

# *In brief*

## A look at current financial reporting issues

October 2014  
No. INT2014-13

### *Change in timing for recording the annual pharmaceutical fee*

#### *At a glance*

New US regulation accelerates recognition of the annual fee on sales of branded prescription drugs in Q3, resulting in a double-hit to income in 2014 for many pharmaceutical manufacturers and importers

#### *Issue*

The US Department of Treasury and Internal Revenue Service (IRS) issued final regulations in July 2014 describing how to calculate the annual fee on sales of branded prescription drugs ('annual fee') under the Patient Protection and Affordable Care Act (PPACA). This release updated preliminary regulations that had been in effect until final regulations could be written and approved.

It is widely understood in the pharmaceutical industry that the annual fee is a levy within the scope of IFRIC 21. Preliminary, regulations issued in August 2011 suggested that the obligating event for the levy was the 'first sale of the following year'. Thus, the pharmaceutical companies had a general practice of recognising the liability for the annual fee in the year following relevant sales (for example, Pharma A would recognise the levy for the sales in 2012 on 1 January 2013).

The final regulations include an illustrative example of the annual fee calculation and an additional description of 'covered entity' that collectively accelerate the obligating event. The newly issued regulations suggest a company has a liability for its annual fee in the period sales occur regardless of the status of its business or sales in the subsequent year. The liability should therefore be recognised in the same period as the sales occur. The new regulation means most US pharmaceutical manufacturers and foreign companies doing business in the US will need to record a cumulative adjustment in Q3 2014 to 'catch-up' the current year. The consequence is that there will be a double-hit recognised in the income statement in 2014, as the liability for the 2013 sales would have been recorded in January 2014 and the liability for 2014 sales will also be recognised in 2014.

#### *Insight*

The final regulations, upon issuance, altered the definition of the obligating event for this liability. Therefore, we would view this as a change in facts and circumstances, not as a prior period error or a change in accounting policy. We would encourage companies to offer additional disclosures to help investors understand the unusual nature of the catch-up adjustment in 2014, as well as the change to the obligating event for recording the liability prospectively.

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### *Questions*

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### *IRS regulation reference*

Section 9008 of the Patient Protection and Affordable Care Act (ACA), Public Law 111-148 (124 Stat. 119 (2010)), as amended by section 1404 of the Health Care and Education Reconciliation Act of 2010 (HCERA), Public Law 111-152 (124 Stat. 1029 (2010)), imposes an annual fee on each covered entity engaged in the business of manufacturing or importing branded prescription drugs, to be paid not later than September 30th of each year. On July 28, 2014, the Internal Revenue Service (IRS) issued final regulations (26 CFR Parts 51 and 602) on the fee.

