FASB Emerging Issues Task Force

Issue No. 10-D

Title: Fees Paid to the Federal Government by Pharmaceutical Manufacturers

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Background

1. This Issue addresses the accounting for the annual fee due from the pharmaceutical manufacturing industry each calendar year beginning on or after January 1, 2011, that was mandated by the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (in combination, the Act).

2. At the July 29, 2010 EITF meeting, the Task Force reached a consensus-for-exposure on this Issue that the annual fee should be presented as an operating expense. Additionally, the Task Force reached a consensus-for-exposure that upon recognition of the liability, the annual fee should be recognized over the year the fee is payable using a straight-line method of allocation unless another method better allocates the fee over the year.

3. The Board ratified the consensus-for-exposure and approved the issuance of a proposed Accounting Standards Update (proposed Update) for public comment on August 18, 2010. The

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

proposed Update was posted to the FASB website on August 24, 2010, with a comment period that ended on October 8, 2010. Six comment letters were received on the proposed Update and have been distributed to Task Force members. At the November 19, 2010 EITF meeting, the Task Force will have the opportunity to consider the comment letters as it redeliberates the consensus-for-exposure.

Summary of Comment Letters Received and FASB Staff Analysis

4. Six comment letters were received on the proposed Update from the following sources:

Preparers	4
Individuals	1
Accounting/industry association	1
Total	**6**

Comment letter respondents were asked to comment on the following questions in the proposed Update:

> **Question 1:** Do you agree that the scope of this proposed Update should be limited to the fees to be paid by pharmaceutical manufacturers or should it also include other fees required by the Acts that have similar characteristics as the pharmaceutical fees (for example, fees to be paid by health insurers)?
>
> **Question 2:** The amendments in this proposed Update require that upon recognition of the liability, the fee should be recognized over the calendar year the fee is payable using a straight-line method of allocation unless another method better allocates the fee over the calendar year the fee is payable. Do you agree with this conclusion? If not, how do you think the fee should be recognized and why?
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> **Question 3:** The amendments in this proposed Update require the fee to be classified as an operating expense in the income statements of pharmaceutical manufacturers. Do you agree with that conclusion? If not, how do you think the fee should be classified and why?
>
> **Question 4:** Do you agree that no additional disclosures are necessary upon adoption or after the adoption of the amendments in this proposed Update? If not, please describe what disclosures should be required and why.

The staff has identified and analyzed the significant comments in the paragraphs that follow.

Although all respondents' views were generally in agreement with the proposed Update, the staff believes that it is important to highlight that none of those respondents were pharmaceutical manufacturers.

5. In Question 1, constituents were asked whether they agreed that the scope of this Issue should be limited to the fees to be paid by pharmaceutical manufacturers or whether it also should include other fees required by the Act that have characteristics that are similar to the pharmaceutical manufacturing industry fees (for example, fees to be paid by the health insurance industry). The majority of respondents requested that the scope of this Issue be expanded to include the fees to be paid by the health insurance industry. This scope question is addressed later in this Issue Supplement.

6. In Question 2, constituents were asked whether they agreed that upon recognition of the liability, the fee should be recognized over the calendar year the fee is payable using a straight-line method of allocation unless another method better allocates the fee over the calendar year the fee is payable. Five of the six comment letter respondents (CL#1, CL#2, CL#4, CL#5, and CL#6) agreed with the conclusion that the fee should be recognized over the calendar year it is payable. The remaining respondent (CL#3) did not directly address the question.

7. In Question 3, constituents were asked whether they agreed with the requirement in the proposed Update that the fee be classified as an operating expense in the income statements of pharmaceutical manufacturers. Five of the six respondents (CL#1, CL#2, CL#4, CL#5, and CL#6) agreed with the Task Force's conclusion. The remaining respondent (CL#3) did not directly address the question.

8. In Question 4, constituents were asked whether they agreed that no additional disclosures are necessary as a result of the proposed Update. Four of the six respondents (CL#1, CL#4, CL#5, and CL#6) agreed with the Task Force's conclusion, while the remaining two respondents did not comment on the question.

9. Given the feedback received from comment letter respondents, the staff is recommending that the Task Force affirm its consensus-for-exposure with respect to the accounting for the annual fee due from the pharmaceutical manufacturing industry.

Does the Task Force agree with the staff recommendation to affirm the consensus-for-exposure with respect to the accounting for the annual fee due from the pharmaceutical manufacturing industry?

10. In addition to agreeing with the Task Force's conclusions on the timing and recognition of the fee to be paid by pharmaceutical manufactures, the majority of the comment letter respondents requested that the scope of this Issue be expanded to include the fee to be paid by health insurers. Five of the six comment letter respondents (CLs #1, CL#2, CL#4, CL#5, and CL#6) indicated that they believe that the fee to be paid by health insurers is similar in substance to the fee to be paid by pharmaceutical manufacturers. Therefore, those respondents have requested that the final Update include amendments to clarify that the accounting for both fees be the same. The staff has provided additional information related to the fee to be paid by health insurers in Exhibit 10-DA. Additionally, the table below compares the fees to be paid by pharmaceutical manufacturers and health insurers pursuant to the Act.

	Pharmaceutical Manufacturer	Health Insurer
Purpose of the fee	To fund other provisions of the Act	To fund other provisions of the Act
Scope	Entities that sell branded prescription drugs to any government program specified in the Act	Entities that provide health insurance or administrative services for any U. S. health risk[1]
Exclusions	Certain entities are excluded if their sales fall below a minimum threshold	Certain entities are excluded if their net written premiums or administrative service fees fall below a minimum threshold
Calculation basis	Liability only exists if entity sells branded prescription drugs to any	Liability only exists if entity provides health insurance in the

[1] Section 9010(d) of the Act defines a U.S. health risk as the health risk of any individual who meets certain citizenship and residence criteria.

	Pharmaceutical Manufacturer	Health Insurer
	government program in the year that the fee is payable (starting in 2011)	year that the fee is payable (starting in 2014)
Calculation of liability	Ratio of entity's eligible sales in prior year to total sales of all covered entities multiplied by a specified annual fee amount	Ratio of entity's eligible health business in prior year to total health business of all covered entities in prior year multiplied by a specified annual fee amount
Payment date	Date specified by Secretary of the Treasury but no later than September 30 (starting 2011)	Date specified by Secretary of the Treasury but no later than September 30 (starting 2014)
Tax status of the fee	Not tax deductible	Not tax deductible

11. As indicated in the table, a health insurer becomes obligated to pay the fee in 2014 and in subsequent years once it provides health insurance for any qualifying U.S. health risk in 2014 and beyond. To address concerns about when a reporting entity would be obligated to pay the annual fee, Senator Baucus, one of the Act's sponsors, read a statement into the congressional record to clarify the intent behind the fee. Relevant excerpts from his statement are as follows:

> ***Now, we understand that there have been questions about the nature of this fee that are affecting how the fee should be treated for accounting purposes. It was our intent that the fee is assessed in the year that it is due.*** [Emphasis added.]
>
> *A fee is assessed on an entity in any given calendar year only if the entity is engaged in the business of manufacturing or importing branded prescription drugs and has sales to the specified government programs in that calendar year.* ***The reference in the legislation to sales for the preceding calendar year is for the sole purpose of providing the method of calculating market share.*** [Emphasis added.]
>
> *It would be difficult to calculate market share and impose and collect the fee in the same year, so we decided to look back to a completed year as a proxy of market share.* ***But it is not intended that a manufacturer or importer would be assessed an annual fee in a calendar year in which it had no branded prescription drug sales to the government programs.*** [Emphasis added.]
>
> *This is regardless of whether the manufacturer or importer had any relevant sales in the preceding year. As an example, suppose a pharmaceutical company made sales in 2011 but in November 2011 shut down its U.S. operations and had no further sales to the specified government programs. In 2012, that pharmaceutical company would not be subject to the fee. Instead, the 2012 aggregate fee would be allocated among those companies selling drugs in 2012 to the specified government programs.* ***These same accounting questions may also be raised under the annual fee on health insurance***

> ***providers--section 9010 of the Patient Protection and Affordable Care Act, as amended. On these issues, our intent as to the treatment of the fees is the same.*** [Emphasis added.]

12. As previously mentioned, respondents believe that the accounting for the fees resulting from the Act to be paid by pharmaceutical manufacturers and health insurers should be the same. Additionally, those respondents were unsure whether the application of existing accounting guidance in Subtopic 405-30, Insurance—Related Assessments, which applies to entities that are subject to guaranty-fund and other insurance-related assessments, would result in accounting similar to that proposed by the Update.

Staff Analysis

Recognition

13. The staff believes that the prior year net premiums and third-party administrative agreement fees are used as a mechanism to allocate the fee among insurance industry participants based on market share of the U.S. health insurance market and that the intent of the Act was for this assessment to result in liability recognition in the year that it is due. However, two comment letter respondents (CL#1 and CL#6) believe that the language in the Act does not fully address the accounting rules specific to the health insurance industry and that two opposing views might result from the application of the existing accounting literature in Subtopic 405-30.

14. The two comment letter respondents (CL#1 and CL#6) indicated that an entity could interpret the existing guidance in Subtopic 405-30 and conclude that the obligating event (that is, the recognition of the liability) occurs in the year it writes certain health insurance business, which could be the year prior to the year in which the fee mandated by the Act is due. Specifically, those entities would reference paragraph 405-30-25-1, which states:

> Entities subject to assessments shall recognize liabilities for insurance-related assessments when all of the following conditions are met:
>
> a. Probability of assessment. An assessment has been imposed or information available before the financial statements are issued or are available to be

issued (as discussed in Section 855-10-25) indicates it is probable that an assessment will be imposed.

b. Obligating event. The event obligating an entity to pay (underlying cause of) an imposed or probable assessment has occurred on or before the date of the financial statements.

c. Ability to reasonably estimate. The amount of the assessment can be reasonably estimated.

15. Additionally, paragraph 405-30-25-4 provides guidance on identifying the obligating event, and states the following:

> Because of the fundamental differences in how assessment mechanisms operate, the event that makes an assessment probable (for example, an insolvency) may not be the event that obligates an entity. The following defines the event that obligates an entity to pay an assessment for each kind of assessment identified in this Subtopic:
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> a. For premium-based assessments, the event that obligates the entity is generally writing the premiums or becoming obligated to write or renew (such as multiple-year, noncancelable policies) the premiums on which the assessments are expected to be based. Some states, through law or regulatory practice, provide that an insurance entity cannot avoid paying a particular assessment even if that insurance entity reduces its premium writing in the future. In such circumstances, the event that obligates the entity is a formal determination of insolvency or similar triggering event. For example, in certain states, an insurance entity may remain liable for assessments even though the insurance entity discontinues the writing of premiums. In this circumstance, the underlying cause of the liability is not the writing of the premium, but the insolvency. Regulatory practice would be determined based on the stated intentions or prior history of the insurance regulators.
> b. For loss-based assessments, the event that obligates an entity is an entity's incurring the losses on which the assessments are expected to be based.

16. The staff believes that the obligating event (that is, the recognition of the liability) occurs when the health insurer provides health insurance for any U.S. health risk during 2014 (the first year in which the fee is due under the Act). The staff believes that this conclusion is consistent with the conclusion reached by the Task Force for the fee to be paid by pharmaceutical manufacturers under the Act. Additionally, the staff believes that this conclusion is consistent with the intent of U.S. lawmakers and is consistent with the definition of a liability contained in

FASB Concepts Statement No. 6, *Elements of Financial Statements*. Concepts Statement 6, paragraph 36, states:

> A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) **the transaction or other event obligating the entity has already happened.** [Emphasis added.]

17. The staff believes that this fee should not be considered to be in the scope of Subtopic 405-30. Paragraph 405-30-05-3 identifies the following four primary methods of guaranty-fund assessments:

a. Retrospective-premium-based assessments. Guaranty funds covering benefit payments of insolvent life, annuity, and health insurance entities typically assess entities based on premiums written or received in one or more years before the year of insolvency. Assessments in any year are generally limited to an established percentage of an entity's average premiums for the three years preceding the insolvency. Assessments for a given insolvency may take place over several years.
b. Prospective-premium-based assessments. Guaranty funds covering claims of insolvent property and casualty insurance entities typically assess entities based on premiums written in one or more years after the insolvency. Assessments in any year are generally limited to an established percentage of an entity's premiums written or received for the year preceding the assessment. Assessments for a given insolvency may take place over several years.
c. Prefunded-premium-based assessments. At least one state uses this kind of assessment to cover claims of insolvent property and casualty insurance entities. This kind of assessment is intended to prefund the costs of future insolvencies. Assessments are imposed before any particular insolvency and are based on the current level of written premiums. Rates to be applied to future premiums are adjusted as necessary.
d. Administrative-type assessments. These assessments are typically a flat (annual) amount per entity to fund operations of the guaranty association, regardless of the existence of an insolvency.

18. The staff believes that the fee mandated by the Act is not a guarantee fund that is typically assessed on entities to provide payment of covered claims or to meet other insurance obligations

of insolvent insurance entities. The staff also believes that the fee mandated by the Act is not an administrative-type assessment that is used to fund operations of the guaranty association, regardless of the existence of an insolvency. Therefore, the staff believes that the fee should be considered to be outside the scope of Subtopic 405-30 and addressed in Topic 720, Other Expenses, similar to the fee to be paid by pharmaceutical manufacturers mandated under the Act.

Subsequent Recognition and Classification

19. The staff views the health insurance industry fee to be similar to the Task Force conclusion regarding the pharmaceutical manufacturers industry fee; a tax imposed by the federal government for the right to participate in the health insurance market in the U.S. and in order to raise revenues to pay for other provisions of the Act. Accordingly, the staff believes that the fee should be recognized as an expense over the calendar year based on the guidance in Topic 270, Interim Reporting, as noted in the following paragraphs:

> 270-10-45-2 ...certain accounting principles and practices followed for annual reporting purposes **may require modification at interim reporting dates so that the reported results for the interim period may better relate to the results of operations for the annual period**. [Emphasis added.]
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> 270-10-45-7 Charges are made to income for all other costs and expenses in annual reporting periods based upon any of the following:
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> a. Direct expenditures made in the period (salaries and wages)
> b. Accruals for estimated expenditures to be made at a later date (vacation pay)
> c. Amortization of expenditures that affect more than one annual period (such as insurance premiums, interest, and rents).
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> 270-10-45-8 The objective in all cases is to achieve a fair measure if results of operations for the annual period and to present fairly the financial position at the end of the annual period. The following standards shall apply in accounting for costs and expenses than product costs in interim periods:
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> a. … **However, if a specific cost or expense item charge to expense for annual reporting purposes benefits more than one interim period, the cost or expense item may be allocated to those interim periods….** [Emphasis added.]

270-10-45-9 A complete list of examples of application of paragraphs 270-10-45-7 through 45-8 is not practical; however, the following examples of applications may be helpful

d. Property taxes (and similar costs such as interest and rents) **may be accrued or deferred at annual reporting date, to achieve a full year's charge of taxes to cost and expenses. Similar procedures shall be adopted at each interim reporting data to provide an appropriate cost in each period**. [Emphasis added.]

20. Additionally, because the staff views the fee to be akin to a tax paid to the U.S. Treasury and not a price concession made to a customer, the staff believes that the fee should be classified as an operating expense. The staff believes that this view is consistent with Senator Baucus' statement and that health insurance industry participants generally view the fee as an annual cost to participate in the U.S. health insurance market for the year that the payment is due.

Staff Recommendation

21. The staff recommends that given their similarity, the fee to be paid by health insurers should be accounted for in the same manner as the fee to be paid by pharmaceutical manufacturers. Additionally, if the Task Force agrees with the staff's recommendation, the staff suggests that the Codification amendments in the final Update be amended to indicate that the accounting for these two fees mandated by the Act be the same. As such, the staff proposes the following changes be made to the proposed Update and be included in the final Update. The highlighted text reflects the changes to the proposed Update:

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–3. **The newly added Subtopic is not underlined to enhance readability**.

Amendments to Topic 405

2. Amend paragraph 405-30-05-01 as follows:

405-30-05-01 Insurance entities as well as noninsurance entities are subject to a variety of assessments related to insurance activities, including those by state guaranty funds and workers' compensation second-injury funds. Some entities may be subject to insurance-related assessments because they self-insure against loss or liability. This Subtopic provides guidance on accounting for insurance-related assessments, except for the annual fee on health insurers imposed by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act. The accounting for that fee is addressed in Subtopic 720-50.

Amendments to Topic 720

32. Add Subtopic 720-50, with a link to transition paragraph 720-50-65-1, as follows:

Other Expenses—Fees Paid to the Federal Government by Pharmaceutical Manufacturers and Health Insurers

General

Overview and Background

720-50-05-1 This Subtopic provides guidance on the annual fees paid by the pharmaceutical manufacturing industry and the health insurance industry to the U.S. Treasury in accordance with the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts).

720-50-05-2 The Acts impose annual fees on the pharmaceutical manufacturing industry and the health insurance industry for each calendar year beginning on or after January 1, 2011, and January 1, 2014, respectively. A pharmaceutical manufacturer's and a health insurer's portion of their respective industry's annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible.

For the pharmaceutical manufacturing industry, the annual fee ranges from $2.5 billion to $4.1 billion in total, a portion of which will be allocated to individual pharmaceutical manufacturers on the basis of the amount of their branded prescription drug sales for the preceding year as a percentage of their industry's branded prescription drug sales for the same period. A pharmaceutical manufacturing entity's portion of the annual fee becomes payable to the U.S. Treasury once the entity has a gross receipt from branded prescription drug sales to any specified government program or in accordance with coverage under any government program for each applicable calendar year.

For the health insurance industry, the annual fee ranges upward from $8.0 billion, a portion of which will be allocated to individual health insurers on the basis of (a) the amount of their net premiums written with respect to health insurance for any U.S. health risk that is written during the preceding calendar year plus (b) 200 percent of the covered entity's (as defined by the Act) third-party administrative agreement fees that are taken into account during the preceding calendar year as a percentage of the same amounts incurred by all other covered entities for the same period. A health insurance entity's portion of the annual fee becomes payable to the U.S. Treasury once the entity provides health insurance for any U.S. health risk for each applicable calendar year.

Scope and Scope Exceptions

General

720-50-15-1 The guidance in this Subtopic applies to all pharmaceutical manufacturers and health insurers that are subject to the annual fees imposed by the Acts described in paragraph 720-50-05-01. This guidance should not be analogized to other government-fee-based arrangements.

Recognition

General

720-50-25-1 Upon recognition of the liability, the annual fees described in paragraph 720-50-05-1 shall be recognized over the calendar year the fees are payable using a straight-line method of allocation unless another method better allocates the annual fees over the calendar year the fees are payable.

Other Presentation Matters

General

720-50-45-1 The annual fees described in paragraph 720-50-05-1 shall be presented as operating expenses.

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2010-XX, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers and Health Insurers*

720-50-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-XX, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers and Health Insurers:*

a. The pending content that links to this paragraph shall be effective for calendar years beginning after December 31, 2010.

22. The staff believes that if the scope of this Issue is expanded to include the fee to be paid by the health insurance industry, the final Update should retain the caveat that the guidance in the Update should not be analogized to other government-fee-based arrangements outside of the two fees mandated by the Act. Lastly, the staff does not believe that this conclusion would require re-exposure given the feedback received from comment letter respondents and the similarity of the conclusions reached by the Task Force on the accounting for the fee to be paid by pharmaceutical manufacturing industry as mandated by the Act.

Does the Task Force agree with the staff recommendation? If not, how should the Task Force proceed to address the fee to be paid by the health insurance industry as mandated by the Act?

Exhibit 10-DA

Background on Health Insurer Fees

The Act imposes an annual fee on covered entities,[2] which subject to a number of exceptions is defined as an entity that provides health insurance for any U.S. health risk during the calendar year in which the fee is due, for each calendar year beginning on or after January 1, 2014. The annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible. The annual fee ranges upward from $8.0 billion, as illustrated in the table below, and will be allocated to covered entities based on the amount of (a) their net premiums written with respect to health insurance for any U.S. health risk that is taken into account during the preceding calendar year plus (b) 200 percent of the covered entity's third-party administrative agreement fees that are taken into account during the preceding calendar year as a ratio to the same amounts for all entities for the same period.[3]

2014	$8,000,000,000
2015	$11,300,000,000
2016	$11,300,000,000
2017	$13,900,000,000
2018	$14,300,000,000

For 2019 and thereafter, the applicable amount shall be the applicable amount for the preceding year increased by the rate of premium growth for such preceding calendar year.

Net written premiums included in the calculation are reduced for entities with premiums of less than $50 million on a sliding scale and eliminated for entities with premiums below $25 million. Third-party administrative fees included in the calculation are reduced for entities with fees of less than $10 million and eliminated for entities with fees below $5 million.

The entire annual fee becomes payable to the U.S. Treasury once a reporting entity meets the definition of a covered entity (that is, an entity that provides health insurance for any U.S. health risk during the calendar year in which the fee is due).

[2] Section 9010 (c) of the Act defines covered entity.
[3] The net premiums written to be included in this computation is reduced 50 percent for net premiums received from certain tax exempt entities as specified in Section 9010 (b)(2) of the Act.