



LeadingAge

# ANNUAL MEETING & EXPO

**October 29 - November 1, 2017**

Ernest N. Morial Convention Center | New Orleans, LA

October 31, 2017

## SESSION 45-E, PART 2. ADDRESSING CHANGES IN FINANCIAL REPORTING FOR LIFE PLAN COMMUNITIES

### PRESENTED BY

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Partner & Practice Leader  
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Founder and CSO  
AV Powell & Associates LLC

**Karen Christiansen**

Executive Vice President & CFO  
ACTS Retirement-Life  
Communities, Inc.

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Senior Vice President & CFO  
Presbyterian SeniorCare Network

# Learning Goals

- Obtain an overview of the rules related to implementation of ASC 606 recognition standards.
- Understand the rationale and mechanics of how the new guidance will affect monthly fee and entry fee income and what types of contracts will be affected.
- Consider the impacts of the new accounting standards using pilot sites on an organization's financial status.

# Agenda

1. Learning Goals
2. ASC 606 Accounting Changes
3. Actuarial Considerations to Implement ASC 606
4. Pilot Site Results
5. Life After ASC 606
6. Questions & Answers

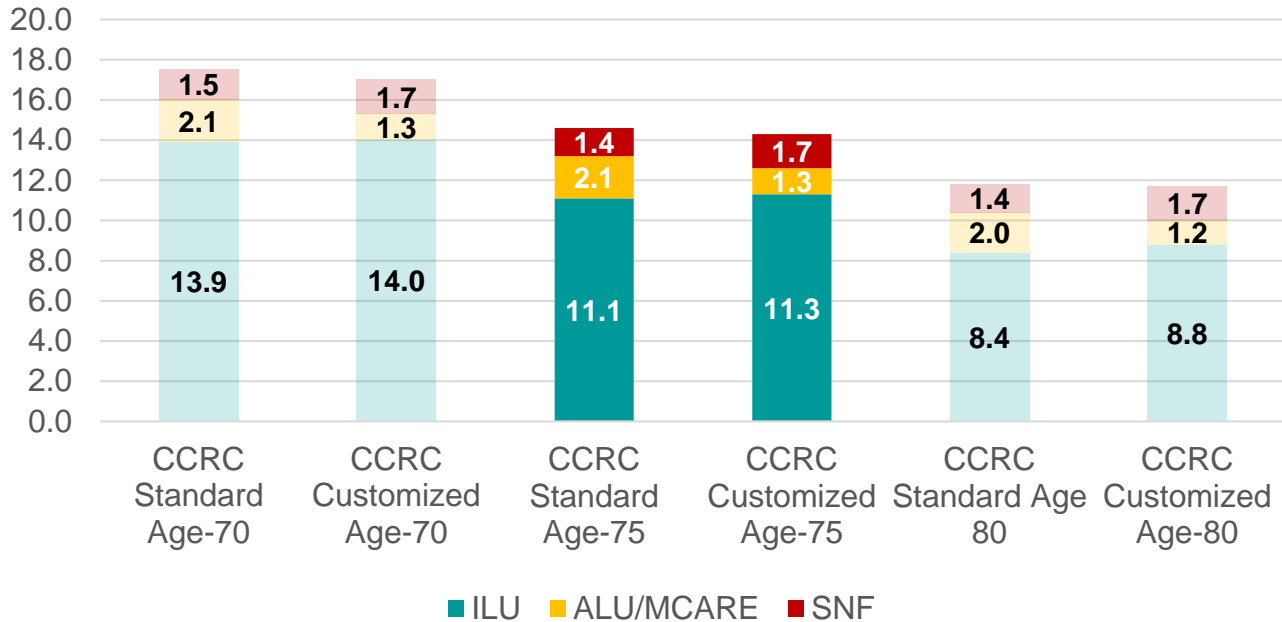
**Alwyn Powell**  
Founder and CSO  
AV Powell & Associates LLC

# Consideration for adopting ASC 606

- Option 1 (legacy)—easy to implement since no changes
- Option 2 (cost-to-cost)—relatively complex to implement
- Actuarial and other required assumptions
  - Life expectancies
  - Costs by level of care matching performance obligations
  - Conventions for resident and contract nuances
- New formula that uses:
  - Life expectancies by level of care, i.e., performance obligation
  - <100% of deferred balance used in calculation
  - Reflects anticipated inflation

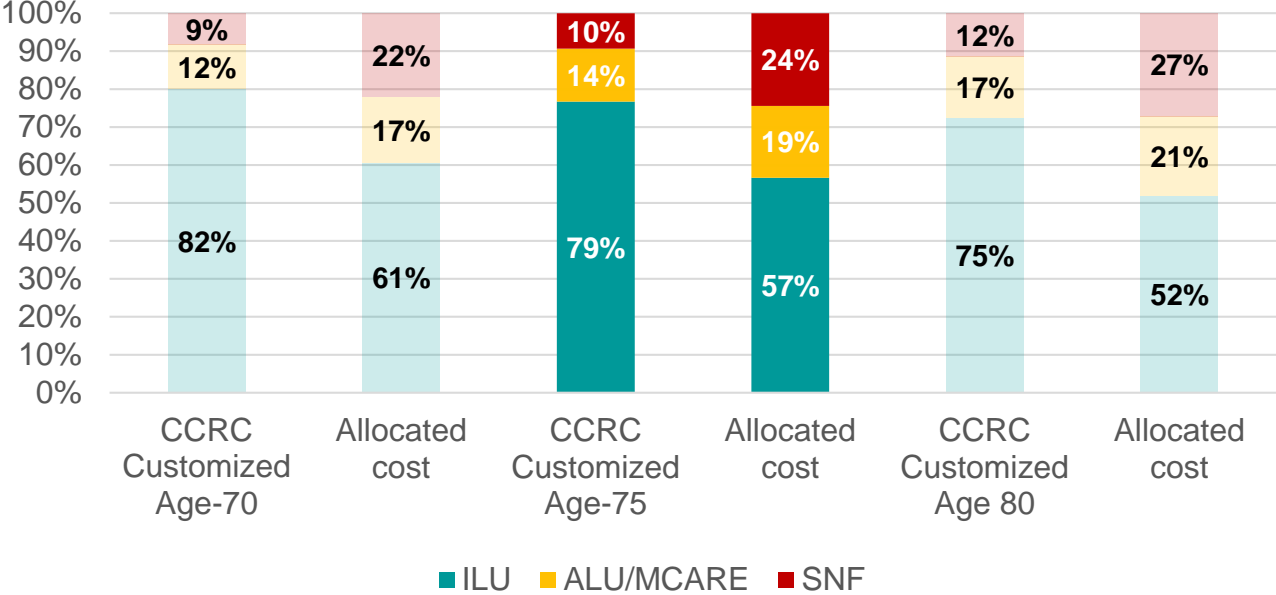
# Life expectancies by level of care

## Female Life Expectancies



# Cost-to-cost methodology reallocates income

## Female Residents



# Simplified comparison of ASC 606 options

Current (legacy) guidance	Assumption	Result
1. Advance fee paid	\$200,000	
2. Total life expectancy (11.3 + 1.3 + 1.7)	14.3	
3. Income recognized in year 1	$(1 \div 2) =$	\$13,986
Proposed (ASC 606) guidance	Assumption	Result
1. Advance fee paid	\$200,000	
2. Percentage of costs in performance level 1	57%	
3. Portion of advance fee that may be recognized	\$114,000	
4. Life expectancy in performance level 1	11.3	
5. Adjustment for revenue inflation of 3%	17.5	
6. Income recognized in year 1	$(4 \div 5) =$	\$6,514



# Which theory is consistent with real world?

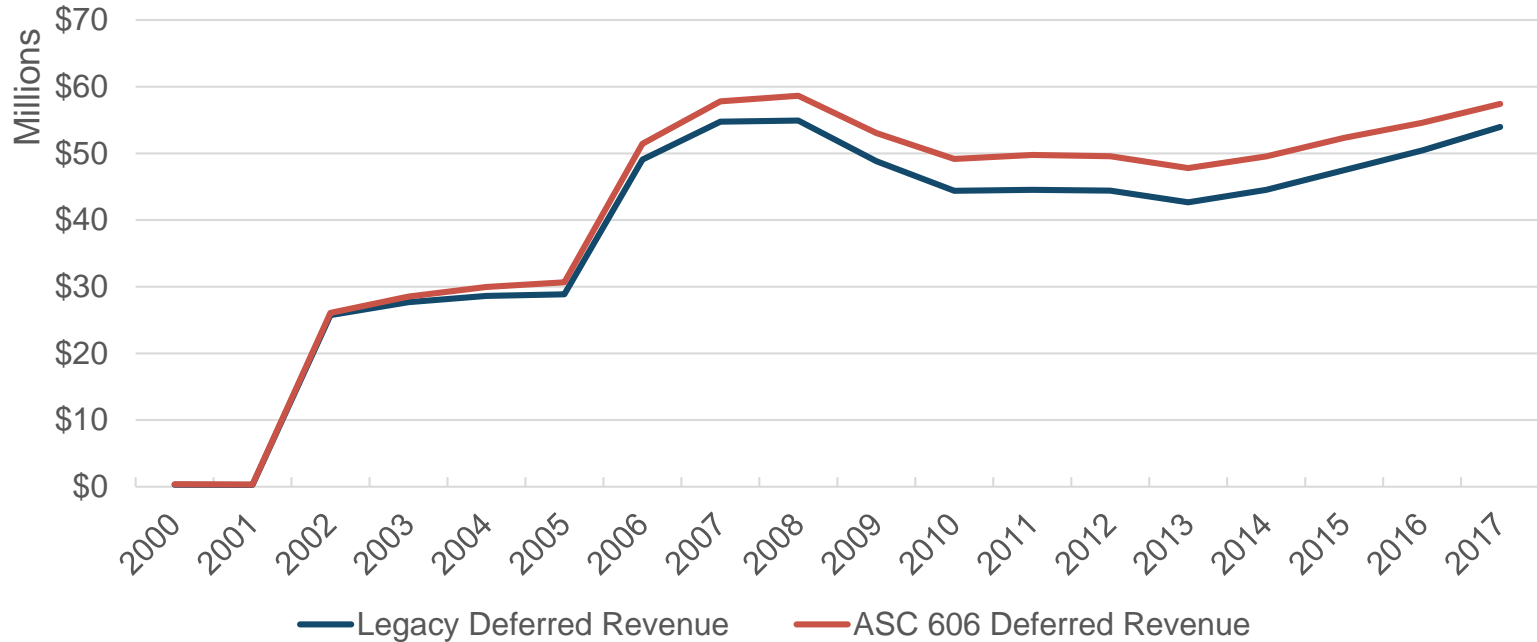
n = 97	Net Operating Expenses	GAAP Depreciation	Operating + Depreciation	Average 1 <sup>st</sup> Person MFs	MF minus Expenses
25 <sup>th</sup> Percentile*	\$ 1,883	\$ 626	\$2,523	\$2,740	\$257
50 <sup>th</sup> Percentile*	2,269	817	3,096	3,747	499
Average	2,311	817	3,128	3,620	492
75 <sup>th</sup> Percentile*	2,682	986	3,678	4,206	822
*Values do not sum across categories					

# Steps to comply with new ASC 606 option

- Define historical and future costs by level of care
- Generate/obtain life expectancies by level of care
- Create new software programs to handle complex formulas
- Compare income recognition and deferred balances using
  - Current guidance, i.e., legacy method
  - ASC 606 formula

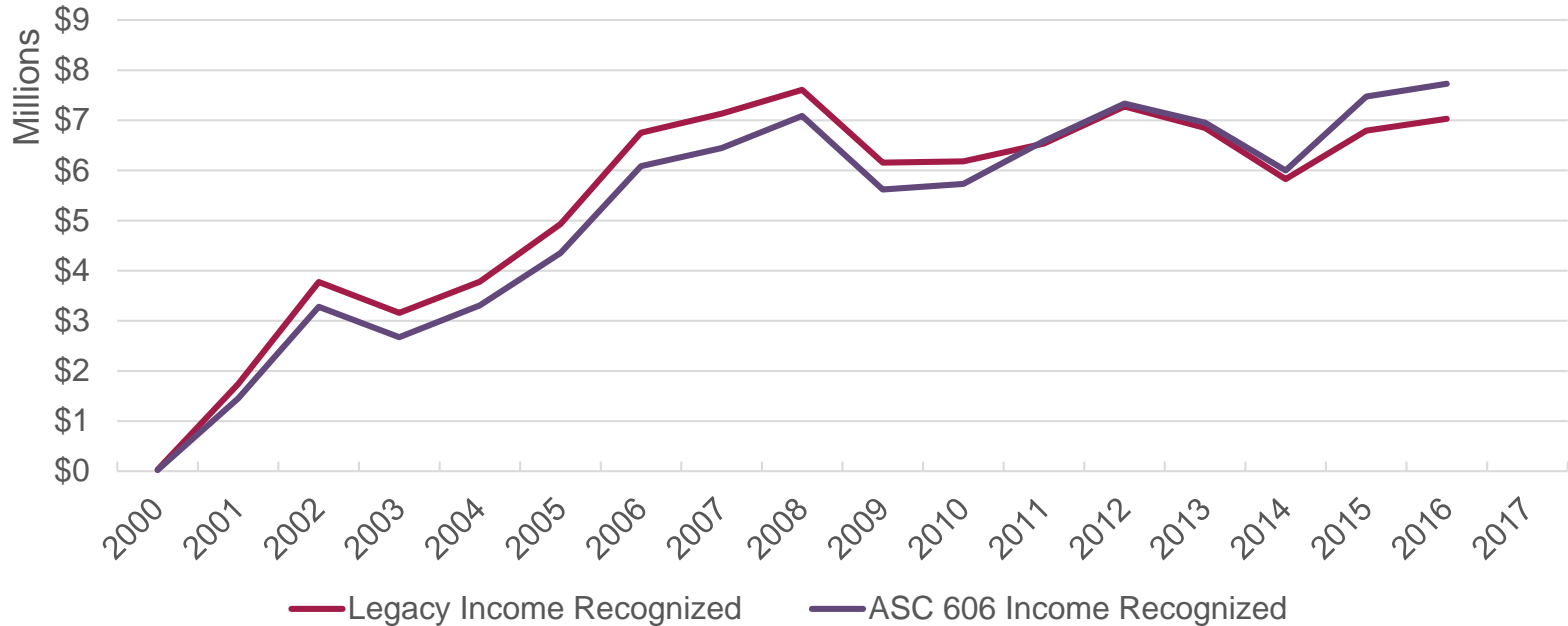
# Pilot site deferred rev. variance: <10%

CAVEAT  $\beta$ eta results



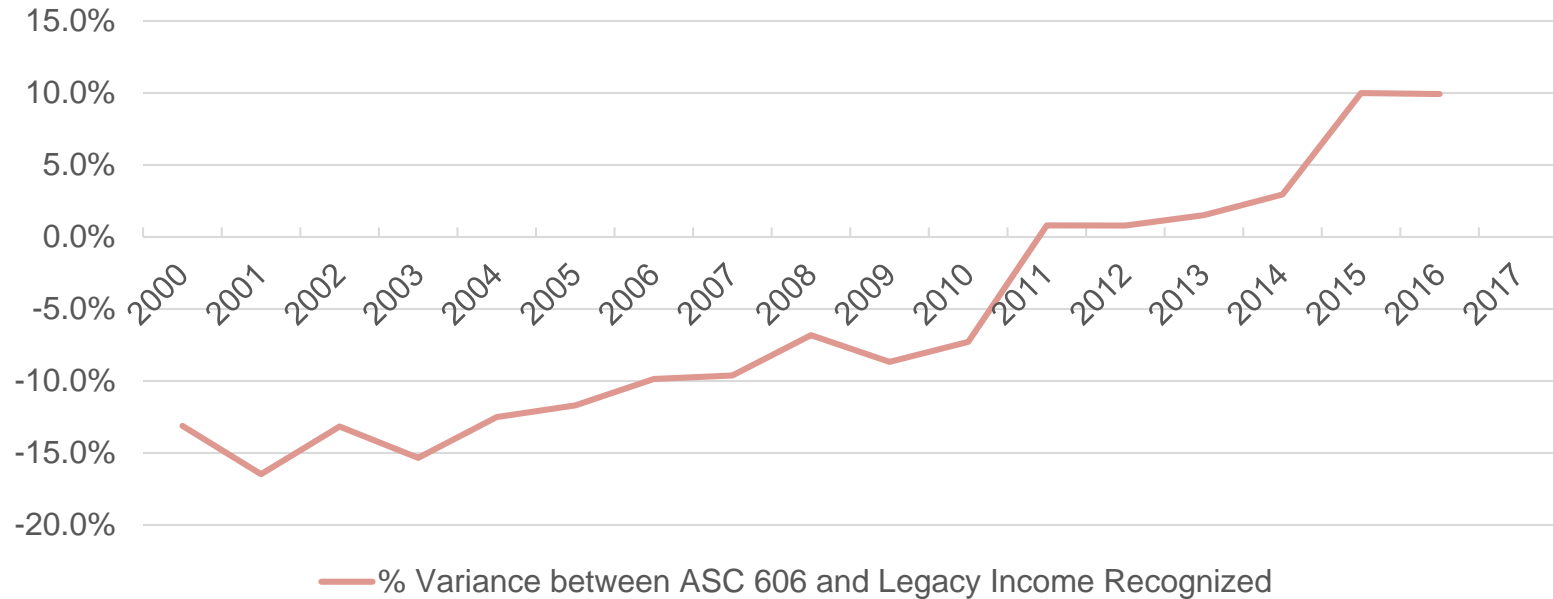
# Income recognition variance: -17% to + 10%

CAVEAT:  $\beta$ eta results



# ASC 606 may materially impact financials

CAVEAT:  $\beta$ eta results



# Many moving parts in ASC 606 formula

**CAVEAT: beta results**

Cum. Results as of 12.31.16 (dollars in thousands)	Deferred Revenue	Percent Variance	Income Recog.	Percent Variance
Legacy (current guidance):	\$53,950	(6.0%)	\$91,809	3.9%
Benchmark ASC 606: IL:AL:NC cost ratio 1:1.46:2.50 All inflation assumptions match	<b>\$57,414</b>	<b>0.0%</b>	<b>\$88,345</b>	<b>0.0%</b>
Health care inflation: +3%	\$60,020	4.5%	\$85,739	(2.9%)
Revenue inflation: -1%	\$56,700	(1.2%)	\$89,059	0.8%
Change to AVP legacy standard life expectancies:	\$57,207	(0.4%)	\$88,551	0.2%

# Many moving parts in ASC 606 formula (cont.)

**CAVEAT:  $\beta$ eta results**

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Legacy (current guidance):	\$53,950	(6.0%)	\$91,809	3.9%
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IL:AL:NC cost ratio: 1:2:5 Based on ASC 606 illus. costs	\$62,273	8.5%	\$83,486	(5.5%)
IL:AL:NC cost ratio: 1:1:1 Illustrative constant cost	\$52,885	(7.9%)	\$92,874	5.1%
IL:AL:NC cost ratio: 1:1.56:2.88 Based on client expenses	\$57,284	(0.2%)	\$88,474	0.1%
IL:AL:NC cost ratio: 1:2.10:3.58 Based on AVP median exps.	\$60,182	4.8%	\$85,577	(3.1%)

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# Conversation with attendees

- What questions are Boards likely to ask about options?
  - Are there standard decision criteria to adopt change or not
  - Is the more conservative option “correct”
- How does ASC 606 affect creditworthiness evaluations?
- Do ASC 606 options affect budgeting policies?
- Should practices to set fees be changed?
- Do ASC 606 financial statements or FSO measure solvency?
- Will future GAAP converge to one ASC 606 option?

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