



# DEATHCARE ACCOUNTING

Service Corporation International

[www.sci-corp.com](http://www.sci-corp.com)



## Introduction

We are Service Corporation International, North America's largest funeral and cemetery company. Our operations consist of funeral service locations, cemeteries, crematoria and related businesses, which enable us to service a wide array of customer needs. To our customers, we are best known for our Dignity Memorial® brand, which provides a caring resource to help families in need with end-of-life arrangements. Dignity Planning™ is North America's largest and most secure provider and resource to plan end-of-life arrangements.



This document is intended to help explain certain unique, industry-specific characteristics and terminology in the deathcare industry and its accounting. We will cover our primary business offerings, the types of contracts offered, funding options, and how we account for the revenue recognition and related cash flows associated with these contracts. We've also included a Glossary of Terms in Appendix 1 for clarity on industry-specific terminology.

As used herein, "SCI", "the Company", "we", "our", and "us" refer to Service Corporation International and companies owned directly or indirectly by Service Corporation International, unless the context requires otherwise. Please refer to Appendix 2 for some important disclaimers.

## Our Business

We offer our funeral, cremation, and cemetery merchandise and services in two different scenarios: atneed and preneed. In an atneed sale, a death has occurred and the family of the deceased makes arrangements for merchandise, services, and/or cemetery property interment rights ("cemetery property") on behalf of the deceased. An atneed sale is accounted for similar to other retail sales, with revenue recognized and cash received at the time of delivery of merchandise and performance of services.

In a preneed sale, an individual makes arrangements for merchandise, services, and/or property *prior* to their death or the death of a loved one. There are three categories of these preneed sales—trust-funded funeral and cemetery merchandise and service contracts, cemetery property contracts, and where permitted, insurance-funded funeral contracts. Under these preneed contracts, we provide the purchased items at the time of fulfillment for the price guaranteed at the time of sale. While merchandise and service items are generally not delivered until after a death has occurred, the cemetery property interment right is conveyed to the property owner once we receive payment in full.

Preneed sales are subject to certain state or provincial laws and regulations because the merchandise and services will not be provided until an unknown time in the future, generally when the beneficiary is deceased. Because preneed funeral, cremation, and cemetery services or merchandise will not be provided until sometime in the future, most states and provinces require that we deposit all or a portion of the funds collected from customers on preneed funeral and cemetery contracts into merchandise and service trusts until the merchandise is delivered or the service is performed. This gives the customer financial assurance that the monies they are placing with us today under a preneed contract will be available at the time of need.



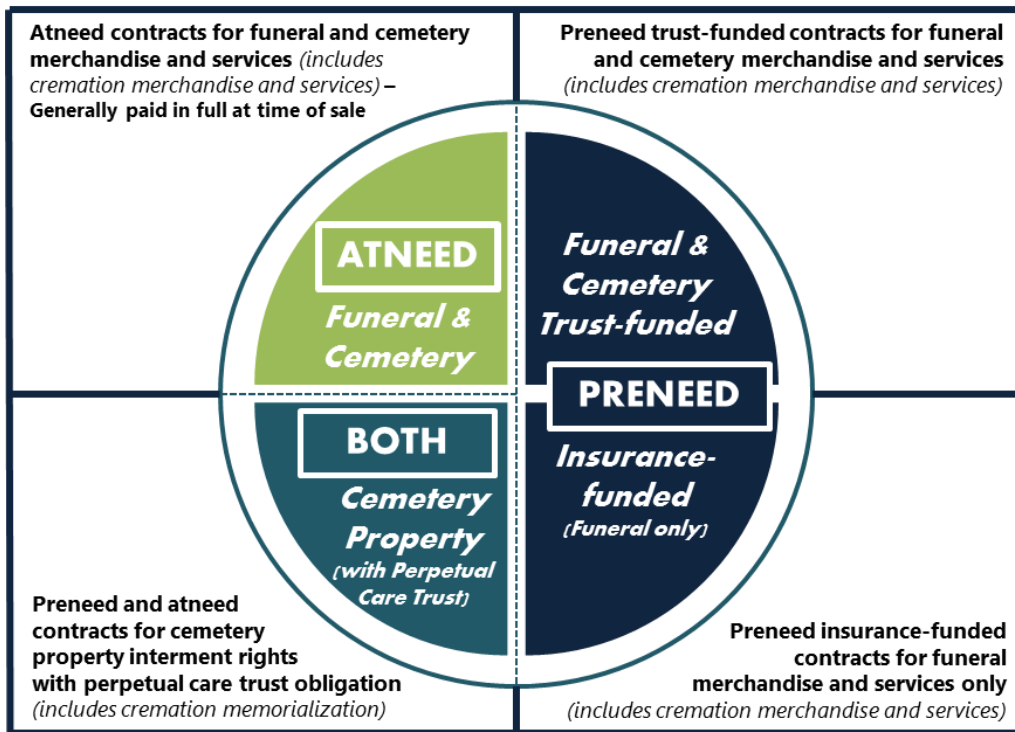
The required percentages of customer funds are deposited in state and provincial-regulated trusts with independent trustees to be invested and managed by professional investment managers until the merchandise is delivered or the service is performed. SCI is entitled to the trust investment earnings, which are expected to mitigate the inflationary costs of providing the preneed funeral, cremation, and cemetery merchandise and services in the future for the prices that were guaranteed at the time of sale. Upon the delivery of the merchandise and performance of the services, we are entitled to withdraw the funds deposited as well as the undistributed trust investment earnings.

Where permitted by state or provincial law, customers may arrange their preneed funeral contract by purchasing a life insurance policy from third-party insurance companies, for which we earn a commission as general sales agent for the insurance company. Upon the beneficiary's death and our delivery of the merchandise and performance of services included under the preneed funeral insurance-funded contract, we file a claim to receive the policy proceeds.

When we sell cemetery property, we are required by state and provincial law to deposit a portion of the proceeds from the sale into cemetery perpetual care trusts. For these trusts, the original corpus remains in the trust in perpetuity and the net ordinary investment earnings are distributed to us regularly and are intended to defray our expenses incurred to maintain the cemetery. While some cemetery property is purchased atneed, we sell the majority of our cemetery property on a preneed basis.

Exhibit 1 below summarizes our primary contract types.

*Exhibit 1—Primary Contract Types*





## Primary Business Operations

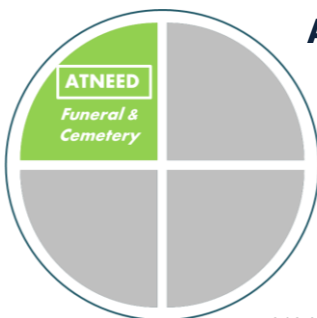
Our business primarily consists of funeral and cemetery operations. The funeral business provides professional services and merchandise for both burial and cremation customers. The cemetery business provides professional services, merchandise, and cemetery property interment rights ("cemetery property").

The following exhibit details some of our funeral and cemetery offerings:

*Exhibit 2—Typical Funeral and Cemetery Offerings*

	Professional Services	Merchandise	Cemetery Property
Funeral	<ul style="list-style-type: none"> <li>• Arranging and directing services</li> <li>• Use of funeral facility</li> <li>• Use of motor vehicles</li> <li>• Removal, preparation, and embalming</li> <li>• Cremations</li> <li>• Catering</li> </ul>	<ul style="list-style-type: none"> <li>• Burial caskets and related accessories</li> <li>• Urns and other cremation receptacles</li> <li>• Outer burial containers (stand-alone funeral homes)</li> <li>• Flowers</li> <li>• On-line and video tributes</li> <li>• Stationery products</li> <li>• Other ancillary funeral and cremation merchandise</li> </ul>	Not applicable
Cemetery	<ul style="list-style-type: none"> <li>• Opening and closing fees (interments/inurnments)</li> <li>• Graveside services</li> <li>• Merchandise installation fees</li> </ul>	<ul style="list-style-type: none"> <li>• Outer burial containers</li> <li>• Memorial markers and bases</li> <li>• Cemetery floral placements</li> <li>• Other ancillary merchandise</li> </ul>	<ul style="list-style-type: none"> <li>• Lots</li> <li>• Lawn crypts</li> <li>• Mausoleum spaces</li> <li>• Niches</li> <li>• Other cremation memorialization and interment options</li> </ul>

## Accounting for Deathcare Contracts



### Atneed Contracts

Atneed funeral and cemetery revenue is recognized when the funeral, cremation, and cemetery merchandise is delivered and the funeral, cremation, and cemetery services are performed. Personalized merchandise (generally markers) will typically lag the recognition of property and burial and cremation-related merchandise and services because of the time required to manufacture and then install these items. These items and any related services are deferred until the delivery occurs. Funeral, cremation, and cemetery costs are recognized concurrently with the revenue recognition.



The cash flows associated with the atneed funeral and cemetery contracts are generally concurrent with the activity within the income statement and balance sheet as the cash is collected at the time of sale and the merchandise and services are generally provided within days of the contract signing.

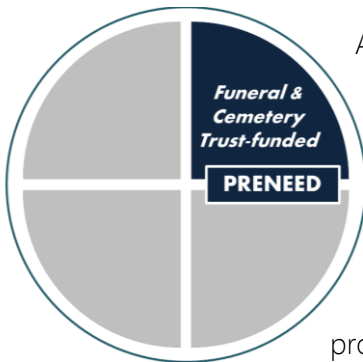
The timing of revenue recognition and net cash flows associated with an atneed contract are typically as follows.

*Exhibit 3—Timing of Revenue Recognition and Net Cash Flows for Atneed Contracts*

	INCOME STATEMENT When Delivery Occurs		CASH FLOW STATEMENT	
	At or Near Time of Sale	After Sale	At or Near Time of Sale	After Sale
<b>Funeral (including Cremation)</b>				
Merchandise	X	-----	X	-----
Services	X	-----	X	-----
<b>Cemetery</b>				
Non-personalized merchandise	X	-----	X	-----
Personalized merchandise	-----	X	X	X (1)
Services	X	-----	X	-----
Property	X	-----	X	-----

(1) Cash outflow for payment to vendor(s) for purchase of personalized merchandise.

### Preneed Funeral and Cemetery Trust-funded Contracts



A preneed contract is entered into when a customer agrees to purchase funeral, cremation, or cemetery merchandise and services *prior* to a death. Under these preneed contracts, we are contractually obligated to provide the merchandise and services in the future at the price secured at the time of sale. Revenues associated with sales of preneed funeral and cemetery contracts are deferred until such time that the merchandise is delivered and services are performed.

Since preneed funeral, cremation, or cemetery services or merchandise will not be provided until sometime in the future, most states and provinces require that all or a portion of the funds collected from customers on preneed funeral or cemetery contracts be paid into merchandise and service trusts until the merchandise is delivered or the service is performed. We retain any funds above the amounts required to be deposited into the trusts and use them for working capital purposes, generally to offset the selling and administrative costs of our preneed programs.

These trust deposits are considered variable interest entities and are included on our consolidated balance sheet as assets, but the customer is still the legal beneficiary. As such, there is a corresponding liability for the amounts held in trust. These trust funds, along with the amounts remaining to be collected from the customer and the amounts that have been received but were not required to be placed in trust, represent future revenues. Thus, our future revenues (deferred revenue, which is included in our preneed backlog) are segregated on our consolidated balance sheet until the related merchandise is delivered or the services are performed between the amounts that:



- Are held in trust, which are presented in the line item *Deferred preneed receipts held in trust*, and
- Are still receivables from customers or are collected but we were not required to deposit into trust. These amounts are presented in the line items *Deferred preneed funeral revenues* and *Deferred preneed cemetery revenues*.

We mark to market our trust investments each month. Net realized gains or losses are recorded as an increase or decrease in our consolidated balance sheet to either *Preneed funeral receivables, net and trust investments* or *Preneed cemetery receivables, net and trust investments* and an increase or decrease to *Other income (expense), net* in our consolidated statement of operations. Net unrealized gains or losses are recorded as an increase or decrease in our consolidated balance sheet to either *Preneed funeral receivables, net and trust investments* or *Preneed cemetery receivables, net and trust investments* and an increase or decrease to *Accumulated other comprehensive income* in our consolidated balance sheet. However, because these net gains or losses (both realized and unrealized) in the merchandise and service trust investments are attributable to our preneed customers, the activity in *Other income (expense), net* and *Accumulated other comprehensive income* is offset with a corresponding reclassification to the *Deferred preneed receipts held in trust* line item in our consolidated balance sheet.

The investment earnings on the trust funds are intended to offset inflationary price increases in the cost to deliver the merchandise and services in the future when the contract is fulfilled. The investment earnings are allocated to the individual contract items and are deferred until the related merchandise item is delivered or the services are performed, at which time they are recognized as trust fund income in our funeral and cemetery revenues.

All preneed direct selling costs are recognized at the time of sale of the preneed contract, while most of the revenues are deferred until the contract is fulfilled.

The following exhibit shows the profit and loss and cash flow impact of preneed funeral and cemetery trust-funded contracts.



Exhibit 4—Profit and Loss and Cash Flow Impact of Preneed Funeral and Cemetery Trust-funded Contracts

	INCOME STATEMENT		CASH FLOWS	
	Revenues	Expenses	Inflows	Outflows
1. Prior to sale				
- Advertising and promotion costs	-----	X	-----	X
2. Time of sale				
- Down payment	-----	-----	X	-----
- Deposits to trust	-----	-----	-----	X
- Selling compensation costs	-----	X	-----	X
3. Financing term, if not paid in full at time of sale				
- Monthly payment	-----	-----	X	-----
- Finance charges as earned	X	-----	X	-----
- Deposits to trust	-----	-----	-----	X
4. Time of delivery of merchandise and services				
- Sales price for delivered merchandise and services	X	-----	-----	-----
- Trust fund income associated with delivered items	X	-----	-----	-----
- Any remaining receivable balance	-----	-----	X	-----
- Cost of delivered merchandise and services	-----	X	-----	X
- Withdrawal of trust proceeds – principal deposits plus trust fund income including unrealized gains and losses	-----	-----	X	-----



### Preneed Funeral Insurance-funded Contracts

In certain cases and where permitted by state and provincial law, our customers may arrange their preneed funeral contracts by purchasing a life insurance policy from third-party insurance companies, for which we earn a commission as general sales agent for the insurance company. We generally do not sell cemetery contracts under our life insurance program due to the multiple delivery and recognition events and the mandatory perpetual care obligations.

This general agency commission, which averages approximately 20% of the face amount of the policy, is included in our funeral revenues as earned at the time of sale, net of an estimated cancellation reserve as it is subject to chargeback if the customer cancels the policy within a defined time period. The cash flow from the general agency commission mitigates the selling and administrative costs of our preneed programs.

Because the insurance contract is between the customer and the third-party insurance company, the customer pays the third-party insurance company directly. The insurance contract is not considered our asset or liability, as we have no claim to the insurance proceeds until the contract is fulfilled and no obligation under the contract until the benefits are assigned to us after the time of need. Therefore, we do not include the unfulfilled preneed funeral insurance-funded contract amounts in our consolidated balance sheet. We do, however, include these amounts in the "Preneed Funeral and Cemetery Activities and Backlog of Contracts" section in the *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our annual and quarterly reports filed with the SEC.

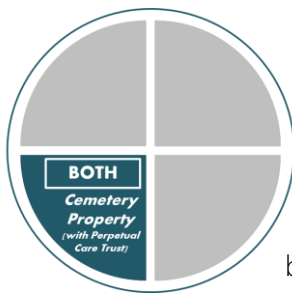


The insurance policy has an increasing death benefit that grows at an annual rate of approximately 1%, per our agreement with the insurance company. Similar to how the investment earnings are recognized on preneed funeral trust-funded contracts, this policy growth for preneed funeral insurance-funded contracts is recognized in revenues along with the revenues for the merchandise and services delivered when the insurance contract is fulfilled. This growth, along with the general agency commission, is intended to mitigate inflationary price increases in the cost to deliver the merchandise and services in the future when the contract is fulfilled.

The following exhibit shows the profit and loss and cash flow impact of preneed funeral insurance-funded contracts.

*Exhibit 5—Profit and Loss and Cash Flow Impact of Preneed Funeral Insurance-funded Contracts*

	INCOME STATEMENT		CASH FLOWS	
	Revenues	Expenses	Inflows	Outflows
1. Prior to sale				
- Advertising and promotion costs	-----	X	-----	X
2. Time of sale				
- General agency revenue, net of cancellations	X	-----	X	-----
- Selling compensation costs	-----	X	-----	X
3. Time of delivery of merchandise and services				
- Sales price for delivered merchandise and services	X	-----	-----	-----
- Policy growth	X	-----	-----	-----
- Cost of delivered merchandise and services	-----	X	-----	X
- Death benefit claim on insurance policy including growth	-----	-----	X	-----



### **Cemetery Property Contracts and Perpetual Care Trusts**

Sales of cemetery property interment rights (“cemetery property”) are generally not subject to trusting requirements if the property is constructed and available for interment. If sold prior to construction of the cemetery property, we are required in certain states to provide financial assurance, which we generally achieve by securing a construction surety bond until the construction is complete in lieu of trusting. These rights of interment may be in ground burial lots, lawn crypts, mausoleum spaces, niches, and cremation memorialization items such as benches, boulders, statues, etc.

We recognize cemetery property revenue when 10% of the purchase price has been collected from the customer and the property is fully constructed and available for interment. While cemetery property can be sold on either an atneed or preneed basis, the vast majority of our cemetery property is sold on a preneed contract.

Costs related to the sales of cemetery property include the property and construction costs specifically identified by project. These costs are charged to costs and expenses at the time the revenue is recognized.





While the sale of the cemetery property interment right itself is not generally subject to trusting, we are required by state/provincial law to pay a portion of the proceeds from the sale into cemetery perpetual care trusts. The percentage required varies by state or province, but is typically around 10% of the sale amount of the cemetery property. These trust funds are generally invested in fixed income securities to establish an income stream that is distributed to us to provide for the care and maintenance of the cemetery grounds in perpetuity. The earnings generated from the perpetual care trust will not reach their maximum potential until all of the cemetery property interment rights have been sold.

While the trust assets are included in our consolidated balance sheet as *Cemetery perpetual care trust investments*, the corpus of the trusts generally cannot be withdrawn and we do not have a legal right to the assets held within the trusts. Thus, we record a corresponding non-current liability titled *Care trusts' corpus* on our consolidated balance sheet.

The net ordinary investment earnings (generally interest and dividends less trustee expenses and taxes) are distributed from the trust regularly to defray our cash outlays related to maintaining the grounds and features within the cemetery. These distributed earnings are recognized as trust fund income in our cemetery revenues in the period earned to the extent we have incurred qualifying maintenance expenses. All cemetery maintenance expenses are recorded in our costs and expenses as incurred.

Capital gains within the perpetual care trusts are generally not distributable to us, so they are not included in our revenues. However, the capital gains increase the investable perpetual care trust assets and trust corpus, increasing the potential for higher ordinary investment income in the future. In the states where capital gains can be distributed to us, they are recognized as cemetery revenues in the period earned.

The following exhibit shows the profit and loss and cash flow impact of cemetery property contracts and the related cemetery perpetual care trusts.



Exhibit 6—Profit and Loss and Cash Flow Impact of Cemetery Property Contracts and Perpetual Care Trusts

	INCOME STATEMENT		CASH FLOWS	
	Revenues	Expenses	Inflows	Outflows
1. Construction/development of cemetery property inventory (can be prior to or after sale)				
- Construction/development costs	-----	-----	-----	X (1)
2. Prior to sale				
- Advertising and promotion costs	-----	X	-----	X
3. Time of sale				
- Down payment	-----	-----	X	-----
- Deposits to care trust	-----	-----	-----	X
- Selling compensation costs	-----	X	-----	X
4. Recognition of cemetery property revenues (when property constructed and 10% of purchase price received)				
- Sales price	X	-----	-----	-----
- Cost of cemetery property	-----	X	-----	(2)
5. Financing term, if not paid in full at time of sale				
- Monthly payments	-----	-----	X	-----
- Finance charges as earned	X	-----	X	-----
- Deposits to care trust	-----	-----	-----	X
6. Investment/trust management phase—in perpetuity for perpetual care trust				
- Net ordinary trust fund income	X	-----	X	-----
- Cemetery maintenance	-----	X	-----	X

(1) Construction/development costs are reflected as "Capital expenditures" in *Cash flows from investing activities*.

(2) The cost of cemetery property is reported as "Amortization of cemetery property" in the *Adjustments to reconcile net income to net cash provided by operating activities*. The investing cash outflows occurred when the cemetery property inventory was developed during the construction phase.

## Conclusion

We hope this information has helped you gain a better understanding of the deathcare industry, its unique characteristics and terminology, and how we account for the revenue recognition and related cash flows associated with the preneed and atneed contracts we offer.

For additional information, please contact Debbie Young, Director/Investor Relations at [debbie.young@sci-us.com](mailto:debbie.young@sci-us.com) or 713-525-9088.



## Appendix 1: Glossary of Terms

The following terms are common to the deathcare industry, are used throughout this document, and have the following meanings:

***Atneed***— Funeral and cemetery arrangements sold after a death has occurred.

***Cancellation***—Termination of a preneed funeral or cemetery contract, which relieves us of the obligation to provide the goods and services included in the contract. Cancellations may be requested by the customer or be initiated by us for failure to comply with the contractual terms for payment. State or provincial laws govern the amount of refund, if any, owed to the customer.

***Care Trust Corpus***—The deposits and net realized capital gains and losses included in a perpetual care trust that cannot be withdrawn. In certain states, some or all of the net realized capital gains can be distributed, so they are not included in the corpus.

***Casket***—A four-sided rectangular box, generally made of wood or metal, used for burial of a deceased individual or pet. Caskets frequently contain a split-lid that can be opened for viewing purposes prior to the burial. Caskets can be customized in a variety of ways including engravings, pockets or drawers to hold keepsakes, and decorative emblems and corner pieces.

***Cemetery Perpetual Care or Endowment Care Fund (ECF)*** — A trust fund established for the purpose of maintaining cemetery grounds and property into perpetuity. Also referred to as a perpetual care trust. For these trusts, the corpus remains in the trust in perpetuity and the net ordinary investment earnings are distributed to us regularly and are intended to defray our expenses incurred to maintain the cemetery. In certain states, some or all of the net realized capital gains can also be distributed.

***Cemetery Property***—Developed lots, lawn crypts, mausoleum spaces, niches and cremation memorialization property items (constructed and ready to accept interments) and undeveloped land we intend to develop for the sale of interment rights. Includes the construction-in-progress balance during the preconstruction and construction phases of projects creating new property inventory.

***Cemetery Property Interment Rights***—The right to inter human remains in a specific cemetery property inventory space. See also Cemetery Property Revenue below.

***Cemetery Property Revenue***— Recognized sales of interment rights in cemetery property when a minimum of 10% of the sales price has been collected and the property has been constructed and is available for interment.

***Cemetery Merchandise and Services***—Stone and bronze memorials, markers, merchandise installations, urns, outer burial containers, and burial openings and closings.

***Cremation***—The reduction of human remains to bone fragments by intense heat.

***Cremation Memorialization***—Products specifically designed to commemorate and honor the life of an individual that has been cremated. These products include cemetery property inventory types that provide



for the disposition of cremated remains within our cemeteries such as benches, boulders, statues, etc. They also include memorial walls or books where the name of the individual is inscribed but the remains have been scattered or kept by the family.

***Cremation Receptacles***—Merchandise items designed to hold cremated remains. These may be simple sealed containers used for temporary storage until the remains are scattered or may be containers intended for permanent placement in a ground niche or burial lot. They may also be urns or decorative boxes intended for permanent display in a glass-front niche or within a family's home.

***Funeral Merchandise and Services***—Funeral-related merchandise, including caskets, casket memorialization products, burial vaults, cremation receptacles, cremation memorial products, and flowers and professional services relating to funerals and cremations including arranging and directing services, use of the funeral facility, use of funeral vehicles, cremations, memorialization, visitations, and catering.

***General Agency (GA) Revenues***—Commissions we receive from third-party life insurance companies for life insurance policies sold to preneed customers for the purpose of funding preneed funeral arrangements. The commission rate paid is determined based on the product type sold, the length of payment terms, and the age of the insured/annuitant.

***Interment***—The burial or final placement of human remains in the ground, in mausoleums, or in cremation niches.

***Inurnment***—The placement of an urn or other cremation receptacle containing cremated remains in a niche or cremation memorialization property.

***Investment Earnings***—Net investment income earned within a funeral or cemetery merchandise and service trust. The investment earnings are allocated or attributed to the individual merchandise and service items within the trust. These earnings include ordinary income and realized and unrealized gains and losses net of trustee expenses and taxes. These attributed earnings are deferred until the related merchandise is delivered and service is performed, at which time they are recognized as trust fund income in our funeral or cemetery revenues. Within a perpetual care trust, the net ordinary income of the investment earnings is distributable to us as trust fund income to the extent we have qualifying cemetery maintenance expenses and is then considered revenue.

***Lawn Crypt***—An underground outer burial receptacle constructed of concrete and reinforced steel, which is usually pre-installed in predetermined designated areas.

***Marker***—A method of identifying a deceased person in a particular burial space, crypt, or niche. Permanent burial and cremation memorialization markers are usually made of bronze or stone.

***Mausoleum***—An above ground structure that is designed to house caskets and cremation urns.

***Merchandise and Service Trust***—A trust account established in accordance with state or provincial law into which we deposit the required percentage of customers' payments for preneed funeral, cremation, or cemetery goods and services to be delivered or performed by us in the future. The amounts deposited can



be withdrawn only after we have completed our obligations under the preneed contract or the cancellation of the contract.

***Net Ordinary Investment Earnings***—Interest, dividends, tax-exempt income, rent, and partnership income less trust expenses and taxes earned by the investments within a cemetery perpetual care that can be distributed to defray the expenses incurred to maintain the cemetery.

***Niche***—A property type used for the placement of an urn containing cremated remains. These can be in-ground or above-ground within a mausoleum.

***Outer Burial Container***—A reinforced container intended to inhibit the subsidence of the earth and house the casket after it is placed in the ground (also known as burial vaults).

***Perpetual Care Obligation***—The portion of the sale price for property interment rights that must be deposited into the perpetual care trust.

***Preneed***— Purchase of products and services prior to a death occurring.

***Preneed Backlog***—Future revenues from unfulfilled preneed funeral, cremation, and cemetery contractual arrangements.

***Preneed Funeral Insurance-funded Contract***—Contract for funeral or cremation merchandise and services purchased prior to the death of the beneficiary using a third-party insurance company.

***Preneed Funeral Trust-funded Contract*** —Contract for funeral or cremation merchandise and services purchased prior to the death of the beneficiary. For this type of contract, all or a portion of the customer's payments are deposited in state and provincial-regulated trusts with independent trustees to be invested and managed by professional investment managers until the merchandise is delivered or the service is performed.

***Selling Compensation***—The amounts earned by our sales counselors (preneed planning advisors and family service counselors) for sales of preneed funeral and cemetery contracts and certain items on atneed cemetery contracts. These direct selling costs are expensed at time of sale and are generally computed as a percentage of the net sales price of the items.

***Trust Fund Income***— Recognized investment earnings from our merchandise and service and perpetual care trust investments.

***Urn***— A decorative cremation receptacle used to store cremated remains.



## Appendix 2: Disclaimers

The statements in this document that are not historical facts are forward-looking statements made in reliance on the “safe harbor” protections provided under the Private Securities Litigation Reform Act of 1995. These statements are based on assumptions that we believe are reasonable; however, many important factors could cause our actual results in the future to differ materially from the forward-looking statements made herein and in any other documents or oral presentations made by, or on behalf of, the Company.

For further information on these and other risks and uncertainties, see our most recent Securities and Exchange Commission filings, including our Annual Report on Form 10-K and our Form 10Q for the quarterly period. Copies of these documents as well as other SEC filings can be obtained from our website at [www.sci-corp.com](http://www.sci-corp.com). We assume no obligation to publicly update or revise any forward-looking statements made herein or any other forward-looking statements made by us, whether as a result of new information, future events, or otherwise.