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Memorandum

Date:

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To:

Susan Cosper

Practice Fellow

Financial Accounting Standards Board

Letter of Comment No: 4

File Reference: FSP78U

From:

Dick Dallas

Subject:

Accounting and Reporting by Continuing Care Retirement Communities for the

Refundable Portion of Entrance Fees

Message: I have read the July 15, 2005 AICPA Healthcare Expert Panel Issue Summary (Issue Summary) entitled "Accounting by Continuing Care Retirement Communities (CCRCs) for the refundable portion of entrance fee deposits" and the accompanying cover letter from Dan Noll of the American Institute of Certified Public Accountants (AICPA) to Lawrence W. Smith of FASB. I have also reviewed the professional pronouncements referred to in the Issue Summary and selected audited financial statements of CCRCs issued in recent years.

I believe that View B in the Issue Summary is the appropriate position, with regard to the applicability of Statement of Financial Accounting Standards 78, Classification of Obligations That are Callable by the Creditor (SFAS 78), to CCRC entrance fee accounting and reporting. In my view SFAS 78 was primarily intended to address demand paper issued by financial institutions and other lenders, which is substantially different than refundable entrance fee contracts, for the reasons discussed in View B in the Issue Summary.

Accounting and reporting for refundable entrance fees was widely debated, prior to the issuance of AICPA Statement of Position 90-8, *Financial Accounting and Reporting by Continuing Care Retirement Communities*, (SOP 90-8) in November 1990. I believe that the accounting and reporting treatment directed in paragraph 22 of SOP 90-8 and paragraph 14.22 of AICPA Audit and Accounting Guide, *Health Care Organizations*, (the Guide) remain the appropriate accounting and reporting for CCRC refundable entrance fees.

These two professional pronouncements appropriately direct the following accounting and reporting treatment for refundable entrance fees: "The estimated amount of advance fees that is expected to be refunded to current residents under the terms of the contracts should be accounted for and reported as a liability. The estimated amount should be based on the individual facility's own experience or, if records are not available, on the experience of comparable facilities. The remaining amount of advance fees should be accounted for as deferred revenue within the liability section of the balance sheet." "The gross amount of contractual refund obligations under existing contracts and the CCRC's refund policy should be disclosed in the notes to the financial statements."

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Seeing the issuance of audited financial statements with refundable entrance fee reporting consistent with the provisions of SOP 90-8 and the Guide, not SFAS 78, has been my experience, since refundable entrance fees began appearing in the 1980s.

In an independent auditor's report, the auditor opines on, among other things, whether an audited entity's financial position is fairly presented in all material respects. In my view, issuing a balance sheet that includes material amounts of deferred entrance fees as current liabilities when, based on historical experience, there is no reasonable expectation of refund, represents a material misstatement of financial position, and to some extent is not consistent with the "going concern" concept of financial reporting, which assumes that assets will be consumed and liabilities will be satisfied in the normal course of business. The normal course of business or operating cycle of a CCRC, with respect to satisfying obligations associated with entrance fees, is most likely 10-12 years for a new CCRC and 7-8 years for a "mature" CCRC, based on the estimated remaining life expectancies of its continuing care contract resident population.

Another factor to take into consideration, in the resolution of this issue, is the potential effect on the required annual calculation of a CCRC's future service obligation (FSO), if any. If SFAS 78 is determined to be the governing professional pronouncement on accounting and reporting for refundable entrance fees, and subsequently reduces the amount of deferred entrance fees includable in the FSO calculation, it may result in CCRC's having to "book" and report FSO liabilities, which don't in fact exist, resulting in a material misstatement of financial position.

An additional factor to take into consideration, in the resolution of this issue, is how CCRC financial statements, prepared in accordance with the provisions of SFAS 78, will be interpreted by the various users of such statements. Bond rating agencies, such as FitchRatings and Standards & Poor's possess sufficient industry knowledge to understand that the implementation of SFAS 78's provisions for CCRC accounting and reporting is not indicative of a CCRC's actual financial position, and these agencies also possess the sophistication to make the adjustments necessary to determine a CCRC's actual financial position. Likewise for investment bankers, such as Herbert J. Sims & Co., Inc., UBS Financial Services Inc., and Ziegler Capital Markets Group. However, an important user group, prospective CCRC residents and their financial advisors may not possess sufficient industry knowledge and accounting sophistication to make such adjustments. Also, it is my understanding that Dun & Bradstreet, whose ratings are often relied upon by prospective CCRC residents and their financial advisors, does not currently have a financial model capable of correcting the overstatement of current liabilities which would occur with the implementation of SFAS 78's provisions for CCRC accounting and reporting.

I appreciate the opportunity to comment on this issue of critical importance to the CCRC industry. Should you have any questions or require additional information, please contact me.