PROPOSED FASB STAFF POSITION

No. FAS 106-a

Comment Deadline: December 26, 2003

Title: Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003

The Board directed the FASB staff to issue this FASB Staff Position (FSP) which defers any accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 and requires additional disclosures pending further consideration of the underlying accounting issues.

Background

On December 8, 2003, the President signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Questions have arisen regarding whether an employer that provides postretirement prescription drug coverage (a plan) should recognize the effects of the Act on its accumulated postretirement benefit obligation (APBO) and net postretirement benefit costs and, if so, when and how those effects should be accounted for.

FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions, addresses employers' accounting for postretirement health care benefits. Paragraph 40 of Statement 106 states:

Certain medical claims may be covered by governmental programs under existing law or by other providers of health care benefits.\(^{17}\) Benefit coverage by those governmental programs shall be assumed to continue as provided by the present law and by other providers pursuant to their present plans. Presently enacted changes in the law or amendments of the plans of other health care providers that take effect in future periods and that will affect the future level of their benefit coverage shall be considered in current-period measurements for benefits expected to be provided in those future periods. Future changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers shall not be anticipated. [Emphasis added.]

\(^{17}\) For example, a retiree's spouse also may be covered by the spouse's present (or former) employer's health care plan. In that case, the spouse's employer (or former employer) may provide either primary or secondary postretirement health care benefits to the retiree's spouse or dependents.
Medicare existed when Statement 106 was issued, and it is a “governmental program” that should be considered under paragraph 40 in measuring the APBO and net periodic postretirement benefit cost. However, the Act introduces two new features to Medicare that may impact those measurements: (1) a subsidy to a plan’s sponsor based on 28% of the plan’s share of an individual beneficiary’s annual prescription drug costs between $250 and $5,000,\(^1\) and (2) the opportunity for a retiree to obtain a prescription drug benefit under Medicare.

**Federal Subsidy**
A plan sponsor’s eligibility for the 28% subsidy depends on whether the plan’s prescription drug benefit is as at least “actuarially equivalent” to the Medicare Part D benefit. At present, detailed regulations necessary to implement the Act have not been issued, including those that would specify the manner in which actuarial equivalency must be determined and the evidence required to demonstrate actuarial equivalency to the Secretary of Health and Human Services.\(^2\) In addition, the magnitude of the subsidy for an employer depends on how many Medicare-eligible retired plan participants choose not to enroll in the voluntary Medicare Part D plan. Further, specific regulations regarding the documentation requirements and payment/reimbursement mechanism for the subsidy are yet to be defined by the appropriate administrative agency. Therefore, it is unclear at present whether the subsidy is substantively similar to other Medicare benefits that existed when Statement 106 was issued and therefore, should be accounted for as a reduction of the APBO and net periodic postretirement benefit cost, or whether the subsidy represents a payment to the employer that is determined by reference to the plan’s benefit payments but is not, in and of itself, a direct reduction of postretirement benefit costs.

**Effect on Per Capita Claims Cost**
The effect of the Medicare Part D benefit on a plan that currently provides a prescription drug benefit depends on (a) whether current and future retirees (or their beneficiaries under the employer-sponsored plan) choose to enroll in the voluntary Medicare Part D plan and pay (initially) the $35 monthly premium and (b) the Act’s macro socioeconomic effects on health care cost trends and consumers’ behavior.

**Other Considerations**
In addition, the Act excludes the direct subsidy from the gross income of the plan sponsor for federal income tax purposes.\(^3\) That provision, depending on how the subsidy is ultimately viewed for accounting purposes, may affect the temporary difference relating to the APBO that gives rise to a deferred tax asset under FASB Statement No. 109, *Accounting for Income Taxes*.

The Act also provides for a two-year transitional period to allow for, among other items, the possibility that plan sponsors may amend existing plans (or establish new ones) in

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\(^1\) New Section 1860D-22(a) of the Social Security Act created by Section 101 of the Act.
\(^2\) Section 1860D-11(c) of the Social Security Act, as amended by the Act, states that “the Secretary shall establish processes and methods for determining the actuarial valuation of prescription drug coverage.”
\(^3\) New Section 139A of the Internal Revenue Code established by Section 1202 of the Act.
response to the legislation in order to achieve maximum direct financial benefit as well as improve employee relations.\(^4\) To the extent that plan sponsors amend plans (positively or negatively) for employee services already rendered, the APBO will be affected by the direct effects of the change in the benefit formula. Whether or not amended, an existing plan’s APBO will be affected by any expected changes of present and future retirees’ coverage elections as a result of the Act.

**FASB Staff Position**

Paragraph 40 of Statement 106 requires presently enacted changes in relevant laws to be considered in current period measurements of postretirement benefit costs and the APBO. Therefore, under that guidance, existing obligations and subsequent measurements of postretirement benefit costs incurred after the date of enactment should reflect the effects of the Act.

However, (1) certain accounting issues raised by the Act may not be explicitly addressed by Statement 106, and (2) significant uncertainties presently exist both as to eventual regulations required to implement the Act and the Act’s overall effect on plan participants’ behavior and health care costs. Accordingly, plan sponsors or their advisors may not have either (a) sufficiently reliable information available on which to measure the effects of the Act, (b) sufficient time before issuance of financial statements for fiscal years that include the Act’s enactment date to prepare actuarial valuations that reflect the effects of the Act, or (c) sufficient guidance to ensure reasonably comparable accounting by plan sponsors for the effects of the Act. Therefore, pending further consideration of those issues, it would be premature for any plan sponsor to reflect enactment of the Act in the accounting for its plan or providing disclosures related to the plan required by FASB Statement No.132, *Employers’ Disclosures about Pensions and Other Postretirement Benefits*. Likewise, it would be premature to disclose any anticipated effects regarding the accounting in subsequent periods.

Pending further consideration by the FASB staff of the underlying accounting issues, a sponsor of a postretirement health care plan that provides prescription drug benefits should disclose the existence of the Act, and the fact that, in accordance with this FSP, any measures of the APBO or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the plan. A sponsor is encouraged to provide additional disclosure of any information that the sponsor has and believes is appropriate for the reader to understand the Act’s possible economic consequences for the sponsor including whether the sponsor intends to amend the plan in light of the new legislation.

**Transition**

The guidance in this FSP is effective for financial statements for fiscal years ending after December 7, 2003.

\(^4\) Section 111 of the Act calls for an initial study (due one year after enactment) and a final study (due no later than January 1, 2007) by the Comptroller General on the impact of the Act on plan design and, in particular, calls for the final study to include recommendations on how the various incentives for private plan sponsors in the Act may be improved.

Proposed FSP on Statement 106 (FSP FAS 106-a)  p.3
Submitting Comments on a Proposed FSP

Responses from interested parties wishing to comment on a proposed FSP must be received in writing by the comment deadline indicated for each FSP. Interested parties should submit their comments by email to director@fasb.org, and include "Comments on Proposed FSP" along with the reference number (for example, FSP FIN 46-f) in the subject line of the email. Those without email may send their comments to "Director, TA&I—FSP" at the following address:

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Responses should not be sent by fax.