FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2012-01
July 2012

Health Care Entities (Topic 954)

Continuing Care Retirement Communities—Refundable Advance Fees

An Amendment of the *FASB Accounting Standards Codification®*

Financial Accounting Standards Board
of the Financial Accounting Foundation

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

For additional copies of this Accounting Standards Update and information on applicable prices and discount rates contact:

Order Department
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Please ask for our Product Code No. ASU2012-01.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published quarterly by the Financial Accounting Foundation. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is $242 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 371**

Accounting Standards Update

No. 2012-01
July 2012

Health Care Entities (Topic 954)

Continuing Care Retirement Communities—Refundable Advance Fees

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, PO BOX 5116, NORWALK, CONNECTICUT 06856-5116

Accounting Standards Update 2012-01

Health Care Entities (Topic 954)

Continuing Care Retirement Communities—

Refundable Advance Fees

July 2012

CONTENTS

Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Subtopic 954-430, Health Care Entities—Deferred Revenue, requires that a continuing care retirement community recognize a deferral of revenue when a contract between a continuing care retirement community and a resident stipulates that (1) a portion of the advanced fee is refundable if the contract holder's unit is reoccupied by a subsequent resident, (2) the refund is limited to the proceeds of reoccupancy, and (3) the legal environment and the entity's management policy and practice support the withholding of refunds under condition (2). Questions have arisen in practice about cases where the refund depends on reoccupancy. The objective of this Update is to clarify the reporting for refundable advance fees received by continuing care retirement communities.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect continuing care retirement communities that have resident contracts that provide for a payment of a refundable advance fee upon reoccupancy of that unit by a subsequent resident.

What Are the Main Provisions?

The amendments in this Update clarify that an entity should classify an advance fee as deferred revenue when a continuing care retirement community has a resident contract that provides for payment of the refundable advance fee upon reoccupancy by a subsequent resident, which is limited to the proceeds of reoccupancy. Refundable advance fees that are contingent upon reoccupancy by a subsequent resident but are not limited to the proceeds of reoccupancy should be accounted for and reported as a liability.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update clarify the situations in which recognition of deferred revenue for refundable advance fees is appropriate. Clarifying that guidance will improve current U.S. GAAP by eliminating diversity in practice.

When Will the Amendments Be Effective?

For public entities (including conduit bond obligors), the amendments in this Update are effective for fiscal periods beginning after December 15, 2012. For nonpublic entities, the amendments in this Update are effective for fiscal periods beginning after December 15, 2013. Early adoption is permitted. The amendments in this Update should be applied retrospectively by recording a cumulative-effect adjustment to opening retained earnings (or unrestricted net assets) as of the beginning of the earliest period presented.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not provide any specific guidance on accounting for refundable advance fees of continuing care retirement communities.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 954-430

2. Amend paragraphs 954-430-25-1 and 954-430-35-4 and add paragraphs 954-430-25-1A through 25-1B, with a link to transition paragraph 954-430-65-1, as follows:

Health Care Entities—Deferred Revenue

Recognition

> Continuing Care Retirement Community—Advance Fees

954-430-25-1 Under provisions of continuing-care contracts entered into by a continuing care retirement community and residents, nonrefundable advance fees represent payment for future services and shall be accounted for as deferred revenue. The estimated amount of advance fees that is expected to be refunded to current residents under the terms of the contracts shall be accounted for and reported as a liability. The remaining amount of refundable advance fees shall be accounted for as deferred revenue within the liability section of the balance sheet. ~~The portion of the fees that will be paid to current residents or their designees, only to the extent of the proceeds of reoccupancy of a contract holder's unit, shall be accounted for as deferred revenue, provided that legal and management policy and practice support the withholding of refunds under this condition. Similar amounts received from new residents in excess of the amount to be paid to previous residents or their designees also shall be deferred. See Section 954-605-05 for background on advance fees and reoccupancy clauses. See also Example 1 (paragraph 954-430-55-1).~~ **[Content amended and moved to paragraphs 954-430-25-1A through 25-1B]**

954-430-25-1A In situations where a contract between a continuing care retirement community and a resident stipulates that all or a~~The~~ portion of the refundable advance fees ~~that~~ will be paid to current residents or their designees, only to the extent of the proceeds of reoccupancy of a contract holder's unit, that portion shall be accounted for as deferred revenue, provided that legal and management policy and practice support the withholding of refunds under this condition. Similar amounts received from ~~new~~subsequent residents in excess of the amount to be paid to previous residents or their designees also shall be deferred. **[Content amended as shown and moved from paragraph 954-430-25-1]**

954-430-25-1B See Section 954-605-05 for background on advance fees and reoccupancy clauses. See also Example 1 (Section 954-430-55~~paragraph 954-430-55-1~~). **[Content amended as shown and moved from paragraph 954-430-25-1]**

Subsequent Measurement

954-430-35-4 When a contract between a continuing care retirement community and a resident stipulates that all or a portion of the advance fee (see paragraph 954-430-25-1A) may be refundable if the contract holder's unit is reoccupied by another person and that the refund amount is limited to the extent of the proceeds of reoccupancy of a contract holder's unit, and if legal and management policy and practice support the withholding of refunds under this condition, the resulting deferred revenue shall be amortized to income over future periods based on the remaining useful life of the facility. The basis and method of amortization shall be consistent with the method for calculating depreciation.

3. Add paragraph 954-430-65-1 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2012-01, *Health Care Entities (Topic 954): Continuing Care Retirement Communities—Refundable Advance Fees*

954-430-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2012-01, *Health Care Entities (Topic 954): Continuing Care Retirement Communities—Refundable Advance Fees:*

a. The pending content that links to this paragraph shall be effective for fiscal periods beginning after December 15, 2012, except for **{add glossary link to 1st definition}nonpublic entities{add glossary link**

to 1st definition}, which shall apply the pending content that links to this paragraph for fiscal periods beginning after December 15, 2013.

b. An entity shall apply the pending content that links to this paragraph retrospectively by recording a cumulative-effect adjustment to opening retained earnings (or unrestricted net assets) as of the beginning of the earliest period presented.

c. Earlier application of the pending content that links to this paragraph is permitted.

d. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

4. Add paragraph 954-430-00-1 as follows:

954-430-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
954-430-25-1	Amended	2012-01	07/24/2012
954-430-25-1A	Added	2012-01	07/24/2012
954-430-25-1B	Added	2012-01	07/24/2012
954-430-35-4	Amended	2012-01	07/24/2012
954-430-65-1	Added	2012-01	07/24/2012

The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Mr. Linsmeier dissented.

Mr. Linsmeier dissents to the issuance of this Update for two reasons. First, he does not believe that the deferred revenue that is required to be recognized under this Update should be amortized to income over the useful life of the facility because that amortization period presumes that the continuing care retirement community will find new occupants for each unit throughout the life of the facility. He believes that there is more than a trivial risk that a new occupant will not be found to occupy vacated units and, therefore, believes the better accounting would be to amortize the deferred revenue relating to the advance fee paid by current occupant into income over the expected term of the current occupant's contract. Second, Mr. Linsmeier objects to the requirement that links the method for amortizing deferred revenue into income to the method for calculating depreciation. Mr. Linsmeier believes that revenue recognition has nothing to do with an entity's depreciation policy and, therefore, believes that an amortization method that is consistent with the pattern of how revenue is earned under the contract should be the required method for amortizing deferred revenue into income under this Update.

Members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information and Basis for Conclusions

BC2. Many continuing care retirement communities have resident contracts that provide for payment of large advance fees. The extent to which advance fees are refundable varies depending on the contract. Generally, the refundable portion is accounted for and reported as a refund liability, while the nonrefundable portion of advance fees is accounted for as deferred revenue and amortized into income based on the estimated life of the resident or on the contract term, if shorter.

BC3. U.S. GAAP also provides specific guidance for advance fees that are refundable but only to the extent of the proceeds of reoccupancy of a contract holder's unit (that is, if the subsequent entrance fee received is lower, the refund is limited to that amount). Subtopic 954-430 indicates that the portion of the fees that will be paid to current residents or their designees, but only to the extent of the proceeds of reoccupancy of a contract holder's unit, should be accounted for as deferred revenue, provided that the legal environment and the entity's management policy and practice support the withholding of refunds under this condition. A number of continuing care retirement communities interpreted this guidance as stating that refundable advance fees can be accounted for as deferred revenue in all situations where payment of a refund is contingent upon receipt of an advance fee from the subsequent resident of that unit. The guidance in Subtopic 954-430, however, is intended to apply only to the subset of those situations in which all or a portion of the amount of the potential refund payable is limited to the proceeds from reoccupancy of that unit by a subsequent resident. The basis for this exception is that in this instance the continuing care retirement community is merely acting as an agent between the current resident and the subsequent resident and bears no risk associated with the refund.

BC4. The FASB learned of the diversity in practice after the AICPA exposed for public comment a working draft of an updated Audit and Accounting Guide for health care organizations in 2011. That working draft proposed clarifying the guidance about the recognition and subsequent measurement of refundable advance fees where refund amounts are contractually limited to the proceeds of reoccupancy received from the subsequent resident. The responses received by the AICPA indicated that the proposed clarifications were inconsistent with how the guidance was being interpreted. As a result, the FASB exposed the proposed amendments related to the recognition and subsequent measurement of refundable advance fees that are limited to the proceeds of reoccupancy by a subsequent resident in its October 2011 proposed Accounting Standards Update, *Technical Corrections*. Six comment letters were received that specifically addressed the continuing care retirement community proposed amendments.

BC5. Some Board members questioned the impact of the proposed amendments. Entities that have refundable advance fees that are not limited to the proceeds of reoccupancy would likely have a reclassification from deferred revenue to a refund liability, an increase in the refund liability, and a reduction to net assets and revenue for previously amortized deferred revenue. Such a reclassification also may trigger recognition of a liability associated with the obligation to provide future services. On an annual basis, a continuing care retirement community is required to evaluate whether the costs that are expected to be incurred to provide future services and the use of facilities to individuals over their remaining lives exceed the related anticipated revenues to determine whether a liability should be reported in the financial statements. The liability calculation includes the present value of future net cash flows, minus the balance of unamortized deferred revenue, plus depreciation of facilities to be charged related to contracts, plus unamortized costs of acquiring the related initial continuing-care contracts, if applicable. Therefore, the proposed amendments could have a direct impact on the obligation to provide future services calculation and whether a liability is recorded as a result.

BC6. Some Board members questioned the awareness of the proposed amendments within the October 2011 Technical Corrections Exposure Draft given the significance of the impact on continuing care retirement communities. The proposed amendments had been exposed by the AICPA before their exposure in the proposed Update on technical corrections. In addition, staff outreach indicated that a substantial portion of the continuing care retirement community industry was aware of the proposed amendments. However, to provide greater visibility to stakeholders the Board decided to finalize the proposed amendments in a separate Update.

Effective Date and Transition

BC7. In reviewing Subtopic 954-430, some Board members and staff members raised concerns about how deferred revenue is initially measured and the pattern of release into earnings. However, the majority of the Board does not view reconsideration of that issue as a technical correction, but rather, a reconsideration of revenue recognition, which is within the scope of the Board's active joint project with the IASB. Those Board members decided that any reconsideration of the revenue recognition for these contracts should be done within the context of the Boards' revenue recognition project, rather than to initiate a project to reconsider this narrow issue at this time.

BC8. The Board decided that the amendments in this Update should be effective for public entities for fiscal periods beginning after December 15, 2012.

BC9. The Board considered the amount of time that nonpublic entities would need to adopt the amendments in this Update, including the education cycle for many preparers and auditors of nonpublic entities, and decided that for those entities the amendments should be effective for fiscal periods beginning after December 15, 2013.

BC10. The Board decided that the amendments in this Update should be applied retrospectively by recording a cumulative-effect adjustment to retained earnings (or unrestricted net assets) as of the beginning of the earliest period presented. The Board concluded that this transition method will create better comparability of financial information of an entity across periods, noting that continuing care retirement communities should have the information readily available, since it would be needed if the Update was to be applied at the beginning of the period of adoption.

BC11. The Board decided to permit early adoption of the amendments in this Update to eliminate existing diversity as soon as practicable.

Benefits and Costs

BC12. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC13. The Board understands that some entities will incur incremental costs as a result of the amendments in this Update but those costs are not expected to be recurring. Those one-time incremental costs are expected to be associated with determining the amount of deferred revenue that should be reclassified to refund liability, the amount of revenue previously recognized related to that deferred revenue that must be reversed, and the impact to the calculation of the obligation to provide future services. The amendments will provide the benefit of eliminating diversity in practice by increasing the consistency of the treatment of refundable advance fees of continuing care retirement communities, which the Board believes justifies those costs.

Amendments to the XBRL Taxonomy

The following changes to the U.S. GAAP Financial Reporting Taxonomy (UGT), subject to the process described below, will be required as a result of the amendments to the *FASB Accounting Standards Codification*®. The changes to the UGT are available for public comment in the development UGT throughout the year at www.fasb.org. Changes to the UGT for final Accounting Standards Updates are formally exposed for public comment and finalized as part of the annual release process starting in September of each year.

New Element

Element Name	**Standard Label**	**Documentation**
AccountingStandardsUpdate201201Member	Accounting Standards Update 2012-01 [Member]	Accounting Standards Update 2012-01 Health Care Entities (Topic 954): Continuing Care Retirement Communities—Refundable Advance Fees