



## Board Meeting Handout

### Proposed FASB Staff Position FAS 78-a, “Entrance Fees and Deferred Revenue in the Continuing Care Retirement Community Industry”

February 1, 2006

#### PURPOSE

The purpose of this meeting is for the Board to discuss whether to add a project to its agenda to consider whether FASB Statement No. 78, *Classification of Obligations That Are Callable by the Creditor*, applies to refundable entrance fees in the continuing care retirement community (CCRC) industry and to decide whether a FASB Staff Position (FSP) should be issued to address this particular issue.

#### BACKGROUND

In response to guidance provided by the SEC to a publicly registered company in the CCRC industry, the AICPA requested the FASB to provide authoritative guidance on whether refundable amounts of entrance fees should be considered *callable* and subject to Statement 78 in the CCRC industry.

The guidance provided by the SEC has created diversity in practice within the CCRC industry (primarily between public and nonpublic entities) on how to classify the refundable portion of entrance fees and on whether the obligation should be recognized based on the estimated obligation or the legal obligation.

CCRCs provide a full range of services, and contracts that are commonly made between a resident and a CCRC generally involve a substantial up-front entrance fee that allows the resident to live in the community for the remainder of his or her life. Portions of these fees are often refundable to the resident upon their request, with terms that vary from facility to facility.

Historically, CCRCs have presented the estimated liability for the refundable portion of entrance fees and related deferred revenue as a long-term liability in the financial

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statements. The estimate of the amount of refundable entrance fees is often an amount substantially less than the legal obligation because there is an expectation, based on historical experience, that a small percentage of the legal obligation will actually be refunded.

The issue that the AICPA requested the Board to consider is as follows:

- a. Should the provisions of Statement 78 apply to refundable entrance fees that are due on demand for CCRCs?

In addition to the question requested by the AICPA above, the staff understands that there is diversity in the interpretation of how Statement 78 would be applied, and an overall difference on how the liability and related revenue should be recognized. As a result, if the Board chooses to add this project to the agenda, the FASB staff would like the Board to consider the following additional issues:

- b. If the Board concludes that Statement 78 applies to refundable entrance fees in the CCRC industry, how should CCRCs recognize the liability for refundable entrance fees within the financial statements?
- c. If the Board concludes that Statement 78 does not apply to refundable entrance fees in the CCRC industry, how should CCRCs recognize the liability for refundable entrance fees within the financial statements?

The FASB staff notes that these issues may overlap with initiatives currently underway as part of the FASB Financial Performance Reporting by Business Entities and Revenue Recognition projects.

## **ISSUES TO DISCUSS**

### **Issue 1: Does the Board agree to add this project to the agenda?**

The staff has identified three alternatives for the Board to consider:

1. Alternative A–The Board agrees to add this project to the agenda addressing issues (a), (b), and (c) as described above.
2. Alternative B–The Board agrees to add this project to the agenda, addressing only issue (a) as described above.
3. Alternative C–The Board does not agree to add this project to the agenda.

*The staff will recommend that the Board select Alternative A.*

*(If the Board answers “C” to Issue 1, no additional questions will be addressed.)*

**Issue 2: Does the Board believe that an FSP is the best form for this guidance?**

*The staff will recommend that an FSP is the best form of guidance for this issue.*

**Issue 3: Should the provisions of Statement 78 apply to refundable entrance fees that are due on demand for CCRCs?**

The staff has identified two alternatives for the Board to consider:

1. Alternative A–Statement 78 should apply to refundable entrance fees that are due on demand for CCRCs.
2. Alternative B–Statement 78 should not apply to refundable entrance fees that are due on demand for CCRCs.

*The staff will recommend that the Board select Alternative B.*

**Issue 4: If the Board concludes that Statement 78 applies to refundable entrance fees in the CCRC industry, how should CCRCs recognize the liability for refundable entrance fees within the financial statements? *(If Alternative B is selected for Issue 3, this question will not be addressed.)***

The staff has identified two alternatives for the Board to consider:

1. Alternative A–In applying Statement 78, CCRCs should recognize the legal obligation of the refundable entrance fees as a current liability.
2. Alternative B–In applying Statement 78, CCRCs should recognize the legal refundable entrance fee obligation as a current liability comprised of the estimated liability for refundable entrance fees and deferred revenue.

*The staff will recommend that the Board select Alternative A.*

**Issue 5: If the Board concludes that Statement 78 does not apply to refundable entrance fees in the CCRC industry, how should CCRCs recognize the liability for refundable entrance fees within the financial statements? (If Alternative A is selected for Issue 3, this question will not be addressed.)**

The staff has identified two alternatives for the Board to consider:

1. Alternative A—CCRCs should record the legal obligation as a long-term liability and estimate the current portion of that liability based on historical experience.
2. Alternative B—CCRCs should estimate the amount of the total liability and classify the amount they estimate to be paid in the next year as the current portion of that liability.

*The staff will recommend that the Board select Alternative A.*

#### **EFFECTIVE DATE, TRANSITION, AND DISCLOSURE**

The staff recommends that entities should recognize the provisions of this FSP in accordance paragraph 7 of FASB Statement No. 154, *Accounting Changes and Error Corrections*, and provide the following disclosures within the notes to the financial statements:

- a. The total amount of refundable entrance fees for each balance sheet date presented
- b. The amount of refundable entrance fees outstanding for each of the next five years
- c. The classification of these fees within the balance sheet if not readily distinguishable from the face of the statements
- d. The accounting policy for the recognition of refundable entrance fees.

**Issue 6: Does the Board agree with the transition and disclosure provisions as described above?**

**Issue 7: What should be the effective date of this FSP?**

The staff has identified two effective date alternatives for the Board to consider:

1. Alternative A–The effective date for the FSP shall be the first annual reporting period ending after the date the FSP is finalized. The FSP is expected to be finalized in May 2006.
2. Alternative B–The FSP shall be effective for fiscal periods ending after December 15, 2006.

*The staff will recommend that the Board select Alternative A.*



## Board Meeting Handout

### Proposed FASB Staff Position FAS 123(R)-d, “Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event”

February 1, 2006

#### OBJECTIVE

At the February 1, 2006 Board meeting, the Board will consider comments received from respondents during the exposure period and whether to proceed to drafting a final FSP.

#### COMMENT LETTER SUMMARY

The staff received 13 comment letters (4 from accounting firms, 6 from preparers, 2 from consulting firms, and 1 from a constituent organization) as of the comment period deadline. Those respondents generally agree with the conclusions in the proposed FSP and support the issuance of a final FSP. However, the respondents made certain recommendations for improvement. The Board will be asked to consider certain of these recommendations.

#### ISSUES INCLUDED IN NOTICE TO RECIPIENTS

*Issue 1: Do you think the Board should restrict the guidance in this FSP only to specific contingent events (that is, change in control)?*

All of the respondents were in agreement that the guidance in this FSP should not be restricted only to specific contingent events. In general, the respondents did not believe this guidance would allow for abuses and therefore it was unnecessary to restrict this guidance only to specific contingent events. Additionally, some respondents believed restricting this guidance would add unnecessary confusion in determining equity versus liability classification of employee share-based payment awards, in that, there are many variations of these contingent cash settlement features. Trying to restrict certain features while including others may become overly burdensome.

**Issue 1: Does the Board wish to restrict the guidance in this FSP only to specific contingent events?**

*Issue 2: Do you believe the grandfathering approach more appropriately addresses the current practice issue?*

All but one of the respondents support the probability approach presented in the proposed FSP. In general, the respondents' rationale for supporting the probability approach is the consistency between the classification of (a) shares and (b) option or similar instruments

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when the instruments are issued as employee compensation and embody a conditional obligation to transfer assets.

The respondent in support of the grandfathering approach did not wish to create additional differences in the accounting model for instruments issued to nonemployees and those issued as employee compensation. This respondent did note absent the Board pursuing the grandfathering approach, they are also supportive of the probability approach included in the proposed FSP.

**Issue 2: Does the Board wish to retain the probability approach included in the proposed FSP?**

**SCOPE**

One of the respondents commented that it was unclear whether the guidance in the proposed FSP could be applied by analogy to nonemployee awards. In drafting the proposed FSP it was not the staff's intent to alter the classification guidance for nonemployee awards within the scope of this FSP. That is, the staff did not intend to change the guidance provided in EITF Issue 96-18 and DIG Issue C3 regarding nonemployee awards. As a result, in drafting the final FSP the staff will make it clear the guidance in this FSP should only be applied to employee share-based payment arrangements and should not, by analogy or otherwise, apply to instruments outside of employee compensation.

**Issue 3: Does the Board agree that nonemployee awards should not be included within the scope of this FSP?**

**DRAFTING OF FINAL FSP**

The staff will ask the Board whether they should proceed to drafting a final FSP.