What financial information do you need for prudent decision-making?

A Primer of CCRC Financial Reporting

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CCRCs are subject to a variety of financial analyses, each with a different purpose and sometimes with conflicting results. The most common types of financial statements are accounting, statutory, actuarial, and accreditation.

Accounting statements are based on standards developed by the American Institute of CPAs (AICPA), and consist of interim reports and the annual audited report. The purpose of these statements is to indicate the CCRC's financial condition as a result of operations to-date, and to allow readers to compare financials from one period to the next and between one CCRC and another. AICPA standards also govern the methodology for conducting financial feasibility studies.

Statutory requirements vary by state, and generally fall into one of the following categories:
- Disclosure or filing
- Minimum asset accruals
- Actuarial reserve evaluation
- Alternative reserve evaluation

The disclosure or filing requirements are frequently the least stringent, and often receive only a cursory review by state regulators. The minimum asset accrual standards require CCRCs to meet certain target levels of cash or assets, relative to their expenses or liabilities. The reserve evaluation standards incorporate a test of reserve adequacy, and thus require a long-term projection of revenues and expenses. The purpose of statutory financial standards is to protect consumers in the state and provide a mechanism to alert regulators of serious financial problems.

Actuarial projections are based on standards developed by the American Academy of Actuaries, for the purposes of assessing long-term solvency and providing an early warning of potential problems. Actuarial standards also provide a methodology for projecting the cost of long-term health care needs, which is essential for planning and financial projection purposes.

Accreditation standards for CCRCs are developed by the Continuing Care Accreditation Commission (CCAC) to ensure that accredited facilities maintain short-term financial stability and long-term financial resources. Accreditation standards are based on accounting methodologies relating to financial reporting, although the CCRC must be in compliance with statutory financial standards and both statutory and actuarial financial statements are subject to review by the CCAC.

The most frequent situation where results may appear conflicting is in comparison of the accounting calculation of the future service obligation and the actuarial calculation of reserve evaluation. The future service calculation is required for a CCRC statement of financial position (balance sheet). The CCRC must project future revenues and future expenses for the current group of residents. If future revenues are less than future expenses, as they usually are for CCRCs with entrance fees, the deferred revenue balance must be greater than the difference or a liability is recorded on the balance sheet. Most CCRCs do not book a liability for the future service obligation, because their deferred revenues plus future revenues exceed future expenses. However, in our experience, most CCRCs are not fully funded from an actuarial perspective, which means that current reserves plus future revenues are not adequate to cover future expenses for the current group of residents.

An illustration of the differences between these standards is shown in the chart below. The actual results from the four different types of standards are displayed for five CCRCs in the table below. As one can observe, there is no consistent pattern in the results.

Why do the accounting financial reports and the actuarial financial reports produce these seemingly conflicting results? The answer lies in differences in purpose and in differences in methodology. The primary purpose of the future service obligation is to determine whether the CCRC has incurred a loss by entering into an unprofitable contract, and to reflect this loss when it is incurred. This calculation is generated as a liquidation liability, and therefore allows certain expenses such as administration and marketing to be excluded from the calculation. Another purpose of calculating the future service obligation from an accounting perspective is to control the recognition of entrance fees into income. If entrance fees are recognized too fast, then deferred revenue is inadequate to cover the difference between future revenues and expenses, so the future service obligation is added to the liability side of the balance sheet.

The actuarial valuation, on the other hand, seeks to establish a going concern liability, so administration and marketing costs are not excluded from the future expense calculation. The actuarial valuation defines a target reserve that is the difference between future revenues and future expenses, and the target reserve is compared to current reserves. The current reserves are equal to the CCRC's assets minus liabilities, adjusted for present values. If the current reserves equal the target reserve, the CCRC is fully funded, and the funded status is 100%. If the current reserves are greater than the target reserves, the funded status is greater than 100%. If the current reserves are less than the target reserves, the funded status is less than 100%. The median funded status for over 200 CCRCs evaluated by A.V. Powell & Associates is 95%. However, as stated above, the vast majority of

Comparison of Standards: Solvency Status

	Actuarial	GAAP	Statutory	Accredited?
Case #1 (CA)	($1,566)	$5,638	$13,649	Yes
Case #2 (FL)	$1,609	($2,631)	Ratio=3.53 Chapter 651	Yes
Case #3 (NY)	($4,237)	($5,391)	($4,980)	No
Case #4 (AZ)	($4,363)	$910	Approved	No
Case #5 (TX)	$3,388	$7,599	Acceptable	No

these CCRCs do not record an accounting future service liability.

The accounting calculation for future service liability is not a measure of long-term financial solvency. It does not include all operating expenses. It also uses deferred revenue, which does not represent reserves, to offset the shortfall between future revenues and future expenses. Deferred revenue reflects entrance fees that have not yet been recognized as income; it does not reflect investments in financial instruments or fixed assets. In reality, many CCRCs have already used the cash to fund operating losses or for other purposes.

The actuarial calculation for reserve evaluation is the only financial report that tests the solvency of a CCRC. Actuarial standards also produce the only methodology for developing adequate fees for CCRC contracts that contain discounted health care or refund guarantees.

CCRCs and their constituents need the capability to quantify answers to financial questions. Accounting, statutory, actuarial and accreditation standards all provide information upon which to make prudent decisions. There may be some duplication between financial reporting requirements, and sometimes results may be misleading or appear conflicting, but recognizing the purpose behind the standards will help those who need to rely on CCRC financial information sort through the different types of statements.

John Valorz is a senior consultant with AV Powell & Associates and is the firm's professional standards officer. A CPA for more than 30 years, Mr. Valorz was formerly a partner with a Big-5 accounting firm and chair of the AICPA committee that issued Statement of Position 90-8 ("SOP 90-8") guidelines for preparing audit reports of CCRCs. Mr. Valorz participates in the preparation and presentation of actuarial studies to management and heads the firm's financial feasibility practice for tax-exempt financing of CCRCs.

DEVELOPMENT & EXPANSION

New Amenities for New Lifestyles

By J. Kirk Gulledge, Project Coordinator, Asbury Development & Management

"The old gray CCRC, she ain't what she used to be."

No, CCRCs of the 21st Century are not like they used to be. Just as the perceptions of retirement and aging have evolved over the last several decades from frailty and dependence to vigor and self-fulfillment, the look and function of modern CCRCs have undergone a remarkable transformation in their residential environments.

So, what's new?

The most obvious change in modern CCRCs is the size of their living units. While the communities of the 70s were designed with an average apartment size of 600 square feet, modern communities will often have average apartment sizes of 1,200 square feet or more, reflecting the lifestyles and needs of today's retirees. There are many more styles of apartments, garden homes, and cottages available today than ever before, and sizes may range from 600 square feet to over 3,000 square feet to offer the greatest flexibility to retirees.

The second significant change in modern CCRCs is the increased emphasis on wellness. Gone are the days when the CCRC just provided nursing care when needed; the focus now is on providing the facilities and programs that allow residents to stay healthy and active throughout their retirement years. The communities of the 21st Century will be featuring full-service Wellness Centers, with exercise equipment, swimming pools, fitness classes, and counseling in healthy diet and lifestyle. The Wellness Centers will often be open to the surrounding community to encourage intergenerational activities and to develop linkages with potential future residents.

A third development in strategically planned CCRCs is the availability of business centers to support the entrepreneurial and continuing business activities of its residents. The business centers may provide not only business machines such as copiers, printers and binders, but also secretarial support, and offices for private meetings with clients. There is a clear trend among today's retirees of continuing part-time business activity, and the best CCRCs will provide the support services needed to ensure their success.

Finally, the CCRCs of the future will offer the best of information technology to its residents. The fastest growing segment of computer and Internet users is the senior segment, and future cohorts of retirees will be highly computer-literate and demanding of information services. Future-oriented CCRCs are offering fiber-optic or other wide-band wiring along with direct Internet service to all residential units (and to some nursing and assisted living units) so that residents can have the full benefit of modern communication media. At least one planned CCRC has announced that a computer terminal will be installed in each new residence, and other CCRCs are examining the potential of utilizing the Internet or Intranet for on-campus communications (news, notices and email) among both residents and staff.

Watch the D&O FORUM for articles about other CCRC innovations for the future.

Architectural Aspects, *Continued from pg.5*

lifestyle. A most important consideration, among many, is that the CCRC should represent a gracious and comfortable place to live. It should be a place to view with pride and the conviction that the right decision was made. It should be "home."

The roofline of a CCRC has an important impact on overall design and the way the facility is perceived by residents and prospects. The roof can be one of the strongest architectural elements and can project an image of attractiveness, quality, and prestige. From a distant view right up to the main entrance, a thoughtful and well-designed roof provides a CCRC with all the elements that impart appeal.

Charlie Wilscam, AIA, is one of the principals of RDG Schutte Wilscam Birge, founded in the mid-1960's. Mr. Wilscam's responsibilities in the firm have been in the design of educational facilities and other projects. Principals Roger Schutte and John Birge have concentrated intensively on the design of retirement centers and have to their credit numerous CCRCs, life care retirement centers, nursing homes, and specialized assisted living units throughout the U.S. In addition to membership in several professional societies, Mr. Schutte, AIA, belongs to the National Association of Senior Living Industries and the American Association of Homes and Services for the Aging. John Birge, FAIA, has memberships in AAHSA, NIC, ALFA, NASLI, ASHE, ASA and other professional organizations.