

# FINANCIAL ACCOUNTING SERIES



## ACCOUNTING STANDARDS UPDATE

No. 2011-06  
July 2011

### Other Expenses (Topic 720)

Fees Paid to the Federal Government  
by Health Insurers

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*<sup>®</sup>

Financial Accounting Standards Board  
of the Financial Accounting Foundation

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## CONTENTS

	Page Numbers
Summary.....	1–2
Amendments to the <i>FASB Accounting Standards Codification</i> ® .....	3–7
Background Information and Basis for Conclusions .....	8–9
Amendments to the XBRL Taxonomy .....	10



## Summary

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

The objective of this Update is to address questions about how health insurers 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). Those questions were raised in comment letters received on the proposed Accounting Standards Update, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers*.

The Acts impose an annual fee on health insurers for each calendar year beginning on or after January 1, 2014. A health insurer'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 for the health insurance industry will be allocated to individual health insurers based on the ratio of the amount of an entity's net premiums written during the preceding calendar year to the amount of health insurance for any U.S. health risk that is written during the preceding calendar year.

A health insurer'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.

### Who Is Affected by the Amendments in This Update?

The amendments in this Update affect reporting entities that are subject to the fee imposed on health insurers 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 once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable 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.

Additionally, this Update indicates that the fee would not meet the definition of an *acquisition cost*; that definition was amended by FASB Accounting Standards

Update No. 2010-26, *Financial Services—Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*.

## **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 diversity in the way in which entities account for and present the fee when it becomes effective.

## **When Will the Amendments Be Effective?**

The amendments in this Update are effective for calendar years beginning after December 31, 2013, 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.

# Amendments to the *FASB Accounting Standards Codification*<sup>®</sup>

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## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–11. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

## Amendments to Subtopic 405-30

2. Amend paragraph 405-30-05-1, with a link to transition paragraph 720-50-65-2, as follows:

### **Liabilities—Insurance-Related Assessments**

#### **Overview and Background**

**405-30-05-1** 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. The annual fee imposed on health insurers by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts) is not considered an insurance-related assessment. The accounting for the Acts' fee is addressed in Subtopic 720-50.

3. Amend paragraph 405-30-15-3, with a link to transition paragraph 720-50-65-2, as follows:

#### **Scope and Scope Exceptions**

**405-30-15-3** The guidance in this Subtopic does not apply to the following transactions and activities:

- a. Amounts payable or paid as a result of reinsurance contracts or arrangements that are in substance reinsurance, including assumed reinsurance activities and certain **involuntary pools** that are covered by Topic 944.
- b. Assessments of depository institutions related to bank insurance and similar funds.
- c. The annual fee imposed on health insurers by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts). The accounting for the Acts' fee is addressed in Subtopic 720-50.

## Amendments to Subtopic 720-50

4. Amend the title of Subtopic 720-50, with no link to a transition paragraph, as follows:

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

5. Amend paragraphs 720-50-05-1 through 05-2 and add paragraphs 720-50-05-3 through 05-4, with a link to transition paragraph 720-50-65-2, as follows:

### **Overview and Background**

**720-50-05-1** This Subtopic provides guidance on the annual ~~fees~~fees paid by pharmaceutical manufacturers and health insurers 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 ~~fees~~fees on the pharmaceutical manufacturing industry for each calendar year beginning on or after January 1, 2011, and on the health insurance industry for each calendar year beginning on or after January 1, 2014. 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.~~ **[Content amended and moved to paragraph 720-50-05-3]**

**720-50-05-3** 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 ~~entities~~ pharmaceutical manufacturers 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. ~~AA~~ pharmaceutical manufacturing entity's portion of the annual fee becomes payable to the U.S. Treasury once ~~the 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. **[Content amended as shown and moved from paragraph 720-50-05-2]**

**720-50-05-4** For the health insurance industry, the annual fee will be allocated to individual health insurers based on the ratio of the amount of an entity's net premiums written during the preceding calendar year to the amount of health insurance for any U.S. health risk that is written during the preceding calendar year. 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 calendar year beginning on or after January 1, 2014.

6. Amend paragraph 720-50-15-1, with a link to transition paragraph 720-50-65-2, as follows:

## Scope and Scope Exceptions

**720-50-15-1** The guidance in this Subtopic applies to all pharmaceutical manufacturers and health insurers that are subject to the annual fee imposed by the Acts described in paragraphs 720-50-05-1 ~~and 720-50-05-2~~ through 05-4. The guidance in this Subtopic is based on the unique facts and circumstances of the fee to be paid by pharmaceutical manufacturers and health insurers 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.

7. Amend paragraph 720-50-25-1, with a link to transition paragraph 720-50-65-2, as follows:

## Recognition

**720-50-25-1** The liability related to the annual fee described in ~~paragraph~~ paragraphs 720-50-05-1 through 05-4 shall be estimated and recorded in full upon the first qualifying sale for pharmaceutical manufacturers or once the entity provides qualifying health insurance for health insurers in the applicable calendar year in which the fee is payable 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. The

annual fee imposed on health insurers does not represent a cost related to the acquisition of policies that is consistent with the definition of an *acquisition cost* in Subtopic 944-30.

8. Amend paragraph 720-50-45-1, with a link to transition paragraph 720-50-65-2, as follows:

## **Other Presentation Matters**

**720-50-45-1** The annual fee described in ~~paragraph~~paragraphs 720-50-05-1 through 05-4 shall be presented as an operating expense.

9. Add paragraph 720-50-65-2 and its related heading as follows:

### **> Transition Related to Accounting Standards Update No. 2011-06, Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers**

**720-50-65-2** The following represents the transition and effective date information related to Accounting Standards Update No. 2011-06, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers*:

- a. The pending content that links to this paragraph shall be effective for calendar years beginning after December 31, 2013.
- 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.

10. Add paragraph 405-30-00-1 as follows:

**405-30-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
405-30-05-1	Amended	2011-06	7/21/11
405-30-15-3	Amended	2011-06	7/21/11

11. Amend paragraph 720-50-00-1, by adding the note and the following items to the table, as follows:

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

**Note:** Subtopic title changed by Accounting Standards Update No. 2011-06 on 07/21/11 from *Other Expenses—Fees Paid to the Federal Government by Pharmaceutical Manufacturers* to *Other Expenses—Fees Paid to the Federal Government by Pharmaceutical Manufacturers and Health Insurers*.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
720-50-05-1	Amended	2011-06	7/21/11
720-50-05-2	Amended	2011-06	7/21/11
720-50-05-3	Added	2011-06	7/21/11
720-50-05-4	Added	2011-06	7/21/11
720-50-15-1	Amended	2011-06	7/21/11
720-50-25-1	Amended	2011-06	7/21/11
720-50-45-1	Amended	2011-06	7/21/11
720-50-65-2	Added	2011-06	7/21/11

*The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Mr. Schroeder dissented.*

Mr. Schroeder objects to the issuance of the amendments in this Update. Mr. Schroeder agrees with recognition of the liability for the fee, but disagrees with the timing of its recognition and the related deferred cost being amortized over the calendar year the fee is payable. Mr. Schroeder believes that the fee generally meets the essential characteristics of a liability, as outlined in paragraphs 35 through 40 of FASB Concepts Statement No. 6, *Elements of Financial Statements*, in the year used to calculate the fee and should be accrued over the course of that year. This is based on the view that an entity subject to the fee incurs a constructive liability throughout the year as related revenues are recognized. Following that view, the constructive liability then becomes a legal liability the first day revenues are recognized in the subsequent year; a relatively inconsequential event for a going concern. Mr. Schroeder believes that absent a decision (before the start of the next calendar year) to cease doing business, an entity should record a liability in the same year related revenues are recognized.

*Members of the Financial Accounting Standards Board:*

Leslie F. Seidman, *Chairman*  
Daryl E. Buck  
Russell G. Golden  
Thomas J. Linsmeier  
R. Harold Schroeder  
Marc A. Siegel  
Lawrence W. Smith

## Background Information and Basis for Conclusions

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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. This issue arose due to comment letters received on the proposed Accounting Standards Update, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers*, which addressed the fees assessed on pharmaceutical manufacturers by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts). The respondents agreed with the accounting for the fee; however, certain respondents requested that the scope be broadened to address the accounting for similar fees required to be paid by health insurers under the Acts. This Update addresses those concerns, and it will prevent diversity in the way in which entities account for and present the fee in both the income statement and statement of financial position when the Acts become effective.

BC3. The Task Force observed that the amendments in the Update were based on the unique facts and circumstances of the fee to be paid by health insurers; accordingly, an entity should apply judgment when evaluating the facts and circumstances of other fee arrangements before analogizing to those amendments.

BC4. 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.

BC5. At the November 19, 2010 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 10-H, "Fees Paid to the Federal Government by Health Insurers." A proposed Accounting Standards Update was issued on December 17, 2010, with a comment period that ended on April 18, 2011. Four comment letters were received on the proposed Update.

BC6. The Task Force decided that the fee to be paid to the government by health insurers is similar to the fee to be paid to the government by

pharmaceutical manufacturers and, as such, should be classified as an operating expense. In reaching its consensus, the Task Force noted that the total annual fee is based on health insurance premiums written by all health insurers and it is not tax deductible.

BC7. The Task Force decided that the liability for the fee should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable 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 is based primarily on the guidance in Topic 270, Interim Reporting.

BC8. The Task Force decided that the fee does not represent a cost related to the acquisition of policies that is consistent with the definition of an *acquisition cost* as amended by the guidance in Update 2010-26. Additionally, the Task Force noted that most health insurance policies provide coverage for one year, similar to the period over which the Task Force concluded that the fee should be amortized.

## Benefits and Costs

BC9. 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.

BC10. 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 2014 calendar year.

## Amendments to the XBRL Taxonomy

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