

Health Care Providers Spotlight

Questions About Presentation of Insurance Claims and Related Insurance Recoveries Under ASU 2010-24

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The Bottom Line

As a result of the ASU, health care entities that had a policy of netting claims liabilities with insurance recoveries will most likely need to change their balance sheet presentation.

- In August 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*. The ASU's objective was to address diversity among health care entities regarding the balance sheet presentation of medical malpractice claims and similar liabilities and the related anticipated insurance recoveries. The ASU eliminates a health care industry exception to determining when net presentation ("offsetting") is permitted.
- The ASU clarified that the amount of a claim liability should be determined without consideration of insurance recoveries and that a health care entity should not net insurance recoveries against a related claim liability without having met the criteria for netting in ASU 210-20.¹
- Since the ASU's issuance, health care practitioners have had questions about what liabilities are within its scope, its effect on the financial reporting of accruals of legal costs associated with contingencies, and its effect on retrospectively rated insurance policies.
- The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010.

¹ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification."

Beyond the Bottom Line

This *Health Care Providers Spotlight* discusses questions constituents have raised about the scope of ASU 2010-24, its effect on the financial reporting of accruals of legal costs associated with contingencies, and its effect on retrospectively rated insurance policies.

Changes to Financial Reporting Under ASU 2010-24

Historically, health care entities have used one of two methods to present malpractice claims or similar liabilities and related insurance recoveries on the balance sheet: (1) application of the industry guidance in ASC 954, which allows the netting of insurance recoveries with the estimated accrual for related claims, or (2) presentation of the claim liability separately from the related insurance recovery on the balance sheet in a manner consistent with ASC 210-20. Although most health care entities have used the first method, the FASB and the EITF ultimately decided that GAAP would be improved if health care entities followed the same accounting requirements as those followed by other industries for balance sheet offsetting.

To achieve such consistency, ASU 2010-24 eliminated any health care industry exceptions to the general offsetting requirements of GAAP and clarified that health care entities must follow the guidance in ASC 210-20 when determining whether assets and liabilities can be offset in the statement of financial position. Under ASC 210-20, the offsetting of conditional or unconditional liabilities with anticipated insurance recoveries from third parties is not permissible.

Questions About Applying ASU 2010-24

During the first year of implementation, health care practitioners had questions about certain aspects of the ASU, which are outlined in the discussion below.

Presenting Malpractice Claims or Other Similar Contingent Liabilities Net of Anticipated Insurance Recoveries

The ASU clarifies that health care entities should not net insurance recoveries against related insurance claim liabilities (i.e., malpractice claims or other similar contingent liabilities) unless the requirements of ASC 210-20 are satisfied. Some constituents have questioned whether this guidance solely applies to malpractice claims and, if not, what other types of similar contingent liabilities it would apply to.

The presentation guidance applies not only to malpractice claims but also to other similar contingent liabilities. Although the Codification does not define similar contingent liabilities, the definition would include items such as workers' compensation claims and officers' and directors' claims.

Other health care practitioners have questioned whether the balance sheet presentation guidance in the ASU, and specifically the amendments made to ASC 954-450-25-2, applies even when the health care entity's insurer under the medical malpractice insurance policy deals with all aspects of the claims, including settlement. In such cases, the insurer is handling the claims and is making payments to the plaintiffs directly, and the health care entity is neither paying its own claims nor ever receiving the insurance recoveries.

In the above scenario, even though the insurer is handling and paying the claims, the health care entity is still the primary obligor for payment of the claim. Therefore, the amendments made to ASC 954-450-25-2 apply. Unless it is determined that offsetting is appropriate under ASC 210-20-45-2, the health care entity must record the entire amount of the claims liabilities as an obligation and separately record and present a receivable for the insurance recoveries that it is entitled to receive. In many cases, this would result in reporting by the health care entity of a receivable that mirrors the amount of estimated losses accrued that is covered by insurance.

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Accrual of Legal Costs Associated With Other Contingencies

Health care practitioners have questioned whether the ASU broadened the scope of ASC 954-450's requirement to accrue estimated legal costs related to defending malpractice claims in the period the incident occurs to also include other contingent liabilities (e.g., workers compensation claims). Before the ASU, health care entities followed the guidance on other contingent liabilities in ASC 450-20, which permits such institutions to make a policy election to either to expense claim-related legal fees in the period in which the costs are actually incurred or to accrue them in the period in which the associated claims arise.

The ASU does not affect the guidance in ASC 954-450 that requires health care entities to accrue estimated legal costs for defending malpractice claims in the period the incident occurs. That is, a health care entity may not make a policy choice regarding legal costs related to defending malpractice claims.

The ASU also does not affect the health care entity's prior elected policy of accounting for legal costs associated with contingencies other than medical malpractice liabilities. Regarding legal costs associated with contingencies other than medical malpractice, entities should, on the basis of their policy before the issuance of the ASU, continue to either (1) expense them as incurred or (2) accrue them in the period in which the incident occurs. Any policy changes by the health care entity in connection with legal costs related to contingencies other than medical malpractice should be made in accordance with ASC 250-10-25.

The ASU does not affect the health care entity's prior elected policy of accounting for legal costs associated with contingencies other than medical malpractice liabilities.

Retrospectively Rated Insurance Policies

Health care practitioners have also been uncertain about whether the ASU's amendments to ASC 954-720-25-1, which addresses retrospectively rated insurance coverage, conflict with the ASU's fundamental requirement that health care entities apply ASC 210-20 to other types of insurance coverage. Retrospectively rated insurance coverage is designed so that the health care entity pays the insurer a minimum premium plus an experience portion (based on the entity's estimated loss experience for the year). The experience portion is then adjusted after the year-end to reflect the claims actually reported, and there may be a stipulated maximum premium.

The amendments to ASC 954-720-25-1 are intended to be consistent with the fundamental requirement of the ASU that health care entities must apply ASC 210-20 before offsetting assets and liabilities.

Thinking Ahead

As a result of the ASU, health care entities that had a policy of netting claims liabilities with insurance recoveries will most likely need to change their balance sheet presentation. Unless the strict criteria in ASC 210-20 for offsetting are met, such entities need to identify those claims liabilities and related insurance recoveries that have been recorded or presented net and separately record and present the claims liabilities from related insurance recoveries.

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