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Accounting for title insurance companies : proposal to the Financial Accounting Standards Board. January 31, 1980; Statement of position 80-1;

American Institute of Certified Public Accountants. Accounting Standards Division

Statement of Position 80-1

Accounting for Title Insurance Companies

January 31, 1980

Proposal to the Financial Accounting Standards Board

Issued by
Accounting Standards Division

American Institute of
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AICPA

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NOTE

Statements of position of the accounting standards division are issued for the general information of those interested in the subject. They present the conclusions of at least a majority of the accounting standards executive committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting and cost accounting.

The objective of statements of position is to influence the development of accounting and reporting standards in directions the division believes are in the public interest. It is intended that they should be considered, as deemed appropriate, by bodies having authority to issue pronouncements on the subject. However, statements of position do not establish standards enforceable under the Institute's code of professional ethics.

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Accounting Standards Division

Accounting Standards Executive Committee
(1979–1980)

Insurance Companies Committee
(1979–1980)

AICPA Staff

The committee expresses appreciation to John E. Hart, Cormick L. Breslin, Frank A. Bruni, James L. George, and R. Lawrence Soares who served on the 1978–79 AICPA Insurance Companies Committee and to David V. Roscetti, former AICPA staff aide to the committee. They contributed significantly to the project during its development.

Accounting for Title Insurance Companies

1. The AICPA Insurance Companies Committee has reviewed existing accounting literature dealing with variances between (*a*) generally accepted accounting principles and (*b*) practices prescribed or permitted by insurance regulatory authorities, as those practices relate to title insurance companies, and has identified areas in which further clarification seems necessary. The committee has also identified certain areas that are not covered in present accounting literature.

2. An exposure draft of a proposed statement of position on *Accounting for Title Insurance Companies* was issued for comment on May 1, 1978, and a public hearing on it was held on July 17, 1978. A second exposure draft was issued on March 16, 1979. Comments received on the exposure drafts and presentations made at the public hearing were considered in preparing this statement of position.

3. In recent years, accountants, investors, and other users of financial statements have expressed concern over the acceptability of accounting alternatives for similar business transactions. The accounting standards division believes that it is not desirable to have acceptable accounting alternatives in the title insurance industry. Therefore, this statement of position expresses the division's conclusions on accounting methods that should be used in the areas in which accounting alternatives exist.

4. This statement of position applies to title insurance company financial statements that are intended to present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles. In addition, the section on accounting for title plant (paragraphs 25 through 40) applies to financial statements of all entities that use a title plant in their operations. Those entities include, but are not limited to, title insurance companies (underwriters), title abstract companies, and title agents.

5. The interests of policyholders and the public in the financial integrity of the title insurance industry make it important that the solvency of title insurance companies be demonstrated to regulatory authorities. Consideration of those interests, together with the uncertainties inherent in the future, has resulted in the conservative accounting practices prescribed or permitted by insurance regulatory authorities (statutory accounting practices[1]). Solvency must be continuously demonstrated for a title insurance company to be permitted to offer its services to the public. Federal income taxation of title insurance companies is also based primarily on statutory accounting practices. The use of generally accepted accounting principles, as discussed below, should not be construed as an indication that those accounting principles should also be used in reporting to regulatory or taxing authorities.

Premium Revenue Recognition

Discussion

6. The title insurance business primarily involves the issuance of title insurance policies or binders to real estate owners, purchasers, and mortgage lenders, indemnifying them against loss or damage arising out of defects in, or liens on, the title to real estate. Title insurance differs from other traditional property and liability insurance in that the term of the policy is indefinite and the premium is not refundable.

7. While title insurance premiums generally are collected at the time policies are issued or within a reasonable time after issuance, practices vary within the industry regarding when the revenue is recognized as earned.

8. Under statutory accounting practices, title insurance companies are required to defer a portion of their premium revenue based on statutory formulas, which vary by state. Unearned premiums represent a significant liability in the statutory financial statements of a title insurance company and are recognized as revenue over a relatively long period of time. The statutory method of recognizing revenue is intended to be a conservative means of providing additional protection to policyholders.

[1]*Statutory accounting practices* are practices that have been prescribed by statute, regulation, or rule, or have been permitted by specific approval or acceptance.

9. Some title insurance companies include the unearned premium reserve as an additional provision for losses in their financial statements that are intended to be presented in conformity with generally accepted accounting principles. Title insurance companies usually do not charge losses against the unearned premium reserve; instead, they establish separate loss reserves for claims that have been reported.

10. Most title insurance companies recognize the entire premium as revenue at the policy effective date when reporting in conformity with generally accepted accounting principles. The effective date of the policy can be (*a*) the date the real estate sale or loan is closed, (*b*) the date the deed or other instruments are filed, (*c*) the date the policy is issued, or (*d*) the date indicated on the policy as the effective date. Those who support the effective date as the basis for revenue recognition believe that this method produces a proper matching of costs and revenue, since most costs associated with the policy have been incurred by the time the policy becomes effective. Immediate recognition of all revenue is further justified by the fact that there is no cancellation provision or policy term. Those who support immediate recognition of the premium as revenue believe that losses on title insurance policies have occurred by the time the policies are issued and, therefore, loss reserves should be provided concurrent with revenue recognition.

11. Some companies recognize the premium as revenue at the time a binder is given. In practice, the binder and effective dates can vary from being almost simultaneous to being several months apart, depending on the type of real estate insured (for example, residential, commercial, or construction) and local title search procedures. Those who support the binder date as the point of revenue recognition believe that the title search has been performed as of that date, most related costs have been incurred, and title insurance is in effect. Those who support the effective date rather than the binder date as the basis for revenue recognition believe that the effective date is more conservative than the binder date, since it is not possible to determine at the time a binder is issued whether a policy will ultimately be issued.

12. A title insurance policy may also be issued by an agent who performs the title search and is authorized to act on behalf of a title insurance company. In those circumstances, the title insurance

company may be notified of the issuance of the policy some time after the effective date. It has generally been industry practice to recognize such premium revenue when reported by an agent. Others believe that an estimate should be recorded for such delayed-reported premiums.

Conclusions

13. Revenue should be recognized as earned when the title insurance company is legally or contractually entitled to collect the premium. In most circumstances, revenue would be recognized on the effective date; however, the binder date would be appropriate if the title insurance company is legally or contractually entitled to collect the premium on the binder date.

14. If reasonably estimable, revenue and expenses related to policies issued by agents should be recognized when the agents are legally or contractually entitled to collect the premiums, using estimates based on past experience and other sources; if not reasonably estimable, the revenue and expenses should be recognized when agents report the issuance of the policies.

Losses

Discussion

15. Under existing statutory accounting practices, a provision is included in the financial statements for losses that have been reported to the company. However, there is no specific recognition (in the form of loss reserves) in the statutory financial statements for incurred but not reported losses. Statutory accounting practices, however, require that a portion of title insurance premiums received be deferred and taken into income over a number of years. The actual number of years depends on the state in which the policy is written. That practice may be viewed as creating a reserve that is essentially available for losses inasmuch as there are no contractual provisions of the title policy that require the return of any portion of the premium.

16. Events giving rise to a loss in the title insurance industry for the most part occur before the policy is issued, which contrasts with the typical property and liability loss in which the event giving rise to the loss occurs after the policy is issued. The exceptions to

the general rule concerning prior occurrence may arise in certain special types of title coverage, such as mechanics liens coverages in construction projects, in which the events giving rise to losses may occur after the policies are issued.

17. Industry practice in accounting for title insurance company losses under generally accepted accounting principles varies somewhat, although most companies establish liabilities for all losses on existing policies, including estimates for incurred but not reported losses. The estimates are intended to provide for the ultimate cost of settlement and are based generally on the company's historical experience adjusted for recent developments and trends.

18. Title insurance companies may sometimes obtain the insured's mortgage, deed of trust, or fee interest in the insured's real estate in connection with the settlement of a claim. The title insurance company's ability to realize a recovery from real estate interests varies substantially as a result of differing circumstances regarding the value of the property and the status of the ownership interest acquired.

Conclusions

19. Under generally accepted accounting principles, losses should be recognized in the financial statements at the time the related premium revenue is recognized. At that time, a provision should be made for all estimated losses that will result from the issuance of the policies, reduced by estimated recoveries. Unpaid losses, including incurred but not reported losses, should be based on the best estimate of the ultimate cost of settlement, including the effects of inflation and other social and economic factors, reduced by estimated recoveries using past experience adjusted for current trends and any other factors that should modify past experience. Changes in loss estimates resulting from the continuous review process, and differences between estimates and ultimate payments, should be reflected in operations of the period in which the estimates are changed.

20. Estimated recoveries on unsettled claims, such as a potential ownership interest in real estate, should be evaluated in terms of their estimated realizable value and recorded as a reduction of

unpaid losses. The estimated amount of recoveries on settled claims should be reported as an asset.

21. Property acquired in settling claims should be accounted for at the amount of cash, or its equivalent, expected to be derived from the sale of the property, net of costs such as maintenance and selling expenses required to be incurred prior to sale. Such property should be separately presented in the balance sheet and should not be classified as an investment. Subsequent reductions in the carrying amount and realized gains and losses on the sale of such property should be charged or credited to claims incurred.

22. No conclusion has been reached on the issue of whether loss reserves should be discounted—that is, whether the time value of money should be considered in determining loss reserves. Because of the importance of that issue, the division believes that it should develop an issues paper on the subject for submission to the Financial Accounting Standards Board. Until the issue is resolved, companies that discount loss reserves or loss adjustment expenses (see paragraphs 23 and 24) should disclose that fact in their financial statements, together with the effects on the financial statements.

Loss Adjustment Expenses

Discussion

23. In the course of settling title insurance claims, a title insurance company frequently incurs expenses for outside services (primarily legal) as well as internal settlement expenses. Internal settlement expenses, which are insignificant, generally consist of fixed costs associated with a permanent employee staff handling a variety of functions, including loss adjustment. Practice varies within the industry with respect to recording those expenses. Settlement expenses are accrued by some companies at the time the loss is recognized; settlement expenses are treated by others as period costs.

Conclusions

24. Internal settlement expenses should be expensed as period costs and external settlement expenses expected to be incurred should be accrued at the time the related losses are accrued.[2]

[2]See paragraph 22.

Title Plant

Discussion

25. *Nature of Title Plant.* The business of issuing title insurance policies to insure the condition of title to real estate requires the gathering of all public records relating to the properties that, by law, impart constructive notice of their contents. Generally, public records are not indexed or filed according to particular parcels of property, which makes searching records for particular parcels of property a costly, complex, and inefficient process. In view of the time required and costs incurred to examine pertinent public records and abstract (summarize) their contents, title insurance companies construct or purchase an integrated and indexed collection of title records covering all parcels of real estate within a county before they commence business in the county. The title records, referred to in the industry as a title plant, represent the principal productive asset used to generate title insurance revenue.

26. A title plant consists of (*a*) indexed and catalogued information for a period of time concerning the ownership of, and encumbrances on, real estate, (*b*) information relating to persons having an interest in real property, (*c*) maps, plats, and so forth, (*d*) copies of prior title insurance policies and reports, and (*e*) other documents and records. In summary, a title plant constitutes an historical record of all matters affecting title to parcels of land in a particular geographic area. The number of years covered by a title plant varies, depending on regulatory requirements and management decisions concerning the minimum information period needed to issue title insurance policies efficiently. Title plants are updated on a daily or other frequent basis by the addition of copies of documents on the status of title to specific parcels of real estate.

27. A title plant, or an ownership interest in a title plant, is obtained either by construction or by purchase. Construction of a title plant consists of (*a*) obtaining copies of all historical documents affecting real estate and documents relating to persons having an interest in real estate in a particular county for a specified period of time, (*b*) organizing and summarizing the historical information in an efficient and useful manner, (*c*) designing a system to store and retrieve the information, and (*d*) transcribing the summarized information into the storage and retrieval system. The information

obtained can be maintained on a variety of media such as manually-prepared records, machine-prepared records, microfilm, microfiche, or magnetic tape and may be stored in racks, folders, cabinets, or computers. Costs incurred to construct a title plant consist principally of payroll and document copying costs and other costs directly related to title plant construction. Industry practice generally has been to capitalize title plant construction costs until, in the judgment of management, the title plant is operational. A title plant is considered operational at the time it can be used for title searches.

28. A title plant is composed of (*a*) documents containing historical information relating to real estate in a particular county and (*b*) a system to store and retrieve the information efficiently and effectively. The historical information in a title plant is not consumed by use, is not replaced in the ordinary course of business, and has an indefinite life as long as the information is updated on a current basis. It is often necessary to search records for the earliest recorded documents in order to provide indemnification; in other instances, a title search involves reading information summarized in the most recently issued title report. Accordingly, the economic useful life of the information is indefinite and indeterminable.

29. *Maintenance of Title Plant.* Maintenance involves the recurring activities required to update a title plant on a daily or other frequent basis. The title plant is updated by adding (*a*) copies of official documents, (*b*) updated reports on the status of title to specific parcels of real estate, and (*c*) records relating to security or other ownership interests. Title insurance companies presently charge maintenance costs to expense as incurred.

30. Some believe that maintenance costs sustain the value and utility of the title plant but do not add to the asset or result in a new asset. They believe that expensing maintenance costs as incurred is consistent with the industry's general practice of not deferring a portion of the premium and, thus, provides an appropriate matching of costs and revenue. Others believe that maintenance costs add to the value of a title plant and should be capitalized.

31. *Storage and Retrieval.* Title insurance companies, from time to time, design or acquire new storage and retrieval systems or convert the historical information from one storage and retrieval

medium to another (for example, from manually-prepared records to microfilm) in response to new technology, the need to process greater volumes of business, or the need to reduce space required to store historical information. Presently, some title insurance companies identify and capitalize as title plant the costs associated with modernization programs, while others charge the costs to expense as incurred. Some believe that such costs provide economic benefits beyond the accounting periods in which they are incurred, that the storage and retrieval systems have determinable economic useful lives, and that the costs associated with the systems should be capitalized and systematically allocated to operations over their estimated useful lives.

32. *Sale of Title Plant.* A title insurance company may sell (*a*) all or a portion of a title plant and convey all or an undivided interest in ownership rights to the buyer, (*b*) the right to use all or a portion of a title plant, or (*c*) the right to copy a particular title plant. Accounting practice for those transactions varies. Some companies record the sales proceeds as revenue and do not expense a portion of the cost of the title plant, whereas other companies record the sales proceeds as revenue and expense a portion of the cost of the title plant. Some companies that offset a portion of the cost of the title plant against the sales proceeds present the resulting gain or loss as a separate item in the statement of income. In addition, some companies may consider the entire proceeds from the sale as a return of the cost of the title plant and reduce the cost of the title plant accordingly.

Conclusions

33. *Nature of Title Plant.* A title plant is a tangible asset that is unique to the title insurance industry. If properly maintained, the historical information in a title plant has an indeterminate life and does not diminish in value with the passage of time.

34. *Capitalization of Title Plant.* Costs incurred to construct a title plant, including the costs incurred to obtain, organize, and summarize historical information in an efficient and useful manner, should be capitalized until the title plant can be used by the company to conduct title searches and issue title insurance policies. The capitalized costs should be directly related to, and properly identified with, the activities necessary to construct the title plant.

After the construction or purchase of a title plant, a company may decide to purchase or construct a title plant (backplant) that antedates the period of time covered by the existing title plant. Costs to construct a backplant must be properly identifiable to qualify for capitalization. Capitalized costs of a title plant should not be depreciated.

35. Purchased title plants, including a purchased undivided interest in a title plant, should be recorded at cost at the date of acquisition. For a title plant acquired separately, cost should be measured by the fair value of the consideration given.[3] Title plants purchased as part of a group of assets or as part of a business combination accounted for as a purchase should be accounted for in accordance with APB Opinion 16, *Business Combinations*.

36. *Maintenance of Title Plant.* Costs incurred to maintain a title plant should be expensed as incurred.

37. *Cost of Title Searches.* Costs incurred to perform title searches should be expensed as incurred.

38. *Storage and Retrieval.* Costs incurred after a title plant is operational to (*a*) convert the information from one storage and retrieval system to another or (*b*) modify or modernize the storage and retrieval system should not be added to the carrying amount of the title plant; however, such costs may be separately deferred and amortized in a systematic and rational manner.

39. *Sale of Title Plant.* A title insurance company may (*a*) sell its title plant and relinquish all rights to its future use, (*b*) sell an undivided ownership interest in its title plant, that is, the right to its joint use, or (*c*) sell a copy of its title plant or the right to use it. If the company relinquishes all future rights to its title plant, the amount received as consideration for the sale should be presented as a separate component of revenue, net of the carrying amount of the title plant. If the company sells an undivided interest in its title plant, the amount received as consideration for the sale should be presented as a separate component of revenue, net of a pro rata portion of the carrying amount of the title plant. If the company sells a copy of its title plant or the right to use it, the amount

[3]Nonmonetary transactions should be accounted for in accordance with APB Opinion 29, *Accounting for Nonmonetary Transactions*.

received should be presented as a separate component of revenue. Ordinarily, no cost should be allocated to the sale of a copy or the right to use a title plant. However, if the value of the title plant decreases below its carrying amount as a result of the sale, the carrying amount of the title plant should be written down to its estimated net realizable value.

40. *Impairments.* Ordinarily, a title plant has an indeterminate life and does not diminish in value with the passage of time; however, the following circumstances may indicate that its value has been impaired:

a. Changes in legal requirements or statutory practices.

b. Effects of obsolescence, demand, and other economic factors.

c. Actions of competitors and others that may affect competitive advantages.

d. Failure to update (maintain) the title plant properly on a current basis.

e. Abandonment of a title plant or other circumstances that indicate obsolescence.

If the value of a title plant decreases below its carrying amount as a result of one or more of the foregoing or other circumstances, the title plant should be written down to its net realizable value.

Valuation of Investments and Recognition of Related Realized and Unrealized Gains or Losses

Discussion

41. Under statutory accounting practices, investments in common and preferred stocks are carried at market value, bonds generally are carried at amortized cost, mortgages are carried at unpaid principal or amortized cost if purchased at a discount or premium, and real estate generally is carried at depreciated cost. Realized investment gains or losses are credited or charged to income. Changes in the carrying amount of investments representing unrealized appreciation or depreciation are credited or charged to stockholders' equity.

42. The statutory method of accounting for investments is supported by the following reasoning:

a. Carrying bonds whose value has not been permanently impaired at amortized cost is appropriate since a company that has the ability and intent to hold the investments to maturity will be able to realize face amount. Market values that reflect periodic changes in prevailing interest rates are irrelevant in valuing bonds that are expected to be held to maturity.

b. Carrying common and preferred stocks at market is appropriate because a company has no assurance that it will receive more or less than the current market value.

c. Including realized investment gains and losses in net income is appropriate since it is based on the realization principle. Periodic fluctuations in market value are appropriately recognized in valuing equity investments but should not be included in net income because the fluctuations do not meet the realization principle.

43. Some believe that realized and unrealized investment gains or losses should be combined in a separate financial statement. They believe that valuation of investments under the statutory method is appropriate for the reasons stated above. However, they advocate that changes in the value of investments, whether realized or unrealized, should be presented in a separate financial statement as one combined amount. They believe that this treatment is the most meaningful since the realization of a gain or loss has an offsetting effect on the related unrealized gain or loss. Because of the materiality of the amounts and the significant fluctuations that occur, they believe that realized and unrealized gains or losses should not be included in the determination of net income because that would make net income meaningless.

44. Some believe that realized gains and losses should be reported as an integral part of a title insurance company's results of operations because an investor's appraisal of a title insurance company's performance should include the results of realized gains and losses over a period of years.

45. FASB Statement no. 12, *Accounting for Certain Marketable Securities*, discusses the accounting treatment to be followed

by specialized industries, such as title insurance companies, with respect to investments in common and preferred stocks.

Conclusions

46. Bonds should be carried at amortized cost if the company has both the ability and intent to hold the bonds until maturity and there is no decline in the market value of the bonds other than a temporary decline. In those rare instances in which a company is a trader in bonds and does not intend to hold the bonds until maturity, the bonds should be carried at market; temporary fluctuations in the market value of such bonds should be recognized as unrealized gains or losses.

47. Common and nonredeemable preferred stocks should be carried at market. Preferred stocks that by their terms must be redeemed by the issuing company should be carried at amortized cost if the company has both the ability and intention to hold the stocks until redemption and there is no decline in the market value of the stocks other than a temporary decline.

48. Mortgages should be accounted for at unpaid principal or amortized cost if purchased at a discount or premium unless collectibility is uncertain. Real estate investments should be accounted for at depreciated cost unless there is an impairment in value.[4] Amortization, depreciation, and other related charges or credits should be charged or credited to investment income. Charges and credits to valuation accounts should be included in realized gains and losses.

49. Realized gains and losses on all assets held for investment (including, but not limited to, stocks, bonds, mortgage loans, real estate, joint ventures, and subsidiaries held for investment) should be included in the statement of income, below operating income and net of applicable income taxes. Realized gains and losses on the sale of other assets, such as property used in the business and operating subsidiaries, should be included in the statement of income before applicable income taxes. Unrealized investment gains and losses should be recognized in stockholders' equity net of applicable income taxes and should not be included in net income.

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[4]Investments in leased assets should be accounted for in accordance with FASB Statement no. 13, *Accounting for Leases*.

50. If a decline in the value of an investment in a security below its cost or amortized cost is other than temporary, the investment should be written down to its net realizable value, which becomes the new cost basis. The amount of the writedown should be accounted for as a realized loss. A recovery from the new cost basis should be recognized as a realized gain only at sale, maturity, or other disposition of the asset.

51. Valuation accounts should not be used for common stocks, preferred stocks, or publicly traded bonds.[5]

Real Estate

Discussion

52. Under statutory accounting practices, real estate is classified as an investment regardless of its use. For real estate used in operations, rent is included in investment income and is charged to the operating departments.

Conclusions

53. Real estate should be classified either as an investment or as property used in the business, based on its predominant use. Depreciation and other real estate operating expenses should be classified as investment expenses or operating expenses consistent with the balance sheet classification of the related asset. Imputed investment income and rent expense should not be attributed to real estate used in the business. (Property acquired in settling claims should be accounted for as discussed in paragraph 21.)

Transition

54. The conclusions in this statement of position should be applied to financial statements for fiscal years beginning after December 31, 1980. Earlier application, however, is encouraged. An accounting change to adopt the provisions of this statement of position should be made retroactively by restating the financial statements of prior periods. If information for restatement of prior

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[5]This paragraph is not intended to preclude the accrual of losses from uncollectible receivables when both conditions in paragraph 8 of FASB Statement no. 5, *Accounting for Contingencies*, are met.

periods is not available, financial statements and summaries for prior periods presented should be restated for as many consecutive periods preceding the transition date of this statement as is practicable, and the cumulative effect of applying its provisions on the retained earnings at the beginning of the earliest period restated (or at the beginning of the period in which the statement is first applied if it is not practicable to restate any prior periods) should be included in determining net income of that period (see paragraph 20 of APB Opinion 20, *Accounting Changes*). Disclosures should be made in the financial statements in the period of change in accordance with paragraph 28 of APB Opinion 20.

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