by Daniel M. Isard, MSFS

1.800.426.0165
danisard@f4sight.com

ICCFA Magazine author spotlight

➤Isard is president of The Foresight Companies, LLC, a Phoenix-based business and management consulting firm specializing in mergers and acquisitions, valuations, accounting, financing and customer surveys.

➤He is the author of several books, and the host of “The Dan Isard Show.” ***http://funeralradio.com***

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➤Educational information, including copies of this article, can be found at ***www.f4sight.com***

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Editor’s note: The Cemetery Impossible column is written by the staff of The Foresight Companies. **If you have a question you want to be featured in this column, please send it to danisard@f4sight.com.** Dan Isard or a member of his staff will call you to get more information and a recommendation will be provided via this column, helping not only you but also others who are facing similar challenges.

MANAGEMENT

Cemeteries have long relied on advance sales, but sometimes they can be a two-edged sword. If your sales commission policies are not set correctly, an otherwise strong advance sales program could leave you cash poor.

Cemetery Impossible

How can strong advance sales translate to a good (instead of terrible) cash position?

Dear Cemetery Impossible,
I am experiencing good advance sales but my cash position is terrible. What causes this situation and how do I change it?

Dear Terrible Cash Position,
Running a cemetery business is very difficult. It is a business that has a high investment in inventory and management of a sales team. As if this is not tough enough, it requires a stewardship of property and record keeping. The issue you are writing about is very common. We saw this with the now defunct Loewen Group in the 1990s.

Cemeteries are dealers in their own inventory and therefore taxed on the accrual basis. Yet not every sale is paid in full at the time of the sale. Advanced sales are more likely paid for on installment with a down payment made up front. Furthermore, most cemeterians pay their commissions on the accrual basis.

For example, suppose you make a $1,000 sale of an interment right. You book $1,000 as income. You pay a commission (as an example) of 20 percent, or $200. If we assume you have a cost of goods and routine operating costs of $100, you might owe income taxes of $200 on that sale (based on a 30 percent tax rate). So, cash in is $1,000 and cash out is about $400 for taxes and commissions.

Now, let’s change one assumption in the above example: change the sale to $1,000 with $200 down and $800 paid over time. So you wind up having $200 in and $400 out, plus the normal costs of operation.

If you have 80 percent cash sales and 20 percent installment sales, you will not have a negative cash flow. However, in most cemeteries with strong advance sales, it is more like 80 percent installment sales and 20 percent cash sales. When that happens, you will be bleeding cash like a Chicago politician on Election Day.

This operating problem is exacerbated when the sales manager is paid an override based on sales as recorded on the accrual basis. The sales manager is focused on creating sales, not the effect on cash in the balance sheet. This adversely affects cash even more.

CI solution

The solution is simple. Don’t pay your commission on the accrual basis. Don’t pay your override to the sales manager on the accrual basis. Use the cash with the contract to pay the commission.

If there is a $1,000 interment sale and the consumer only pays $250, pay a commission on $250. As the $750 balance due is paid over time, pay commission as the payments are received, only on the amount of payment received.

This way of handling commissions causes the sales manager to focus on the mix of business and encourages the sales team to get as much as they can up front with each contract.

Years ago, I had a client who paid commissions weekly. Commissions were paid Friday afternoon based on sales recorded by the sales team, using 9 a.m. Friday morning as the cut-off time. This system caused a lot of problems.

As I watched the sales teams’ behavior, I found many contracts were paid with cash, and a large number of contracts were turned in Friday morning, before the 9 a.m. deadline. It seemed that the sales team members had learned they could turn in contracts Friday morning with a small amount of money as the deposit and receive the full commission by Friday afternoon.

I also learned that more than 80 percent of contracts paid for with cash were canceled within a month. This created an atmosphere of fraud and killed the owner's cash flow. To me, this was criminal behavior by staff members involved.

We don't see these problems with families making a purchase at need. When there is a problem like this, it is typically only on advance sales.

Not only do I recommend that commissions and override get paid on a cash basis for advance sales, but I like the commission percentage to be based on the amount of money received with the contract. For example, if the contract is paid in full, then commission is 20 percent. If half is paid on a contract, then pay a commission of 17.5 percent on the payments, when they are received. If 30-49 percent is paid with the contract, then pay a lesser commission, maybe 15 percent. And, for a 20-30 percent minimum payment with the contract, pay a commission of 12.5 percent.

Do not accept a contract with less than 20 percent cash up front, because as illustrated in my example, that creates negative cash flow due to the tax and commission owed.

Make sure your contract with sales personnel specifies this payment scale. Your bookkeeper will have to work a bit harder, but this policy will promote the payment plans you want.

Also, staff should realize that commissions are not vested beyond their employment period, so if they leave, they don't receive further commissions.

In the last two years before Loewen went bankrupt, they turned to their cemetery team to give an illusion of strength. The cemetery people did a great job of pushing sales. The stock market didn't understand that increased revenue did not mean increased profit.

As revenue increased, cash decreased. As defaults kicked in during the following year, Loewen wrote off the defaulting contracts. Since there was no way of reclaiming the lost sales or taxes, this caused the market to realize the emperor had no clothes.

Just two years later, the SEC introduced FASB 101. This financial accounting standard requires public companies to disclose their income "as realized," meaning when received. This is shown as a separate statement on the cash basis.

This means that those who are dealers in their own inventory, who get payments over time, need to demonstrate the true cash accounting. This protects investors and allows even casual investors to better understand the inner workings of a company.

To sum up, use this three-step approach to solve your negative cash flow problems:

1. Pay commissions on a cash basis.
2. Set the commission rate to be tied to the amount of cash paid with the contract.
3. Make sure your sales manager is paid the same way as your sales team.

Running a cemetery is tough. Running one without enough cash is Cemetery Impossible. ❐