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**CONTINUING CARE RETIREMENT COMMUNITIES  
ENCOUNTER ACTUARIAL PROGRESS,  
BUT STIFFENED TENSIONS AMONG PROFESSIONS**

**By David L. Hewitt (USA)**

In my report two years ago I described how continuing care retirement communities operate. Since then, CCRC actuaries have experienced two opposing trends. On the positive side we find developments that are expected to enhance our services. On the negative side we see the formalization of differences between actuaries and accountants.

**Industry-Wide Data Collection**

The most important new development is the conditional agreement between actuaries and providers to perform an industry-wide collection and analysis of experience data. This should lead to the long-awaited availability of broadly based CCRC experience tables. But the caveat is that charitable foundation money is sought to finance the project, and at this writing, January 1992, it has not been obtained.

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The significance of the subject is widely recognized, and success in finding financial support is anticipated. A contract to perform the full project has been awarded, a pilot study has been completed, and the representative data collection and analysis will follow when funding is on hand.

### **Enhancing the Actuarial Standard**

Another positive development is the preparation to reissue our 1987 actuarial standard, with several improvements. In particular, it is proposed to add guidelines on determining the financial provision for use of physical assets.

#### Provision for Use of Land and Facilities

The following method of charging for use of land and facilities would be identified as acceptable.

Each item would be assigned an assumed useful lifetime and an appropriate rate of inflation. They would be grouped by year of acquisition and duration. In the case of land the useful lifetime is perpetual.

The actuarial charge for use of an asset would be calculated as: an indexed annual charge whose present value when the asset is acquired equals its cost. (The charge can be separated into interest at the assumed rate, and the remainder, which is capital depreciation. The capital depreciation derived in this way differs in amount from that usually determined by accountants. In the case of land the charge equals the

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amount by which assumed interest exceeds assumed inflation, applied each year to the inflated cost.)

Thereafter, the actuarial present value of the asset would always equal the present value of the future charges.

It would also be assumed that each item (other than land) will be replaced at the end of its useful lifetime, with a new one whose cost equals the original cost indexed for inflation. This would be a continuing sequence. Note that the same residents may enjoy use of a current asset and also its future replacement or replacements.

These elements would then be combined, for the closed group of current residents, as follows:

The closed group actuarial liability for the promised future use of the physical assets and their replacements would equal the discounted value of that proportion of the charges for the assets in all future years, which the projected number of survivors from the closed group bears to the projected total population in each such future year.

This is my interpretation of the creative work of other actuaries. The method offers the advantage of present values that are discounted for interest. While it seems to be elegant and obvious, it was not reached without debate.

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### Testing for Applicability of Component Approach

A clarification would be added regarding use of the component approach. The component approach concentrates on the distinctly actuarial aspects of a CCRC, especially the need for health care.

We observe that, in order to obtain results under the component approach that are comparable with those of the comprehensive approach, the non-health operations of a CCRC need to be maintained on a break-even basis, producing neither substantial gains nor substantial losses. A comment would be added pointing out that it may be necessary to test for this condition actuarially. This could limit the applicability of the component approach.

These changes are among the ones being readied (at the time of this writing) for submission to the Actuarial Standards Board, as part of the reformatted standard on CCRCs.

### **Interdisciplinary Barrier: AICPA's SOP 90-8**

At the end of 1990 the American Institute of Certified Public Accountants promulgated a Statement of Position (SOP 90-8) for Financial Accounting and Reporting by CCRCs. This closed off a lengthy discussion by and with accountants, in which the actuaries made progress, but not enough. We still find actuarial flaws and other distortions in their position. Here are some of them:

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The SOP identifies the full present value of projected interest expense as a liability item, in addition to any underlying debt. We actuaries would identify only variations from the assumed interest rate, as producing either an added liability or asset item.

A similar problem is likely to arise with respect to projected interest receipts on required investment holdings. The SOP implies that it counts the full present value of the interest receipts as an asset item, in addition to the underlying investments, rather than considering only variations from the assumed rate.

The SOP does not consistently recognize the time value of money. For example, it does not use an interest discount in determining the liabilities for refunds of entry fees, and for deposits on hand from prospective residents--even though the refunds and deposits will be paid or credited at future times without added interest. (The SOP acknowledges that discounting is a subject which needs further exploration.)

In amortizing nonrefundable entry fees over the expected lives of residents, the SOP takes the current year amortization for living residents and adds to it the full amount of the unamortized balances of those who die. We believe the balances of those who die should be amortized over the expected lives of the survivors.

In measuring the cash flows for operating a community, the SOP excludes the CCRC's general and administrative expenses. This is unrealistic.

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Accountants frequently accept the findings of other professions in matters requiring outside expertise. They thus recognize the place of actuaries in insurance and in retirement plans. But in SOP 90-8 they prescribe their own answers to problems that remain actuarial. The accountants still need our help to reach the goal of correct financial measurement and reporting for CCRCs. We should work together to solve mutual problems.

We actuaries have been striving for improved methods of analysis; the accountants have been engaged in a similar effort, but took formal action before they were ready, affecting most CCRCs. Together, we need to construct a combined measurement system from which the two professions can extract harmonious answers.

Meanwhile, CCRCs needing favorable audit reports, and also desiring to follow actuarial principles, must maintain separate records for each purpose. This creates confusion for the providers and the public.

### **Insurance Commissioners**

The state insurance commissioners who regulate CCRCs are attempting to make use of the advice of actuaries and accountants in developing their own specifications for financial reporting. They would like a single, unambiguous, generally accepted formula, to test the fiscal soundness of a CCRC.

### **Closing Observation**

It's still fascinating to be part of a new, evolving field. Preparing this report for IACA helps put our activities into perspective.