licensee’s fiscal year-end. If the cemetery licensee’s fiscal year-end is December 31, then the filing deadline (postmark date) is no later than June 1 of the following year.

If the cemetery licensee has a different fiscal year-end other than December 31, then the filing deadline is no later than five months after the close of the fiscal year.

#### Funeral Licensees

The filing deadline to file the annual Preneed Funeral Trust Fund Report (long form) is no later than May 1 of the following year, if the funeral licensee’s fiscal year-end is December 31. If the funeral licensee has a different fiscal year-end other than December 31, then the filing deadline is no later than 120 days after the close of the funeral licensee’s fiscal year.

If the funeral licensee is exempt from filing the “long form” and only required to file the one-page, Preneed Funeral Trust Fund – Declaration of Non-Reporting Status form, the deadline to file is also no later than May 1 of the following year.

The Declaration of Non-Reporting Status form is on a calendar year reporting basis. The May 1 postmark deadline still applies even if the funeral licensee is on a fiscal year-end other than December 31.



### **K. CHANGING FISCAL YEAR END FOR REPORTING**

Most certified public accountants (CPAs) are busy with tax season from January through April of each year. This makes it challenging for Bureau licensees to have their CPAs perform the annual audit and issue their audit report before the due date. The Bureau suggests two options for the **cemetery** licensee:

- Send the Bureau a written request for a 30-day extension to file the Annual Report and CPA audit report. The request must be received by the Bureau prior to the due date; or
- Petition the Bureau in a written request to change your fiscal year-end from December 31. See Business and Professions Code Section §9650.1 for specific guidelines on changing your fiscal year-end. This request also must be received by the Bureau prior to the due date.

It is important to note that the Bureau is unable to grant filing extensions beyond 30 days from the due date under the laws and regulations that govern cemetery licensees.

For **funeral** licensees, there is no provision in law that allows an extension to file. However, the late filing fee is substantially less penalizing than for cemetery licensees.

### **L. PENALTIES FOR LATE OR NON-FILING**

Under Business and Professions Code Section §9650.4, any cemetery authority that does not file its Annual Report by the deadline may be assessed a fine in an amount not exceeding four hundred dollars (\$400) per month for a maximum of five months (\$2,000). Any fraction of a month is considered an entire month's fine. Therefore, filing three days late may trigger a \$400 fine.

Under California Code of Regulations Section §1257(l), the fee for a timely filing of an individual Preneed Funeral Trust Fund Report or a combined Preneed Funeral Trust Fund Report is two hundred dollars (\$200). The fee for a late filing of any report on preneed funeral trust funds is three hundred dollars (\$300 total, not \$500).