

FD-07-03

California Master Trust

Trustees

**Comerica Bank
&
Funeral Directors Service
Corp.**

Review for Compliance

**For the Period of
January 1, 2000
through
August 31, 2009**

(Revised June 2010)

**California Master Trust Audit
Audit No. FD-07-03
Report Contents**

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Audit Report

Summary

The Department of Consumer Affairs, Cemetery and Funeral Bureau (Bureau) has completed the audit of the Preneed Funeral Trust Funds held in the California Master Trust (CMT) under the control of Comerica Bank (Comerica) and the Funeral Directors Service Corporation (FDSC) for the period of January 1, 2000 through August 31, 2009.

A Preneed Trust Fund (Trust) is the moneys paid and securities delivered to be held in trust by the funeral establishments selling preneed services and merchandise as required under Business and Professions Code (BPC) Section 7735.

The audit was performed under the authority vested in the Bureau by Title 16, Section 1267 of the California Code of Regulations (CCR) and according to generally accepted governmental auditing standards. The scope of the audit was limited to the areas specified in the Objectives, Scope, and Methodology section of this report.

In order to expedite the examination and reduce the burden to the trust of producing all the records, the Bureau requested permission to inspect the workpapers of the independent auditors who reviewed the trust financial records and issued the audited financial statements for the master trust. The Bureau did not receive permission from FDSC.

Most of the records requested in the audit engagement letter dated November 9, 2007 were not provided until August 2009. Due to the delay in providing the records, the original audit period was extended to include the period up to August 31, 2009. Additionally, not all records requested by the Bureau were provided. This audit is based upon the information the Trustees were willing to provide to the Bureau absent a subpoena.

For the period under examination, the Bureau has determined that CMT was not in compliance with applicable state laws and regulations governing the administration of Preneed Funeral Trust Funds. The deficiencies are as follows:

Finding 1 – FDSC Is a De Facto Trustee in Violation of BPC Section 7736

BPC Section 7736 requires that a trustee is a banking institution or a trust company legally authorized ... by the State of California to act as trustee ... or not less than three persons one of whom may be an employee of the funeral establishment. Despite FDSC's assertions to the contrary, FDSC is a de facto

trustee of CMT. This is based upon written agreements executed, statements made, and powers exercised by FDSC in the management and control of CMT. However, according to Section 7736, FDSC is not qualified to act as a trustee. FDSC is neither a banking institution nor is it a trust company. Moreover, each of its four Board of Directors and all of its Corporate Officers are owners or employees of funeral establishments. Consequently, FDSC, which is acting as a de facto trustee of the California Master Trust, is in violation of BPC Section 7736.

Finding 2 – Payments Made in Violation of BPC Section 7735

BPC Section 7735 permits “income from the trust” to be used for payment of a “reasonable annual fee for administering the trust.” However, Section 7735 requires that administration_fees be paid only from the trust income of the immediately preceding 12 months. In 2001 and 2002 there was no income, in fact, there was a loss.

In 2001 and 2002, the Trust incurred losses, and could not pay administration costs. To overcome the losses and pay \$4,837,292 in annual fees for trust administration, FDSC created a plan whereby it mischaracterized as income the purchase of a negative intangible accounting balance with a Promissory Note. This plan was called the Disparity Resolution Plan and mischaracterized as income \$9,462,430 in 2001 and \$6,796,361 in 2002. In total, the Trust mischaracterized \$16,258,791 as income for the two years from the \$9,790,996 Promissory Note.

FDSC violated BPC Section 7735 and CCR 1275 by paying the trust administration costs with trust funds that were not trust income from the preceding 12 months.

Finding 3 – Trustees Failed to Return The Corpus To The Funeral Establishments Or Trustors as Required by BPC Section 7737

BPC Section 7737 requires the trustee, upon servicing the contract, to deliver the corpus and accumulated income to the establishment and upon revocation, the corpus and accumulated income, less the revocation fee, to the trustor.

In 2007 the FDSC Board of Directors implemented a policy to pay less than a trust accounts’ corpus when the market value of the trust account was less than its corpus or book value. They thereby were returning less than the full balance of the corpus to the trustor and funeral establishment in violation of BPC Section 7737.

- Finding 4 – Trust Paid Unauthorized “Participation Distributions” To Funeral Establishments in Violation of BPC Section 7735** BPC Section 7735 allows for a reasonable annual fee for trust administration. However, the funeral establishments do not incur trust administration costs for the Trust. Therefore, the participation distributions to the funeral establishments are not trust administration costs and the payments are in violation of BPC Section 7735. In violation of this Section, the Trust paid participation distributions an audited total of \$4,231,376 for the period of 2000 through 2008 to funeral establishments and reported the costs as trust administration.
- Finding 5 – Trust Paid Unauthorized Fees to FDSC in Violation of BPC Section 7735** BPC Section 7735 allows for a reasonable annual fee for trust administration. In violation of Section 7735, The Mechanics Bank and Comerica paid an audited \$7,724,058 (for the period of 2000 through 2008) to FDSC for non-trust administration costs (e.g., “upstreaming” money to California Funeral Directors Association (CFDA), paying for lobbying fees, sponsoring conventions for CFDA, etc.). FDSC remitted an audited \$5,693,640 to the Trust. FDSC used the remaining \$2,030,418 for other non Trust administration costs. FDSC must return the \$2,030,418 to the Trust.
- Finding 6 – Funds not Returned to Trustor After the Funeral Establishment Not Able To Perform Contracted Funeral Services in Violation of CCR Section 1274** CCR 1274 requires that when a funeral establishment is not able to perform or provide the contracted services and merchandise, the trust funds must be returned to the trustor, beneficiary, or legal representative, without imposition of a revocation fee. In violation of CCR Section 1274, FDSC and Comerica did not return preneed funds to the trustor when a funeral establishment could no longer perform the services for 611 accounts with an audited aggregate book value of \$1,175,735 (as of August 31, 2009).
- Finding 7 – Buying And Selling Funeral Services After Death or While a Death is Impending in Violation of BPC Sections 7694 and 7697** BPC Sections 7694 and 7697 prohibit the solicitation or buying of funeral directing and embalming businesses by a licensee after a death has occurred or while a death is impending. In violation of these sections, preneed contracts were bought, sold, and transferred after a death had occurred or was impending.
- Finding 8 – Refunds to the Trustor Not Made Within 15 Days of Receipt of Written Request for Contract Revocation in Violation of CCR Section 1264** CCR Section 1264 requires the corpus and accumulated earnings, less a revocation fee, be returned to the trustor within 15 days after cancellation or revocation of a contract. FDSC and Comerica did not refund contracts to trustor within 15 days.

Finding 9 – Failure To Maintain Preneed Trust Records in California in Violation of CCR Section 1267

CCR Section 1267 requires each funeral establishment with preneed arrangements to maintain, or cause the trustee of the preneed trust to maintain, complete financial records in California at all times. Neither the funeral establishments, FDSC, nor Comerica maintained in California at all times all the records required by CCR Section 1267.

Finding 10 – Records Not Made Available For Inspection by The Bureau in Violation of CCR Section 1267

CCR Section 1267 requires that the funeral establishment or trustee make the trust records available for inspection in California by the Bureau during reasonable working hours. In violation of CCR 1267, the Trust did not make available for inspection all the records requested during the examination.

Background

The California Funeral Directors Association (CFDA) established California Funeral Funding, Inc. in May of 1985 to manage and control the CMT Trust. In January 1993, the name was changed to Funeral Directors Service Corporation (FDSC).

Since April 2008, FDSC has reported to the California Secretary of State that their business address is in Beaverton, Oregon. Previously, FDSC was located in Folsom, California.

All of the FDSC Directors and Corporate Officers have been or are part of the CFDA.

Name	FDSC	CFDA
Mark Kuhn	President	Past President
Damon Ullrey	Treasurer	Treasurer
Scott Pennington	Secretary	Past President
Todd Beckley	Director	Past President
Richard Jungas	Director	Vice President
Merrill Mefford	Director	Past President
Victor Savino	Director	President
James Draper	Recording/Secretary	Past President

According to CFDA, the purpose of the CMT Trust is to offer its members a preplanning trust program as an extension of their existing services. The CMT program is designed by funeral directors.

The CMT program enables participating funeral establishments to deposit new or rollover existing preneed trust funds into the CMT Trust.

The “California Master Trust” is a service mark registered to FDSC.

Objectives, Scope and Methodology

The purpose and objectives of this review is to determine if the CMT Trust is in compliance with applicable state laws and regulations governing funeral preneed sales.

The audit objectives were to determine compliance with California laws and regulations for:

- Trust Administration;
- Contracts;
- Use of Income;
- Investments;
- Payment for Services; and,
- Recordkeeping.

The scope of the audit included a review of applicable laws and regulations, preneed agreements and records, and the controls over the preneed trust funds.

To achieve the audit objectives, the Bureau performed and attempted to perform tests on accounting and preneed records and documents as deemed necessary.

Conclusion

The audit of the California Master Trust disclosed that Comerica Bank and Funeral Directors Service Corporation (FDSC) have not complied with applicable state laws and regulations governing preneed records and preneed funds collected. As a result, the funeral establishments licensed by the Bureau that have contracted with FDSC are similarly in noncompliance with the Bureau's laws and regulations governing preneed trust funds collected. Their failure to comply is noted in the findings below.

By April 30, 2010, the funeral establishments or their representatives must submit to the Bureau their resolution to the deficiencies noted. The funeral establishments or their representatives response to the deficiencies must be specific and should address the items noted in the findings and "corrective actions required" sections of this report.

PHIL HARRIS
Supervising Auditor

Audit Team

Phillip Harris, Supervising Auditor
Rafael Ixta, General Auditor

FINDINGS AND RECOMMENDATIONS

Definitions

Agreement: Master Trust Agreement of California Master Trust effective February 15, 2002 between FDSC and Comerica. The agreement is included as **Exhibit A**.

ARC: Association Resource Center.

Beneficiary: The consumer entitled to the contracted funeral services to be provided by the funeral establishment.

Ms. Bergen: Grace J. Bergen

- Legal representative for FDSC and CFDA.
- Legal representative for Comerica until January 27, 2010.

BPC: Business and Professions Code.

Bureau: Cemetery and Funeral Bureau.

CCR: Title 16 of the California Code of Regulations.

CFDA: California Funeral Directors Association.

CMA: Charter Management Associates, Inc.

CMT: California Master Trust

- Program offered by FDSC to the members of CFDA to entrust preneed funds.
- "Service Mark" that FDSC has a "Certification of Registration of Service Mark". Registration No. 056321.

Comerica: Comerica Bank, Inc.

Disparity Resolution Plan: The Disparity Resolution Plan prepared by FDSC and ARC and effective June 30, 2001

EPG: Essential Planning Group.

FDSC: Funeral Directors Service Corporation

- Corporate No. C1275299
- Business Address of:
 - 8305 SW Creekside Place, Suite A
 - Beaverton, Oregon

Ms. Fowler: Penny Fowler

- Senior Account Manger for CMT per emails and business cards
- Senior Account Manger for Charter Management Associates, Inc.

Mr. Gajewski: Robert H. Gajewski, Senior Vice President – Western Division, Comerica Bank.

Hillside: Hillside Memorial Park and Mortuary (FD1358).

Mr. Kuhn: Mark Kuhn

- President, FDSC 2003 – Current.
- President, CFDA 1998.
- Former Board of Director of CFDA.
- Past FDSC Board of Director first appointed as July 1, 2001 while still on the CFDA Board,

Note: The Promissory Note from FDSC to the Trust for \$9,790,996 dated June 30, 2001.

Plan or “The Plan”: The Disparity Resolution Plan prepared by FDSC and ARC and effective June 30, 2001.

Promissory Note: The Promissory Note from FDSC to the Trust for \$9,790,996 dated June 30, 2001.

Trust or “CMT Trust”: The trust entitled California Master Trust.

Trustor: The consumer who enters into a preneed contract with a funeral establishment.

Application of Title 16 CCR Section 1263 CCR Section 1263 states that “trust funds shall be invested and reinvested, and kept invested”. This is to ensure that the funds generate income for the trustors.

As a result, the audit findings indicate that trust funds were not invested as required by CCR Section 1263 and instead were misdirected to pay unauthorized expenses. The misdirected trust funds (funds withdrawn from the Trust and recommended to be returned to the Trust) must be returned along with a calculated amount of lost income based on the Trust’s “Return on Investment”.

When the recommendation states funds must be returned or reimbursed to the Trust the words “plus lost earnings” will be added to account for the lost investment income of the funds misdirected from the Trust.

Codes and Regulations The codes and regulations referred to in this report are presented in **Exhibit D**.

Finding 1 –**FDSC Is A De Facto Trustee in Violation of BPC Section 7736****Condition**

A trustee is defined as 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 (BPC Section 7736). California's "Trust Law" contained in the California Probate Code (CPC), commencing with Section 15000, sets forth the duties of the trustee.

Although Comerica Bank is reported as the trustee of the CMT Trust, the Trust is managed and controlled by the FDSC. The current Master Trust Agreement (**Exhibit A**) effective February 15, 2002 between FDSC and Comerica grants FDSC trustee powers over the Trust. Though the Agreement labels FDSC as the Program Administrator, FDSC is empowered to and acts as a de facto trustee.

The Agreement bestows FDSC with the following powers:

1. FDSC appointed Comerica as the trustee. FDSC has the power to appoint, remove, and name a successor trustee.
2. FDSC has power to hire and compensate Investment Advisors, Agents, Trust Account Administrators, Legal Counsel, and CPAs.
3. FDSC has the power to develop and adopt the investment policy for the trust.
4. FDSC has the power to revise the investment policy for the trust.
5. FDSC has the power to direct the trustee to hold certain assets for the purpose of offsetting fluctuations in the investments due to marketplace changes.
6. FDSC has the power to determine the amount to reserve.
7. FDSC has the power to direct the trustee to make payments on trust accounts that have been serviced, cancelled, or revoked.
8. FDSC has the power to create and administer the trust accounts on behalf of the trustor, record pro rata share of income to each trustor account, transmit deposits received to the trustee.

Items 1 and 2 grant FDSC the power to hire which is a trustee power per Probate Code Section 16247.

Items 3, 4, 5, and 6 relate to the investment policy and when to hold or sell investments. Probate Code Section 16047 states, a trustee shall invest and manage trust assets. Probate Code Section 16049 states a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets.

Item 7 is the power to direct the trust to make payments which is a trustee power per Probate Code Section 16242.

Item 8 is the power to create and administer the trust account on behalf of the trustors which is a trustee power per Probate Codes Section 16220 and 16246.

Section C (1) (b) of the Agreement is in conflict with the Probate Code. This section of the Agreement states that FDSC shall not be deemed the trustee or be deemed to have the duties of a trustee, implied or otherwise. However, based on the powers delegated through the Agreement and the implementation of those powers, FDSC is a de facto trustee of the California Master Trust.

Admission to FDSC's Fiduciary Responsibility

In the Spring 2007 issue (page 9) of the CFDA newsletter, Mark Kuhn, President of FDSC wrote,

“The FDSC – Funeral Directors Service Corporation – the wholly owned “for profit” division of CFDA, who has the fiduciary responsibility of the “California Master Trust – CMT”, has noticed several trends regarding the Trust and I would like to share with you some of the recent changes that have taken place over the past year and were enacted on January 1, 2007.” (Emphasis added)

Based on the Master Trust Agreement, written documents provided, and the probate code, FDSC is a de facto trustee of the California Master Trust.

FDSC Does Not Qualify to be a Trustee

BPC Section 7736 states that a trustee must be a banking

institution or trust company legally authorized ... by the State of California to act as trustee ... or not less than three persons one of whom may be an employee of the funeral establishment.

As FDSC is not a banking institution or trust company, FDSC must have at least three persons on the Board of Directors controlling the corporation, and only one Board member can be an employee of a funeral establishment. However, in the case of FDSC, all four members of the FDSC's Board of Directors are either a funeral director of a funeral establishment, an owner of a funeral establishment, or a corporate officer of a corporation that owns the funeral establishment.

FDSC does not qualify as a trustee and is in violation of BPC Section 7736.

CMT Did Not Have a Trustee for Four Months

From October 16, 2001 through February 15, 2002, the Trust was without a reportable trustee. FDSC accepted the resignation of The Mechanics Bank as trustee on October 16, 2001. On February 15, 2002, Comerica became the banking trustee of the CMT Trust.

The Trust reported on the 2001 CMT Trust filing document that the resignation of The Mechanics Bank was effective December 31, 2001 and that effective February 15, 2002 Comerica became the Trustee. However, the 2002 document filed states that The Mechanics Bank was the Trustee until February 15, 2002 and that Comerica became the Trustee on February 15, 2002.

The CFDA Board minutes indicate that FDSC accepted The Mechanics Bank's resignation and named Argent Financial as the Trustee effective October 16, 2001. Correspondence from FDSC and Ms. Grace Bergen indicates that Argent was never a Trustee of the CMT Trust.

It is the Bureau's opinion, based on the limited records examined; that The Mechanics Bank ceased being the Trustee on October 16, 2001 and Comerica was named as Trustee effective February 15, 2002.

For the period of October 16, 2001 through February 15, 2002 the Bureau cannot conclude whether Argent Financial was the Trustee as noted in the CFDA Board minutes. For this period of time the Trust was without a reportable trustee

and FDSC and Comerica failed to disclose this information to the Bureau.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC must immediately cease being and acting as the de facto trustee of the California Master Trust.
2. FDSC must immediately transfer all trustee powers to an independent trustee and conform to the requirements of BPC Section 7736.
3. FDSC must remove from its website and all written materials all inferences that the State of California has authorized Comerica Bank to serve as trustee of the CMT Trust and that the California Department of Consumer Affairs reviews the CMT Trust program annually.

**Finding 2 –
Payments Made in
Violation of BPC
Section 7735**

Condition

FDSC and Comerica violated BPC Section 7735 which requires that administrative fees be paid only from the trust income of the preceding 12 month period. Annual administrative fees may only be paid from current trust income per CCR Section 1265

Though the Trust incurred net losses for 2001 and 2002, FDSC and Comerica allowed \$4,837,292 to be paid as administrative fees in those years in violation of BPC Section 7735 and CCR Section 1265. To overcome the losses, FDSC and Comerica mischaracterized and reported income that was in fact not income for the two years. By mischaracterizing the income, FDSC and Comerica made it appear that the trust was profitable. This mischaracterization was effectuated as follows.

In 2001, FDSC, entered into a related party transaction with the Trust to cover the realized losses incurred by the Trust. FDSC signed a \$9,790,996.50 non-interest bearing Promissory Note (**Exhibit B**) payable to the Trust for the purchase of the Trust’s “Disparity”. “Disparity” is defined as the “difference between the Book Value and the Fair Market Value of the CMT Assets” in the Disparity Resolution Plan (**Exhibit C**).

In the 2001 Preneed Funeral Trust Fund Report, FDSC and Comerica reported to the Bureau \$9,462,430 as “Disparity Resolution Income”. Without modifying the Note for the 2002 year, FDSC and Comerica reported an additional \$6,796,361 in “Disparity Resolution Income”. FDSC and Comerica reported \$6,467,794.50 more in “Disparity Resolution Income” than the claimed purchase price.

<u>Description</u>	<u>Income Reported</u>
2001	\$ 9,462,430.00
2002	6,796,361.00
Total Income Reported	\$ 16,258,791.00
Promissory Note	9,790,996.50
Income over the Note Reported	\$ 6,467,794.50

The “Disparity Resolution Income” allowed sufficient income to be reported in 2001 and 2002 to pay Administrative Fees. With the exception of the last line “Net Loss before DRI & Admin”, the following was reported on the 2001 and 2002 “Statement of

Revenue and Expenses” in audited financial statements filed with the Bureau:

Revenue:	<u>2001</u>	<u>2002</u>
Interest	\$886,064	\$2,296,033
Dividends	1,735,352	822,928
Loss on sale of investments	(9,509,221)	(6,445,778)
Disparity resolution income	9,462,430	6,796,361
Total Revenue	\$2,574,625	\$3,469,544
 Expenses:		
Administrative fees	2,330,807	2,506,485
Net Revenue over Expenses	\$243,818	\$963,059
Net Loss before DRI & Admin	(6,934,596)	(\$2,976,234)

In the November 29, 2007 entrance teleconference, Ms. Bergen and Mr. Gajewski twice indicated to the Bureau that the Disparity Resolution Income reported on the 2001 and 2002 “Statement of Revenue and Expense” was not income.

Their statements were memorialized in the November 30, 2007 letter from the Bureau to Ms. Bergen, Mr. Gajewski, Mr. Kuhn, and Ms. Fowler. The letter stated, “In the conference, it was stated several times that the Disparity Resolution Income reported on the 2001 and 2002 “Statement of Revenue and Expense” was not income and that the FDSC “Note receivable” was a liability of FDSC and an asset to CMT.” (Emphasis added)

When the Bureau asked for the legal reasoning why the Promissory Note was treated as Income, Mr. Kuhn did not provide an explanation and wrote in his October 16, 2009 letter, “Objection as to request for legal reasoning. The CMT acts upon advice of its legal counsel and accountants, and cannot provide legal reasoning. The Promissory Note was written in 2001...and those persons responsible for drafting its terms are no longer representing the CMT.” (Emphasis added)

The Bureau’s opinion is, based on the information provided, that the Disparity Resolution Income is based on the reported 2001 Promissory Note amount and Note balance at the end of 2002. As the Trust generated sufficient income in subsequent years, the Note balance was never reported as income again.

In Summation of the Trust - Trustee Transaction

Probate Code Section 16002 states, “The trustee has a duty to administer the trust solely in the interest of the beneficiaries.”

Probate Code Section 16004(a) states, "The trustee has a duty not to use or deal with trust property for the trustee's own profit or for any other purpose unconnected with the trust, nor to take part in any transaction in which the trustee has an interest adverse to the beneficiary."

Probate Code Section 16004(c) states, "A transaction between the trustee and a beneficiary ... by which the trustee obtains an advantage from the beneficiary is presumed to be a violation of the trustee's fiduciary duties. This presumption is a presumption affecting the burden of proof."

The Plan and Note were related party transactions as disclosed on the financial report and were not arrived at independently. FDSC claimed to have purchased the Disparity. The Disparity is the negative difference of the investments between the market value and book value. This is an intangible item with no positive value. As the Disparity has no value, no independent party would purchase it and no income would be generated.

The Bureau's opinion is, based on the information provided, that the transaction was meant to circumvent BPC Section 7735 and allow for Administrative Fees to be paid from the Trust's funds to the benefit of FDSC, Comerica and any contractees providing administrative services for the Trust.

The transaction does not benefit the trustor. The beneficiaries and trustors have been harmed in violation of Probate Code Sections 16002 and 16004. The harm to the beneficiaries and trustors is the amount of Administrative Fees that should not have been paid totaling \$4,837,292 (Administrative Fees for 2001 and 2002).

Who Verified the Accuracy of the Reports

Instead of filing the required 21P-4A form (Preneed Funeral Trust Fund Report) for 2001 and 2002, FDSC and Comerica provided a letter with an attachment entitled "Pre-Need Funeral Trust Report" for each of the 2001 and 2002 year filings. CCR 1269 (a) specifically states, "Each licensed funeral establishment ... who enters into any preneed arrangements ... shall file with the Board annually ... a written, verified or audited report, on form 21 P-4A (1/94) prescribed and furnished by the Board ...". CCR 1269 (f) states, "Two or more funeral establishments who utilize a common trust fund ... may cause the trustee of that common trust

to file one combined annual report ...”

Regardless, in the attachment attesting to the accuracy of the audited financial statements, the first line of the attachment provided to the Bureau states, “This report is prepared on behalf of the California Master Trust for all mortuaries participating in the California Master Trust (see supplemental schedules of the certified audit report).”

Under the “Verification by Corporate Officers” section of the document, it states, “I hereby certify or declare under penalty of perjury, under the laws of the State of California, that, to the best of my knowledge and belief, the foregoing report, including all attachments thereto, is complete, true and correct.”

Mr. Gajewski of Comerica and Robert Pierce, FDSC President, signed the 2001 and the 2002 attachment provided to the Bureau attesting that the reports were “complete, true and correct”. As the new trustee, Mr. Gajewski signed the document as the FDSC Board accepted the resignation of Mechanics Bank as the Trustee on October 16, 2001.

Repayment of Note Methodology

FDSC took on the Trust’s Disparity with the Promissory Note. Section 2d of the Note and Section IIC3 of the Plan allows the Note to be paid off partly with the appreciation of the Trust’s investment. The appreciation of the Trust’s investment is income to the Trust and FDSC has no rights to the appreciated value of the investments of the trust. The Trust’s gains from investments should not pay for FDSC’s Note Payable to the trust as this is not a cost of trust administration.

An example of this application is in the independent audit report for the 2001 year. Note 5 of the audit report identifies that \$1,067,109 in the Trust’s recognized capital gains was applied to the claimed debt of FDSC.

Financial Interest

The Plan was prepared and implemented by FDSC and ARC. The Plan was created without The Mechanics Bank, the trustee at that time.

In the “Agreement” section II C1b of the Plan, FDSC is to receive

75% (3% out of 4%) of the estimated administrative fees. The remaining 25% is made available by FDSC for the funeral establishments to receive as participation distributions. The Plan allocates administrative fees as follows:

Funeral Establishments	25.0%
FDSC	75.0%
<u>Breakdown of FDSC 75% Share</u>	
Net Income to FDSC	25.0%
Overhead	17.5%
ARC to receive	25.0%
Trustee to receive	7.5%

Attempts to Acquire Information Related to the Transaction

The Bureau requested in the audit engagement letter dated November 9, 2007 a copy of the Disparity Resolution Plan and Promissory Note.

In the entrance conference on November 15, 2007, Ms. Bergen indicated that the Disparity Resolution Plan would not be provided due to a confidentiality agreement between the CMT Trust and ARC.

The Bureau requested the Plan and Note on five (5) additional instances before the Note and a partial copy of the Plan were provided on August 3, 2009. Excluded from the Plan was “Exhibit B” which was described in the Plan as the “accounting practices” for the Plan.

To gain a better understanding of the Disparity decision by the FDSC Board, the Bureau requested a copy of the High Country Capital Management report issued on April 10, 2001 presenting alternatives for eliminating the disparity between market value and cost of the Trust’s investments. On August 3, 2009, FDSC provided an incomplete “Draft” report dated March 26, 2001. Only, the following pages were provided, 2, 5, 8, 10, 13, 15, 17, 19, 21, 23, 25, 27, 29, 31, 34, 36, 38, 40, 42, 48, 50, 51, 53, 55, 57, and 59.

The report was to present:

- Alternatives to improving the expected rates of return at reasonable risk levels.
- Description of the applicable laws and regulations regarding assumptions.

- Evaluation of the ability to re-allocate between Trust income and principle accounts, cost reductions, revisions of the investment policy, and the use of additional investment managers.

Disclosure of the Disparity Resolution Plan

The Trustee, Trustors, Participating Funeral Establishments, and Bureau all have the right to know contents of the Plan. But FDSC and ARC excluded them from viewing the document.

Though the Bureau originally requested a copy of the Plan and Note on November 9, 2007 and several times afterwards, FDSC and Comerica did not provide the Bureau a copy of each until August 3, 2009.

The Plan stated under the “Agreement” section I 9, “FDSC and ARC agree not to seek a ruling on this Plan from the Department of Consumer Affairs;...” (emphasis added)

The Plan stated under the “Agreement” section H entitled “Confidentiality”, “FDSC and ARC agree to keep confidential, and not to disclose at anytime in any manner, any of the terms of this Plan to anyone other than (a) counsel...representing either party; (b) paralegal assistants, clerical and other support staff of the counsel; and (c) officers, directors and employees of any Party to this agreement, and (d) accountants, auditors, and their support staff.” (Emphasis added)

It continues, “The terms of this Plan are to be disclosed to the trustee of the CMT only to the extent determined FDSC or ARC to be necessary for the trustee’s performance of its duties, and only after receipt of a written Confidentiality Agreement by the Trustee.” (Emphasis added)

The Plan also stated under the “Agreement” section G, “Neither the commitment to execute this Plan nor the performance of any terms of this Plan by FDSC or ARC constitute nor are they to be construed as an admission of any liability or wrongdoing whatsoever by FDSC or ARC.” (Emphasis added)

Allocation of the 2001 Loss to the Accounts

CCR Section 1267(b) requires the Trust to record “all income prorated in accordance with the ratio which the trust corpus of the

account bears to the entire corpus invested.”

On August 3, 2009, a file entitled “FDSC Note Alloc.txt” was provided by FDSC to the Bureau. This file allocated the entire FDSC Note to all trust accounts that existed as of June 30, 2001 but written prior to January 1, 2000. The allocation was based on the net accumulated income of each account and not based on the trust account balances per CCR Section 1267(b).

The Bureau selected Hillside to test for any inequity between the two allocations. The Trust allocated \$1,034,593 in disparity losses to Hillside’s accounts based on the each account’s net accumulated income. Based on the aggregate trust account balances as required by CCR Section 1267 (b), the audited allocation to all of Hillside’s trustors should be \$859,425. The Trust over allocated the Disparity losses to Hillside’s trustor accounts by \$175,168.

In allocating the 2001 losses in accordance with CCR Section 1267 (b) to the entire list of accounts, the balances of 12,808 or 47.5% of the 26,953 accounts listed would be less than their corpus. As of June 30, 2001, the corpus shortfall for those accounts would have amounted to \$2,349,220.

Summary

As a result of mischaracterizing income that was not income, the Trust should not have paid \$4,837,292 for trust administration in violation of BPC Section 7735 and CCR Section 1265.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must reimburse the trust a total of \$4,837,292 plus lost earnings for the funds expended on Administrative Fees in violation of BPC 7735 and CCR Section 1265.
2. FDSC and Comerica must identify all the active contracts and prorate the appropriate share of the Administrative Fee and the 2001 and 2002 net losses incurred to the individual trust

account.

3. FDSC and Comerica must identify all the contracts cancelled, revoked, and serviced during the audit period and refund and reimburse an appropriate share of the Administrative Fee and assess an appropriate share of the 2001 and 2002 net losses incurred to the trustor or funeral establishment affected.
4. FDSC and Comerica must not sign the 21P-4A form as being "complete, true and correct" unless the person signing knows that the information contained in the form is complete, true and correct.
5. FDSC and Comerica must cease reducing the Promissory Note due to the appreciation of the Trust's investments.
6. FDSC and Comerica must make the contents of the Disparity Resolution Plan and Promissory Note available to the trustors.
7. In the future, FDSC and Comerica must provide the Bureau with all records requested in accordance with CCR Section 1267.

**Finding 3 –
Trustees Failed to
Return the Corpus to
the Funeral
Establishments or
Trustors as Required
by BPC Section 7737**

Condition

At the beginning of 2007 and in violation of BPC Section 7737, FDSC's Board of Directors implemented the practice to pay less than a trust accounts' corpus when the market value of the trust account was less than its corpus or book value.

From the cancelled and serviced contract listings provided for the periods of January 1, 2007 through December 31, 2007 and January 1, 2009 through August 31, 2009, the Bureau identified 454 violations of BPC Section 7737. The trustors and funeral establishments were paid less than the corpus an audited aggregate amounted of at least \$15,671. This amount is based solely on the limited time periods examined and referenced above. The Bureau did not receive the requested listing for cancelled and serviced contracts for the period of January 1, 2008 though December 31, 2008.

BPC Section 7737 requires that the corpus and the accumulated income be delivered to the funeral establishment performing the services once the trustee receives proof of death and performance of the services.

BPC Section 7737 also requires that the corpus of the trust, together with any income accrued in the Trust, less the revocation fee be delivered to the trustor once the trustee receives a written demand for the funds. CCR Section 1275 (j) limits the revocation fee to be taken from the accumulated income only and not from the corpus.

Background

In a Spring 2007 article, Mr. Kuhn wrote, "The Board has also recognized that in order to avoid future disparities, it was necessary to change the methods of accounting used by the former management company, which recommended the practice of marking to book instead of marking to market value. Therefore the Board, along with professional counsel from our Trustee, Investment Advisor and others, has decided to correct the problems of the past by presenting a comprehensive 'Action Plan' for the California Master Trust." (Emphasis added).

In an email dated June 13, 2007 discussing the new practice of paying less than corpus, Ms. Fowler wrote the following:

- "... the Trust was continually paying out more on claims and cancellations than what the market value of the contract was due to the fact the contracts were being paid on book value rather market value."
- "... there was about a 10 million dollar disparity between the book value and the market value."
- "... effective with 2007 all claims would be paid at market value rather than book value."

In a letter dated July 5, 2007 from Mr. Kuhn and Hal Martin (CEO for CMA and Administrator for the CMT Trust), they made the following statements:

- "At the beginning of 2007, it was the decision of the current Board of Directors to take corrective measures and made the right decision that the trust pay claims based on market value rather than book value as it had in the past. FDSC used to make up the losses each year, however the loss amount between market value and book value has grown so much that it is no longer something that can be absorbed. The board made the decision to pay any negative market fluctuations on a death claim that would be effected by the disparity for 24 months following January 1, 2007, because there wouldn't be enough time for the trust to make it up, however when someone is leaving the trust due to cancellation, they will incur their portion of the disparity and the market value loss."
- "We agree tha(t) an opinion should be received from the State of California regarding the interpretation of Corpus and the return of such when invested in a vehicle that has risk associated with it. An attempt will be made by the FDSC Board of Directors along with the CFDA to obtain an opinion regarding the code ..."

As the FDSC Board and CFDA had not contacted the Bureau for an opinion, the Bureau was contacted on the issue by a participant of the CMT program. On July 27, 2007, the Bureau stated the following:

- "Death Claims. In the case of a death claim, trustees should pay the corpus (i.e., all moneys paid and securities delivered by the trustor) and net income to the funeral establishment."
- "Refunds based on cancellations or revocation request of a trust agreement: In this case, trustees must pay the corpus and accrued income less any applicable revocation fee to the trustor or legally appointed representative."

In the letter that Mr. Steve Buss of CMA wrote dated August 14, 2007, he stated the following:

- “California Statutes allow for the investment of trust assets in instruments that have a potential for market value fluctuations, however there doesn't appear to be any allowance in the current interpretation of the Regulations for the recognition of losses.” (Emphasis added).

On March 3, 2009, the Bureau emailed Mr. Gajewski the audit's general issues that had been identified by the Bureau at that point in time. The second bulleted finding stated, “Failure to reimburse the full trust account amount as required by law per Business and Professions Code Section 7737.”

Scope Limitation

As the FDSC Board decided at the beginning of 2007 to pay less than the corpus when the market value of an account drops below the corpus value, the Bureau attempted to identify all the corpus violations. However, FDSC and Comerica failed to provide a listing of the cancelled and serviced preneed contracts for the January 1, 2008 through December 31, 2008 period. This prevented the Bureau from identifying additional instances of corpus violations.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must stop the practice of paying out less than the corpus.
2. For those instances where the Trust paid less than the corpus on revocations by trustors or reimbursement for services rendered by funeral establishments, FDSC and Comerica must refund or reimburse the full amount of the corpus.
3. In the future, FDSC and Comerica must provide the Bureau with the records requested in accordance with CCR Section 1267.

**Finding 4 – Trust Paid Condition
Unauthorized
“Participation
Distributions” To
Funeral
Establishments in
Violation of BPC
Section 7735**

Per BPC Section 7735 and CCR Section 1265, the trustee is allowed to pay a reasonable annual fee for trust administration.

In violation of BPC Section 7735 and CCR Section 1265, FDSC paid \$4,231,376 in participation distributions to funeral establishments and reported the costs as trust administration. This is the audited total of the annual participation amounts disclosed in or derived from the audited financial statements for 2000 through 2008 prepared by independent auditors and filed with the Bureau as required. These are not trust administration costs and are not permitted to be paid from the earnings of the trust.

The Agreement defines who can receive ‘Administrative Fees’. The Agreement lists FDSC, Trustee, and Investment Advisor. In addition, the Agreement lists who can receive FDSC fees: the Trust Accounts Administrator, Consultants, Accountant, Legal Counsel, and Auditor. Fees paid to funeral establishments are not included in the definition of ‘Administrative Fee’.

In contrast to the Agreement, one of the program options offered by FDSC to funeral establishments which participate in the CMT program is the option to receive a portion of the Trust’s earnings. For those funeral establishments electing to receive the distribution of earnings, the Trust paid 1½% of the trust ending balance during 2000 and 2001 and 1% for 2002 through 2009.

The funeral establishments make annual elections on the “Distribution Option Form” to receive or not receive the distribution. Those electing to receive the distributions are paid quarterly.

In a letter dated July 31, 2009 from FDSC to the Bureau, FDSC wrote, “No services are performed for the Trust by the funeral establishments except for the selling of the CMT Pre-need contracts within their funeral homes. Upon completion of a consumer contract the contract is sent to the Trustee Bank and domiciled at each firm in the state of California.”

ARC’s representatives informed the Bureau that the role of the funeral establishments were to sell the preneed contracts. Each November, funeral establishments elected to receive or not the 1% distribution. The funeral establishments use the money to pay for the preneed counselors and administrative costs.

Approximately 60% of the funeral homes elect to receive the 1% distribution. The distributions were paid quarterly but the distributions were calculated monthly. This was done to ensure that sufficient income was earned during the year before the last payment was made.

The CMT Trust's 'Distribution Option Form' states that the 1% distribution is to cover the 'expenses of the funeral establishment'. These are not trust administration costs and are not permitted to be paid from the earnings of the trust. These are standard administrative costs of the funeral establishment.

In violation of BPC Section 7735 and CCR Section 1265, FDSC made payments to funeral establishments totaling \$4,231,376 and reported them as trust administration fees. These payments are not 'reasonable administrative' fees of the Trust. The independent auditors, the President of FDSC, the former and current third party administrators stated that the payments to the funeral establishment are to promote funeral preneed sales.

Effect of the Finding 2 Adjustment

As reported on the audited financial statements from 2000 through 2008, the total administrative fees paid to participating funeral establishments was \$4,231,376. Finding 2 eliminated the entire administrative fee for 2001 and 2002 since the trust did not have sufficient income to charge an administrative fee. The fee paid to funeral establishments for these years is \$996,140 and the net amount without the 2001 and 2002 distributions is \$3,235,236.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must cease the practice of paying funeral establishments participation distributions from trust funds.
2. FDSC and Comerica must recover from the funeral establishment or reimburse the Trust a total of \$3,235,236 plus lost earnings (\$4,231,376 less the \$996,140 disallowed in 2001 and 2002 due to insufficient income).
3. FDSC and Comerica must re-compute lost earnings from the withdrawal of the \$4,231,376 funds from the Trust.

**Finding 5 –
Trust Paid
Unauthorized Fees to
FDSC in Violation of
BPC Section 7735**

Condition

BPC Section 7735 allows for a reasonable annual fee for trust administration to be recovered. CCR Section 1265 restricts the recovery to a ceiling of 4% of the trust balance.

Based on the information provided the Bureau, \$2,030,418 should be returned to the trust by FDSC. The audit revealed that these expenses were not reasonable trust administration fees incurred by FDSC for the period of January 1, 2000 through December 31, 2008, and were inappropriately retained by FDSC.

During this period, the Bureau determined that The Mechanic's Bank and Comerica paid FDSC an estimated \$16,286,764 in trust administration fees. Of the funds received, FDSC paid contractees performing administration services for the Trust an audited \$8,448,013. In addition, the Bureau verified that FDSC incurred an audited \$114,693 in trust administration costs for travel per diem and the cost to hold FDSC Board meetings. The remaining \$7,724,058 was for non-trust administration costs in violation of BPC Section 7735. Of this \$7,724,058, FDSC returned \$5,693,640 to the Trust. This leaves an outstanding balance of \$2,030,418 that must be repaid to the Trust by FDSC.

Non-Trust Administration Costs

As noted in the audited financial statements submitted, FDSC remitted \$5,693,640 to the Trust to reduce FDSC's Note liability. Reduction of FDSC's Note liability is not a trust administration cost. FDSC should have remitted the funds to the Trust as over payment of their costs.

Of the remaining \$2,030,418 retained by FDSC, the Bureau was able to identify other non-trust administrative costs. Below are examples of some of the non-trust administrative costs identified.

In the Hillside/CMT Trust litigation matter, "Notice of Response to Order for Accounting and Summary of Accounting" dated September 22, 2009, the following FDSC disbursements' were reported:

- \$129,166.54 in lobbying fees was paid to Aaron Reed & Associates between August 4, 2005 and December 11, 2008. It is the Bureau's opinion that the lobbying fees paid are not valid trust administration fees. Additionally, no contract was provided to substantiate the nature of the services rendered.

After reviewing the Secretary of State's website for information reported by the lobbying firm, neither FDSC nor the CMT Trust were listed as a client. CFDA was listed since January 1, 2005. The lobbying firm did not report FDSC or the CMT Trust as making payments to them. CFDA was reported to have paid the lobbying firm \$129,383 during the 2005 and 2006 reporting period and \$130,581 during the 2007 and 2008 reporting period.

- \$75,000 was paid to ARC for mediation settlement. The Bureau was informed that the settlement was confidential and would not be provided.
- \$30,200 was reported as sponsorship costs paid to CFDA.
 - \$10,000 on June 26, 2006 described as "sponsorship".
 - \$10,200 on June 8, 2007 described as "annual sponsorship".
 - \$10,000 on October 23, 2008 described as "convention sponsorship".

None of these payments are related to trust administration.

In the January 16, 2001 FDSC Board Minutes, it states, "Motion Berlin/Wallin that CMT Sponsor the CFDA Convention for not to exceed \$164,000. Motion Carried." In the same document, the Board noted, "...the disparity between the market value of the fund and the book value of the fund has been reduced from \$13.2 million to \$8.3 million." Even though the Trust was trying to recover from an \$8.3 million disparity, FDSC was willing to expend \$164,000 on non-trust administration items.

FDSC referred to paying these CFDA expenses as "upstreaming".

According to the ARC representatives, FDSC stopped making dividend payments to CFDA around 2003. Later, it was determined that it was better for FDSC to pay for CFDA programs directly. This was referred to as "upstreaming".

In the August 19, 2009 meeting between FDSC's representative and the Bureau's representatives, Mr. Kuhn commented about how FDSC would make a profit and "upstream" the funds to CFDA.

In the Fall 2008 CFDA Newslines article, Mr. Kuhn wrote "CFDA is YOUR Association and the California Master Trust is YOUR

Trust. Participation and support of the Trust enables FDSC to “upstream” funds to CFDA.”

“Upstreaming funds” is not a reasonable Trust administration cost.

Trust Administration Costs

FDSC does not have any paid employees. The only direct expenses that FDSC incurs are per diem reimbursements to their Board of Directors and Officers and the cost to hold the board meetings. The estimated trust administration costs for these expenses from January 1, 2000 through December 31, 2008 were \$114,693 or \$12,744 annually.

The CMT Agreement between FDSC and Comerica defines FDSC’s duties and responsibilities for the Trust. The FDSC volunteers do not personally perform all the required duties and responsibilities under the Agreement. The FDSC volunteers contract all the trust administration services and day-to-day operations to various contractees. Though FDSC is the responsible party, the contractees actually perform the required duties and responsibilities.

Based on the information provided, the costs identified for trust administration were the travel and board meeting costs directly incurred by FDSC and the contracted trust administration costs (paid under the recordkeeping, consultant and trustee contracts).

Automatic 4% Charge for Administrative Fees

FDSC’s representatives have stated that FDSC is annually entitled to 4% of the trust balance as an administrative fee. CMA’s Request for Proposal dated September 15, 2006 describes how they calculate the administrative fees. The introductory line states, “The methodology for computing the 4% administration expense is as follows:” The Request for Proposal then details how they systematically calculate the administration expense at 4%. In an email dated June 14, 2007, Ms. Fowler details the same calculation described in the Request for Proposal.

The Bureau has informed FDSC that the annual fees are for trust administration services actually performed only and the 4% limitation in CCR 1265 is a ceiling. It does not permit or authorize an automatic 4% fee deduction from the trust income.

The 4% to be taken by FDSC is broken down in the Disparity Resolution Plan. The Plan allocates the administrative fees as follows:

Funeral Establishments	1.0%
FDSC	3.0%
<u>Breakdown of FDSC 3% Share</u>	
Net Income to FDSC	1.0%
Overhead	0.7%
ARC to receive	1.0%
Trustee to receive	0.3%

Though the plan does not assign any trust administrative duties to be performed, the Plan estimated that FDSC would be paid and retain 1% as Net Income and 0.7% as Overhead.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must cease paying FDSC, CFDA and other persons non-trust administration costs.
2. FDSC must cease “upstreaming” funds for non-trust administration costs.
3. FDSC and Comerica must cease reducing the Promissory Note due to the appreciation of the Trust’s investments.
4. FDSC and Comerica must recover or reimburse the Trust for the annual fee for the non-trust administration services paid to FDSC plus lost earnings since January 1, 2000.
5. FDSC and Comerica must identify all the active contracts and prorate the appropriate share of the Administrative Fee that should not have been paid to FDSC for trust administration.
6. FDSC and Comerica must identify all the contracts cancelled, revoked, and serviced during the audit period and refund and reimburse to the trustor or funeral establishments a prorated share of the Administrative Fee that should not have been paid to FDSC for trust administration.
7. In the future, Trustees must provide the records requested in

accordance with CCR 1267.

**Finding 6 –
Funds not Returned to
Trustor After the
Funeral Establishment
not able to Perform
Contracted Funeral
Services in Violation
of CCR Section 1274**

Condition

When a funeral establishment can no longer perform the contracted preneed services, the preneed trust funds must be returned in full without imposition of a revocation fee to comply with CCR Section 1274.

Contrary to CCR Section 1274 and the CMT’s own contract language, FDSC and Comerica have established a practice of retaining trustor funds even though the licensee is no longer operating and can not provide the services. The standard language in the CMT contract states,

“Inability of the Funeral Establishment to Perform. If for any reason the Funeral Establishment becomes unable to substantially perform this Agreement prior to or upon the death of the Beneficiary, the Trustee shall return to the Funeral Establishment for delivery to the Trustor or Beneficiary, as applicable, or to the Trustor’s or Beneficiary’s representative, as defined by Health and Safety Code section 7100, all funds in the Trustor’s account, less any fees provided herein, not to exceed the maximum allowable by law. No revocation fee shall be charged.”

Mr. Kuhn summed up the Trust’s position when he stated, “Because CMT is a Master Trust, consumers can leave their funds in the Trust even if the firm through which they wrote the contract can no longer do business.”

As of August 31, 2009, the Bureau identified 34 licensees whose licenses were cancelled, revoked, or inactive and could no longer perform the contracted services and the Trustees have not refunded the appropriate persons as required under CCR Section 1274. Of the 34 licensees identified, the Bureau identified 611 active contracts with an audited aggregate corpus of \$864,574.23 and an audited aggregate book value of \$1,175,735.01.

From the listing of licensee contracts as of August 31, 2009, the Bureau identified 33 of the funeral establishments who could no longer perform the contracted services.

From the listing of contracts transferred in 2007, the Bureau identified one funeral establishment, licensee FD 0061, that had closed in 2007. The Trustees had transferred the contracts to licensee FD 1228 without receiving authorization from the trustors.

When the contracts were transferred, the prefix to the contracts was changed from 0061 to 1228. As a result of the prefix change, the licensee who was the original party to the contract could not be identified on the August 31, 2009 listing provided. In order to identify all the transfers during the audit period, the Bureau would have to review all the active contracts or a listing of all the cancelled and transferred contracts.

Scope Limitation

Because the contract prefix is changed when the contracts are transferred to another licensee, the Bureau needed the contracts in Oregon to be brought to California for examination. In lieu of this, the Bureau requested listings of all the cancelled and transferred contracts for the January 1, 2000 to December 31, 2006 and the January 1, 2008 to December 31, 2008 periods.

The FDSC and Comerica failed to provide the listings. This prevented the Bureau from identifying additional instances of CCR Section 1274 violations.

Active Contracts of Deceased Clients

Of the 661 contracts identified above, 57 or 8.6% of the beneficiaries have been identified as deceased for more than 6 months from the date of the listing provided. As of August 31, 2009, the audited aggregate corpus for the 57 was \$51,117.56 and the audited aggregate book value was \$85,982.38.

As of August 31, 2009, the 57 deceased beneficiaries had been dead for an audited average of 7 years. These beneficiaries are presumed to have been serviced, and their funeral and embalming services funded through other sources.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must identify all the active contracts with a cancelled, inactive, or revoked licensee and refund the monies according to CCR Section 1274 or escheat the funds to the State Controllers Office (SCO) as unclaimed property.

2. FDSC and Comerica must identify all the active contracts that have been transferred without the trustor's authorization from a cancelled, inactive, or revoked licensee to an active licensee and refund the monies according to CCR Section 1274 or escheat the funds to the SCO as unclaimed property.
3. FDSC and Comerica must stop transferring the contracted funeral and embalming services from the licensee who can not perform the services to a licensee who can without the authorization from the trustor.
4. FDSC and Comerica must periodically review contracts for deceased beneficiaries. For those identified, the trustee must return the funds according to CCR Section 1274 or escheat the funds to the SCO.

Finding 7 –**Buying and Selling
Funeral Services After
Death or While a
Death is Impending in
Violation of BPC
Sections 7694 and
7697****Condition**

BPC Sections 7694 and 7697 prohibit the solicitation or buying of funeral directing and embalming business by a licensee after a death or while a death is impending by the agents, assistants or employees of the licensee.

In violation of BPC Sections 7694 and 7697, CMA, the Trust's bookkeeper, transferred 141 preneed contracts with an audited aggregate contract value of \$65,143.92 from Kiefer and Eyerick Mortuary (Kiefer) to Crawford Mortuary (Crawford).

Crawford reported to CMA that they had purchased the rights to provide funeral directing and embalming services for \$2,500. CMA did not require any written consent from any of the trustors or beneficiaries before transferring the contracts to Crawford. CMA accepted from Crawford a copy of the sales agreement dated April 18, 2007. Based on the closed dates reported on the transfer listing provided by FDSC and Comerica, the contracts were transferred from Keifer to Crawford on September 11, 2007.

As of January 11, 2010, an audited count of 41 beneficiaries of the 141 transferred contracts, with an audited aggregate contract value of \$65,143.92, were either dead or died since the date of the sale on April 18, 2007. The audited amounts were derived from the August 31, 2009 active contract listing. In violation of BPC Sections 7694 and 7697, six beneficiaries with an audited aggregate contract value of \$5,854 were deceased before the date of the sale.

The two funeral establishments with the assistance of the Trustees have violated BPC Sections 7694 and 7697.

BPC Section 7718 prohibits any person from receiving valuable consideration, directly or indirectly, from a funeral establishment in order that the funeral establishment might obtain business.

FDSC and Comerica have received valuable consideration from this transfer of contracts, by being able to retain the funds in the Trust, rather than disbursing the funds to beneficiary, trustor or their legal representative.

As Keifer closed in 2007 and can no longer perform any services, the FDSC and Comerica should have returned the trust corpus and net income to each beneficiary, trustor or their legal

representative without the imposition of any revocation charge in accordance with CCR Section 1274.

When asked why the funds were not returned, Mr. Kuhn stated, "Because CMT is a Master Trust, consumers can leave their funds in the Trust even if the firm through which they wrote the contract can no longer do business."

Scope limitation

FDSC and Comerica failed to provide a listing of the cancelled and service preneed contracts for the January 1, 2000 through December 31, 2006 and the January 1, 2008 to December 31, 2008 periods. This prevented the Bureau from identifying additional instances of BPC Sections 7694 and 7697 violations.

Corrective Action Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must cease the practice of transferring preneed contracts rights and responsibilities to licensees not party to the original contract without obtaining any written consent of the trustor and beneficiary.
2. FDSC and Comerica must review all open preneed contracts in which the contract rights and responsibility were transferred without the written consent of the trustor and beneficiary to licensees not party to the original contract. Then FDSC and Comerica must reinstate the contracts to the original licensee. If the licensee is no longer able to provide the services, FDSC and Comerica must refund the monies directly to the beneficiary, trustor or their legal representative or escheat the funds to the SCO as unclaimed property
3. In the future, FDSC and Comerica must provide the Bureau with the records requested in accordance with CCR Section 1267.

**Finding 8 –
Refunds to Trustors
Not Made Within 15
Days of Receipt of
Written Request for
Contract Revocation
in Violation of CCR
Section 1264**

Condition

CCR Section 1264 requires that the trustee refund the corpus and accumulated earnings, less a revocation fee to the consumer within 15 days after the trustor cancels a funeral preneed contract.

Of the 14 contracts sampled for 2007, 11 contracts were not refunded within 15 days, which is a violation of CCR Section 1264. This is a non-compliance rate of 79% (11/14). The value of the contracts not in compliance with CCR Section 1264 is an audited \$36,778.07 or 82% (\$36,778.07 / \$44,919.36) of the sample.

The number of days lapsed from the time the contract was revoked in writing by the trustor until the time the refund was made is as follows:

Date Range	# of Occurrences'
0 – 15	3
15 – 20	1
20 – 30	6
30 – 40	1
> 40	3

The above findings were determined by comparing the date the trustor signed the revocation agreement with the date on the refund check.

In addition, the Bureau conducted an inspection of Hillside’s records for contracts cancelled in 2009. The inspection revealed that of the eight (8) contracts reviewed, only three (3) had sufficient information to make a determination if the refund was timely. None of the three were refunded to the trustor within 15 days from the date of the revocation date. Two of the three contracts with sufficient information had check dates that were within 15 days from the date the trustor signed the revocation. However, the checks were mailed to the funeral establishment, instead of directly to the trustor. Subsequently, the funeral establishment mailed the checks to the trustor after the 15 days lapsed.

The internal procedure for this funeral establishment is to receive the refund check of the trustor at the address of the funeral establishment. The funeral establishment then forwards the check to the trustor with a cover letter.

This procedure violates CCR Section 1264 and reveals an internal control weakness. In violation of this CCR, the Trust procedures require that the revocation be on the Trust's "Revocation of Trust Agreement" document and that a funeral director of the funeral establishment also sign it. CCR Section 1264 only requires that it be on a written document from the trustor.

The procedure and form allowing for the refund check to be mailed to the funeral establishment is an internal control weakness. Not only does this delay the refund, but it affords the funeral establishment or person at the funeral establishment controlling the requests the opportunity to submit a fraudulent request and cashing the check as it comes in.

Trustors are often the named beneficiary. Occasionally when the trustor/beneficiary dies, the responsible party who handles the affairs is unaware of the existence of the preneed contract and trust account. Finding 6 clearly identifies this as a problem under the heading "Active Contracts of Deceased Clients".

When the monies are left in the trust account of a deceased beneficiary for years and the Trust fails to identify and return the funds to the heirs or escheat the funds to the State Controllers Office, the funds are susceptible to misappropriation as mentioned above.

The potential theft described above may never be discovered as the Trustees are relying on the internal controls of each separate funeral establishment which is unknown to the Trustees.

FDSC and Comerica violated CCR Section 1264 since it is their practice of not refunding contracts within 15 days from the date of cancellation by the trustor.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica must refund the trustor's corpus and accumulated earnings within 15 days from the date of the written notice of termination.
2. FDSC and Comerica must cease the practice of requiring trustors to use a specific form to cancel a preneed contract.

Refunds must be provided upon any written request in accordance with CCR Section 1267 without the necessity of providing a form.

**Finding 9 –
Failure to Maintain
Preneed Trust
Records In California
in Violation of CCR
Section 1267**

Condition

Each funeral establishment with preneed arrangements is required to maintain or cause the trustee of the preneed trust to maintain in California and available for inspection by the Bureau, complete financial records of all preneed contracts and arrangements in accordance with generally accepted accounting principles (CCR Section 1267).

FDSC maintained the trust records in Folsom, California until February 2007. On January 1, 2007, FDSC retained CMA as the ‘third party administrator’ in Oregon to provide accounting and bookkeeping services for the Trust. In February 2007, the trust records were picked up and transported to Oregon by Mark Kuhn, President of FDSC and Charles Wetmore, of CMA. Representatives from ARC, the former third party administrator, confirmed that they released the Trust records to Mr. Kuhn and Mr. Wetmore and had advised the Trustees that the records should remain in California.

Reporting

Instead of filing the 21P-4A forms (Preneed Funeral Trust Fund Report) for the 2000 through 2005 reporting years as required under CCR Section 1269, FDSC, The Mechanics Bank and Comerica annually substituted a letter with an attachment entitled “Pre-Need Funeral Trust Report” for each of the year filings in violation of CCR Section 1269.

FDSC, The Mechanics Bank and Comerica reported that the trust’s records were maintained in Folsom, California with the third party administrator.

Beginning with the 2006 reporting year, FDSC and Comerica filed on the 21P-4A forms as required. On the 2006, 2007, and 2008 forms, FDSC and Comerica stated that the records were maintained “ON-SITE”. Mr. Kuhn in a letter dated October 16, 2009 stated that “On-site” means that the Trust’s records are located at each individual firm throughout California.

Records Not in California

One issue in the “ON-SITE” reporting are the 33 funeral establishments that have been identified as closed, inactive, or revoked licensees in Finding 6. For the funeral establishments that have closed, their records are only available through FDSC, Comerica and the third party administrator in Oregon.

Also, in contrast to the statements made by Mr. Kuhn, Hillside did not maintain all the trust records as claimed by him. Based on interviews with staff and a site visit conducted by the Bureau on October 26, 2009, Hillside did not maintain the following records as required:

- Request for Proposals and responses. When the Trustees place a contract out for bid, such as for the bookkeeping services in which CMA won the contract.
- All account correspondence between the trustor and CMA
- Vendor contracts with FDSC to provide service for the Trust.
- Record of the Administrative costs.
- Records of the Administrative costs allocated to FDSC, Comerica Bank, Mechanics Bank, Argent Financial Services, ARC, EPG, CMA, CFDA
- Disparity Resolution Plan.
- Action Plan.
- Cash receipts journal or Cash Disbursements Journal (CCR 1267 (c) & (d)).
- General ledger (CCR 1267 (f)).
- Portfolio of all the Trust's investments (CCR 1267 (g)).

Who Attested to the Record Locations

On the 2005 document filed instead of the 21P-4A form Mark Kuhn for FDSC and Robert Gajewski for Comerica, signed the verification statement claiming that the forms were "complete, true, and correct to the best of my knowledge and belief." They reported that the records were in Folsom, California.

For 2006 through 2008, Mr. Kuhn and Mr. Gajewski signed the verification statement attesting to the fact that the records were maintained "ON-SITE".

Summation

FDSC, Comerica, and each participating funeral establishment violated CCR 1267 since they did not maintain in California, at all times, complete financial records of all preneed contracts and arrangements.

Corrective Actions Required

The funeral establishments must ensure the following corrective actions are taken.

1. FDSC and Comerica need to comply with CCR 1267 and, at all times, must maintain in California and available for inspection by the Bureau complete financial records of all preneed contracts and arrangements. These records must be maintained in accordance with generally accepted accounting principles.
2. FDSC and Comerica must submit correct, true, and accurate information in compliance with CCR Sections 1267 and 1269.

Finding 10 –**Records Not Made Available for Inspection by the Bureau in Violation of CCR Section 1267****Condition**

CCR Section 1267 requires that the funeral establishment or trustee shall make the trust records available for inspection by the Bureau during reasonable working hours. Not all of the documents requested were provided. A few of the more relevant documents not provided are listed below.

Request to Save the Trust the Cost of Retrieving and Producing Records

In the audit contact letter dated November 9, 2007, the Bureau requested to review the independent auditor's workpapers. The workpapers serve as a reconciliation between the "Annual Funeral Trust Fund Report" filed with the Bureau and the records maintained by the Trust. The workpapers attest to the accuracy of their records and indentifies what tests the independent auditors performed to arrive at their conclusions. Through the workpapers, the subsequent independent auditors can rely on their work reducing their testing process saving the Trust time and costs.

In the November 9, 2007 email, Ms. Fowler informed the Bureau that the Bureau could review the audit files of the independent auditors. However, the written approval was never provided.

The Bureau made the request on two additional instances. In the last request, September 11, 2009, the Bureau included authorization forms for FDSC to sign. The authorization forms were never signed.

On October 16, 2009, Mr. Kuhn, President of FDSC, wrote, "This request is overbroad, burdensome and oppressive." "Auditing the CPA's will cause additional costs to the consumers/ contract holders, as these outside accounting firms will bill the Trust." "Their reports including notes are filed as part of each annual report sent to DCA and are available for you to review."

As FDSC did not provide access to the prior auditor's workpapers, the Bureau could only seek verification of the annual reports from the limited Trust's records made available to the Bureau.

“CMT Trial Balances” for 2000 through 2006

ARC informed the Bureau that the independent auditors used the CMT Trial Balances that ARC had prepared to perform their independent financial audit for 2000 through 2006. The CMT Trial Balances were kept in binders and were surrendered to Mark Kuhn of FDSC and Charles Wetmore of CMA who drove them to Oregon. The Bureau requested the CMT Trial Balances in the September 11, 2009 letter.

In response to the request for Trial Balances, the Trustees stated in their October 16, 2009 letter, “We did find approximately 10 very large boxes (larger than banker boxes) containing monthly “CMT Balancing Back-up” for all the years listed.” “As most of these documents were made available to you either electronically or on paper, and the independent auditor that was hired to review each annual report has already reviewed them, we object on grounds that it is duplicative, burdensome and oppressive for us to duplicate these documents and send to your office.” (Emphasis added).

These documents have never been provided to the Bureau or made available to the Bureau at a location in California as required by CCR Section 1267. To date, the Trustees provided electronic data and schedule for accounts that existed in 2006. The Trustees have not provided any electronic files of serviced or cancelled trust accounts for the period January 1, 2000 through December 31, 2005. The only paper document provided was the unauditable “Account Statements” that Comerica took one work day to print. The Comerica document did not contain any transactions prior to February 2002.

Comerica Print Outs

On December 21, 2007, the Trustees provided approximately 7,000 pages of the “Account Statements” of cash disbursements and receipts. According to Gajewski, the documents were printed in one work day. The document was not reconcilable to the reports under audit.

The audit was attempting to reconcile the Trustees records to what the Trustees reported on their annual Preneed Funeral Trust Fund Reports and audited financial statements submitted to the Bureau. The independent auditors submitted their reports based on the income tax basis of accounting and the Account Statements were prepared on the cash basis of accounting. None of the amounts reported on 2006 Account Statements could

be reconciled to either 2006 Preneed Funeral Trust Fund Report or the 2006 audited financial statements.

On August 3, 2009, the Trustees provided a disc entitled "CMT Dec-06 From ARC" with 2006 data and schedules. One file was provided entitled "2006 Expense Detail Report (Run date 1/3/07)" and contained the 2006 funeral establishments' participation distributions. The Bureau reconciled the schedule back to the 2006 audited amount of funeral distributions.

The Bureau then attempted to reconcile the 2006 Expense Detail Report to the Account Statements. As funeral establishments' participation distributions are made quarterly, the Bureau attempted to trace the last quarter's payments listed by funeral establishment to the Account Statements. The Bureau found some of the payments listed in 2007 Account Statements.

Not all of the payments could be traced as the Account Statements descriptions were incomplete. For instance, five payments were made to one funeral establishment. However, the 2006 Expense Detail Report indicated that the funeral establishment received only one of the payments. The amounts of the other four payments could be matched to other funeral establishments with different names but there was no substantiation that they were the funeral establishments being paid.

Even after trying to match the payment amounts, 48 of those listed on the 2006 Expense Detail Report still could not be found. Additionally, the Account Statements listed some payments to funeral establishments that could not be traced to the 2006 Expense Detail Report.

Additionally, the Account Statements did not cover the audit period of January 1, 2000 through August 31, 2009. The Account Statements began in February 2002. Twenty-five and a half months were not covered.

Finally, the Account Statements do not provide an accounting of each trustor's account. The amount of investment income or losses allocated to the accounts is not within the document. CMA is the entity contracted by FDSC to allocate the income and expenditures to each trust account per CMA's response to FDSC Request for Proposal.

Disparity Resolution Income Supporting Documents

On November 9, 2007, the Bureau requested the following to document the Disparity Resolution Income reported on the 2001 and 2002 independent audit reports and the Promissory Note reported since 2001.

- Disparity Resolution Plan.
- Note receivable from the FDSC (Promissory Note).
- High Country Capital Management report dated April 10, 2001.
- Documentation supporting the Disparity Resolution Income.

After five additional requests, the Trustees provided the following on August 3, 2009 (21 months after the first request).

- A partial Disparity Resolution plan without Exhibit B. Exhibit B was not provided but it was described as containing an explanation of the accounting practice for accounting for gains and losses.
- Note Receivable (Promissory Note).
- An incomplete draft of the High Country Capital Management report dated March 26, 2001. Only, the following pages were provided, 2, 5, 8, 10, 13, 15, 17, 19, 21, 23, 25, 27, 29, 31, 34, 36, 38, 40, 42, 48, 50, 51, 53, 55, 57, and 59.

Disparity Resolution Plan binder

On September 11, 2009, the bureau requested the Disparity Resolution Plan binder that ARC informed the Bureau that it had surrendered to Mark Kuhn of FDSC and Charles Wetmore of CMA who drove the document to Oregon. The binder reportedly contains the Exhibit B, allocations and reasons behind the Plan.

On October 16, 2009, FDSC responded and informed the Bureau that they could not locate the binder.

FDSC Sub-Contracts to Provide Trust Administration

Per the Agreement, FDSC is required to perform many tasks under the Agreement. See Finding 1. FDSC contracted out the trust administration to various entities. On November 9, 2007, the Bureau requested any past and current contracts with FDSC to support the reported trust administration costs. After several

additional requests, the Trustees provided the following on August 3, 2009:

- Master Trust Agreement with Comerica.
- Master Trust Agreement with Mechanics Bank.
- A partial CMA contract. The contract was missing Exhibit A which described CMA's obligations under the contract.
- A partial EPG contract. The duties to perform were on EPG's response to FDSC's Request for Proposal.
- ARC contract.
- Several contracts for audit services.

On August 13, 2009, CMA's Exhibit A was provided.

Corrective Action Required

The funeral establishments must ensure the following corrective action is taken.

In the future, Trustees must make the records available to the Bureau at a location in California in accordance with CCR 1267.