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# American Seniors Housing Association

VIA Fax  
October 31, 2005

Letter of Comment No: 7  
File Reference: FSP78U

Susan Cospers  
Practice Fellow  
Financial Accounting Standards Board  
401 Merrit 7  
Norwalk, CT 06856

*RE - Refundable Entrance Fees - Balance Sheet Classification and Staff Position*

Dear Susan:

I am writing to you as president of the American Seniors Housing Association (ASHA), a professional organization that represents the interests of companies involved in the development, management, and finance of the full spectrum of seniors housing property types, including continuing care retirement communities (CCRCs) with refundable entrance fees. It is my hope that you will find our comments related to the accounting of refundable entrance fees to be helpful as FASB prepares guidance on entrance fee deposits and deferred revenue associated with entrance fees.

The Securities and Exchange Commission (SEC) has advised that refundable entrance fees should be considered "callable," defined as "subject to demand for presentation for payment," under Financial Accounting Standard (FAS) 78, *Classification of Obligations That Are Callable by the Creditor*, and accordingly that the refundable portion should be classified as a current liability. The Financial Accounting Standards Board (FASB) is now considering this decision and would issue an FASB Staff Position (SFA 78) on this matter.

### Entrance Fees - Background

Entrance fees are lump sum payments made by senior adults as they move into a CCRC. Entrance fees provide long term capital for the community, thereby reducing its reliance on third party debt and the related debt service costs which must be paid by the seniors through monthly service fees. Entrance fees typically have a refundable and a nonrefundable component, although there are contracts that are 100% refundable and contracts that are completely nonrefundable. The nonrefundable component amortizes into the equity of the community over the life expectancy of the resident. The amount that is unamortized is reported as long term unearned revenue. The contractually refundable portion of the entrance fee is typically repaid upon the earlier of the resale of the apartment or within x months after the resident has vacated the community, whichever comes first.

Because residents of CCRCs are free to move out at will, the SEC has likened the contractually refundable portion of an entrance fee to a callable bond, and determined that it should be classified as a short term liability.

We believe that refundable entry fee obligations are not appropriately characterized as “callable,” and that they should continue to be classified as long-term, consistent with specific continuing care retirement community accounting literature (Chapter 14 of the *AICPA Audit and Accounting Guide: Health Care Organizations*, previously known as SOP 90-8) and long-standing accounting and industry practice.

Nonetheless, we propose disclosure enhancements and identification of probable refunds due within the next fiscal year as a current liability (in addition to those instances wherein reporting entities do not already report a current liability based on contract terms regarding the refund of vacated living units).

#### Proposal Rationale

CCRCs combine elements of hospitality, healthcare and housing in a long term arrangement. Entrance fee agreements are an integral part of the capital structure of the retirement community. We believe that enhanced disclosure is a means of providing readers of financial statements with a more expansive understanding of the CCRC capital situation.

Because it is a fact that a relatively predictable number of contracts will turn over in any current year, it may also be desirable to amend Chapter 14 of the AICPA Health Care Audit Guide to provide for the classification of a portion of contractually refundable entry fee obligations as short term, in those instances wherein the reporting entity does not do so based on the contract with the entrance fee resident.

The disclosure and classification treatment would satisfy a number of objectives:

- Reflect the long-term economics of the underlying contractual agreements
- Provide information as to the amount of entrance fee obligations likely to become due with 12 months
- Avoid the creation of current deferred revenues where such is not the case
- Comport with the standard concepts of working capital and liquidity
- Provide more specific narrative disclosure to better inform the reader as to the terms of the contracts
- Remain consistent with many state regulations that have been developed around the guidance previously provided by Chapter 14
- Preserve consistency and comparability

#### Chapter 14 and Actuarial Probability

Chapter 14/SOP 90-8 was the product of careful and informed deliberation and has provided effective direction for more than 25 years. It has guided the formulation of individual state statutes regulating CCRCs and financial covenants of third party debt. Section 14.22, states

that advance fees otherwise classifiable as deferred revenues should be recorded as a liability “based on the individual facility’s own experience or, if records are not available [as with a new community], on the experience of comparable facilities.” The two events that trigger refunds are death and voluntary move-outs, and both of these events are remarkably predictable. Historically, in typical entrance fee communities, death of 10%-12% of residents is typical and no more than 1%-3% move out voluntarily in any one year.

#### Deferred Revenue as Current Liability

Chapter 14 provides guidance as to the determination of what portion of entry fees should be classified as refundable obligations and what portion should be classified as deferred revenues. The SEC’s directive as to the short term classification of all contractually refundable entry fees leads to the creation of short term deferred revenues in certain instances and current liabilities in all cases. We do not believe that this is a logical or beneficial addition to the existing accounting literature.

#### Matching Current Assets with Current Liabilities Principles

CCRC refunds are typically paid from the subsequent resale of the vacated apartments, and therefore refundable entrance fee liabilities generally do not require use of the CCRCs existing cash balance or other current assets in order to be satisfied. Because new long term liabilities will replace expiring long term liabilities, there should be no need to classify as current any but the known refund obligations because of death or move out. Because entrance fee turnover is such a significantly positive and essential component of CCRC economics, and because the refunds do not consume current assets, recording all entry fee refund obligations as a current liability is misleading.

#### Going Concern Uncertainty

The proposed accounting treatment will cause the financial statements of many entrance fee CCRCs with less-than-one-year contractual refund terms (which are actually mandated in several states) to have extremely unbalanced, negative working capital positions. This will falsely suggest to the user (lender, investor, 75 year old prospective resident contemplating investing a substantial portion of their net worth to provide care and housing for their lifetime, or existing resident who has already made that investment) that the entrance fee CCRC may not be a viable and sustainable business model.

Currently, there is only one public company whose financials have been re-stated at the direction of the SEC to reflect all non-contingent entry fee refunds as current, and (after moving \$119.3m refundable entry fee and deferred revenue from long term to current) the restatement left the company with a negative \$84.1m working capital imbalance. The investment community appears to have so far completely ignored the large negative working capital resulting from this company’s restatement. Nonetheless, we urge you to not introduce new accounting applications that require the users of financial statements to “look through” the statements and to ignore commonsense principles of working capital and liability in order to effectively grasp the true substance of the underlying transactions.

### Dissimilarity between Callable Bonds and Entrance Fee Agreements

The SEC's position on entry fee liabilities seems to rest on the analogy between entry fee agreements that are cancelable at the option of the resident and bonds that are callable by their holders. We believe there are a great many dissimilarities between the two transactions. The entrance fee refund is not a financial instrument that is callable at the option of the holder; it is a lifetime interest in a particular space and place. Residence agreements are non-transferable. To terminate a residency agreement and receive a refund a resident must: 1) vacate their residence and obtain a new primary residence, 2) give up the lifecare and healthcare benefits they "purchased," and 3) suffer the economic detriment of the amortized refund.

The accounting literature in Chapter 14 deals with entrance fee agreements specifically, and rather than resort to a questionable analogy with callable bonds in order to resolve a classification issue that Chapter 14 currently fails to address, we believe it would be preferable for the guidance in Chapter 14 to be expanded to address it.

### Supplemental Disclosure

We believe that Chapter 14 reflects the long term nature of all contractual relationships of a typical CCRC and provides a framework that adequately addresses the accounting issues. The entrance fee contract is multi-dimensional and includes occupancy rights and obligations (whereas, callable bonds include none of these features). The contractual parties anticipate that it will constitute a long-term agreement. In fact, most residents expect that it will continue to be in place for the remainder of their lifetime.

We believe that disclosure is a much more desirable manner to provide the reader of financial statements needed information than reclassifications of the liability on the balance sheet. Therefore, a suggestion would be enhanced disclosure of the nature of the entrance fee agreements, including a description of contract types, the turnover experience of the community, the amount of refunds paid historically, and the current amount of entry fees that are contractually refundable.

### Current Portion of Entry Fee Liabilities

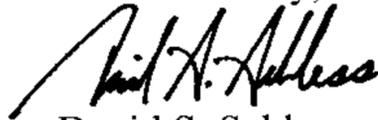
It is true that a certain number of contracts will turn over each year. Although the SEC's position on the classification of entry fee obligations is based almost solely on the recognition that the contracts are cancelable (callable), cancellation is a less significant contributor to entry fee turnover than natural mortality and morbidity.

It is well established that entrance fee community mortality, morbidity and move-out statistics are very stable. Accordingly, if enhanced disclosure is deemed inadequate to fully address GAAP requirements, we believe that Chapter 14 could be augmented with guidance aimed at identifying the amount of entry fee obligations expected to become due within the current year, and that this amount could be classified as current. In this case, in addition to the disclosure requirements listed above, disclosure commentary would also provide the reader with information regarding the basis used in the determination of amounts classified as current and non-current.

The Importance of Continuity

In most states, CCRCs are required to provide annual disclosure statements with audited financials. Resident and prospective residents and their family and advisors rely heavily on these statements to evaluate the creditworthiness of the communities and the soundness of their existing or prospective entrance fee investment. The classification of entrance fee obligations is a very important one. We believe that the accounting guidance provided by Chapter 14 has been responsible and effective for many years, and that it can be updated and supplemented to provide a responsible and effective solution to the classification issue.

Most sincerely,

A handwritten signature in black ink, appearing to read "David S. Schless". The signature is written in a cursive style with a large initial "D".

David S. Schless  
President