NATIONAL CONTINUING CARE RESIDENTS ASSOCIATION
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Re: Request for Comments on the February 1, 2018, AICPA "Working Draft: Health Care Entities Revenue Recognition Implementation Issue…. Issue #8-3 – Application of FASB 606, Revenue from Contracts with Customers, to Continuing Care Retirement Community Contracts"

The National Continuing Care Residents Association is the sole national resident organization representing the estimated 700,000 residents of Continuing Care Retirement Communities (CCRCs) in the United States. In CCRCs as commonly configured, residents pay large entrance fees, and recurring fees thereafter, in return for a contract typically promising lifetime residence and the availability of care services when, and if, needed.

CCRCs exist to shelter and serve their residents. Residents are the primary stakeholders in these enterprises, and they trust that their contracts upon entry will be fulfilled to provide them with lifetime security when, as, and if they grow frail and vulnerable with age. It is a lifelong contractual commitment, grounded in trust, to sustain the elderly against the contingencies and transitions of age to which the elderly are subject.

Revenue Recognition.

For some years, the Financial Accounting Standards Board (FASB) has been considering changes to the rules for revenue recognition to give revenue recognition greater integrity than it has had heretofore and to conform revenue recognition more closely to the fundamental principles that seek to conform Generally Accepted Accounting to the economic realities of the businesses presented in audited financial statements. It is agreed that fair accounting requires that revenue for each obligation within a contract be attributed to that individual obligation even if obligations are bundled as part of a business model. Such bundling is commonplace among CCRCs.

CCRCs have been singled out for special treatment in the accounting rules that apply in the United States (First in FASB's Accounting Standards Codification 954-430 and now in ASC 606/IFRS 15). The effect of this special treatment for this single industry is to increase revenue recognition in the early contract years leaving deficits in the later years that must be made up by ad hoc fee increases. This is adverse to fair treatment of residents and adversely impacts residents as they age. In 2011, NaCCRA quantified this for FASB in an Excel spreadsheet referenced in a submission then to FASB, which submission was made publicly available on the FASB website. That spreadsheet can still be accessed at http://www.naccrau.com/Advocacy/PrincipledAccounting/PrincipledAccounting.html.

Principled Accounting.

Accounting as a profession, has a long and lustrous history, dating back to ancient times with cuneiform tablets and advancing into modern times with the advent of double entry bookkeeping. In more recent times, beginning with the rise of industry in the 19th century, accountancy has become a profession, avowing a commitment to high ideals as in the following excerpt from the AICPA's Code of Ethics: "Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism."

It is in that spirit that NaCCRA has reviewed the subject "Interpretation Issue" from the perspective of the CCRC residents, who are the principal stakeholders in a CCRC enterprise (especially those enterprises that claim tax exemption as public interest entities), and ask that the entire approach be rethought from the perspective of these stakeholders and looking at the CCRC business entities as stewards for the welfare of those who trust their entrance fees, lives, and well-being for the rest of their lives to these businesses.

Accounting as a discipline only attains credibility when it is principled. Accountancy as a profession only attains stature when it serves the public interest. High among accounting principles are those calling for consistency – to assure comparability of results among enterprises and across years – and matching – to assure that earnings are only recognized when they are earned. Contrary to these principles of integrity are the notion that accounting ought not to be unduly burdensome (see, as an example, the rationalization in Paragraph 25 of the AICPA document on which we now comment.) and the liberal use of the notion of materiality to justify financial statements that can be misleading for key users or otherwise deceptive.

For the sake of clarity, our remarks may seem pointed. We do not dismiss the good intentions of the accounting profession. We are asking that accountancy as a profession consider in its interpretations and promulgations the guiding principles of accountancy, as above special interest or arbitrary guidance, that it have in mind the public interest in the welfare of those who are least able to assert their own needs living them highly vulnerable to dictates of the profession.

At one time, accounting was principled. Now it has become a complex, and increasingly arcane, fabric of rules that require years of schooling so that accountants can apply the complexity. The CCRC residents, whom NaCCRA serves, are potential (and often real) victims of this arcane, recondite structure. The distraction of seeking to master and integrate this massive structure of codifications and interpretations deters professionals from taking a more principled look at the equitable underpinnings of any particular undertaking.

This is a challenge in many corners of business and finance on which the profession of accounting touches. We are looking at it here specifically through the lens of those elderly persons who inhabit CCRCs, most of whom do not have the understanding to grasp whether a particular enterprise is financially sound or not. Yet, they trust in their dependence that the lifetime promises of services and care which have drawn them into residence will be so accounted for that they can depend on balance sheet strength as a simple measure of the security they rightfully expect.

We urge a return to principled accounting on which the public and affected stakeholders can rely for integrity and which can provide a measuring tool for managements to evaluate their performance while also better serving the public good. At a minimum, we urge changes to conform CCRC accounting to the consistency and matching principles that long applied to the accounting profession. Special legislated (codified) treatment for a single industry conflicts with the consistency principle since consistency would have like transactions recorded in like fashion regardless of the context in which they occur.

The February 1 "Interpretation Issue" purports to be limited to Type A, care inclusive CCRC contracts only. There is a myth in the industry that Type A entrance fees are materially different from Type B and Type C contracts (using the providers' LeadingAge typology). This is not true since all entrance fees are a prepayment for lifetime services. The only difference among the types lies in the services to be bundled into those lifetime commitments. Correspondingly, we have not limited our comments here only to Type A but, instead, develop the overwhelming rational framework that lifetime entrance fee payments are no different from single premium life annuities and that all should be accounted for as such.

Specifically, with respect to the controversial entrance fee element of CCRC pricing, we make the following observations:

- An entrance fee is a single premium life annuity producing income in the form of reduced future recurring payments over the resident-annuitant's lifetime that would otherwise be required.

- An entrance fee is not an investment and a continuing care contract is not a security.

- Some annuity contracts have refund features. Some entrance fee contracts have refund features.

- Some annuity contracts include long term care insurance benefits. Some entrance fee contracts likewise include long term care protections.

- There is no difference between (1) entrance fees paid for lifetime benefits (regardless of whether the contracts are classified as Type A, Type B, Type C, or Type D by the LeadingAge classification system) and (2) insured life annuities.

Consistency requires that entrance fee contract considerations be accounted for the same as are identical single premium life annuity contracts.

Relevant Aside.

Although not addressed by the subject "Implementation Issue," residents have noted that many CCRC enterprises operate with a negative net asset position, and accountants dismiss such a condition as of no concern as long as entrance fees provide sufficient cash income to cover debt covenants. Some accountants have been heard to dismiss such a balance sheet as no more than an accounting technicality.

Such a view negates the value of accounting altogether. We believe that a negative balance sheet is inherently risky, and further that the diversion of cash from entrance fees toward enterprise undertakings benefits provider interests at the expense of the residents who trust them. We urge the accounting profession to address this issue if accounting and the resulting balance sheets are to have any meaning at all.

Attached are detailed comments on the February 1, 2018 AICPA Draft "Implementation Issue."

Respectfully submitted,

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Submitted pursuant to a unanimous vote by NaCCRA's Board

NaCCRA Comments on the February 1, 2018, AICPA "Working Draft: Health Care Entities Revenue Recognition Implementation Issue…. Issue #8-3 – Application of FASB 606, Revenue from Contracts with Customers, to Continuing Care Retirement Community Contracts"

1. We find that the proposed implementation of FASB's revenue recognition codification is well-intentioned in support of the CCRC enterprises that are the audit and consulting fee-paying clients of public accounting firms. We further find that it overlooks that trust relationship that such CCRC enterprises have toward the residents in their care, who entrust the CCRC with their entrance fees and living circumstances, and who are the principal stakeholders in such undertakings.

2. Throughout, CCRCs are treated inconsistently with the treatment of similar transactions from other industries as if the "bundling" of services constituted a material business difference. FASB clearly requires that bundled services be accounted for separately for each component in the bundle and this would seem to be the more principled approach to such business arrangements.

3. The "Implementation Issue" is limited to Type A contracts even though all entrance fee contracts are congruent with single premium life annuity undertakings and should be accounted for consistently with their identical counterparts.

4. Paragraph 5 refers to entrance fees "guaranteed to be refunded" which ignores the cascading perpetual contingency attached to most such contractual commitments.

5. Paragraph 7 concludes: "Because a CCRC resident has the ability to move out and discontinue paying the monthly fee at any time, FinREC believes the resident agreement for a Type A life care CCRC resident is generally a monthly contract with the option to renew." The payment of entrance fees as partial consideration for lifelong residency belies this facile "belief." The contract provides a lifetime license to occupy a residential unit with standby health assistance, if needed. Thus, it is a lifetime lease much like the Proprietary Leases common with cooperative apartment dwellings.

6. Paragraphs 15 and 16 contain a confusing discussion of extra-contractual promises made to induce acceptance of a contract. As such, the extra-contractual inducements are tantamount to provider consideration and as such should be treated as part of the contract itself.

7. Paragraph 17 obscures the clear reality that an entrance fee is a life annuity that may have long term care features and may include refund features. The conclusion in Paragraph 17 is rightly characterized as a "belief" since it does not accord with a reasoned view of such a transaction developed by those who specialize in such annuity undertakings.

8. Paragraph 18 is even more confusing than elucidating in its generalities. Since this is a lifetime contract, there is no monthly renewal option other than the possibility of premature termination of the contract for non-payment of fees or by mutual agreement between the provider and the resident.

9. Paragraph 19: Contrary to the fundamental premise of this paragraph, rerating factors are not generally specified in continuing care contracts. Such repricing reflects the sole judgment of the provider enterprise. Practices for rerating, and consequent results, vary widely from

enterprise to enterprise. As a lifetime contract, it's not true that residents have a monthly "option" to continue. They are committed for life and only leave at a cost to the resident. In the case of nonrefundable entrance fees, the cost is the full forfeiture of the future value of services for which the provider is otherwise contractually committed. That is a sizable forfeiture to the detriment of the resident and providing an unearned gain for the provider. For contingent refundable entrance fees – the industry norm for refundable contracts – the resident must wait months or years to receive the funds to which the refund entitles the resident.

10. Paragraphs 20 through 22 conjecture on refund features incorporated into some entrance fee annuity-type contracts. Like Biblical fundamentalists who insist on the inerrancy of the Bible, the conjecturing seeks to rationalize the conjecturer's wishful beliefs in the light of various FASB codifications. This raises plausibility and rationalization to a level that it simply can't support. In clarity, refunds, or the lack thereof, are no different from such features when included in single premium life annuity contracts and should be accounted for consistently.

11. Labeled "Assessing Significance", Paragraphs 23 through 26 address the controversial matter of "financing". The term "financing" is used ambiguously throughout these paragraphs. On the one hand, it has hints that it refers to entrance fees as a component of enterprise financing of needed capitalization, which is critical for the "going concern" thesis for enterprises like CCRCs that are capital intensive and, yet, subject to operating volatility and sensitive to economic cycles. On the other hand, it treats "financing" as a contractual element, much as a car dealer "finances" an automobile purchase, but here in reverse with the enterprise "financing" its cost to house residents as a collective group.

    The reality is different. Entrance fee CCRC contracts are not sold as "investments" or as "financing" contracts, with the investor risks that such an interpretation would require. They are sold as lifetime leases with ancillary benefits and an individual contract prepayment feature which operates the same as an insured life annuity generating income to offset recurring lease payments that would otherwise be charged.

    It is precisely in this disconnect between that for which providers, and the accountant-auditors they employ, would like to argue and the hard realities of the transactions themselves that the disingenuous nature of the "Implementation Issue" proposals lie. The providers and their accountants would have entrance fee be at risk investment proceeds while in fact they are contractual consideration establishing a lifetime trust relationship between residents and those same providers.

    Lost in the providers' and accountants' fantasy is the stewardship responsibility toward the resident stakeholders who are themselves the business purpose for these business enterprises in the first place. Like insurance and banking, and unlike conventional rental housing, lifetime CCRC contracts are trust transactions requiring the highest level of business and ethical integrity.

    The title, "Assessing Significance," reflects the common accounting "out" of "materiality." The simple test of materiality is that an accounting (or other) deviation from the underlying economic reality is "material" if it is sufficiently significant to mislead a thoughtful, intelligent user of the financial statements (or other representational document). Clearly, treating entrance fees as no more than "financing" will mislead prospective CCRC residents, who with the existing residents form the principal stakeholders for the enterprise. This deception, together with the common accounting assertion that a "negative net asset" balance sheet is negligible for an entrance fee CCRC enterprise nullifies the value of today's CCRC accounting for residents and prospective residents, and for regulators who are charged with protecting vulnerable consumers from misleading business practices.

12. Paragraphs 28 and 29, derivatively, continue this deceptive interpretation of the contractual nature of entrance fees by focusing on the uses which many CCRCs, often acting on advice from the consulting arms of "audit" firms, make of those entrance fees. The source of entrance fees lies in the contracts which induce their payment. The source of funds should be viewed separately from the uses to be made of those funds unless such a contract is positioned as an investment security to raise capital for the CCRC enterprise.

    As noted previously, entrance fees are no different from single premium life annuities, for which insurance companies may temporarily invest proceeds in many forms of productive assets to provide an investment return, but for which the insurer is constrained to ensure that it fulfills the obligations in the contracts which provide the source of the funds.

13. At last, in Paragraphs 34 and 35, the author gets to the essence of the transaction, which is largely negated by the rest of narrative of the "Implementation Issue." Again, this is a perplexing inconsistency that belies the credibility of the whole.

14. Unfortunately, in Paragraph 39, the document returns to a premise that blatantly ignores the lifetime commitment of the CCRC contract.

15. Paragraphs 41 to 44, though they don't use the term, refer to actuarial determinations utilizing a non-actuarial methodology and allowing the allocation of all investment earnings from the use of entrance fees to be allocated to profit, fully disadvantaging the reasonable expectations of residents as contract-funders and as stakeholders.

16. Paragraphs 45 and 46 again invoke the shibboleth of "materiality" to allow a questionable "portfolio" methodology when in an age of computers there is no "material" advantage to be gleaned over a seriatim valuation methodology.

17. Paragraphs 47 through 52 contain elaborate rationalizations attempting to assert the adequacy of crude arithmetic concepts over the more refined (and conceptually simpler) actuarial approach. This is devious and professionally self-serving for accountants, who thereby avoid acknowledging the professional capabilities of another profession, all at the expense of the larger public interest in the financially sound and proven methodologies for life annuity determinations.

It is significant that the words "actuary" or "actuarial" appear nowhere in the document which deals primarily with what is a single premium life annuity transaction (clothed in the terminology of an entrance fee). Since life annuities can incorporate all of the refund and long-term care features implicit in CCRC contract types A through C, it is convoluted and unnecessarily arithmetically complex, not to mention less precise, to substitute elaborated arithmetic tabular computations for actuarial determinations. This is analogous to accounting for the engineering of a cantilevered bridge without conferring with a qualified bridge engineer.

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