



STATE OF NORTH CAROLINA

NORTH CAROLINA BOARD OF FUNERAL SERVICE

FINANCIAL RELATED AUDIT

MAY 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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HARRIS B. HIGH, BOARD PRESIDENT

ADMINISTRATIVE OFFICER

PETER M. BURKE, EXECUTIVE DIRECTOR



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AUDITOR'S TRANSMITTAL

May 15, 2013

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
North Carolina Board of Funeral Service
Peter M. Burke, CFSP, Executive Director

This report presents the results of our financial related audit at the North Carolina Board of Funeral Service. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the *Audit Findings and Responses* section of this report.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the ways listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

TABLE OF CONTENTS

	PAGE
BACKGROUND	1
AUDIT SCOPE AND OBJECTIVES	2
METHODOLOGY	3
RESULTS AND CONCLUSIONS	4
AUDIT FINDINGS AND RESPONSES	5
ORDERING INFORMATION	9

BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the North Carolina Board of Funeral Service (Board). There were no special circumstances that caused us to conduct the audit, but rather it was performed in accordance with Chapter 93B of the *North Carolina General Statutes*, which states that the State Auditor shall audit occupational licensing boards occasionally to ensure their proper operation.

The Legislature established the State Board of Embalmers in 1901, which was renamed as the North Carolina Board of Mortuary Science in 2001 and the North Carolina Board of Funeral Service in 2003. The Board is responsible for carrying out the provisions of the Funeral Service Laws for the purpose of better protection of life and health, preventing the spread of contagious, communicable, and infectious diseases, and regulating the practice of embalming and funeral directing and the care and disposition of dead human bodies.

The Board currently oversees 740 funeral establishments, 903 funeral directors, 1,819 funeral service licensees, 191 resident trainees, 2,313 preneed salespersons, and 106 crematories.

AUDIT SCOPE AND OBJECTIVES

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters. Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Our audit scope covered the period January 1 through December 31, 2012. During our audit, we considered internal controls related to the following transaction types and specific objectives:

Inspection and Complaint Resolution – We examined internal control designed to ensure that funeral establishment inspections and investigative complaints are completed in a timely manner and corrective action is taken for noted violations.

Fees and Penalty Revenue – The Board collects application and annual renewal fees for funeral service establishments and licensees, crematories, preneed funeral contracts, and transportation permits. On December 31, 2012, the Board reported approximately \$1.18 million in application and annual renewal fees and \$27,000 in penalties. We examined internal control designed to ensure that the Board's collections of fees and penalties were as authorized by statutory authority and that revenues were properly recognized and accounted for by the Board.

Licensing Operations – The Board is responsible for determining that applicants meet the qualifications as described in *North Carolina General Statutes* Chapter 90 and issuing certificates to those determined to be properly qualified. We examined internal control designed to ensure that the Board issued licenses to only qualified applicants.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the *Audit Scope and Objectives* section of this report and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that provide evidence about our audit objectives. Specifically, we interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions and balances, as considered necessary in the circumstances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in professional auditing standards. As discussed in the standards, internal control consists of five interrelated components: (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESULTS AND CONCLUSIONS

The results of our audit disclosed deficiencies in internal control that are considered reportable under generally accepted government auditing standards. These items are described in the *Audit Findings and Responses* section of this report. Management's responses are presented after each audit finding. We did not audit the responses, and accordingly, we express no opinion on them.

AUDIT FINDINGS AND RESPONSES

1. DEFICIENCIES IN INSPECTION PROCESS

The North Carolina Board of Funeral Service (Board) did not comply with its policies regarding inspections for funeral home establishments and crematories. Noncompliance with the policy increases the risk that violations of state laws and regulations at funeral establishments and crematories could occur and not be detected timely. The Board currently oversees over 700 funeral establishments and 100 crematories.

The Board's operating procedure states that inspections will be performed on a regular basis with no more than three years between inspections of establishments with no serious deficiencies noted on the previous inspection and two years for establishments with serious deficiencies noted on the previous inspection. Our examination of a sample of inspections conducted during the 2012 year revealed noncompliance with this policy as well as other deficiencies that are described below.

- There were four to eight years between inspections for 22 of the 38 establishments tested. The Board does not have a tracking system in place to easily determine the length of time between inspections.
- The Board did not provide evidence that it determined whether violations noted during inspections constituted a serious deficiency. Without tracking serious deficiencies, the Board cannot ensure funeral establishments and crematories are inspected within the two years as stated in the policy.
- The Board did not provide evidence that funeral establishments and crematories took corrective action on violations discovered during inspections. Deficiencies were noted in 23 of the 38 reports examined, however, 13 of the 23 reports did not contain any evidence that the inspector followed up to ensure corrective action was taken. Inadequate follow-up on corrective action could cause funeral establishments and crematories to continue to be in noncompliance.

In addition, the Board did not verify that crematories submitted accurate and complete monthly reports and fees. The Board requires crematories to submit a monthly report detailing the number of cremations performed as well as submit a fee for each cremation performed. However, inspectors did not verify the accuracy and completeness of the report. Lack of verification of the crematories' reports may result in the incomplete collection of all cremation fees.

Recommendation: The Board should strengthen controls over its inspection process to ensure funeral establishments and crematories are inspected timely and corrective action is taken on all violations. The Board should also consider modifying its current policy for crematory inspections to ensure the accuracy of the cremations reported.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: We are aware of our noncompliance with the operating procedures regarding timeliness of inspections. Basically, this is due to the small size of our inspection staff. We have three inspectors who cover the entire state of North Carolina; as you noted this encompasses over 700 funeral establishments (751 as of today) and 100 crematories (110 as of today). The inspections involve not only the physical facilities and Federal Trade Commission Funeral Rule compliance, but also require an audit of the funeral establishment's preneed records for those who are licensed to sell preneed (662 establishments as of early April; 1,673 individuals licensed in those establishments. Over 170,000 contracts exist as of today). If an inspector uncovers irregularities involving preneed, this may lead to a more thorough investigation of their files, and if violations of the Laws and Rules are suspected the investigations can and oftentimes do take weeks. As consumer protection is our primary role, other scheduled inspections are put on hold while an investigation is underway.

The three-year routine inspection rotation was developed in 2009 with the intent that it be revisited once its' validity was measured. Clearly under the present circumstance its' feasibility is questionable. Adding a fourth inspector should alleviate a significant amount of the backlog; we could, for example, assign the additional staff to handle violation investigations exclusively, allowing the other inspectors to continue conducting scheduled inspections and audits. The current total cost to the Board for one additional staff would be \$85,000-\$90,000 per year, and would not be possible without significant fee increases for both individual and establishment licenses. There currently exists some space under our fee ceilings. However as you are aware, a fee increase, once approved by the Board would need to be approved by the Rules Review Commission, and with opposition would need approval by the General Assembly.

On average, a routine establishment inspection takes four to six hours; crematory inspections approximately three hours. Preneed audits can last anywhere from one to several days, depending on the size of a firm.

The seriousness of violations is determined on a case-by-case basis. There currently is no specifically-defined guideline as to what would constitute "serious." However, in all cases indications of missing money (preneed) are considered serious. Other items to be considered serious would include unsanitary or unsafe conditions in an establishment's preparation (embalming) room; erroneous, incomplete forms and documentation related to the Federal Trade Commission's Funeral Rule (16 CFR Part 453) or missing/incomplete crematory records. Violations uncovered which are considered serious are referred to the Board's disciplinary committee for review.

A thorough review of the Establishment Inspections Standard Operating Procedures is currently underway. The revised version, when completed, will include defined steps to document the corrective action which has been taken to address identified violations. In addition, in order to verify the completeness of reporting, inspectors will begin comparing monthly crematory reports with actual files on hand at the crematories upon inspection.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

2. LACK OF SEGREGATION OF DUTIES

The Board did not properly segregate duties in the accounting and reporting of collections and license records. As a result, there is an increased risk that errors or fraud could occur and not be detected timely. However, our test of a sample of 93 out of 486 deposits did not reveal any errors. During our audit period, the Board collected approximately \$1.2 million in licensing fees.

One employee is responsible for recording collections, preparing bank deposits, maintaining licenses records, and reconciling licenses records to the accounting system. Duties should be segregated such that employees, in the normal course of performing their assigned functions, can prevent or detect errors or misappropriations on a timely basis.

Recommendation: The Board should strengthen internal control by segregating the duties of collecting receipts, preparing deposits, and maintaining licensees' records. If the segregation of duties is not possible, effective compensating controls should be implemented.

Agency Response: Our procedures for receiving the mail and depositing checks were interrupted during the last fiscal year due to health issues involving a key staff member, leaving us with limited ability for maintaining proper segregation of duties. In the future, we will make sure that procedures used at all times will include the following:

- a) Two people will process incoming mail
- b) Tapes of all checks in various categories will be prepared at the time the mail is opened, and given to another individual who will verify the total with the validated deposit slip.
- c) Documentation received will be compared with the checks and then routed to the individual responsible for inputting to the database. Where there is no documentation, a copy of the check will be made.
- d) A separate tape will be run for processing the deposit and compared with the original tape.
- e) We have contracted with First Citizens Bank to utilize their Remote Image Deposit system. Their equipment has arrived in-house and will initiate once staff has been trained.

Currently, the Access database is reconciled to the general ledger on a monthly basis and any discrepancies are investigated and corrected.

We will review our processes and look for opportunities to implement compensating controls. In addition, we welcome any suggestions from the Office of State Auditor to help us further improve our processes.

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This audit required 390 audit hours at an approximate cost of \$28,080.