

## Financial Reporting Center – Revenue Recognition

# Working Draft: Insurance Entities Revenue Recognition Implementation Issue



**Issue #9-1:** Considerations for applying the scope exception in FASB ASC 606-10-15-2 and 606-10-15-4 to contracts within the scope of ASC 944

**Expected Overall Level of Impact to Industry Accounting:**  
Moderate

**Wording to be Included in the Revenue Recognition Guide:**

*Contracts in the Scope of Topic 944*

1. FASB ASC 606-10-15-2 states:

An entity shall apply the guidance in this Topic to all contracts with customers, except the following:  
(b) Contracts within the scope of Topic 944, Financial Services— Insurance.

2. BC13 of FASB Accounting Standards Update (ASU) 2016-20: Technical Corrections and Improvements to Topic 606, Revenue from Contracts from Customers, states:

The amendment to paragraph 606-10-15-2(b) clarifies that all contracts (that is, not only insurance contracts) within the scope of Topic 944, Financial Services – Insurance, are excluded from the scope of Topic 606. This exclusion applies to contracts within the scope of Topic 944 such as life and health insurance, property and liability insurance, title insurance, and mortgage guarantee insurance. Topic 944 provides guidance on accounting and financial reporting for those contracts, including guidance that is applied to both insurance and investment contracts to determine the revenue recognition for fees. Investment contracts (defined in the Master Glossary as long-duration contracts that do not subject the insurance entity to risks arising from policyholder mortality or morbidity) are included within the scope of Topic 944. For example, Subtopic 944-825 provides guidance on the accounting for and the financial reporting of financial instruments, including guidance on investment contracts. Those contracts are accounted for under a deposit accounting model, similar to financial instrument contracts issued by entities other than insurance entities. As noted in paragraph 606-10-15-2(c), financial instruments issued by entities other than insurance entities also are excluded from the scope of Topic 606, and, therefore, this technical correction is consistent with the existing scope exceptions for insurance and financial instrument contracts.

3. As explained in BC13 of FASB ASU 2016-20, the intent of the amendment to FASB ASC 606-10-15-2(b) is to clarify that all contracts within the scope of FASB ASC 944, such as investment contracts, life and health insurance, property and liability insurance, title insurance, and mortgage guarantee insurance, are excluded from the scope of FASB ASC 606.

#### *Contracts Provided by Insurance Entities*

4. Insurance contracts typically have components, that consist of various types and varying degrees of activities (enrollment, claim adjudication, administration and payment, and customer service) embodied in them in order for the insurer to fulfill its insurance obligations. In some instances, especially in commercial lines of business such as general liability, contracts may have high deductibles, but the insurance entity adjudicates all claims, including those below the deductible level. In some cases, an insurance entity may provide high deductible coverage, and the policyholder will obtain claims adjudication and settlement services from a third party unrelated to the insurer.
5. Insurance entities can also provide services, such as claims adjudication and settlement, to customers without providing insurance coverage.

#### *Applying Scope Exemption*

6. BC14 of FASB ASU 2016-20, states:

Contracts within the scope of Topic 944 are excluded from the scope of Topic 606. That scope exception applies to contracts within the scope of Topic 944 and does not apply to all contracts of insurance entities. An insurance entity might need to consider whether a contract with a customer is for goods or services that are not within the scope of Topic 944. For example, the Board understands that a contract for administrative services (such as claims processing) without any insurance element is at present accounted for as a revenue arrangement within the scope of Topic 605. The Board expects that those types of service arrangements would be accounted for under Topic 606.

7. BC15 of FASB ASU 2016-20, states:

The Board received questions about the interaction of the guidance in paragraph 606-10-15-2 and the guidance in paragraph 606-10-15-4. Some stakeholders questioned whether the guidance in paragraph 606-10-15-4 requires an insurance entity to bifurcate contracts (within the scope of Topic 944) into elements within the scope of Topic 944 and elements within the scope of Topic 606. The guidance in paragraph 606-10-15-4 is applied after applying the guidance in paragraph 606-10-15-2. For example, if an entity reaches an appropriate conclusion that it has a contract entirely within the scope of Topic 944, then the entity would not apply the guidance in paragraph 606-10-15-4. This is because there are no elements of the contract within the scope of Topic 606 based on the entity's conclusion that the entire contract is included within the scope of Topic 944. This assessment is similar to how an insurance entity determines whether elements of contracts are within the scope of Topic 944 or Topic 605 currently. There could be other activities in the contract, such as insurance risk mitigation or cost containment activities that relate to costs to fulfill the contract within the scope of Topic 944. Those fulfillment activities would not be within the scope of Topic 606 and, instead, similar to current practice, would be considered part of the contract within the scope of Topic 944. This assessment is similar to how an insurance entity determines whether elements of a contract are within the scope of Topic 944 or Topic 605 today.

8. In accordance with BC15 of FASB ASU 2016-20, for contracts that are within the scope of FASB Topic 944, the insurance entity should determine if elements of the contract should be accounted for within FASB Topic 944 or FASB Topic 606. If it is determined that a contract is not entirely within the scope of FASB Topic 944 due to elements of the contract being within the scope of FASB Topic 606, the insurance entity should apply the guidance in FASB ASC 606-10-15-4.
9. Also as explained in BC15 of FASB ASU 2016-20, there could be activities included in the contract, such as insurance risk mitigation or cost containment activities, that should be considered fulfillment activities, not within the scope of FASB Topic 606 but, similar to current practice, considered part of the contract within the scope of FASB Topic 944.
10. The following are examples of activities performed by an insurance entity, included in contracts within the scope of FASB Topic 944, that FinREC believes generally should be considered fulfillment activities (that either mitigate risks to the insurer or contain costs related to services to fulfill the insurer's obligation) that are not within the scope of FASB Topic 606, but should be considered part of the contract within the scope of FASB Topic 944:

- a. Claims adjudication/processing: These activities can be included with commercial property casualty insurance contracts, (e.g., general liability, property, automobile, workers compensation) offered as a high deductible policy, such that the policyholder is “self-insuring” numerous claims below the deductible, that specifies that the adjudication/processing of claims both above and below the deductible amount will be performed by the insurer.

These claim adjudication/processing activities are performed even if the high deductible is ultimately not reached. Compensation for claims adjudication/processing below and above the deductible is either (1) an explicit or implicit component of the policy premium; or (2) separately billed to the policyholder based on a percentage of paid or incurred losses, or as a flat charge per claim and referred to as a claims servicing charge.

For those claim activities below the deductible, although the activities are partially provided as a service to the customer, they also mitigate the insurer’s risk of loss above the deductible. Generally from the insurer’s perspective, a holistic view is taken in managing claims from the ground up (i.e., from below the deductible through the insurer’s limit), whether the insurer performs the claims adjudication or if it is outsourced to a third party. The insurer is integral in developing the strategy/approach for settling a claim below or above the deductible, along with the insured or the third party administrator if one is involved (i.e., whether a loss event is ultimately covered within the insurance protection provided or not).

- b. Health insurance contracts within the scope of FASB ASC 944 (e.g., medical including high deductible health plans (HDHPs), dental, vision, etc.): Additional activities related to the fulfillment of the insurance contract may include but are not limited to: enrollment (for group plans), provider network access, routine physicals and screenings, immunizations, preventative care and wellness benefits, transportation to facilities for treatment, and access to durable medical equipment (e.g., wheelchairs and crutches), and wellness benefits that include biometric screening, tobacco cessation, personal health assessments and records, health coaching, and disease management provided with health insurance contracts within the scope of FASB ASC 944.
- c. Safety inspections: These activities are sometimes provided with a property and liability insurance contract and such activities can be viewed as mitigating the insurer’s risk.
- d. Roadside assistance provided with an automobile insurance policy: Examples of activities provided are: towing cars from an accident location or changing a flat tire, which both help mitigate the risk of a further accident or damage to the car.
- e. Cybersecurity activities: These activities are sometimes provided with a general liability insurance contract and such activities can be viewed as mitigating the insurer’s risk.
- f. A title search provided with a title insurance policy: These activities are part of fulfilling the insurance contract and mitigating the insurer’s risk.

11. In some situations involving claim adjudication and processing activities, these activities may not be part of the fulfillment activities of an insurance contract. For example, structures may be offered in the marketplace in which a commercial customer will purchase a high-deductible property casualty insurance contract. Under this policy, insurance coverage may be provided only for claims above a specified deductible amount, and the customer may obtain claims adjudication/processing services from a third party administrator (oftentimes a subsidiary of another insurance group) unrelated to the insurer providing the insurance coverage. That third party would be subject to FASB ASC 606 for its provision of claims processing services. In these cases the claims adjudication/processing services are not offered in conjunction with an insurance contract. As explained in BC14 of FASB ASU 2016-20, contracts offered by an insurance entity that are not within the scope of FASB Topic 944, such as administrative services only contracts without any insurance element, should be accounted for under FASB Topic 606.

#### *Administrative Services Only Contracts Offered with Stop Loss Insurance Contracts*

12. An insurance entity, such as a health insurer, may enter into an administrative services only contract and an insurance contract at the same time with the same party. If either contract’s price was discounted from the insurance entity’s normal pricing practices for either contract, this may suggest a pricing interdependency under which these contracts may need to be treated as one arrangement. That is, although the combination of contracts guidance in FASB ASC 606-10-25-9 is not applicable to contracts outside the scope of FASB ASC 606 (e.g., a contract in the scope of FASB ASC 944), FinREC believes that insurance entities should consider the economics and nature of the arrangements (including pricing interdependencies), when assessing if contracts with the same customer (or related parties of the customer) should be combined for accounting purposes.

13. If it is determined that the contracts should be combined for accounting purposes, FinREC believes that the insurance entity should look to BC15 of FASB ASU 2016-20, to determine if the activities, other than providing insurance coverage, in the combined contract are predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk.
14. If it is determined that the activities are predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk, FinREC believes that the combined contracts should be accounted for as one contract under FASB ASC 944.
15. If it is determined that certain of the activities of the combined contract are not predominantly performed as part of fulfilling the insurance obligation or mitigating the insurer's insurance risk, FinREC believe that the guidance in FASB ASC 606 should be applied to determine the allocation of the combined consideration between (a) those non-insurance performance obligations to be accounted for under FASB ASC 606 and (b) insurance coverage (assuming that it meets the criteria to be classified as an insurance contract under ASC 944) to be accounted for under FASB ASC 944.

#### *Revenue Recognition for Fees*

16. BC13 of FASB ASU 2016-20, also clarifies that FASB ASC 944 includes guidance that is applied to both insurance and investment contracts to determine the revenue recognition for fees. In accordance with BC13 of FASB ASU 2016-20, the revenue recognition guidance in FASB ASC 944 should be applied to fees associated with insurance and investment contracts.

Comments should be received by April 3, 2017, and sent by electronic mail to Kim Kushmerick at [kkushmerick@aicpa.org](mailto:kkushmerick@aicpa.org), or you can send them by mail to Kim Kushmerick, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.