FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2010-24
August 2010

Health Care Entities (Topic 954)

Presentation of Insurance Claims and Related Insurance Recoveries

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*™

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Summary

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

The objective of this Update is to address current diversity in practice related to the accounting by health care entities for medical malpractice claims and similar liabilities and their related anticipated insurance recoveries. Most health care entities have netted anticipated insurance recoveries against the related accrued liability, although some entities have presented the anticipated insurance recovery and related liability on a gross basis.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect health care entities within the scope of *FASB Accounting Standards Codification*™ Topic 954, Health Care Entities. The amendments are consistent with the guidance on netting receivables and payables in Subtopic 210-20, Balance Sheet—Offsetting, that are more broadly applicable for entities in other industries. The guidance in Subtopic 210-20 does not permit offsetting of conditional or unconditional liabilities with anticipated insurance recoveries from third parties.

What Are the Main Provisions?

The amendments in this Update clarify that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries.

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 are consistent with existing guidance in Subtopic 210-20 on determining whether assets and liabilities can be offset in the statements of financial position and presented on a net basis. The amendments improve current GAAP by clarifying that this guidance also applies to health care entities and, therefore, will reduce diversity in practice. The amendments also improve GAAP by eliminating an industry exception to the general principle on determining when net presentation is permitted.

When Will the Amendments Be Effective?

The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. A cumulative-effect adjustment should be recognized in opening retained earnings in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying the amendments in this Update. The amendments in this Update permit retrospective application. Early application of the amendments in this Update also is permitted.

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

IFRS does not permit offsetting of assets and liabilities in the circumstances described in this Update.

Amendments to the *FASB Accounting Standards Codification*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–8. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 954-450

2. Amend paragraphs 954-450-25-2 and 954-450-25-3, with a link to transition paragraph 954-450-65-1, as follows:

Health Care Entities—Contingencies

Recognition

> Medical Malpractice Claims

954-450-25-2 The ultimate costs of malpractice claims or similar contingent liabilities, which include costs associated with litigating or settling claims, shall be accrued when the incidents that give rise to the claims occur. ~~If the~~ A health care entity ~~has not transferred risk to an external third party, it should~~shall evaluate its exposure to losses arising from ~~malpractice~~ claims and recognize a liability, if appropriate. The liability shall not be presented net of anticipated insurance recoveries. An entity that is indemnified for these liabilities shall recognize an insurance receivable at the same time that it recognizes the liability, measured on the same basis as the liability, subject to the need for a valuation allowance for uncollectible amounts. The provisions in Section 720-20-25 and Subtopic 944-40 discuss the accounting for insurance claims costs, including estimates of costs relating to incurred-but-not-reported claims. Subtopic 450-20 discusses the accounting for loss contingencies.

> Medical Malpractice Trust Funds

954-450-25-3 ~~In general, estimated~~ Estimated losses from asserted and unasserted claims shall be accrued and reported, as indicated in paragraphs 954-450-30-1 through 30-2. The estimated losses are not based on payments to the trust fund. See paragraph 954-720-25-5 for guidance concerning ~~entities~~an entity that transfers risk of loss to a common trust fund and forfeits ~~forfeit~~ its rights to any excess funding. ~~However, accounting for a health care entity that participates in a pooled fund depends on the extent to which the associated risks and rewards have been transferred to another party.~~ See also paragraph 954-810-45-4.

3. Add paragraph 954-450-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*

954-450-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries:*

a. The pending content that links to this paragraph shall be effective for fiscal years, and interim periods within those years, beginning after December 15, 2010.
b. An entity shall apply the pending content that links to this paragraph by recording a cumulative-effect adjustment to opening retained earnings (or unrestricted net assets) as of the beginning of the period of adoption. The entity shall calculate the cumulative-effect adjustment as the difference between the following:
    1. The amount of the liability recognized in the statement of financial position after initial application of the pending content that links to this paragraph that was not previously recognized
    2. The amount of receivables recognized in the statement of financial position for anticipated insurance recoveries after initial application of the pending content that links to this paragraph that was not previously recognized.
c. Retrospective application of the pending content that links to this paragraph is permitted.
d. Early application of the pending content that links to this paragraph is permitted.
e. The disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided in the period an entity adopts the pending content that links to this paragraph.

Amendments to Subtopic 954-720

4. Amend paragraphs 954-720-25-1 and 954-720-25-5, with a link to transition paragraph 954-450-65-1, as follows:

Health Care Entities—Other Expenses

Recognition

> Retrospectively Rated Premiums

954-720-25-1 A health care entity with a retrospectively rated insurance policy whose ultimate premium is based primarily on the health care entity's loss experience shall account for the minimum premium as an expense over the period of coverage under the policy~~ and shall accrue estimated losses from asserted and unasserted claims in excess of the minimum premium~~. ~~Such estimated losses, however, shall not be accrued in excess of a stipulated maximum premium.~~ Insurance recoveries from a retrospectively rated insurance policy whose ultimate premium is based primarily on the health care entity's loss experience shall not be recognized until the estimated losses exceed the stipulated maximum premium.

> Trust Funds

954-720-25-5 An entity that ~~transfers its risk of loss to~~ participates in a common trust fund and forfeits its rights to any excess funding shall expense its contributions and account for its participation in the trust fund based on the type of coverage obtained (for example, occurrence basis, claims-made, or retrospectively rated).

5. Supersede paragraphs 954-720-30-1 through 30-3, with a link to transition paragraph 954-450-65-1, as follows:

Initial Measurement

> Claims-Made Insurance Policies

954-720-30-1 Paragraph superseded by Accounting Standards Update No. 2010-24.~~Paragraph 720-20-30-2 provides guidance for determining the amount of the accrual for a claims-made insurance policy. This estimation is done unless the health care entity has bought **tail coverage** and included the cost of the premium as an expense in the financial statements for that period.~~

954-720-30-2 Paragraph superseded by Accounting Standards Update No. 2010-24.~~If a health care entity either renews a claims-made policy or purchases tail coverage, and the new policy covers claims asserted during the new policy term (regardless of when the incident occurred), the entity has transferred to the insurer the risk for that portion of the entity's claims that is expected to be reported during the new policy term (up to the new policy limits). Accordingly, the entity's liability for the incurred-but-not-reported claims transferred would not exceed the premium on the new policy, except for anticipated claims in excess of the new policy limits. If the health care provider has the unilateral option to purchase tail coverage at a premium that may not exceed a stipulated maximum,~~

~~and the provider intends to purchase that coverage, the amount of incurred-but-not-reported loss to be accrued may effectively be limited to the maximum tail-coverage premium stated in the policy.~~

954-720-30-3 Paragraph superseded by Accounting Standards Update No. 2010-24.~~However, health care entities in the circumstances described in the previous paragraph may not accrue the cost of obtaining tail coverage as a substitute for the incurred-but-not-reported accrual if they do not intend to purchase that coverage.~~

6. Supersede paragraph 954-720-35-3 and its related heading, with a link to transition paragraph 954-450-65-1, as follows:

Subsequent Measurement

954-720-35-3 Paragraph superseded by Accounting Standards Update No. 2010-24.~~See paragraphs 954-720-30-1 through 30-3 for guidance for determining the amount of the accrual for a claims-made insurance policy.~~

7. Add paragraph 954-450-00-1 as follows:

954-450-00-1 The following table identifies the changes made to this Subtopic:

Paragraph Number	Action	Accounting Standards Update	Date
954-450-25-2	Amended	2010-24	08/27/2010
954-450-25-3	Amended	2010-24	08/27/2010
954-450-65-1	Added	2010-24	08/27/2010

8. Add paragraph 954-720-00-1 as follows:

954-720-00-1 The following table identifies the changes made to this Subtopic:

Paragraph Number	Action	Accounting Standards Update	Date
954-720-25-1	Amended	2010-24	08/27/2010
954-720-25-5	Amended	2010-24	08/27/2010
954-720-30-1 through 30-3	Superseded	2010-24	08/27/2010
954-720-35-3	Superseded	2010-24	08/27/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

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

Background Information and Conclusions

BC2. Diversity in practice has developed on how health care entities account for malpractice claims or similar liabilities and related insurance recoveries. Many health care entities have applied industry guidance in Topic 954 (originally from AICPA Audit and Accounting Guide, *Health Care Organizations*), which permitted the netting of insurance recoveries with an organization's estimated accrual for related claims. Other health care entities have presented the claim liability and related insurance recovery on a gross basis consistent with general GAAP applicable to all entities.

BC3. At the March 18, 2010 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 09-K, "Health Care Entities: Presentation of Insurance Claims and Related Insurance Recoveries." A proposed Accounting Standards Update (proposed Update) was issued on April 16, 2010, with a comment period that ended on May 17, 2010. Five comment letters were received on the proposed Update.

BC4. The Task Force concluded that the accounting requirements for claims and recoveries of health care entities should be aligned with the accounting requirements used by entities in other industries. Furthermore, the Task Force concluded that determining whether assets and liabilities should be presented on a gross or net basis should be consistent with Subtopic 210-20. The Task Force considered that, the health care entity generally remains liable for payment of the claim and retains the risk of loss for that claim. This is true even if an insurance entity is paying for the defense of the claim and ultimately pays for some or all of the award or settlement. The Task Force concluded that gross presentation reflects that the health care entity remains obligated for the claim and that the entity is exposed to credit risk from the insurer.

BC5. The Task Force considered the comments from respondents who did not support the proposed amendments. Those included respondents who stated that reflecting the gross liability overstates the entity's liability for a claim because insurance will reduce the net cash outlay to settle the claim. The Task Force decided that gross presentation of the insurance receivable better reflects the retained credit risk if the insurer is unable to pay the claim. The Task Force noted that in many cases the health care entity is fully covered by insurance and the coverage is not disputed by the carrier. The Task Force noted that a receivable should be recognized when realization of the claim for recovery of a loss recognized in the financial statements is deemed probable and measured at the same amount as the associated claim liability, subject to the need for a valuation allowance for uncollectible amounts or other risk retention. The Task Force noted that consistent with paragraph 450-30-25-1, any potential gains resulting from a recovery of a loss that is not reflected in the financial statements (for example, because the amount recovered from insurance was in excess of a loss recognized in the financial statements) should not be recognized until any contingencies relating to the claim have been resolved.

BC6. The Task Force discussed an informal comment received by the staff that questioned whether additional changes to eliminate industry-specific guidance should be made regarding the accrual of legal fees associated with resolving malpractice claims or similar contingent liabilities. The Task Force considered whether the liability for malpractice claims or similar contingent liabilities should include estimated legal fees to litigate the claim or, if consistent with other industries, whether health care entities should be given the opportunity to make a policy election to expense legal fees as incurred. As a result of those discussions, the Task Force decided to separately address this question in EITF Issue No. 10-F, "Accounting for Legal Costs Associated with Medical Malpractice Claims."

Effective Date and Transition

BC7. The Task Force decided that the amendments in this Update should be effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Task Force decided that early application of the provisions of this Update should be permitted.

BC8. The Task Force decided to require that the amendments in this Update be applied as of the beginning of the period of adoption. The Task Force noted that in prior periods many entities may not have estimated the loss amount of the claim under the guidance for accounting for contingencies and that applying this guidance retrospectively may be difficult. The Task Force expects that in most cases the initial application of the amendments in this Update should result in a gross-up in the balance sheet for recognizing the claim liability and anticipated insurance receivable. However, the Task Force acknowledged that in some rare situations the amounts of the claim liability and insurance receivable may not completely offset. Accordingly, the Task Force concluded that the net effect of applying the amendments in this Update should be recorded as a cumulative-effect adjustment to opening retained earnings (or unrestricted net assets) in the period of adoption. The Task Force decided to permit but not require retrospective application of the amendments in this Update.

Benefits and Costs

BC9. 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 Task Force'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.

BC10. The Task Force anticipates that entities will incur incremental costs to implement the amendments in this Update. Those incremental costs are expected to be associated with estimating the amount of claim liabilities and insurance recoveries if entities had not previously performed such an analysis. The Task Force believes that the benefits of improved disclosure of credit risk and the elimination of industry-specific guidance outweigh those costs.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this Update.