EXPOSURE DRAFT
Issue Paper No. 107 - Health Care Receivables

Notice of Public Hearing and Request for Written Comments

Hearing Date: NAIC 2001 Spring National Meeting

Location: Nashville, Tennessee

Deadline for Written Notice of Intent to speak: March 5, 2001

Deadline for Receipt of Written Comments: March 5, 2001

Basis for hearings. The Statutory Accounting Principles Working Group (SAPWG) will hold a public hearing to obtain information from and views of interested individuals and organizations about the standards proposed in this Exposure Draft. The SAPWG will conduct the hearing in accordance with the National Association of Insurance Commissioners (NAIC) policy statement on open meetings. An individual or organization desiring to speak must notify the NAIC in writing by **March 5, 2001**. Speakers will be notified as to the date, location, and other details of the hearings.

Oral presentation requirements. The intended speaker must submit a position paper, a detailed outline of a proposed presentation or comment letter addressing the standards proposed in the Exposure Draft by **March 5, 2001**. Individuals or organizations whose submission is not received by that date will only be granted permission to present at the discretion of the SAPWG chair. All submissions should be addressed to the NAIC staff at the address listed below. Comments can also be submitted by electronic mail to statacct@naic.org.

Format of the hearings. Speakers will be allotted up to 10 minutes for their presentations to be followed by a period for answering questions from the SAPWG. Speakers should use their allotted time to provide information in addition to their already submitted written comments as those comments will have been read and analyzed by the SAPWG. Those submissions will be included in the public record and will be available at the hearings for inspection.

Copies. Exposure Drafts can be obtained on the Internet at the NAIC Home Page (http://www.naic.org). The documents can be downloaded using Microsoft Word or WordPerfect.

Written comments. Participation at a public hearing is not a prerequisite to submitting written comments on this Exposure Draft. Written comments are given the same consideration as public hearing testimony.

The Statutory Accounting Principles Statement of Concepts was adopted by the Accounting Practices & Procedures (EX4) Task Force on September 20, 1994, in order to provide a foundation for the evaluation of alternative accounting treatments. All issues considered by the SAPWG will be evaluated in conjunction with the objectives of statutory reporting and the concepts set forth in the Statutory Accounting Principles Statement of Concepts. Whenever possible, establish a relationship between your comments and the principles defining statutory accounting.

The exposure period is not meant to measure support for, or opposition to, a particular accounting treatment but rather to accumulate an analysis of the issues from other perspectives and persuasive comments supporting them. Therefore, form letters and objections without valid support for their conclusions are not helpful in the deliberations of the working group. Comments should not simply register your agreement or disagreement without a detailed explanation, a description of the impact of the proposed guidelines, or possible alternative recommendations for accomplishing the regulatory objective.

Any individual or organization may send written comments to Dave Christensen at the address listed below, no later than March 5, 2001. Comments can also be submitted by electronic mail to statacct@naic.org.

National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2604
(816) 842-3600

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Statutory Issue Paper No. 107
Health Care Receivables

Status:
Drafted December 4, 2000

Type of Issue:
Common Area

SUMMARY OF ISSUE:

1. SSAP No. 4 – *Assets and Nonadmitted Assets* (SSAP No. 4) provides the definition of admitted and nonadmitted assets.

2. Pharmaceutical rebates are arrangements between pharmaceutical companies and reporting entities in which the entities receive rebates based upon the drug utilization of its subscribers at participating pharmacies. These rebates are typically estimated based upon historical trends and recorded as receivables by the reporting entities. Current statutory accounting guidance does not specifically address the admittance of pharmaceutical rebates. Some reporting entities consider pharmaceutical rebates to be a type of subrogation activity. Accounting guidance for reporting of receivables associated with the coordination of benefits or subrogation is provided in Chapter 8 of the Accounting Practices and Procedures Manual for Health Maintenance Organizations. That guidance states that these receivables are to be reported as an income item in the period received.

3. Claim overpayments may occur as a result of several events, including but not limited to claim payments that will later be recoverable through coordination of benefit provisions, or payments made in error to a provider. Reporting entities often establish receivables for claim overpayments. Current statutory accounting guidance is silent on the admittance of claim overpayments. Claim overpayments may meet the conditions for the right of offset as defined in SSAP No. 64 – *Offsetting and Netting of Assets and Liabilities* (SSAP No. 64). Since claim overpayments are not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual effective January 1, 2001 they would be reported as nonadmitted.

4. The glossary to the statements of statutory accounting principles contained in the Accounting Practices and Procedures Manual effective January 1, 2001, defines a capitation arrangement as a compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider. Risk sharing agreements are contracts with a risk sharing element based upon utilization. The compensation payments for risk sharing agreements are typically estimated monthly and settled annually. These agreements can result in receivables due from the providers if annual utilization is less than that which was used in estimating the monthly compensation. SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25) provides accounting guidance for loans and advances and advances under capitation arrangements to providers who meet the definition of related parties.

5. Current GAAP provides guidance relative to defining a health care receivable and accounting guidance on loan impairment. Such guidance is presented in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide: Health Care Organizations. This audit guide was rejected in *SSAP No. 73—Health Care Delivery Assets – Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities.*

6. The purpose of this issue paper is to establish statutory accounting principles for pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers who do not meet the definition of related parties, capitation arrangement receivables and risk sharing receivables consistent with the Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION:

7. The definition and accounting treatment for nonadmitted assets is outlined in paragraph 3 of SSAP No. 4 as follows:

> As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which may be unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet", and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting , and is one which is:
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> a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or
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> b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.
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> If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's capitalization policy, immaterial amounts of furniture, fixtures, equipment, or supplies, can be expensed when purchased.

8. To the extent they conform to the requirements of this issue paper, pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers, capitation arrangement receivables and risk sharing receivables meet the definition of assets as set forth in SSAP No. 4, and are admitted assets to the extent that the requirements for admission defined in this issue paper are met.

9. This issue paper shall not be considered an all-inclusive list of health care receivables. Certain health care receivables are addressed in other issue papers. Assets not addressed in specific issue papers are nonadmitted until specifically identified as admitted assets.

Pharmaceutical Rebate Receivables

10. Pharmaceutical rebate receivables shall only be recorded when specifically identified and billed in accordance with the pharmaceutical rebate contract provisions. Evaluation of the collectibility of pharmaceutical rebate receivables shall be made periodically. If in accordance with *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets,* it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Pharmaceutical rebates that have not been collected within 90 days of the date billed shall be nonadmitted. Furthermore, any pharmaceutical rebate receivable that represents an estimate of amounts to be received in the future but has not been billed following contractual provisions shall not be recorded.

Claim Overpayment Receivables

11. A claim overpayment shall not be recorded as a receivable until billed. To the extent that the claim overpayment meets the setoff conditions in SSAP No. 64, the right of offset is supported by a contractual agreement, and the overpayment is a specific identifiable payment and not an estimate, the receivable may be admitted up to the amount of the payable to the provider for known claims (i.e., excluding incurred but not reported claims). The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of claim overpayment receivables shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts in excess of that written off that do not meet the right of offset conditions shall be nonadmitted as they are not available to satisfy policyholder obligations.

Loans and Advances to Providers

12. Loans or advances to providers who meet the definition of related parties in SSAP No. 25 shall follow the guidance in that statement. To the extent a loan or advance to a non related party provider meets the setoff conditions in SSAP No. 64 and the right of offset is supported by the contractual agreement, the loan or advance may be offset against the amount of the payable to the provider for known claims (i.e., excluding incurred but not reported claims). The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of loans and advances to providers shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts in excess of that written off that do not meet the right of offset conditions shall be nonadmitted as they are not available to satisfy policyholder obligations.

Capitation Arrangement Receivables

13. Advances to providers under capitation arrangements that are made under the terms of an approved provider services contract in anticipation of future services shall be admitted to the extent that the advanced amount does not exceed one month of average capitation payments for the subject provider during the preceding twelve months, and provided that the contract may not be terminated before the end of the month for which the advanced amount was paid. Evaluation of the collectibility of capitation arrangement receivables shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

Risk Sharing Receivables

14. Risk sharing receivables and payables shall be billed or refunded in accordance with the risk sharing agreement contractual provisions. To the extent a risk sharing receivable meets the setoff conditions in SSAP No. 64 and the right of offset is supported by the contractual agreement, the receivable may be offset against payables to the provider for known claims (i.e., excluding incurred but not reported claims). The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of risk sharing receivables shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts receivable in excess of offsettable amounts that have not been collected within 90 days of the date billed shall be nonadmitted

DISCUSSION:

15. Even though pharmaceutical companies have obligated themselves contractually, pharmaceutical rebates are not certain to be collected. In the past, industry has experienced times when the pharmaceutical companies temporarily suspended or cancelled the rebates. In addition, the calculation for

these rebates are very cumbersome and are based upon utilization reports submitted by the various pharmacies to the pharmaceutical companies. Due to the nature of the calculation (volume of transactions, record keeping of utilization by pharmacies, etc.) it may be difficult for the reporting entities to calculate the rebates and related receivables. Furthermore, it is difficult for the reporting entities to estimate these receivables as there are many variables involved in the calculation (number of prescriptions written/filled, doctor's choice of drugs prescribed, doctor/pharmacist's choice of generic vs. brand-name drug written/filled, etc.). As such, these receivables are typically estimated based upon historical trends. Due to the number of variables involved, rebates calculated based on estimates shall not be accrued.

16. The statutory accounting principles outlined above are consistent with the conservatism and recognition concepts in the Statement of Concepts, current statutory accounting guidance and SSAP No. 4.

> Conservatism
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> Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency.
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> Recognition
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> The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:

Statutory Accounting

17. The Accounting Practices and Procedures Manual for Health Maintenance Organizations (Chapter 8, *Liabilities*) states:

> Items consisting of withholds or the provision for withholds should be reported as a separate liability in the annual statement. Further, claims payable or claims incurred but not reported (IBNR) are not to be adjusted for amounts receivable from other HMOs or indemnity carriers such as coordination of benefits or subrogation. Such receivables are to be reported as an income item in the period received.

18. SSAP No. 64 paragraph 2 provides guidance on accounting for offsetting and netting of assets and liabilities:

> 2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt. A valid right of setoff exists only when all the following conditions are met:
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> > a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;

b. The reporting party has the right to setoff the amount owed with the amount owed by the other party;

c. The reporting party intends to setoff; and

d. The right of setoff is enforceable at law.

19. SSAP No. 25 paragraphs 7 and 8 include the following guidance for loans or advances by a reporting entity:

> 7. Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm's-length transactions as defined in paragraph 10. Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 10 shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.
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> 8. Any advances under capitation arrangements made directly to providers, or to intermediaries that represent providers, that exceed one month's payment shall be nonadmitted assets.

Generally Accepted Accounting Principles

20. The AICPA Audit and Accounting Guide: Health Care Organizations states the following:

> 5.01. Receivables may include amounts due for (*a*) health care services from patients, residents, third-party payors, and employers; (*b*) premiums and stop-loss insurance recoveries; (*c*) intercompany transactions; (*d*) promises to give in future periods (pledges); and (*e*) amounts due from employees, physicians, or others. All loans, such as loans to physicians, should be evaluated periodically for impairment. Loans that are included in the scope of FASB Statement No. 114, *Accounting by Creditors for Impairments of a Loan*, should be evaluated based on the provisions of that statement. A loan is impaired when, based on current information and events, it is probable that the provider will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. If the provider measures an impaired loan using a present value amount, the creditor should calculate that present value based on an estimate of the expected future cash flows of the impaired loan, discounted at the loan's effective interest rate.

RELEVANT LITERATURE:

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Health Maintenance Organizations, Chapter 8
- SSAP No. 4—*Assets and Nonadmitted Assets*
- SSAP No. 5—*Liabilities, Contingencies and Impairment of Assets*
- SSAP No. 20—*Nonadmitted Assets*
- SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*
- SSAP No. 64— *Offsetting and Netting of Assets and Liabilities*

Generally Accepted Accounting Principles

- The AICPA Audit and Accounting Guide: Health Care Organizations

State Regulations

- No additional guidance obtained from state statutes or regulations