

Brief Critique of CCRC Accounting under American GAAP

“Be careful whom you trust.”

Accounting provides the financial measure of management integrity in the use of the resources entrusted to its care. Financial statements are prepared by management, but management is guided in their preparation by standards promulgated, in the U.S., by the American Institute of Certified Public Accountants (AICPA), by the Auditing Standards Board within the AICPA, by Public Company Accounting Oversight Board, by the Financial Accounting Standards Board, and by the Government Accounting Standards Board, as applicable.

The lack of any central principled guidance, as attested by this variety of promulgating authorities, undermines public confidence in the validity of GAAP financials. Principles by definition are general laws of objective, unbiased truth from which others are derived. They are universal and unvaried. So, the existence of different accounting standards for different contexts reveals the diminution of principle as a guide for today’s accounting.

For Entry Fee CCRC accounting, these GAAP standards are flawed with the result that those who move in earlier into to newly opened (or reopened) CCRC are favored over those who move in later after the CCRC is fully established.

Traditionally, accounting standards, familiarly known as GAAP (Generally Accepted Accounting Principles) were in fact “principled,” i.e. grounded in universal concepts for the ethical presentation of financial results. In practice, however, accounting standards today are “rules based” reflecting the promulgations of quasi-legislative bodies, some of which are listed above.

This has been the case at least since March 15, 1992 when Statement on Auditing Standards #69 was released by the AICPA to govern the work of professional CPAs in the United States.

Although SAS #69 has been superseded by later “authoritative” promulgations, the concept remains that accountants are bound by rules and cannot appeal to principle as a matter of professional judgment when following the rules might be considered misleading.

Accounting for tax exempt organizations are governed by FASB although FASBs emphasis has been on publicly traded corporations. The FASB was organized in 1973 as the designated accounting standard setter for public companies recognized by the Federal Securities and Exchange Commission. The Public Company Accounting Oversight Board was created by more recent legislation due to perceived lapses in private auditing integrity.

Historical accounting principles include such elements as the concept that revenue should only be recognized as the commitments made to induce the payment are fulfilled. Other concepts include the principle that similar transactions should be treated similarly whether they occur in different time periods or in different industries.

Since accrual accounting, and “going concern” accounting, require estimates and prognostications, accountants sometimes appeal to materiality as a principle. Less than precise measurements, though, should only be dismissed as immaterial when the result does not cause actions which would differ if the financials were more precisely stated. That is a high bar for materiality, especially in the case of a CCRC in which an increase in monthly fees of 2% or 3% compounding over time may be very material for residents relying on the CCRC for needed services.

Still, even the core principles of matching and consistency have not been applied to entry fee accounting with the consequence that financial results in the earlier periods of a CCRCs existence appear more favorable than those for a latter period. The primary reason for this is the failure of CCRC-specific GAAP to properly recognize the time value of money, i.e. investment related effects, from the provider’s use of entry fees. A secondary reason follows from the accounting for contingent CCRC refund commitments, which frontends revenue recognition. The result is to mislead management into favoring early CCRC residents at the expense of those who move in later.

Recently, in response to international pressure, the American accounting profession, including both the AICPA and FASB, has been reviewing its rules for revenue recognition. Still, the profession is retaining the rules basis for the performance of its practitioners. There is no requirement that an auditor, following a full review of management's preparation of enterprise financial statements, provide an opinion that the audit partner, or other person in charge of the audit, has reviewed the results in the overall context of general principles and has concluded, not only that the rules have been followed, but that in the personal business judgment of the responsible auditor the financials fairly present the current financial position of the enterprise.

Accounting has evolved to elevate a complex, highly technical compliance exercise above the fair presentation of the financial stewardship of the management. This absence of accountability is of major concern for CCRC residents and prospective residents since tax exempt, or closely held, enterprises have no obligation toward the financial security of the residents who are at the bottom of the priority list in the event of financial failure.

Restoring such a principled overview of the financial statements as whole, with the auditor required to opine as to whether or not they fairly reflect the underlying economics of the enterprise, requires a return to the philosopher auditor like those who brought the accounting profession its aura of integrity. This requires a mastery of ethical behavior beyond the rules-based ethics that passes for moral sufficiency in many state statutes and even in some college level ethics courses. It requires an ethical standard of Socratic wisdom.

This may require the accounting profession to consider returning to a time when aspiring accountants not only were expected to master the technical aspects of their craft but when they were also expected to be fully educated in the intellectual history that shapes civilized standards of integrity and that informs the mutual trust and candor that are the bulwark of commendable business enterprises and the foundation of reputation.

Such speculation on steps that the accounting profession might take are well beyond this critique. In the absence, however, of credible ethical standards for CCRC accounting, Active Aging Advocates favors adapting the statutory standards applicable to insured life annuities to the entry fee CCRC industry. In its simplest manifestation, an entry fee contract ensures a

lifetime payment stream to offset recurring fees that would otherwise be required. This is identical to insured immediate life annuities, which likewise provide a lifetime income stream. Adding long term care insurance features to the fundamental annuity undertaking is but a small step from the recognition of entry fee contracts as fully analogous to insured annuities.

Active Aging Advocates
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