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Letter of Comment No: 5
File Reference: FSP78U

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Practice Fellow
Financial Accounting Standards Board
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RE: FASB Staff Position Regarding Refundable Entrance Fees -
Balance Sheet Classification

Dear Susan:

The objective of this letter is to respond to your request for comments regarding a proposed change in the accounting for and reporting of refundable entrance fees of a continuing care retirement communities (CCRCs). Thank you for putting this matter on the agenda of the Financial Accounting Standards Board (FASB) and opening the matter for public comment prior to issuance of a Staff Position interpretation. This agenda item for the FASB is precipitated by the SEC's recent decision directing a registered company to classify all CCRC refundable obligations (which, because they are amortizable into income, typically are called "deferred revenue,") as current liabilities (callable), as opposed to the historic treatment of them being a long-term liability. This treatment could flow from the Staff Financial Accounting Standard 78 (SFAS 78) being applied to the deferred revenue portion (refundable portion) of entrance fees of a CCRC

Life Care Services LLC (LCS) is a privately held company whose ownership is entirely held by its employees. It is a for-profit company specializing in providing services and housing for older adults throughout the United States. It has an operating history of almost 40 years, and during that time has developed and/or managed more than 145 retirement communities. Today it manages 83 retirement communities, representing approximately 24,000 residents, of which 5,000 are residents in skilled nursing facilities. Its campuses typically include the entire spectrum of accommodations, from independent living to assisted living to skilled nursing facilities. The typical resident is a female, in their early 80s; married couples are approximately 25% of the total population, and of a similar age.

The owners of the managed communities are 80% not-for-profit, 20% for-profit. None of its clients are registered with the Securities and Exchange Commission (SEC). In fact,



Susan Cospers, Practice Fellow
Financial Accounting Standards Board
October 31, 2005
Page 2

approximately 0.1 of 1% of the total CCRC industry, probably no more than 3 of a total of approximately 2,500 entities, are registered.

Who are the users of Financial Statements?

LCS is routinely involved in the accounting and reporting to boards of directors of the owners of these communities.

Who are the users of the CCRC financial statements?

It is a very identifiable number of persons - board of directors, owners, creditors (vendors and long-term lenders), and prospective or current residents.

What is a refundable obligation of a CCRC?

An entrance fee is received at the time a resident moves into the communities and is the payment for a life lease on a specific space in the specific community. Typically a substantial portion of the entrance fee is refundable upon death or move-out. Because of the age of the resident, it is reasonable to assume that death will be the dominant reason for the refund becoming due. In fact, experience demonstrates that less than 1% of all refunded fees in any given year are due to move outs - it typically will not exceed 1/2 of 1%.

The other reason for a refund becoming due is because of death. In any given year, 10-12% of all of the units will become available, and therefore a refund will be due.

It is highly unlikely that more than 10-12% of the balance of entrance fees being reported as deferred contract revenue will become due and payable within the next operating cycle.

The average contract duration - expected life expectancy upon move-in - is between 7 and 10 years, and is increasing. This information is based upon LCS's private actuarial database, which includes approximately 3 million life months of experience dating back to the late 1960s. The actuarial database information is continually reconfirmed by independent actuaries.

The refund is due typically upon reoccupancy or one year or more from the time of vacation. Some states do require refunds within a period not to exceed 12 months.

Accounting Practices by LCS

It has been the LCS accounting and reporting practice to immediately classify any refundable entrance fee as current when the unit becomes vacant due to move-out or vacation due to death or other cause, unless contract terms place a longer timeframe on the date the refund is due.



Susan Cospers, Practice Fellow
Financial Accounting Standards Board
October 31, 2005
Page 3

Its accounting practices reflect that any refundable amount due under a contract for a resident who has died or moved out is reflected as a current liability, unless, under the terms of the entrance fee agreement, the time of refund is conditioned on other events. This position is taken regardless of state law, which could permit classification as a long-term liability, and regardless of the fact that this obligation will be typically discharged by the receipt of an entrance fee from a new resident reoccupying the vacated unit.

Further, when a resident becomes sufficiently infirm that they are permanently assigned to the skilled nursing facility, and a new entrance fee has been received on their vacated unit, a portion of the entrance fee is reported as current liability based on actuarial based mortality data.

These accounting practices, which are more conservative than that provided in the applicable audit guides, has nonetheless served it well to communicate to the users of the financial statements, reasonable estimates of working capital and cash flow analyses.

Accounting and Reporting Guidance

Chapter 14 of the American Institute of Certified Public Accountants *Audit and Accounting Guide: Healthcare Organizations*, which incorporates Statement of Operating Position 90-8, has been operational now more than 15 years and was created over several previous years based on developed industry practices. LCS believes it should continue to be the authoritative guide for accounting and reporting of refundable entrance fees, with no change to the current guidance, or at least, specific recognition of the accounting approach now used by LCS.

These reasons include:

- The contract (known as a residency agreement) creates a lifetime interest that history and experience confirms extends beyond more than one operating cycle of the entity. Having sold family homes in order to move into a CCRC, the resident is not likely to move out before death.
- Entrance fees are a source of long-term financing, which in the capital structure of the community, permits a significant reduction in the amount of third-party debt that must be placed on a community. This translates into an elimination or a substantial reduction in the debt service cost which would otherwise be paid by residents on a going-forward basis through monthly service fees.
- The long-term obligation of the refundable entrance fee will be replaced by another long-term obligation. Even given this principle, for those situations that have occurred, and where it is demonstrable that a refund will be made within the next operating cycle of the company, the LCS accounting and reporting practice is to classify refundable amounts so identified as a current liability.



Susan Cospers, Practice Fellow
Financial Accounting Standards Board
October 31, 2005
Page 4

Deferred Revenue

Many of the refundable amounts are controlled by a resident agreement which provides for an annual reduction in the amount of the refund that could be received by the resident; typically the refundable amount is zero after a period of 4-8 years. When the resident agreement has such provisions, such refundable amounts are classified as deferred revenue. It is amortized into income over the life of the resident, even though contractually it is earned in a much shorter time period.

The proposed treatment of classifying the entire amount of the refund obligation as a current liability could create the need for additional examination of the accounting definition of deferred revenue. It will not be possible to bring that current liability into income within the contractual period. Accounting practice has taken a conservative approach, stating that, regardless of the contractual term, deferred revenue will not be taken into equity through the income statement except over the expected life of the resident, which, as previously noted, is typically longer than the amortization period.

Unclassified Balance Sheet

It would seem that if the FASB proceeds to apply SFAS 78 to CCRC refundable entrance fees, the industry should consider adopting an unclassified balance sheet as being more meaningful due to lack of a reliable "working capital" measures.

We urge the FASB to make no change to current practice.

Very truly yours,

Arthur V. Neis
Vice President, Treasurer/CFO

AVN:jh