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Managing cemetery perpetual care obligations within your diocese

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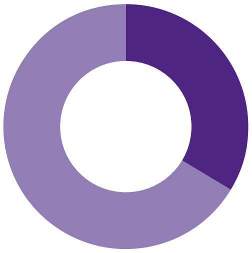
Ensuring sufficient funds for cemeteries' perpetual care operations is a complex issue fraught with a variety of accounting, moral and legal considerations. From an accounting perspective, one of the key questions within the U.S. Roman Catholic Church community is whether or not the financial obligation for perpetual care should be recognized as a liability on the responsible party's balance sheet.

Based on the Accounting Practices Committee of the United States Conference of Catholic Bishops' (USCCB) 2013 survey about perpetual care, this white paper explores and assesses relevant accounting principles, operating issues and social contract considerations, as well as their weighted relevance in determining whether a liability should be recorded for such anticipated future perpetual care costs. Whether you are a finance officer or clergy sharing a fiduciary responsibility at a Catholic diocese, church or cemetery, our insights can help you better manage perpetual care costs and obligations at your institution.

Perpetual care at a glance

Does your diocese record a perpetual care liability on its balance sheet?



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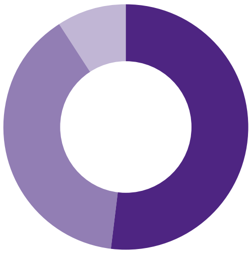
What is the current funding level of your perpetual care obligations?



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Source: Accounting Practices Committee of the United States Conference of Catholic Bishops' 2013 survey about perpetual care

A brief overview of perpetual care in the U.S.

Dioceses and archdioceses of the Catholic Church in the United States (collectively, dioceses) have maintained responsibility for the ownership, maintenance and operation of cemeteries for centuries. Presently, Catholic cemeteries are managed at a diocesan, parish or association level (where a separately incorporated cemetery association maintains responsibility for oversight and operations). Ensuring sufficient funding for maintenance and operations is a priority, regardless of whether a cemetery is at capacity or being actively managed.

Fulfilling the perpetual care obligation typically requires a cemetery operator to care for the grounds, provide access to the resting place, protect and maintain the cemetery's perimeter, and make various capital improvements to existing structures, water systems and driveways, as necessary.

Shifts in perpetual care obligations funding

Not that long ago, the predominant source of funding for perpetual care was an annual payment from decedents' descendants. In other instances, however, cemeteries placed the principal responsibility for maintaining individual graves on each decedent's family, with the cemetery operator focused solely on the common areas of the cemetery. Recognizing that neither of these approaches were entirely effective, cemetery operators implemented the practice of charging a single lump-sum perpetual care fee in an effort to fully fund the costs associated with the future maintenance of the grounds.

In fact, many states have also enacted laws requiring cemetery operators to set aside a certain level of funding, on a per-unit basis, into a perpetual care trust to serve as a funding source in the event the cemetery becomes insolvent and unable to maintain the grounds. However, in several states religious cemeteries are presently exempt from these requirements.

Even as states have become increasingly assertive in legislating new rules mandating expanded structure and oversight around how private cemeteries should fund their perpetual care needs, this matter continues to be of paramount concern to all cemeteries, both religious and private. To begin, the factors impacting future cost projections are significant, many of which are further described below, and the lack of clarity provided by current accounting standards further complicates this issue from a financial reporting perspective.

Recognizing the need for more structured approaches to determine perpetual care needs, cemeteries across the nation have pursued a variety of approaches to project such costs. Certain cemetery operators are taking steps to precisely determine the size of their perpetual care needs and are adopting plans to either fully or partially fund this obligation over a defined period of time, while others are continuing to rely on cemetery operating income, parish offertory collections, and/or other sources to fund the costs of ongoing maintenance.

Defining liability

As defined by the *FASB Master Glossary*, a liability stresses that the following principles need to be present for the upfront recognition of future cash flows:

"Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. Liabilities commonly have other features that help identify them — for example, most liabilities require the obligated entity to pay cash to one or more identified other entities and are legally enforceable. However, those features are not essential characteristics of liabilities. Their absence, by itself, is not sufficient to preclude an item's qualifying as a liability. That is, liabilities may not require an entity to pay cash but to convey other assets, to provide or stand ready to provide services, or to use assets. And the identity of the recipient need not be known to the obligated entity before the time of settlement. Similarly, although most liabilities rest generally on a foundation of legal rights and duties, existence of a legally enforceable claim is not a prerequisite for an obligation to qualify as a liability if for other reasons the entity has the duty or responsibility to pay cash, to transfer other assets, or to provide services to another entity."

Source: *FASB, Statement of Financial Accounting Concepts No. 6*, paragraphs 35 and 36, 2008

4 prevailing views about perpetual care obligations from a financial reporting perspective

According to the USCCB's 2013 perpetual care survey, roughly one-third of respondents — primarily CFOs from dioceses throughout the country — indicated that they record a perpetual care liability. The remaining two-thirds cited many reasons why they're not recognizing such liabilities, with the following four emerging clearly:

1. A liability is not specifically required by U.S. GAAP.
2. The cemeteries are owned by the parishes.
3. Historical records are inadequate or do not exist.
4. It's too difficult to estimate perpetual care liabilities.

Here's our analysis of these explanations and how dioceses may wish to address them.

Belief No. 1: A liability is not specifically required by U.S. GAAP

It's true that the FASB has not created a standard or codification section devoted to accounting matters relevant to Catholic or faith-based cemeteries. However, the absence of such specific guidance does not preclude or excuse a diocese from recognizing an obligation if the facts and circumstances support otherwise.

We argue that a constructive obligation exists, meaning when cemetery products are sold, the buyer — whether acting on a pre-need basis or making an immediate or at-need purchase for a deceased family member — has a reasonable expectation that the cemetery grounds will be indefinitely maintained to a professional standard by the cemetery operator.

Whether expressly stated in a burial plot/mausoleum purchase contract or implied, there is a reasonable expectation that the Catholic Church will both honor the dead and fulfill its obligation to maintain the cemetery.

How Canada tackles ethical and moral obligations

While U.S. dioceses and other Catholic entities do not follow Canadian accounting rules, there is a very strong ethical and moral obligation to maintain the final resting places of the deceased, particularly for those cemeteries that are associated with dioceses. Canada's Accounting Standards Board may have addressed this issue most directly by including in its definition ethical and moral considerations, which in relevant part is excerpted below:

"Liabilities in financial accounting need not be legally enforceable; but can be based on equitable obligations or constructive obligations. An equitable obligation is a duty based on ethical or moral considerations. A constructive obligation is an obligation that is implied by a set of circumstances in a particular situation, as opposed to a contractually based obligation."

Source: Canadian Accounting Standards for Not-for-Profit Organizations, paragraph 30, December 2010

FASB's 3 tenets of liability: Why they imply an obligation and how they may affect you

Based on the FASB's three tenets of a liability, perpetual care obligations could reasonably be considered a liability that cemetery operators should recognize on their financial statements.

1. **The liability embodies a present duty or responsibility to one or more other entities that entail settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event or on demand.** Fulfillment of this obligation would occur with certainty based on the passage of time as grass and shrubbery grow, driveways need to be repaired, and fences replaced, repaired and repainted, among other maintenance activities and betterments which become necessary. This obligation (or the reasonable expectation of fulfillment of this obligation with a high level of certainty) exists at the time of sale based either on contractual or moral obligation on the part of the cemetery operator.

2. **The duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice.** Perpetual care is an obligation of the Catholic cemetery that sold the grave site (or similar final resting place). There seems to be little opportunity to avoid future payments or sacrifices, given the eventual need for the ongoing maintenance of the cemetery.

3. **The transaction or other event obligating the entity has already happened.** The perpetual care obligation would be triggered by an event; for instance, the sale of a burial space/plot triggers the commencement of the perpetual care liability. Arguably, following the substantive organization and creation of a cemetery with the active intent to sell such plots to constituents, the cemetery operator has a moral obligation to forever maintain the grounds in a reasonable and dignified manner, consistent with how they were presented at the time of sale.

What you can do

Determining a perpetual care liability can be complicated. Some of the many factors that influence a cemetery's perpetual care liability include:

- grounds acreage;
- cost of wages and benefits for labor;
- price of fuel;
- age of property structures;
- ornateness and quality of materials used in the construction of fences, driveways, mausoleums, columbariums and statue features embossing entranceways;
- presence of chapel(s);
- irrigation systems, vehicles and other relevant equipment; and
- insurance and landscaping costs.

If your diocese concludes that a perpetual care liability is warranted, you should consider working with a qualified consultant to perform a cost analysis and develop a detailed financial model to determine the value of your perpetual care obligation.

> "Regardless of which entity/entities within a diocese maintain responsibility for this obligation, the broader point is to acknowledge that this potential liability exists somewhere under the auspices of a diocese."

Belief No. 2: The cemeteries are owned by the parishes

About one in three respondents in the USCCB's survey indicated their diocese has not recorded a perpetual care liability on its books due to the fact that the cemeteries within that diocese are operated at the parish level. This causes the related perpetual care expense and any associated projected liability to be borne and recognized by the respective parish.

Regardless of which entity/entities within a diocese maintain responsibility for this obligation, the broader point is to acknowledge that this potential liability exists somewhere under the auspices of a diocese.

What you can do

A diocese can adopt a standardized practice that clearly identifies:

- whether or not a liability should be recorded,
- how the obligation is to be measured, and
- which party/parties within the diocese maintain the responsibility for fulfilling this obligation.

In such an event, these discussions should include all affected parishes and finance councils. Make sure there is a careful balance of canon and civil law considerations, and walk away from these discussions with a clear understanding of the control level that the bishop or archbishop can exert over the entities where this obligation may be recorded.

Belief No. 3: Historical records are inadequate or do not exist

Generally speaking, a lack of historical accounting information is not an appropriate reason for not recording financial obligations. The absence of historical records often affects the precision of how such obligations are measured, but does not affect an entity's responsibility and duty to recognize such future cash flows broadly on its balance sheet.

What you can do

While historical data may be limited, current information — such as total cemetery utilization, acreage and capacity, inventory sales' statistics, and maintenance costs — is likely readily attainable. These are some of the key data inputs required to estimate a cemetery's perpetual care liability. As mentioned earlier, we highly recommend engaging a qualified and experienced consultant to assist with the development of detailed financial models and relevant analyses.

Belief No. 4: It's too difficult to estimate the perpetual care liability

It is a valid argument, but not insurmountable. Many dioceses across the nation have already concluded that assuming a perpetual care liability is appropriate and have instituted and maintained a level of cost reporting and tracking to reasonably measure this obligation on a periodic basis.

What you can do

While there are multiple drivers and assumptions embodied in the calculation of a cemetery's perpetual care obligation, they can be inventoried, measured against objective and widely available market data, and reasonably assessed within the context of each cemetery's operating circumstances.

3 considerations regarding perpetual care obligations

1. The financial statements will be affected — The recognition of a perpetual care liability on the financial statements can have a significant impact on an organization's financial position. For example, archdioceses like Chicago and St. Louis had accrued perpetual care obligations of $471.6 million and $58.7 million, respectively, on their June 30, 2012,[1] financial statements.

Granted, not all dioceses will have to record obligations of that size, but it's still very important to acknowledge that and understand how financial statements will be affected if a perpetual care obligation is recognized. Many dioceses — regardless of size — may experience significant financial challenges to funding such obligations with existing endowed care funds, and will likely have to devise plans to improve future funding.

Further, accruing a perpetual care liability may cause a significant erosion of your entity's unrestricted net assets. In this case, discuss the matter with your diocesan leadership and the finance council in order to evaluate and implement appropriate strategies that generate adequate cash flows for future maintenance.

2. Recording an obligation and related cash flow issues and considerations — Arguably, the decision to initially record an obligation for perpetual care should be treated as a correction of an error, since the obligation likely existed from the time the cemetery's operations started. This change in approach and initial recording of a perpetual care obligation will most likely have a material impact on the financial statements. In turn, this means that you need to carefully weigh the relevant principles of your entity and include a robust discussion in the financial statement footnotes about the nature of future cash flows associated with perpetual care and the main reason(s) for recording — or not recording or disclosing — such obligations.

For those dioceses that have established a liability for the first time, the accounting change resulted in the establishment of a liability and most likely an associated charge to unrestricted net assets. The logic behind this adjustment is based on the fact that funds from each original cemetery plot, crypt or mausoleum sale should have been set aside (deferred) for the future obligation in the year of sale. Furthermore, the *cumulative catch-up entry to unrestricted net assets* reflects this understanding. As noted earlier, for larger cemetery operations this adjustment can be significant.

The application of GAAP to your for-profit counterparts

While Catholic cemeteries' obligations may not be specifically addressed by GAAP, their for-profit counterparts are typically required by state and local laws to establish a perpetual care trust fund or contribute to state or local government-operated perpetual care funds. Contributions to these funds are generally set as a percentage of the original sales price or a flat dollar amount per grave, and reflected on the cemetery operator's financial statements as deferred pre-need funeral and cemetery receipts held in trust.

3. Designating unrestricted net assets, rather than recording a liability — From a purely canonical perspective, there is no explicit obligation on the part of the operators to ensure perpetual maintenance, which is a compelling argument for not recognizing a liability. However, as outlined in Canons 1205-1243, bishops and pastors do maintain a moral and fiduciary responsibility for their cemeteries, as they do for any sacred place. Hence, some dioceses (or more specifically some cemeteries) may opt to only disclose their expected cash outlays for future maintenance.

However, given the nature of the grounds as a sacred and compassionate burial place, some dioceses have decided to care for and maintain their grounds in a respectable and dignified manner, imposing a moral obligation on operators to prudently provide for future costs indefinitely and reflect this certainty in some way in their balance sheets.

With this principle in mind, the governing boards of some operators, who have not recognized a liability, may decide to set aside a portion of their unrestricted net assets (i.e., without formally recording a liability of their balance sheet) to ensure a substantive level of funding exists to provide for perpetual care. In order to designate additional net assets that would satisfy future obligations, some cemeteries have implemented prescriptive and formula-driven strategies based on current operating costs or surpluses. Others have chosen to add to the fund as operating performance allows or based on more subjective measures and governing board resolutions.

"In order to designate additional net assets that would satisfy future obligations, some cemeteries have implemented prescriptive and formula-driven strategies based on current operating costs or surpluses."

[1] Information derived from the audited financial statements on the respective diocese's website.

Questions that diocesan CFOs should consider regarding perpetual care planning

1. How many active or inactive cemeteries do we have within our diocese?

2. Which entities, within our diocese, are responsible for funding our cemeteries' perpetual care obligations? Who has oversight responsibility for this potentially sizable liability?

3. To what extent are our perpetual care liabilities currently funded? Are we 35% funded? Are we 85% funded?

4. How are our cemeteries currently funding existing perpetual care obligations? To what extent is relying on the cemeteries' operating income a sustainable solution? Do we have a complete understanding and costing of our cemetery's operating expenses? Do we know the extent of future maintenance?

5. Is our inventory and perpetual care pricing structure appropriate given the current and future costs of our operations/perpetual care needs?

6. Is our cemetery a separately incorporated entity? Separate and distinct from the diocese? Have we evaluated the benefits of this governance structure from the legal and operational perspectives?

7. What do our sales contracts expressly state about perpetual care? What types of moral and social promises or legal contracts have we entered into with our purchasers?

Next steps

1. Talk to a professional — If your entity chooses to recognize a perpetual care liability, we recommend that you team up with outside experts, including lawyers, accountants and consultants. They'll offer you advice that will cover all aspects of perpetual care liabilities so you don't miss anything that could affect the financial well-being of your entity.

2. Establish who should oversee perpetual care funding — Dioceses and cemeteries need to determine at which level rests the responsibility for funding perpetual care and then determine if the criteria for recognizing a related obligation has been satisfied.

3. Establish a clear plan — Beyond just the financial reporting implications of perpetual care, cemetery operators should ensure adequate funding for future perpetual care cash outlays. Cemetery operators and their governing boards should explore the benefits of establishing independent trusts as a possible mechanism to aid in segregating assets to provide for such future costs. Revisiting the level of perpetual care fees currently being charged should also be considered.

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