

SUNSET EVALUATION REPORT
CEMETERIES AND MORTUARIES
Chapter 441, Hawaii Revised Statutes

A Report to the Governor and the Legislature of the State of Hawaii

Submitted by the
Legislative Auditor of the State of Hawaii
Honolulu, Hawaii

Report No. 87-6
January 1987

FOREWORD

Under the "Sunset Law," licensing boards and commissions and regulated programs are terminated at specific times unless they are reestablished by the Legislature. Hawaii's Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, scheduled for termination 38 licensing programs over a six-year period. These programs are repealed unless they are specifically reestablished by the Legislature. In 1979, the Legislature assigned the Office of the Legislative Auditor responsibility for evaluating each program prior to its repeal.

This report evaluates the regulation of cemeteries and mortuaries under Chapter 441, Hawaii Revised Statutes. It presents our findings as to whether the program complies with the Sunset Law and whether there is a reasonable need to regulate cemeteries and mortuaries to protect public health, safety, or welfare. It includes our recommendation on whether the program should be continued, modified, or repealed. In accordance with Act 136, SLH 1986, draft legislation intended to improve the regulatory program is incorporated in this report as Appendix B.

We acknowledge the cooperation and assistance extended to our staff by the Department of Commerce and Consumer Affairs and other officials contacted during the course of our examination. We also appreciate the assistance of the Legislative Reference Bureau which drafted the recommended legislation.

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January 1987

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Chapter 1

INTRODUCTION

The Hawaii Regulatory Licensing Reform Act of 1977, or Sunset Law, repeals statutes concerning 38 occupational licensing programs over a six-year period. Each year, six to eight licensing statutes are scheduled to be repealed unless specifically reenacted by the Legislature.

In 1979, the Legislature amended the law to make the Legislative Auditor responsible for evaluating each licensing program prior to its repeal and to recommend to the Legislature whether the statute should be reenacted, modified, or permitted to expire as scheduled. In 1980, the Legislature further amended the law to require the Legislative Auditor to evaluate the effectiveness and efficiency of the licensing program, even if he determines that the program should not be reenacted.

Objective of the Evaluation

The objective of the evaluation is: To determine whether, in light of the policies set forth in the Sunset Law, the public interest is best served by reenactment, modification, or repeal of Chapter 441, Hawaii Revised Statutes.

Scope of the Evaluation

This report examines the history of the statute on the regulation of cemeteries and mortuaries and the public health, safety, or welfare that the statute was designed to protect. It then assesses the effectiveness of the statute in preventing public injury and the continuing need for the statute.

Organization of the Report

This report consists of three chapters: Chapter 1, this introduction and the framework for evaluating the licensing program; Chapter 2, background information on the regulated industry and the enabling legislation; and Chapter 3, our evaluation and recommendations.

Framework for Evaluation

Hawaii's Regulatory Licensing Reform Act of 1977, or Sunset Law, reflects rising public antipathy toward what is seen as unwarranted government interference in citizens' lives. The Sunset Law sets up a timetable terminating various occupational licensing programs. Unless reestablished, the programs disappear or "sunset" on a prescribed date.

In the Sunset Law, the Legislature established policies on the regulation of professions and vocations. The law requires each occupational licensing program to be assessed against these policies in determining whether the program should be reestablished or permitted to expire as scheduled. These policies, as amended in 1980, are:

1. The regulation and licensing of professions and vocations by the State shall be undertaken only where reasonably necessary to protect the health, safety, or welfare of consumers of the services; the purpose of regulation shall be the protection of the public welfare and not that of the regulated profession or vocation.
2. Where regulation of professions and vocations is reasonably necessary to protect consumers, government regulation in the form of full licensure or other restrictions on the professions or vocations should be retained or adopted.

3. Professional and vocational regulation shall be imposed where necessary to protect consumers who, because of a variety of circumstances, may be at a disadvantage in choosing or relying on the provider of the services.

4. Evidence of abuses by providers of the services shall be accorded great weight in determining whether government regulation is desirable.

5. Professional and vocational regulation which artificially increases the costs of goods and services to the consumer should be avoided.

6. Professional and vocational regulation should be eliminated where its benefits to consumers are outweighed by its costs to taxpayers.

7. Regulation shall not unreasonably restrict entry into professions and vocations by all qualified persons.

We translated these policy statements into the following framework for evaluating the continuing need for the various occupational licensing statutes.

Licensing of an occupation or profession is warranted if:

1. There exists an identifiable potential danger to public health, safety, or welfare from the operation or conduct of the occupation or profession.

2. The public that is likely to be harmed is the consuming public.

3. The potential harm is one against which the public cannot reasonably be expected to protect itself.

4. There is a reasonable relationship between licensing and protection of the public from potential harm.

5. Licensing is superior to other alternative ways of restricting the profession or vocation to protect the public from the potential harm.

6. The benefits of licensing outweigh its costs.

The potential harm. For each regulatory program under review, the initial task is to identify the purpose of regulation and the dangers from which the public is to be protected.

Not all potential dangers warrant the exercise of the State's licensing powers. The exercise of such powers is justified only when the potential harm is to public health, safety, or welfare. "Health" and "safety" are fairly well understood. "Welfare" means well-being in any respect and includes physical, social, and economic well-being.

This policy that the potential danger be to the public health, safety, or welfare is a restatement of general case law. As a general rule, a state may exercise its police power and impose occupational licensing requirements only if such requirements tend to promote the public health, safety, or welfare. Courts have held that licensing requirements for paperhangers, housepainters, operators of public dancing schools, florists, and private land surveyors could not be justified.¹ In Hawaii, the State Supreme Court ruled in 1935 that legislation requiring photographers to be licensed bore no reasonable relationship to public health, safety, or welfare and constituted an unconstitutional encroachment on the right of individuals to pursue an innocent profession.² The court held that mere interest in the practice of photography or in ensuring quality in professional photography did not justify the use of the State's licensing powers.

The public. The Sunset Law further states that for the exercise of the State's licensing powers to be justified, the potential harm must be to the health, safety, or welfare of that segment of the public consisting mainly of consumers of

1. See discussion in *51 American Jurisprudence*, 2d., "Licenses and Permits," Sec. 14.

2. *Terr. v. Fritz Kraft*, 33 Haw. 397.

the services provided by the regulated occupation. The law makes it clear that the focus of protection should be the consuming public and not the regulated occupation or profession itself.

Consumers are all those who may be affected by the services provided by the regulated occupation. Consumers do not have to purchase the services directly. The provider of services may have a direct contractual relationship with a third party and not with the consumer, but the criterion is met if the provider's services ultimately flow to and adversely affect the consumer. For example, the services of an automobile mechanic working for a garage or for a U-drive establishment flow directly to the employer, but the mechanic's workmanship ultimately affects the consumer who brings a car in for repairs or who rents a car from the employer.

Consumer disadvantage. The exercise of the State's licensing powers is not warranted if the potential harm is one against which the consumers can reasonably be expected to protect themselves. Consumers are expected to be able to protect themselves unless they are at a disadvantage in selecting or dealing with the providers of services.

Consumer disadvantage can arise from a variety of circumstances. It may result from a characteristic of the consumer or from the nature of the occupation or profession being regulated. Age is an example of a consumer characteristic which may cause the consumer to be at a disadvantage. The highly technical and complex nature of an occupation is an illustration of occupational characteristic that may place the consumer at a disadvantage. Medicine and law fit into the latter illustration. Medicine and law were the first occupations to be licensed on the theory that the general public lacked sufficient knowledge about medicine and law to be able to make judgments about the relative competencies and about the quality of services provided to them by the doctors and lawyers of their choice.

However, unless otherwise indicated, consumers are generally assumed to be knowledgeable and able to make rational choices and to assess the quality of services being provided them.

Relationship between licensing and protection. Occupational licensing cannot be justified unless it reasonably protects the consumers from the identified potential harm. If the potential harm to the consumer is physical injury arising from possible lack of competence on the part of the provider of service, the licensing requirements must ensure the competence of the provider. If, on the other hand, the potential harm is the likelihood of fraud, the licensing requirements must be such as to minimize the opportunities for fraud.

Alternatives. Licensing may not be the most appropriate method for protecting consumers. Instead, prohibiting certain business practices, governmental inspection, or the inclusion of the occupation within another existing business regulatory statute may be preferable, appropriate, or more effective in protecting the consumers. Increasing the powers, duties, or role of the consumer protector is another possibility. For some programs, a nonregulatory approach may be appropriate, such as consumer education.

Benefit-costs. Even when all other criteria set forth in this framework are met, the exercise of the State's licensing powers may not be justified if the costs of doing so outweigh the benefits to be gained. The term "costs" in this regard means more than direct money outlays or expenditure for a licensing program. "Costs" include opportunity costs or all real resources used up by the licensing program; they include indirect, spillover, and secondary costs. Thus, the Sunset Law asserts that regulation which artificially increases the costs of goods and services to the consumer should be avoided; and regulation should not unreasonably restrict entry into professions and vocations by all qualified persons.

Chapter 2

BACKGROUND

Chapter 441, Hawaii Revised Statutes, regulates cemeteries, pre-need funeral plans, and their trust funds through licensing. Mortuaries, no longer licensed,¹ are required to disclose the provisions of their sales contracts as are cemetery perpetual care and pre-need funeral authorities.

A licensed "authority" is defined as a person or corporation which establishes, improves, maintains, manages, and operates a cemetery for interment of human remains, offers perpetual care for such a cemetery, or accepts money in advance to cover eventual funeral and interment expenses.

Since regulation began, 19 cemetery authority licenses have been issued, all of them before 1978. Thirteen remain current; three authorities have either merged or changed names (requiring the issuance of a new license and cancellation of the old license), and three have ceased operations. Of the 16 pre-need funeral authorities which obtained licensing, 11 were continued.² For both categories of authorities, the majority of licensees already existed when regulation began and so were licensed in those initial years. Records of the Department of Commerce and Consumer Affairs (DCCA) also show 79 nonprofit cemeteries which are not governed by this statute in that they are either church, association, or family related and operated.

1. The Department of Health regulates mortuaries in terms of their sanitary handling of dead bodies and their reporting same.

2. Department of Commerce and Consumer Affairs, licensing and records branch.

Previous Sunset Review

Our initial sunset review of Chapter 441, submitted to the Legislature in 1981, found serious weaknesses in the system of regulating the cemetery and funeral industry in Hawaii. Consequently, we offered extensive recommendations for major changes. Primary among those was elimination of the regulatory Cemetery and Mortuary Board while otherwise retaining regulation. Subsequently, Act 221, SLH 1981, transferred regulatory authority from the board to the Director of DCCA.

Public testimony at legislative hearings in 1981 on sunseting Chapter 441 drew a diversity of expressions. For the most part they focused on individual concerns, such as changing the amount of bonds needed, excusing mortuaries from licensing, deciding whether 30 percent of moneys collected or some lesser amount would cover licensee front-end costs, and determining how far the State should expect trust companies to monitor and control expenditures by licensees.

Given the inconclusiveness of this testimony, legislators attached seven questions, prompted by the findings in our previous report, to Act 221 which they wanted the Director of DCCA to answer before making further amendments. These concerned appropriate levels of bonding, further licensing of mortuaries, how much to allow licensees to retain from client payments to cover front-end costs, auditing of licensee expenses, contingent liabilities, and adding of income to the corpus of pre-need plans.

The director's response, submitted to the 1982 legislative session, essentially paralleled our recommendations. The director proposed a sliding bond requirement determined by total obligations. This recommendation encountered opposition from the industry and was not enacted. Instead, the bond amount was set at \$50,000 for

all licensees whether large or small, perpetual care cemetery and pre-need funeral plan alike.

Both our sunset review and the director found insufficient need for continued licensing of mortuaries. Licensing pre-need funeral authorities would protect where protection was needed. Act 221, SLH 1981, eliminated mortuary licenses and also removed cemetery and funeral salespersons from a licensing requirement as we had recommended.

Our 1981 review had questioned the 30 percent figure as necessary to cover a licensee's sales costs. Industry spokespersons strongly defended this 30/70 formula, the most favorable among any of the states. The director proposed the use of actuarial studies as a basis for determining how well served the public is by licensees, their sales offers, and their trust funds. A legislative amendment (Act 66, SLH 1982) then instituted annual actuarial studies for both pre-need funeral and perpetual care cemetery authorities.

In line with our recommendations, the Director of DCCA took the position that public protection requires a distinct separation between operators and the management of their trust funds. Despite some industry objections, Act 66 further strengthened this delineation by making trustees independent of operators. It no longer allowed operators to be represented on a trust board or to retain the right to approve trust decisions on investments as initially permitted by Act 221 the previous year.

Act 101, SLH 1985, made further refinements by strengthening the authority of the Director of DCCA to enforce and implement the intent of those changes made in 1981 and 1982. All trust fund moneys must now be placed in and managed by trust companies (or boards of trustees) within the State of Hawaii to enhance

control by the Director of DCCA. Automatic suspension of a license must follow failure to maintain the required bond. Minimum provisions must be stated in written contracts with clients and samples submitted to the department. Actuarial studies, audited financial statements, and trust agreements filed with the department were opened to public scrutiny. And the department received clear authority to impose disciplinary action on failure to comply.

Current Regulation

Ever since Act 221 abolished the Cemetery and Mortuary Board and transferred responsibility and authority to the Director of DCCA, regulation has proceeded without a set of rules. The department interpreted the Legislature's abolition of the board as simultaneously terminating its extant rules. New rules began to take shape only during the last two years in a dialogue between the Professional and Vocational Licensing Division and industry representatives. Consequently, the framework for regulation currently in effect is limited to that prescribed in the statutes.

Sections 441-2 through 441-17, HRS, have remained virtually unchanged since their initial enactment in 1967. These sections cover cemeteries as legal land subdivisions dedicated to perpetual interment. In contrast, the rest of this chapter, which has incurred repeated and rather extensive changes, focuses on how licensees operate, on management of moneys paid in, and on required reporting.

The DCCA may inspect and audit the records of cemetery and pre-need funeral authorities. It may license eligible applicants, or it may withhold licensing: from persons "who do not possess financial integrity;" from those who fail to file proper documentation, contract forms, and bonds; and from any who fail to establish

a prescribed trust fund. A cemetery or pre-need funeral authority must provide purchasers with: a clear and concise statement of all property, goods, and services to be supplied; the purchase price of each item; all related costs; and refund provisions. Prices and items may not be changed unless requested by the purchaser.

The Director of DCCA has the authority to fine, to revoke, or suspend an authority's license, and to refuse renewals for such infractions as: dishonest or fraudulent acts, making repeated misrepresentation in advertising, commingling trust funds with personal money, being insane or incompetent, selling property or services as a speculative investment by the purchaser for resale, failing to file required actuarial studies and audited financial statements, and failing to maintain a bond.

All cemeteries established since Act 199, SLH 1967, must provide perpetual care. Cemeteries begun before that year may not advertise themselves, or even imply, that they include a guarantee of perpetual care unless they fully comply with all provisions of Chapter 441, HRS.

Seventy percent of all moneys paid in by customers for perpetual care plots and pre-need funeral plans must be turned over to a bank, trust company, or a board of trustees which is entirely disassociated from the cemetery or pre-need operator. Only profits from invested principal may be drawn on by a cemetery operator to maintain that facility. Interest from investments for pre-need trusts should be used to keep up with inflation so that the quality of funeral contracted for can be fulfilled. Investment options now are tightly governed as are requirements for full insurance.

Regulating trust fund administration now constitutes a major means for providing public protection. This aspect is covered in Sections 441-24.5 through

441-24.7, HRS. These sections spell out the annual audit statements and actuarial studies upon which trust planning and management and DCCA monitoring should be based. The required actuarial studies are expected to project anticipated life expectancies for purchasers of pre-need arrangements, along with long-range inflation and interest rates for setting prices and ensuring availability of funds as needed.

Chapter 3

EVALUATION OF CEMETERY AND PRE-NEED FUNERAL PLAN REGULATION

This chapter sets forth our updated evaluation and findings regarding the need to regulate cemetery and pre-need funeral authorities and their trust funds in Hawaii. We examine those aspects of regulation which have yet to be corrected and recommend how they might be resolved.

Current Findings

1. There is a continuing need to regulate the trust funds associated with perpetual cemetery care and pre-need funeral plans.
2. Statutory or rule changes are needed to strengthen regulation in such areas as bond requirements, penalties, investment control, reserve funds, and timing of deposits.
3. Capabilities of the Professional and Vocational Licensing Division (PVL) to monitor adequately all regulated aspects of this industry and the reports submitted are limited, given its current resources.
4. Although stronger trust arrangements have made significant gains toward public protection in this area of regulation, the full extent of responsibilities and powers of trustees remain less than certain in the statutes.

Need for Regulation

Disposition of human remains is an inevitable necessity, something families must either prepare for or cope with under the emotional strains of the moment. For many families, death brings major expenses for which considerable financial planning and sacrifice become unavoidable. At the same time, due to the emotional and economic vulnerability on the part of many people, it has proven an attractive field for the unscrupulous to enter, much to the discomfort of those responsible entrepreneurs who would serve the public well. We find no evidence that the basic need to regulate—to keep out the unscrupulous and assist the honest to perform appropriately—has diminished in importance from what it was when Chapter 441, Hawaii Revised Statutes, was first enacted. Regulation should continue.

No consensus has yet emerged among the states on how best to proceed in regulating this industry. Each state has largely gone its own way. Recently, the federal government moved into this area of regulation by having the Federal Trade Commission establish guideline rules for funeral practices.¹ Trust funds for cemetery and pre-need plans, however, remain a state responsibility.

Need for Further Regulatory Adjustments

While virtually all of the major changes recommended in our 1981 sunset evaluation report have now been enacted into law, there remain some areas of regulation where further adjustments appear to be needed. These are set forth below.

1. First promulgated in the Federal Register Vol. 47, No. 186, of September 24, 1982, and made effective as per Federal Register Vol. 50, No. 131, on July 9, 1985.

Bonds. One significant exception to statutory enactment of our previous recommendations involves the requirement of bonding by licensees. Act 199, SLH 1967, had imposed a \$5,000 or \$50,000 surety bond on cemetery authorities, the amount dependent on the previous year's sales. At the time we conducted our 1981 sunset review, those bond amounts remained intact. We recommended then that the prescribed amounts be reevaluated in terms of real need. Two decades after the original maximum \$50,000 amount was set, it is still the amount stipulated. Its arbitrariness raises serious question about the purpose, utility, and meaning of such a bond.

In light of the accelerated rate of costs for bonds, the need to reevaluate just what a bond actually accomplishes, and hence, at what level it would optimally serve its purposes, appears now more appropriate than ever. We agree with the then Director of the Department of Commerce and Consumer Affairs (DCCA) in her response to the Legislature in 1982 that the amount of bond should correspond to the level of total obligation. This approach seems particularly appropriate for perpetual care cemeteries as they begin to fill and have proportionally fewer annual sales.

Acts 35 and 140, SLH 1986, provided a first break from a traditional reliance on bonds. Those acts authorized departmental rules to impose a reasonable alternative to the surety bond in the form of required insurance or other suitable instrument of public protection. The DCCA used this new provision to require all licensees which have appointed boards of trustees (as distinct from regulated banks and trust companies) to post a \$100,000 *cash* bond. This (and possibly other) regulated industries might well benefit from a concerted study of how relatively well bonds (cash or surety), insurance, and any other instrument would provide public protection and at what levels.

Other aspects of bonds, as currently required, cause problems or unfairness. Despite a sizeable difference in the amounts of moneys involved between perpetual care and pre-need trust funds, the statutes impose the same bond requirement on both. We believe that the nature or extent of risk, in addition to size of financial obligation, should receive prime consideration.

There is also the matter of how usable a bond really is when called. As far as we could ascertain, the State has only tried to call in one bond within the last decade in the cemetery and mortuary field. That case reveals how inefficient a surety bond is for protecting the public.

In this instance, the cemetery authority ran into trouble in the late 1970s and surrendered its license in 1982. Six years after investigations began, the bond issue remains tied up in several sets of litigation with no foreseeable resolution. Meanwhile, the injured parties remain without compensation, gaining only mounting attorneys' fees.²

Moreover, a surety bond tends to become a tool of last resort. Once the State goes to court to call in a bond, the licensee has virtually no chance of securing another bond and hence, no way to remain in operation. As in the case just mentioned, bankruptcy is almost inevitable--unless DCCA can find someone else to take over operations. If the State cannot find a new operator, the State faces the prospect, sooner or later, of having to absorb it into receivership and then operate what would, in effect, become a public cemetery despite a lack of statutory provisions for such an entity in Hawaii.

2. Interview with Winfred Pong, the deputy attorney general handling this litigation, August 12, 1986.

To avoid that prospect, DCCA officials have, in recent years, sought to work with licensees to resolve their problems rather than simply police them. So far though, the bond requirement, in its present form, has provided little assistance in carrying out this objective.

Penalties. The maximum penalty set for violations in 1967 was a \$1,000 fine. That same maximum fine remained in effect when we conducted our previous sunset review and prompted our questioning it. Now 20 years since it was enacted, it still remains unchanged.

There is another side to the imposition of fines: that of who is responsible and who pays. Currently, payment of a fine of any amount would come from the trust fund which Chapter 441 attempts to protect and not from the operator who would have committed the infraction deserving punishment. Consequently, imposing fines would penalize the innocent and leave untouched the guilty.

Case law in the area of environmental protection might provide some precedent for imposing penalties on the executives or other personnel who actually commit an infraction. Not only are officials of companies which pollute the environment being fined, some have reportedly even gone to prison. Thus, it might be possible to amend the statute to provide appropriate penalties and to impose them on the perpetrators of violations without subtracting from the very funds the law is expressly supposed to protect. We believe that DCCA, in conjunction with the Attorney General, should pursue this possibility.

Further adjustments. Several technical adjustments in the regulation of cemetery and pre-need funeral authorities appear appropriate. Some of these might be handled through the adoption of rules, but others may require statutory change.

These include: control of trust fund investments, accounting for reserve funds, and setting time limits for making deposits.

1. *Investment controls.* One objective, in those amendments already made to Chapter 441, sought sounder management of trust funds so that they can accomplish, when eventually needed, what clients had paid for. The DCCA has sought to have all trust funds managed by investment professionals at banks and licensed trust companies. However, one licensee has strenuously objected to this move, and current legislation continues to allow appointed boards of trustees. But by persuasion, DCCA has succeeded in having those authorities which have been in financial trouble to switch to a professional trust company or bank form of fund management with, apparently, improvement in their condition.

Another facet of departmental concern focuses on those investments which today appear less than sound. Some of them were made before actuarial studies could provide needed projections for fiscal management or back when licensed operators controlled investment decisions for their trust funds. In drafting rules for this industry, the PVL administrator had to resolve the question of whether to let existing investments stand even where they are seriously flawed or to require full compliance with more suitable investment guidelines.

The rules, as drafted at the time of this writing, will include a requirement that all investments, existing and future, must comply with the guidelines set forth in the rules. Draft rules allow: deposits in a bank which is insured by the Federal Deposit Insurance Corporation, deposits in a savings and loan association which is insured by the Federal Savings and Loan Insurance Corporation, certificates of deposit or other interest-bearing accounts in any insured bank in this State, investment certificates or shares in any state or federally chartered savings and

loan association, interest-bearing bonds of the United States or subdivision thereof, and stocks which are either listed with the New York Stock Exchange and a member of the Securities Investor Protection Corporation with additional insurance coverage of \$1 million per account or are federally insured to the full amount of funds so invested.

Although resistance to this rule might emerge from some individual licensees, we believe the rule is appropriate. A two-year period of transition should allow sufficient time to make the necessary reinvestments without encountering market disadvantages. The Director of DCCA could, of course, provide an extension if a trustee can demonstrate mitigating circumstances.

2. *Reserve funds and refunds.* Chapter 441 provides a system for regulating funds held in trust. It is less specific on how other funds—those not brought under the trust—should be handled. Section 441-39, HRS, for instance, provides for the creation of reserves from surplus income; otherwise, that income would become a part of principal and thereby be immune from expenditure for needed cemetery maintenance and refurbishment. Not spelled out are: who is responsible for investing and accounting for these reserve moneys, whether they come under the required annual audits, and what the auditors should look for if they are supposed to be included. We believe the rules should explicitly cover these aspects of control.

Perpetual care spans a dimension of time well beyond what people today can anticipate and plan for. But cemeteries will inevitably face the need for major repairs, either due to normal wear or to acts of nature, be they storms, erosion, or earthquake. At some point, large costs will occur that cannot be undertaken incrementally. However, a periodic program of refurbishment and preventive

maintenance can minimize those unforeseeable expenses when they do come. How well a cemetery is maintained will likely have much to do with how well its capital investment remains valuable and its reason for being remains viable.

In this light, it appears essential that management of the capital investment and the permitted reserve funds for cemetery preservation be as clearly prescribed as that of the trust funds. Regulation should call for a maintenance plan in conjunction with both those reserve funds and the required actuarial studies.

Section 441-39 also provides for reserve funds to cover refunds. However, it is unclear under what circumstances and through what process such refunds can be made. This matter should be clarified.

3. *Timing of deposits.* Section 441-38, HRS, requires all moneys paid to licensees for pre-need plans to be turned over to their trusts within 30 days of receipt. On the other hand, moneys paid on perpetual care cemetery contracts may be held by a licensed authority until the final installment is made. That gives the licensee uncontrolled use of these moneys for however many months the installments may take.

If there is justification for trust funds to protect the public, then it seems appropriate that all moneys paid in by clients (beyond the 30 percent retention allowance) should go into those trust funds as quickly as possible. In the event the installment contracts are terminated before they are paid off, provisions can be made for making refunds. We have found no rationale in testimony or committee reports which would warrant the difference in handling moneys from client payments between the two forms of licensees.

Moreover, allowing moneys to remain out of trust control for as long as 30 days appears without justification in this age of fast banking. Fifteen days

after receipt of payments from clients should provide more than ample time for clients' checks to clear and licensees to deposit the moneys to their trust funds. We believe the statutes should be so amended.

Departmental Capabilities

Since legislation began to regulate cemeteries in 1967, licensees have had to submit annual financial statements. Act 21, SLH 1975, further opened all financial records of each licensee to inspection by the regulatory agency. In 1982, the Legislature adopted what became Act 66. It mandated an annual audited financial statement and actuarial study. Yet, during this period, several authorities got into serious financial difficulties, one of them going bankrupt.

For example, one 1985 audit of a cemetery authority found that its owner, over four years: (1) had commingled funds between what should have been perpetual care and pre-need trust moneys with the authority's operating funds; (2) had failed to transfer any receipts to the trust during that time; (3) had used accounting methods for accounts receivable which were inconsistent with state laws; (4) had owed the trust nearly a million dollars; (5) could not account for differences, amounting to hundreds of thousands of dollars, between computer and ledger records; and (6) had engaged in questionable real estate transactions involving the licensee's personal investments. Fortunately for those who had purchased burial lots in that cemetery, a new owner has taken over the authority's license during this past year and shows signs of resolving these fiscal irregularities with help from the PVL administrator.

An actuarial study completed in June 1986 for another cemetery authority found that it had operated for a decade with no method of matching income in trust

to actual expenses. As a result, it had no accounting mechanism to handle variable interest and inflation rates in managing cash flow and operations.

Our sunset evaluation report of 1981 recommended a shift in regulatory emphasis from control of licensee operations to control primarily of the trust funds inherent in perpetual care cemeteries and pre-need funeral plans, and from regulation by a board of peers to administrative control by professional regulators with expertise in financial matters. That was why we recommended that the State Bank Examiner should be assigned responsibility for evaluating the records and reports of the regulated business and related trust funds.³ This move presumed that the bank examiner would have the requisite expertise not available among staff assigned to the PVL.

The then Director of DCCA never did, however, assign that responsibility to the bank examiner even though Act 66, SLH 1982, specifically allocated that function to the bank examiner. As a consequence, reports which were submitted to DCCA by the regulated authorities during 1981 through 1983 bounced between the director's office, the Bank Examination Division, and PVL. We can find no evidence that any evaluation was ever made of those reports by anyone at DCCA during 1982 and 1983, the period when the above cited cases of financial trouble among certain licensees were at their worst.

With the arrival in 1984 of the person who now heads PVL, efforts began toward gaining compliance. Delinquent licensees were turned over to the Regulated Industries Complaints Office (RICO) for investigation. That office had only recently

3. Act 203, SLH 1982, established the present position of bank examiner.

acquired increased investigative capabilities as a result of the new compliance fund. Only then was the magnitude of mismanagement by a few errant licensees revealed. And it took the direct personal involvement of both the new head of RICO and new administrator of PVL to save some of those authorities from foundering.

With Act 101, SLH 1985, evaluation of annual financial statements by licensees reverted from the bank examiner to PVL. While that cleared up who would be responsible, it did nothing to ensure that the administering unit had the necessary expertise to fulfill such a task. This division needs to acquire the requisite expertise for auditing financial records, evaluating audited fiscal statements, and appraising financial plans in terms of actuarial data.

Since similar expertise is also needed within this division to monitor and evaluate financial reports from time-share licensees and from licensed contractors, sufficient justification probably exists to warrant adding a qualified accountant, preferably one familiar with actuarial practice, to the division's staff. The DCCA should seek the requisite position and funding.

Trust Fund Administrators

During these two decades of regulation in the cemetery and funeral industry, the general trend has moved from controlling sales and operations to seeking to protect client investments by ensuring soundness in trust funds. Consequently, the role of fund trustee has recently come within the purview of Chapter 441 while other parties have dropped out. However, this trend has left certain areas of responsibility less than adequately specified. This is especially true for trust administrators and the roles they should play.

Section 441-40(b), HRS, authorizes trust administrators to "inquire into the propriety of expenditures made by a cemetery and pre-need funeral authority in connection with the operation of the authority's business." Not stated is what that trustee may and should do if a licensee refuses to respond honestly and fully, or if that trustee sees clear danger in the licensee's managerial decisions.

In testimony at legislative hearings, both the operators and trust fund administrators have expressed concern over how much responsibility and authority a trustee may and should exercise.⁴ Trustees responsible for funds established to support orphaned minors, for instance, may and do monitor expenditures by guardians. Some similar obligation would be appropriate for trustees of funds intended to serve the needs of the deceased.

We believe it is highly desirable that this gray area of responsibility and authority for fund trustees be clarified. The department, assisted by the Attorney General and working with representatives of both the industry and trust managers, should analyze the issues and the options and then recommend an appropriate amendment to the statutes so that everyone involved will know how far a trustee should go and the procedures to follow in monitoring the way funds are expended.

Recommendations

1. *Chapter 441, Hawaii Revised Statutes, should be reenacted, albeit with the chapter's name changed to a more descriptive "Cemetery and Funeral Trusts."*

4. Testimony on Senate Bill No. 594 and House Bill No. 1769 submitted by Samuel E. Woolley to the Senate Committee on Consumer Protection and Commerce in March 1981 expresses views which are representative of these concerns.

2. *The Department of Commerce and Consumer Affairs should undertake a study to determine whether bonds are worth their cost, at what levels or by what formula they should be set, and whether (or to what extent) they should be complemented or replaced by insurance. Similarly, the usefulness of penalties should be thoroughly reviewed, including a rationale for setting them and who should pay them. The results of these studies should lead either to rule provisions or to recommendations for statutory amendments.*

3. *The Department of Commerce and Consumer Affairs should proceed expeditiously with public hearings and adoption of rules. These rules should:*

- . Provide guidelines for acceptable investments by funds in trust, including transition for prior investments rendered unacceptable by those guidelines.*
- . Provide a workable arrangement for monitoring funds now legitimately held in reserve, either for cemetery refurbishment or refunds, and require an ongoing maintenance plan for all cemeteries in the use of those reserve funds.*
- . Require that all moneys paid in by clients (beyond the 30 percent retention allowance) be deposited to trust funds within 15 days.*

4. *The Department of Commerce and Consumer Affairs should establish a position within the Professional and Vocational Licensing Division calling for expertise in accounting and actuarial studies.*

5. *The Department of Commerce and Consumer Affairs, working with the Department of the Attorney General and with representatives of the industry and trust administrators, should determine how best to specify the responsibility and authority of trust fund administrators to monitor and oversee the uses of trust funds.*

APPENDICES

APPENDIX A

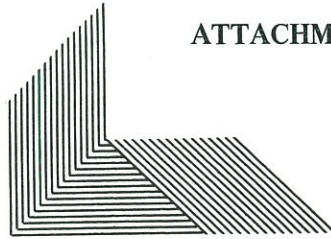
COMMENTS ON AGENCY RESPONSES

A preliminary draft of this Sunset Evaluation Report was transmitted on December 15, 1986, to the Department of Commerce and Consumer Affairs for their review and comments. (There is no board.) A copy of that transmittal letter is included as Attachment 1 of this Appendix. The response from the department is included as Attachment 2.

Overall, the department agrees with our findings and recommendations. It did point out one inadvertent misstatement having to do with the payment of fines on page 17. We have added the missing words in our report to clarify our meaning.

ATTACHMENT 1

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
465 S. KING STREET, RM. 500
HONOLULU, HAWAII 96813



CLINTON T. TANIMURA
AUDITOR

December 16, 1986

C O P Y

Mr. Robert A. Alm, Director Designate
Department of Commerce and Consumer Affairs
State of Hawaii
1010 Richards Street
Honolulu, Hawaii 96813

Dear Mr. Alm:

Enclosed are three preliminary copies, numbered 4 through 6, of our *Sunset Evaluation Report, Cemeteries and Mortuaries, Chapter 441, Hawaii Revised Statutes*.

The report contains our recommendations relating to the regulation of cemeteries and mortuaries. If you have any comments on our recommendations, we would appreciate receiving them by January 15, 1987. Any comments we receive will be included as part of the final report which will be submitted to the Legislature.

Since the report is not in final form and changes may possibly be made to it, we request that you limit access to the report to those officials whom you wish to call upon for assistance in your response. Please do not reproduce the report. Should you require additional copies, please contact our office. Public release of the report will be made solely by our office and only after the report is published in its final form.

We appreciate the assistance and cooperation extended to us.

Sincerely,

Clinton T. Tanimura
Legislative Auditor

Enclosures

ATTACHMENT 2

JOHN WAIHEE
GOVERNOR



ROBERT A. ALM
DIRECTOR
COMMISSIONER OF SECURITIES

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
1010 RICHARDS STREET
P. O. BOX 541
HONOLULU, HAWAII 96809

DEPUTY DIRECTOR

January 15, 1987

RECEIVED

JAN 15 8 12 AM '87

OFFICE OF THE AUDITOR
STATE OF HAWAII

Mr. Clinton T. Tanimura
Legislative Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, HI 96813

Dear Mr. Tanimura:

Thank you for the opportunity to comment on your Sunset Evaluation Report on Cemeteries and Mortuaries.

We would like to address the recommendations contained at the end of your report as follows:

We agree with recommendation number 1, but would like to caution that within Chapter 441, HRS, there are references to "mortuaries" or "mortuary." We would hope that any legislative proposal you may submit would only change the title of the chapter, and would not go so far as to delete the word "mortuaries," or variations of this word, in Chapter 441, HRS. Such changes could create problems which may not be currently foreseen.

The Department finds merit in the recommendation under 2, which encourages "a study to determine whether bonds are worth their cost, at what levels or by what formula they should be set, and whether (or to what extent) they should be complemented or replaced by insurance." Depending on the availability of resources and manpower from our insurance division this matter may be a task for future consideration.

Also, we wish to clarify a matter raised with regard to the imposition of fines and who is responsible to pay for the fine which is a part of recommendation 2. Due to a misunderstanding perhaps, you are of the belief that fines imposed would be paid from the trust fund. However, §441-45, HRS, is clear that it is the licensee who is fined, and

Mr. Clinton T. Tanimura
January 15, 1987
Page 2

payment of the fine would be made by the licensed entity. Under §441-40, HRS, use of the principal of the pre-need trust and use of the principal and income of the perpetual care trust is defined and it is clear that the monies cannot be used for the purpose of paying a fine. As the law allows, the income of the pre-need trust does revert to the licensee and could be used to pay the fine. We do believe that Chapter 441, HRS, is clear on the matter of responsibility for payment of a fine. We, of course, are open to your recommendation that penalty amount be reviewed and revised.

As you acknowledged, the department has a proposed set of rules for Chapter 441, HRS, which are currently being channeled through the formal rule adoption process. The proposed rules contain the first issue listed under recommendation 3. The second issue must be further researched for possible inclusion in future rule changes. The third issue cannot be handled by rule change since it is the statute which dictates the number of days allowed for deposit of payments into the trust. Perhaps your office may wish to consider proposing a bill to address this issue, to which we have no objections.

We appreciate recommendation 4, which proposes that we establish a position within the Professional and Vocational Licensing Division calling for expertise in accounting and actuarial studies. Based on such support we will have additional justification to present to the Legislature when such a request is made.

With regard to recommendation 5, we support such dialogue to be initiated to further clarify the responsibility and authority of trust fund administrators to monitor and oversee the use of trust funds.

We wish to express our appreciation for the comments and recommendations contained in your report. It was encouraging to read a report that acknowledged our efforts for improvement of the program and which offered reasonable recommendations for further improvement. The report will be useful in the continued evaluation of Chapter 441, HRS.

Very truly yours,



Robert A. Alm
Director

APPENDIX B

DIGEST

A BILL FOR AN ACT RELATING TO CEMETERIES

Generally implements recommendations of Auditor's report on cemeteries and mortuaries.

A BILL FOR AN ACT

RELATING TO CEMETERIES.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. Section 26H-4, Hawaii Revised Statutes, is
2 amended to read as follows:

3 "§26H-4 Repeal dates. (a) The following chapters are
4 hereby repealed effective December 31, 1987:

- 5 (1) Chapter 458 (Board of Dispensing Opticians)
6 (2) Chapter 459 (Board of Examiners in Optometry)
7 (3) Chapter 452 (Board of Massage)
8 (4) Chapter 471 (Board of Veterinary Examiners)
9 [(5) Chapter 441 (Cemeteries and Mortuaries)
10 (6)] (5) Chapter 463 (Board of Detectives and Guards)
11 [(7)] (6) Chapter 455 (Board of Examiners in Naturopathy)

12 (b) The following chapters are hereby repealed effective
13 December 31, 1988:

- 14 (1) Chapter 465 (Board of Psychology)
15 (2) Chapter 468E (Board of Speech Pathology and Audiology)
16 (3) Chapter 468K (Travel Agencies)
17
18

(4) Chapter 373 (Commercial Employment Agencies)

(5) Chapter 442 (Board of Chiropractic Examiners)

(6) Chapter 448 (Board of Dental Examiners)

(7) Chapter 436E (Board of Acupuncture)

(c) The following chapters are hereby repealed effective
December 31, 1989:

(1) Chapter 444 (Contractors License Board)

(2) Chapter 448E (Board of Electricians and Plumbers)

(3) Chapter 464 (Board of Registration of Professional
Engineers, Architects, Surveyors and Landscape
Architects)

(4) Chapter 466 (Board of Public Accountancy)

(5) Chapter 467 (Real Estate Commission)

(6) Chapter 439 (Board of Cosmetology)

(7) Chapter 454 (Mortgage Brokers and Solicitors)

(8) Chapter 454D (Mortgage and Collection Servicing Agents)

(d) The following chapters are hereby repealed effective
December 31, 1990:

(1) Chapter 447 (Dental Hygienists)

(2) Chapter 453 (Board of Medical Examiners)

(3) Chapter 457 (Board of Nursing)

(4) Chapter 460J (Pest Control Board)

(5) Chapter 462A (Pilotage)

(6) Chapter 438 (Board of Barbers)

(e) The following chapters are hereby repealed effective
December 31, 1991:

(1) Chapter 448H (Elevator Mechanics Licensing Board)

(2) Chapter 451A (Board of Hearing Aid Dealers and Fitters)

(3) Chapter 457B (Board of Examiners of Nursing Home
Administrators)

(4) Chapter 460 (Board of Osteopathic Examiners)

(5) Chapter 461 (Board of Pharmacy)

(6) Chapter 461J (Board of Physical Therapy)

(7) Chapter 463E (Podiatry)

(f) The following chapters are hereby repealed effective
December 31, 1992:

(1) Chapter 437 (Motor Vehicle Industry Licensing Board)

(2) Chapter 437B (Motor Vehicle Repair Industry Board)

(3) Chapter 440 (Boxing Commission) [.]

(g) The following chapter is hereby repealed effective

December 31, 1993:

(1) Chapter 441 (Cemetery and Funeral Trusts)."

SECTION 2. Chapter 441, Hawaii Revised Statutes, is amended
by amending the title to read as follows:

"[CEMETERIES AND MORTUARIES] CEMETERY AND FUNERAL TRUSTS"

SECTION 3. Section 441-38, Hawaii Revised Statutes, is amended to read as follows:

"§441-38 Contributions and payments to the trustee. (a) A cemetery authority may take, receive, and transfer to the trustee as a part of or incident to the perpetual care fund any property, real, personal, or mixed, bequeathed, devised, granted, given, or otherwise contributed to it for perpetual care purposes and shall transfer to the trustee the amount stipulated in the contract or deed as being for perpetual care purposes for each plot, niche, or mausoleum crypt sold or disposed of, but not less than:

- (1) \$1 per square foot of interment space;
- (2) \$50 for each mausoleum crypt;
- (3) \$15 for each niche.

Such transfer shall be made not later than [thirty] fifteen days after [the] receipt of [the final] payment [of the purchase price of each plot, niche, or crypt sold as] from the purchaser of cemetery property entitled to perpetual care[.] and shall be immediately deposited into trust.

(b) A cemetery or pre-need funeral authority may take and receive, but shall transfer to the trustee as part of or incident to the pre-need trust, all payments received after the recovery of acquisition costs, which shall be the lesser of thirty per

cent of the contract price or the difference between the contract price and the cost of the pre-need interment or pre-need funeral services contracted to be provided. The transfer shall be made not later than [thirty] fifteen days after receipt of payment from the purchaser and shall be immediately deposited in the trust."

SECTION 4. Statutory material to be repealed is bracketed. New statutory material is underscored.

SECTION 5. This Act shall take effect upon its approval.

INTRODUCED BY: _____