

When Inventory Is and Is Not Inventory

by Daniel M. Isard, MSFS

NOTHING IS MORE CONFUSING TO AN OUTSIDER to this business than the concept of “inventory” in the cemetery business. Inventory is defined by most financial dictionaries as “the entire stock of goods, materials and components, finished and unfinished, of a business.” Therein lies the problem. The definition does not apply to the unique nature of the cemetery business.

I have performed almost 1,000 valuations of cemeteries in my career. Routinely, each and every balance sheet of a business will list items as inventory. Some such items of a cemetery will be identified on their balance sheet as inventory. However, not all items that are called inventory by an accountant are, in reality, inventory because the definition is flawed.

Cost of Goods Not a Good Measure

Inventory is used in accounting as a “Cost of Goods,” but not all “Goods” can be sold or liquidated. For merger and acquisition purposes, as well as for lending purposes, inventory is an economic value of these items, assuming they could be sold. Can grave spaces or mausoleum and columbaria spaces be sold if the cemetery were to fail and go broke? No! You would have to sell the right to operate the cemetery; and the interment spaces go with the right to operate the business. Interment rights are really not inventory. They can only be sold or liquidated if the cemetery is an operating enterprise.

Let’s say you are an accountant. Your client is a home builder. The builder has \$20,000 in wooden 2 × 4s. The builder goes broke. Can you resell the inventory/wood? Of course.

But let me change the question slightly. Imagine if the homebuilder in the time it takes for him to keep his books up to date has taken that \$20,000 of wood and constructed a home with it. Do you still have \$20,000 of wood as inventory? Of course

not. You cannot sell the wood without selling the constructed home. The wood has changed its identity.

Translating this to our business, if you have 40 acres of land mapped and platted for 40,000 graves. Do you have 40,000



graves as inventory? No! You cannot sell a grave unless you are actively managing the cemetery business. In this analogy, the land is like the wood of the homebuilder. Until you put a fence around the cemetery, the land is land. Its value is the value as land. However, once you put a fence around the land, hang up a sign proclaiming the land is now a cemetery, and then consecrate the area as a cemetery, it is not land anymore. The land value vanishes the day the cemetery becomes a cemetery.

Economic Value: A Better Measure

Accounting is not perfect. Accounting should be viewed with its limitations. The objective for most business managers is to understand Economic Value. I would define Economic Value as “what something is

worth in the real world.” We use this concept of Economic Value all the time.

Imagine you buy a car for \$50,000. We know that by the time you drive that car off the new car dealer’s lot, it is not worth \$50,000 any longer. If you hated the car, the same dealer that sold it to you would buy it back, but at a discount. Yet, your balance sheet is reflecting the auto at \$50,000. The balance sheet will depreciate the auto each year. The degree of depreciation taken is subject to law and your tax-driven desires.

But the value on the balance sheet at the end of the first year is not reflecting its Economic Value; and if it does, it is probably a coincidence.

How to Value a Cemetery

Many times in my career, I have gotten a request to value a “cemetery” whereby there is plenty of acreage and the owner (or lender) perceives they have millions of dollars of value, when in reality the newly formed cemetery is worthless.

In one case, there was a newly consecrated 60 acres of land and a plat map showing some 70,000 future graves! The prospective appraisal client said, “The way I look at it, each grave sells for \$1,000 so I have \$70,000,000 of value!” The mathematical illogic being $\text{Graves} \times \text{Selling Price} = \text{Instant Millionaire!}$ That is where the discussion between the prospective client and me breaks down because the graves are not inventory regardless of what the accountant has said.

I have seen lenders make the same mistake, making a loan to a cemetery based on the value of the land. If a cemetery were 40 acres and each acre valued at \$10,000, does that mean the cemetery has a starting value at \$400,000? Absolutely not. Once that land is deemed to be a cemetery, it stops being land. It might look like land, mow like land,

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turn green or brown seasonally like land ... but it is not land. It is a cemetery.

A mausoleum is a great example. Assume you build a 500-crypt mausoleum. It might cost you about \$500,000 to construct (for example purposes only). That building, once fully sold out might generate more than \$3,000,000 in sales. But the moment it is built, if there are no sales, what is its value on the balance sheet? I know, per the rules of accounting, it is going to be on the balance sheet at \$500,000. But what is that building really worth on the balance sheet? Without any sales, the inventory value is \$0, in my opinion. That is because the only way to convert that to value is to be in an active selling role and being successful at the art of active selling.

You would not value that mausoleum at \$3,000,000 before you can prove a successful active selling program, would you? If you would, then start pricing the services of skilled bankruptcy attorneys because you will need one.

Cemeteries are unique. Those that apply common accounting issues to them are making dramatic errors. I would define a cemetery as "a business providing for the marketing of interment rights and providing a service to care for the dead." As a business, it must generate revenue sufficient to provide for its business operating purposes. As a service, "care of the dead" requires ground keeping, insurance, and security. "Marketing" requires staffing and advertising.

Actual Inventory

That is not to say that a cemetery doesn't often have inventory in the universal definition of inventory. The cemetery could have vaults, bases, vases, and maybe flowers as inventory. If I have vaults, bases and vases in "inventory", those vaults could be sold off if the business were to be liquidated.

However, vaults that are awaiting burying could be sold off. Once you put the vaults in the ground, either one at a time or pre-vaulting a section, those vaults are no longer inventory. They are only of value when they are converted to revenue, as sold for their purpose. They are akin to the wood, constructed within the house above. In the case of a business failure, it would cost more to disinter those pre-buried vaults than you can sell them for.

Many years ago, we were helping a client buy a cemetery. The balance sheet stated there were \$50,000 of vaults. As we were doing our onsite due diligence, I asked the seller, "Where are these vaults?" He stated, "They were behind the work shed." At about \$200 each, I knew we would have to see about 250 vaults, so we

drove over to the work shed area, and sure enough, there were 250 concrete vaults. The 250 vaults took up about a quarter of an acre, sitting behind this work shed, exposed to the elements.

By state law, the business could recognize the income from the advance sale of graves and grave vaults, if the cemetery actually took possession of these vaults awaiting the death of the consumer to open the grave and put the vault in the ground. Had the owner not taken possession of the vaults, they could only have recognized a portion of the sales revenue and the balance would have been in a merchandise trust.

I had never seen this many concrete grave vaults, sitting above ground, piled two high, awaiting placement. Upon further review, many of these were cracking in spots, losing their structural integrity, due to being exposed to the weather. Many due to these evolving defects, if lifted for placement would have crumbled as concrete will do. I agree, that in this case, there were vaults as inventory, less a discount for those that were cracking.

For the sake of accounting, we do many things that make no sense in reality. Calling graves, niches, or crypts inventory when they really can't be sold off or liquidated is one of them. Having a balance sheet without understanding the economic value or appraised value is an error for lenders and owners. ❑



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