

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2010-27
December 2010

Other Expenses (Topic 720)

Fees Paid to the Federal Government
by Pharmaceutical Manufacturers

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification™*

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The objective of this Update is to address questions concerning how pharmaceutical manufacturers should recognize and classify in their income statements fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts).

The Acts impose an annual fee on the pharmaceutical manufacturing industry for each calendar year beginning on or after January 1, 2011. An entity's portion of the annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible. The annual fee ranges from \$2.5 billion to \$4.1 billion for all affected entities in total, a portion of which will be allocated to individual entities on the basis of the amount of their branded prescription drug sales for the preceding year as a percentage of the industry's branded prescription drug sales for the same period.

An entity's portion of the annual fee becomes payable to the U.S. Treasury once a pharmaceutical manufacturing 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 calendar year beginning on or after January 1, 2011.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect reporting entities that are subject to the pharmaceutical fee mandated by the Acts.

What Are the Main Provisions?

The amendments in this Update specify that the liability for the fee should be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

It is unclear how existing GAAP would be applied to the fee that is the subject of this Update. Thus, the amendments in this Update are a clarification of the application of existing GAAP to a specific situation. The Task Force considered the amendments to be necessary to avoid future diversity in the way in which this fee is recognized and presented.

When Will the Amendments Be Effective?

The amendments in this Update are effective for calendar years beginning after December 31, 2010, when the fee initially becomes effective.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

There is no specific guidance in IFRS for the fee covered by this Update. Diversity in practice exists on whether similar fees are presented as an expense or a reduction of revenue under IFRS.

Amendments to the *FASB Accounting Standards Codification*TM

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 720

2. 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

Overview and Background

General

720-50-05-1 This Subtopic provides guidance on the annual fee paid by pharmaceutical manufacturers 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 an annual fee on the pharmaceutical manufacturing industry for each calendar year beginning on or after January 1, 2011. An entity's portion of the annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible. The annual fee ranges from \$2.5 billion to \$4.1 billion in total, a portion of which will be allocated to individual entities on the basis of the amount of their branded prescription drug sales for the preceding year as a percentage of the industry's branded prescription drug sales for the same period. An entity's portion of the annual fee becomes payable to the U.S. Treasury once a pharmaceutical manufacturing 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 calendar year beginning on or after January 1, 2011.

Scope and Scope Exceptions

General

720-50-15-1 The guidance in this Subtopic applies to all pharmaceutical manufacturers that are subject to the annual fee imposed by the Acts described in paragraphs 720-50-05-1 through 720-50-05-2. The guidance in this Subtopic is based on the unique facts and circumstances of the fee to be paid by pharmaceutical manufacturers in accordance with the Acts; accordingly, an entity should apply judgment when evaluating the facts and circumstances of other fee arrangements before analogizing to the guidance in this Subtopic.

Recognition

General

720-50-25-1 The liability related to the annual fee described in paragraph 720-50-05-1 shall be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable.

Other Presentation Matters

General

720-50-45-1 The annual fee described in paragraph 720-50-05-1 shall be presented as an operating expense.

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers*

720-50-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers*:

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

- b. The pending content that links to this paragraph does not require an entity to reevaluate its existing policies related to similar fees assessed by governmental authorities.
3. Add paragraph 720-50-00-1 as follows:

720-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
720-50-05-1	Added	2010-27	12/16/2010
720-50-05-2	Added	2010-27	12/16/2010
720-50-15-1	Added	2010-27	12/16/2010
720-50-25-1	Added	2010-27	12/16/2010
720-50-45-1	Added	2010-27	12/16/2010
720-50-65-1	Added	2010-27	12/16/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Leslie F. Seidman, Acting Chairman
Russell G. Golden
Thomas J. Linsmeier
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

BC2. Questions were raised about how to classify the fee mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act in the income statement of pharmaceutical manufacturers and how to account for the fee once it is recognized as a liability. This Update addresses those questions and is intended to prevent diversity from occurring in advance of the fee affecting both the income statement and statement of financial position of the pharmaceutical manufacturers that are subject to the Acts.

BC3. At the July 29, 2010 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 10-D, "Fees Paid to the Federal Government by Pharmaceutical Manufacturers." A proposed Accounting Standards Update was issued on August 24, 2010, with a comment period that ended on October 8, 2010. Six comment letters were received on the proposed Update.

BC4. The Task Force decided that the fee paid to the government should be classified as an operating expense rather than as a reduction of revenues similar to the accounting for sales incentives. The Task Force concluded that the facts and circumstances of the fee are more similar to revenue-raising activities of the government than to the negotiation by the government of the price paid for the products it purchases or pays for through its programs. In reaching its consensus-for-exposure, the Task Force noted that the total annual fee is fixed, that it is not tax deductible, and that the amount to be paid does not necessarily correlate with the amount of revenues that are generated or earned in the year the payment is due.

BC5. The Task Force decided that the liability for the fee should be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. This conclusion was based primarily on the guidance in Topic 270, Interim Reporting.

BC6. The Task Force observed that the decisions in the Update were based on the unique facts and circumstances of the fee to be paid by pharmaceutical manufacturers; accordingly, an entity should apply judgment when evaluating the facts and circumstances of other fee arrangements before analogizing to those decisions.

BC7. The Task Force observed that an entity is not required to reevaluate its existing policies related to similar fees assessed by governmental authorities. An entity that chooses to reevaluate its existing policies for similar fees and elects to change those policies must follow the requirements of Topic 250, Accounting Changes and Error Corrections, which provide that an entity may voluntarily change its accounting principles only to adopt a preferable accounting principle.

Benefits and Costs

BC8. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC9. In the Task Force's view, this guidance will avoid potential diversity in practice on how this fee is presented when it becomes effective. The Task Force anticipates that an entity will not incur any additional cost to implement this guidance because the fee is not effective until the 2011 calendar year.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this Update.