Part 1:
The State of Employer-Sponsored Health Insurance in Tennessee

and

Part 2:
The Health of Tennessee's Health Insurers

to

Cover Tennessee

A project of the Tennessee Department of Commerce and Insurance

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THE UNIVERSITY of TENNESSEE
Center for Business and Economic Research

Project Background and Purpose

The state of Tennessee Department of Commerce and Insurance was awarded a grant sponsored by the US Department of Health and Human Services, Health Resources and Services Administration (HRSA) State Planning Grants (SPG) Program. In performance of this grant, the Tennessee Department of Commerce and Insurance contracted with the Center for Business and Economic Research (CBER) at the University of Tennessee to 1) research employer-sponsored health insurance coverage in Tennessee (Part 1: The State of Employer-Sponsored Health Insurance in Tennessee), and 2) review existing data on health insurance companies (also referred to as "market participants") and similar entities providing coverage to Tennesseans (Part 2: The Health of Tennessee's Health Insurers).

Part 1 of the project discusses the methodology and findings of the employer-sponsored health insurance research. This research was specifically designed to fill in gaps and supplement data provided by the 2002 Medical Expenditure Panel Survey (MEPS), which provided the only base of information in its survey of 600 Tennessee businesses.

The report then turns to Part 2 of the project and discusses the methodology and findings of the research into the health of Tennessee's health insurers.

The Health of Tennessee's Health Insurers

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Table of Contents for Part 2

I. Project Overview and Background

According to project guidelines set forth by the Department of Commerce and Insurance representatives Jay Harrington and Kristin Coile, a report was to be prepared on the health of Tennessee's health insurers for years 2003, 2002, and 2001, similar to a report prepared for the Rhode Island health insurers ("The Health of RI's Health Insurers," Cryan, 2003). The following Tennessee organizations, which represented the majority of the premium income in the state, were to be included in the analysis: Aetna Health Inc. TN Corp., BCBS of TN Inc., Cariten Health Plan, Cariten Ins. Co., Cigna Healthcare of TN Inc., Humana Health Plan Inc., John Deere Health Plan Inc., and United Healthcare of TN. Each of these organizations was to be analyzed individually. The Tennessee health insurer information was also to be compared with Missouri, Kentucky, and Georgia as well as the overall United States health insurer industry. This benchmark financial information was purchased from A.M. Best Company. The Tennessee financial information was graciously supplied by Robert Ripe and Trey Hancock of the Financial Affairs Section (State of Tennessee).

As with the Rhode Island report, ratio analysis is used to assess the performance of these health insurers. This report examines financial operations only. It does not include information on other aspects of performance such as access, utilization, and satisfaction, et cetera. All health insurers are evaluated regardless of tax status, product line or organizational structure differences.

In addition, an overall market and product business line summary reports were to be prepared on the Tennessee health insurance market for the same period. In other words, these reports would summarize by year the premium income and underwriting gain (loss) generated for each of the above health insurers and aggregate by specific business line by year premium income and underwriting gain (loss) for all the above health insurers. Again, this information was graciously supplied by Robert Ripe and Trey Hancock of the Financial Affairs Section (State of Tennessee). The data was drawn from page 7 of the Annual Statement Health Blank: "Analysis of Operation by Lines of Business (Gain and Loss Exhibit)." As Mr. Hancock pointed out, "The majority of the companies only have information completed for the Comprehensive (Hospital and Medical) line. The other lines of business reported are Medicare Supplement, Dental only, Vision Only, Federal Employees, Medicare, Medicaid, Stop Loss, Disability Income, Long Term Care, Other Health, and Other Non-Health."

The ratios shown in this report are developed from raw financial numbers in the statutory reports, which are not included in this report. The Tennessee state level numbers (i.e., the numbers used to compare Tennessee with the other states and US) are averages of each of the data items analyzed. For example, the number for cash and short-term investments—used in the development of the current ratio—would be the average of the eight companies noted above. A.M. Best Company numbers are also averages of all the health insurers writing policies in that particular state or (for the overall US) averages of all US health insurers. Consequently, more companies may be included in the average numbers reported for Georgia, Kentucky, Missouri and the US

Blue Cross Blue Shield of Tennessee is classified as a nonprofit organization[1] under the business type filings with the Tennessee Secretary of State. However, according to Susan Prudowsky, Manager, Corporate Communications of Blue Cross Blue Shield of Tennessee (BCBS), "BCBS plans are taxable as commercial insurance companies under IRS code section 833 and have the same filing requirements as other commercial insurance companies—and not as other not-for-profit foundations." Accordingly, I have treated BCBS as a for-profit organization in line with the seven other organizations included in this analysis. Finally, Cariten Ins. Co. did not provide a health blank for 2001; only totals were provided. For uniformity in the segment analysis, all Cariten Ins. Co. numbers for 2001 were placed in the category Comprehensive Hospital and Medical.

To make the numeric and graphical information easier to follow, abbreviated names were used for the Tennessee health insurers and the states:

Tennessee Health Insurer:	**Abbreviated Name:**
Aetna Health Inc. TN Corp.	AHTN
BCBS of TN Inc.	BCBS
Cariten Health Plan	CAHP
Cariten Ins. Co.	CAIC
Cigna Healthcare of TN Inc.	CHTN
Humana Health Plan Inc.	HHPI
John Deere Health Plan Inc.	JDHP
United Healthcare of TN.	UHTN

States and US Averages:	**Abbreviated Name:**
Tennessee	TN
Georgia	GA
Kentucky	KY
Missouri	MO
United States	US

Business Product Line	**Abbreviated Name:**
Comp (Hospital & Medical)	COMP
Medicare Supplement	MS
Dental Only	DO
Federal Health Employee Benefit	FHEB
Title XVII – Medicare	XVII
Title XIX – Medicaid	XIX
Other	Other

[1] The nonprofit status of Tennessee Rural Health was also investigated and revealed that Tennessee Rural Health is not an tax-exempt organization according to IRS code and therefore is not required to provide a Form 990. Tennessee Rural Health was not included in this analysis.

II. Executive Summary

Overall Tennessee Health Insurer Market Summary

The eight health insurers in Tennessee constitute a $5.1 billion dollar industry. The two largest health insurers in 2003 in terms of net premium income are Blue Cross Blue Shield ($1.5 billion) and Humana Health Plan Inc. ($2.2 billion). The two most profitable organizations in 2003 in terms of absolute value of underwriting gains are Blue Cross Blue Shield ($113 million) and Humana Health Plan Inc. ($43 million). The three most profitable companies in 2003 in terms of net underwriting margin (i.e., relative to net premium income) in 2003 are Aetna Health Inc. TN Corp. (15.58 percent), United Healthcare of TN (8.27 percent), and BCBS of TN Inc. (7.14 percent).

Overall Tennessee Product Business Line Summary

The three largest business lines of insurance written by these eight Tennessee organizations in 2003 are Comprehensive Hospital and Medical ($3.8 billion), Title XVII – Medicare ($782 million), and Federal Health Employee Benefit ($367 million). The two most profitable product business lines in 2003 in terms of absolute value of underwriting gains are Comprehensive Hospital and Medical ($112 million) and Title XVII – Medicare ($43 million). The three most profitable business lines in 2003 in terms of net underwriting margin (i.e., relative to net premium income) in 2003 are Dental Only (11.48 percent), Medicare Supplement (10.69 percent), and Title XVII – Medicare (5.43 percent).

Overall Ratio Analysis

Table 1 compares Tennessee firms to their state counterparts (Kentucky, Georgia and Missouri) and overall US averages for the three-year period, 2001 to 2003, in terms of profitability, liquidity, leverage, and efficiency. Profitability measures the overall financial performance of an organization. Higher values are preferred. Two profitability measures are highlighted: net profit margin and return on assets. These two measures represent the organization's ability to translate revenue and assets into profits. Liquidity measures the ability of a health insurer to cover its current obligations. Two liquidity measures are highlighted: claims payment period and current ratio. From a liquidity standpoint, lower values are preferred for claims payment period while higher values are preferred for the current ratio. Deterioration in these measures can indicate potential cash flow problems and financial difficulty.

Leverage measures the extent of the firm's financing with debt and current liabilities. The amount and proportion of debt (current and long-term) is important in analyzing the potential risk of an organization. In this section, two leverage measures are highlighted: months reserves and debt ratio. From a leverage standpoint, higher values are preferred for months reserves and lower values are preferred for the debt ratio. Deterioration in these measures can indicate that organizations may have difficulty meeting their fixed commitments and therefore enterprise risk increases. Efficiency refers to how the health insurer is managing its business. Two efficiency measures are examined: total asset turnover and general administrative expense ratio. From an efficiency standpoint, higher values are preferred for asset turnover and lower values are preferred for the administrative expense ratio. Total asset turnover measures the organization's

efficiency in terms of generating revenues from the existing assets. Administrative expense ratio measures the efficiency of administrative activities in terms of each dollar of revenue generated.

Table 1:
Overall Ratio Analysis of Tennessee Firms, Other States, and the US

(Numbers and ratios below are averages over the 2001 - 2003 period)				
	Preferred Values	TN Firms	State Counterparts	US
Profitability Measures:				
Net Profit Margins	Higher	2.12%	2.63%	2.42%
Return on Assets	Higher	5.50%	8.84%	6.23%
Liquidity Measures:				
Claims Payment Period	Lower	42.38 days	44.99 days	46.87 days
Current Ratio	Higher	.70	.58	.80
Leverage Measures:				
Months Reserves	Higher	2.39	1.73	1.92
Debt Ratio	Lower	49.10%	57.74%	60.91%
Efficiency:				
Asset Turnover	Higher	2.60	3.16	2.62
Administrative Overhead	Lower	10.60%	9.72%	8.65%

Overall, Tennessee health insurers have:

(1) lower profit margins and return on assets compared with their state counterparts and US industry averages,

(2) a lower claims payment period compared with their state counterparts and the US average and have a higher current ratio than their state counterparts but lower than the US industry averages,

(3) higher months reserves and lower debt ratios compared with their state counterparts and US industry averages, and

(4) lower asset turnover and higher administrative overhead compared with their state counterparts and US industry averages.

It appears that Tennessee firms, on average, are less profitable, are in a better liquidity and leverage position, have higher administrative expenses, and lower ability to turn assets into revenues than their state counterparts and US averages.

III. Market Overview

The eight health insurers in Tennessee constitute a $5.1 billion dollar industry. The two largest health insurers in 2003 in terms of net premium income are Blue Cross Blue Shield ($1.5 billion) and Humana Health Plan Inc. ($2.2 billion). The two most profitable organizations in 2003 in terms of absolute value of underwriting gains are Blue Cross Blue Shield ($113 million) and Humana Health Plan Inc. ($43 million). The three most profitable companies in 2003 in terms of net underwriting margin (i.e., relative to net premium income) in 2003 are Aetna Health Inc. TN Corp. (15.58 percent), United Healthcare of TN (8.27 percent), and BCBS of TN Inc. (7.14 percent).

Net premium income increases 10.56 percent from 2001 to 2003 (see Table 2 and Figure 1). Underwriting gains (losses) change from a loss of $33 million in 2001 to a gain of $164 million in 2003 (see Table 3 and Figure 2). Overall, it appears that the industry net premium income is growing at an approximate annual rate of 5.28 percent and the financial strength (e.g. profitability) of the industry is improving. Net industry underwriting margins increase from a -.7 percent in 2001 to a 3.21 percent in 2003 (see Table 4 and Figure 3). However, this net underwriting margin increase is not equally distributed across the eight Tennessee health insurers. Cariten Ins. Co., Cigna Healthcare of TN Inc., and John Deere Health Plan Inc. report net underwriting margin losses for 2003 of -$ 7 million, -$ 6 million, and -$ 5 million. In fact, Cariten Ins. Co. reports net underwriting margin losses for all three years.

Table 2:
Net Premium Income for Tennessee Insurers

	(in millions)		
	2003	2002	2001
Aetna Health Inc. TN Corp.	$ 84	$ 86	$ 44
BCBS of TN Inc.	$ 1,577	$ 1,445	$ 1,247
Cariten Health Plan	$ 132	$ 103	$ 75
Cariten Ins. Co.	$ 157	$ 121	$ 65
Cigna Healthcare of TN Inc.	$ 221	$ 172	$ 174
Humana Health Plan Inc.	$ 2,171	$ 2,200	$ 2,259
John Deere Health Plan Inc.	$ 642	$ 586	$ 572
United Healthcare of TN.	$ 136	$ 165	$ 196
Total	$ 5,119	$ 4,878	$ 4,630

Figure 1:

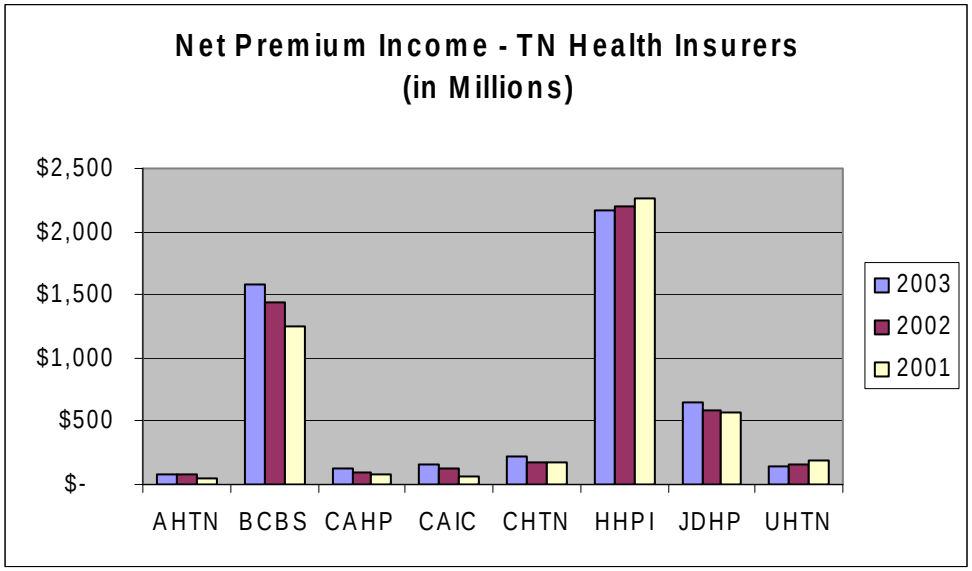


Table 3:
Net Underwriting Gain (Loss) for Tennessee Insurers
(in millions)

	2003	2002	2001
Aetna Health Inc. TN Corp.	$ 13	$ 2	$ (5)
BCBS of TN Inc.	$ 113	$ 99	$ 19
Cariten Health Plan	$ 2	$ 3	$ 5
Cariten Ins. Co.	$ (7)	$ (7)	$ (1)
Cigna Healthcare of TN Inc.	$ (6)	$ 7	$ (2)
Humana Health Plan Inc.	$ 43	$ (18)	$ (48)
John Deere Health Plan Inc.	$ (5)	$ 1	$ 2
United Healthcare of TN.	$ 11	$ 0	$ (3)
Total	$ 164	$ 88	$ (33)

Figure 2:

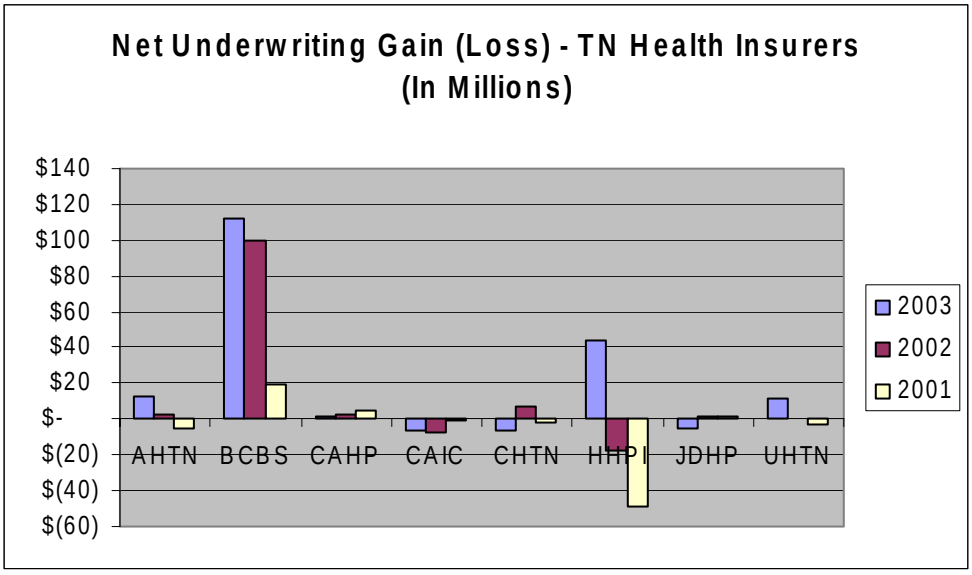
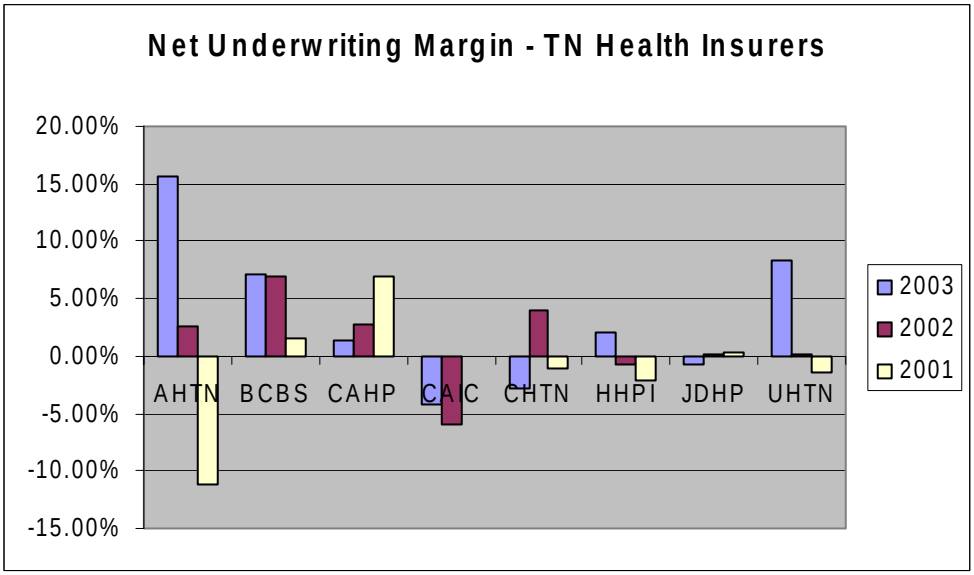


Table 4
Net Underwriting Margin for Tennessee Insurers

	2003	2002	2001
Aetna Health Inc. TN Corp.	15.58%	2.55%	-11.09%
BCBS of TN Inc.	7.14%	6.87%	1.52%
Cariten Health Plan	1.33%	2.73%	7.02%
Cariten Ins. Co.	-4.26%	-5.89%	-1.11%
Cigna Healthcare of TN Inc.	-2.83%	3.97%	-1.05%
Humana Health Plan Inc.	2.00%	-0.80%	-2.15%
John Deere Health Plan Inc.	-0.80%	0.20%	0.34%
United Healthcare of TN.	8.27%	0.23%	-1.48%
Total	3.21%	1.81%	-0.70%

Figure 3:



IV. Product Business Line Overview

The three largest business lines of insurance written by these eight Tennessee organizations in 2003 are Comprehensive Hospital and Medical ($3.750 billion), Title XVII – Medicare ($782 million), and Federal Health Employee Benefit ($367 million). The two most profitable product business lines in 2003 in terms of absolute value of underwriting gains are Comprehensive Hospital and Medical ($112 million) and Title XVII – Medicare ($43 million). The three most profitable business lines in 2003 in terms of net underwriting margin (i.e., relative to net premium income) in 2003 are Dental Only (11.48 percent), Medicare Supplement (10.69 percent), and Title XVII – Medicare (5.43 percent).

From 2001 to 2003, Comprehensive Hospital and Medical premium income increases 28.61 percent and Federal Health Employee Benefit premium income increases 29.0 percent (see Table 5 and Figure 4). Over the same period, Title XVII – Medicare premium income decreases -28.57 percent and Title XIX – Medicaid XIX premium income decreases -63.94 percent. Thus net premium income increases 10.56 percent from 2001 to 2003 (i.e., average rate of 5.28 percent) while the decrease in Title XVII and Title XIX premiums appears to offset with increases in Comprehensive Hospital and Medical and Federal Health Employee Benefit premiums. Net industry underwriting margins also increase from a -.7 percent in 2001 to a 3.21 percent in 2003, but this increase is not equally distributed among product business lines (see Tables 6 and 7 and Figures 5 and 6 for both dollars and percent of premium gains (losses)). From 2001 to 2003, Title XVII – Medicare, Comprehensive Hospital and Medical and Federal Health Employee Benefit net underwriting margins increase approximately 8.09 percent, 3.76 percent and 2.70 percent respectively. However, Title XIX – Medicaid net underwriting margins decrease approximately -12.27 percent over this same period. Thus, it appears that net premium income is increasing (decreasing) for product lines with positive (negative) underwriting margins, with the exception of Title XVII – Medicare. While premiums decrease 28.57 percent from 2001 to

2003, net underwriting margins increase 8.09 percent. Two possible interpretations of this result are: 1) overhead expenses related specifically to XVII product line have decreased over this time period or 2) health insurers are making more underwriting profits on the business they kept in place.

Table 5:
Premium Income by Product Line

	(in millions)		
	2003	2002	2001
Comp (Hospital and Medical)	$ 3,750	$ 3,383	$ 2,915
Medicare Supplement	$ 102	$ 105	$ 104
Dental Only	$ 33	$ 33	$ 31
Federal Health Employee Benefit	$ 367	$ 321	$ 284
XVII – Medicare	$ 782	$ 870	$ 1,095
XIX – Medicare	$ 68	$ 151	$ 188
Other	$ 17	$ 15	$ 12
Total	$ 5,119	$ 4,878	$ 4,630

Figure 4:

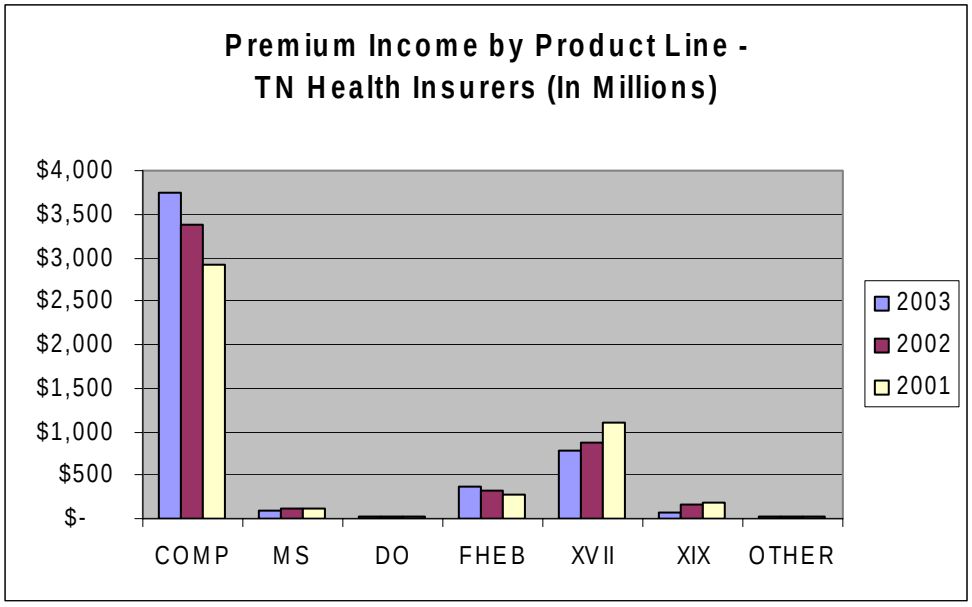


Table 6:
Underwriting Gain (Loss) by Product Line

	(in millions)		
	2003	2002	2001
Comp (Hospital and Medical)	$ 112	$ 34	$ (23)
Medicare Supplement	$ 11	$ 17	$ 13
Dental Only	$ 4	$ 6	$ 5
Federal Health Employee Benefit	$ 7	$ 3	$ (2)
XVII – Medicare	$ 43	$ 11	$ (29)
XIX – Medicare	$ (5)	$ 17	$ 9
Other	$ (7)	$ (1)	$ (5)
Total	$ 164	$ 88	$ (33)

Figure 5:

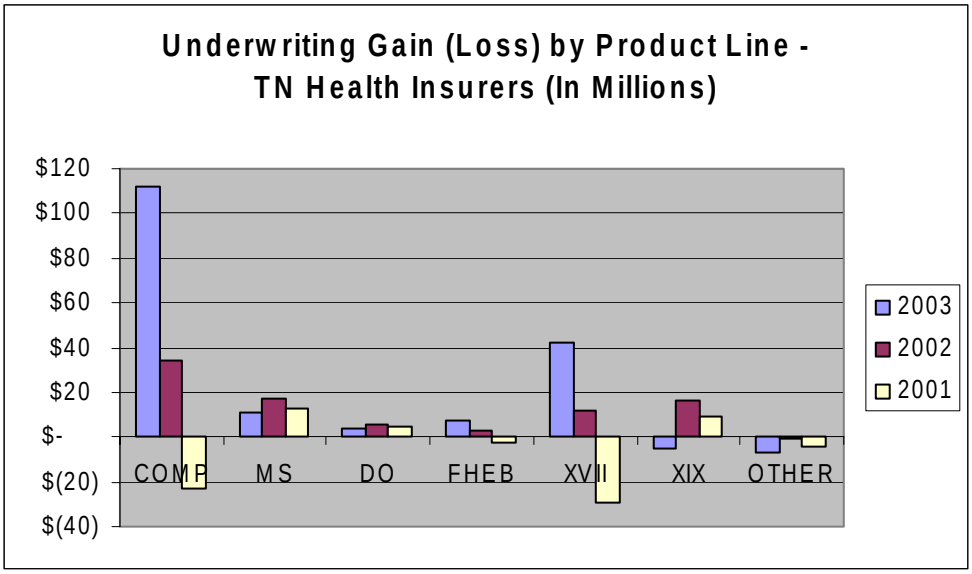
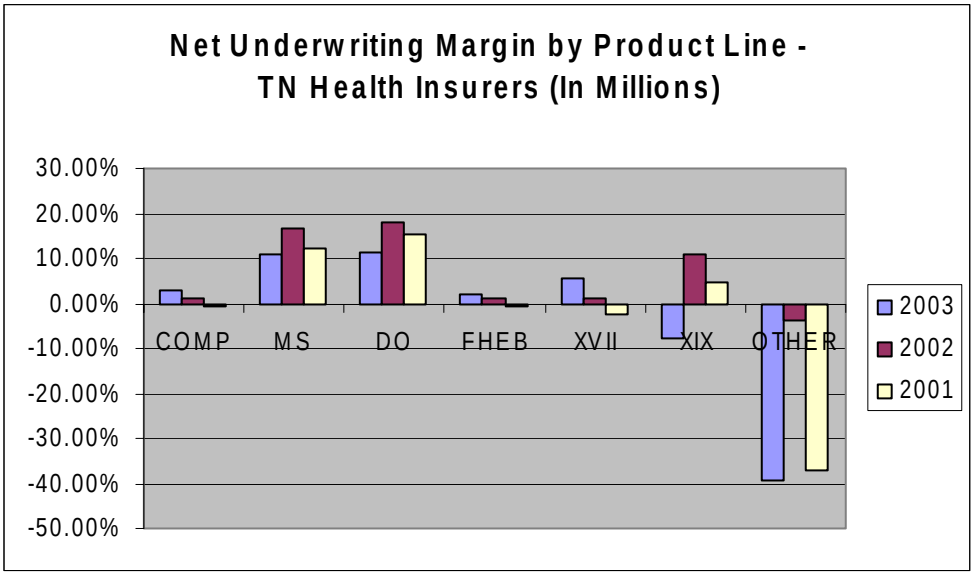


Table 7:
Net Underwriting Margin by Product Line

	2003	2002	2001
Comp (Hospital and Medical)	2.98%	1.01%	-0.78%
Medicare Supplement	10.69%	16.67%	12.06%
Dental Only	11.48%	17.98%	15.12%
Federal Health Employee Benefit	1.93%	0.89%	-0.77%
XVII – Medicare	5.43%	1.32%	-2.66%
XIX – Medicare	-7.60%	10.96%	4.67%
Other	-39.52%	-3.92%	-36.95%
Total	3.21%	1.81%	-0.70%

Figure 6:



V. Profitability Ratio Analysis

Profitability measures the overall efficiency and performance of an organization. Higher values are preferred. In this section, two profitability measures are highlighted: net profit margin and return on assets. These two measures represent the organization's ability to translate revenue and assets into profits.

Net Profit Margin

Net Profit Margin is defined as net income after taxes divided by total revenue. It measures profit generated after consideration of all operating expenses. Below are numeric and graphical depictions of the net profit margins for the Tennessee health insurers, along with various state and US averages.

Table 8:
Net Profit Margin

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	9.92%	2.29%	-7.22%
BCBS of TN Inc.	7.10%	6.69%	3.21%
Cariten Health Plan	1.61%	4.97%	10.35%
Cariten Ins. Co.	-3.07%	-4.50%	2.15%
Cigna Healthcare of TN Inc.	-1.50%	4.59%	-0.06%
Humana Health Plan Inc.	1.69%	-0.07%	-0.68%
John Deere Health Plan Inc.	0.32%	1.11%	1.38%
United Healthcare of TN.	7.11%	1.26%	0.44%
Tennessee, Other States and US			
TN	3.18%	2.32%	0.85%
GA	3.95%	2.98%	2.42%
KY	2.29%	2.07%	0.48%
MO	5.40%	3.40%	0.66%
US	3.66%	2.18%	1.43%

Figure 7:

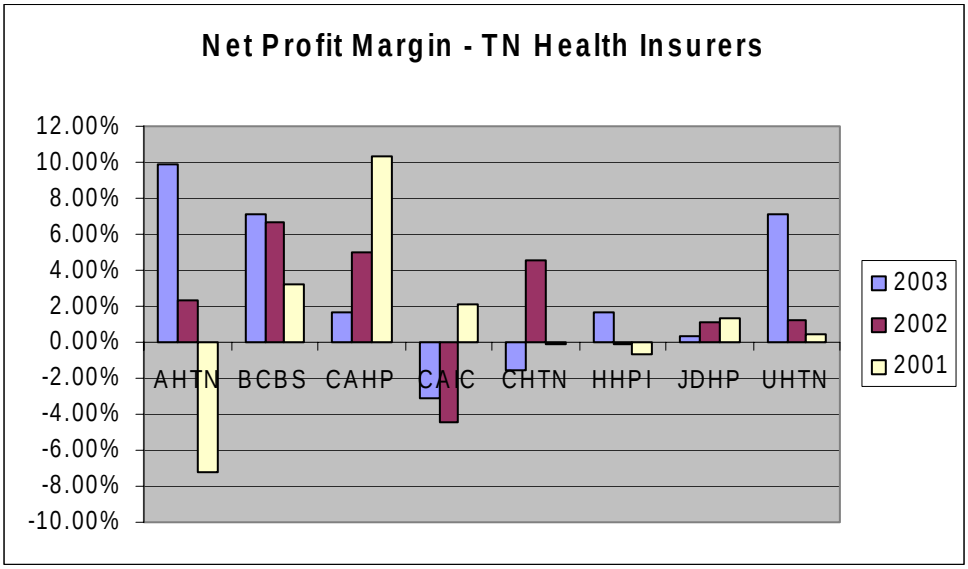
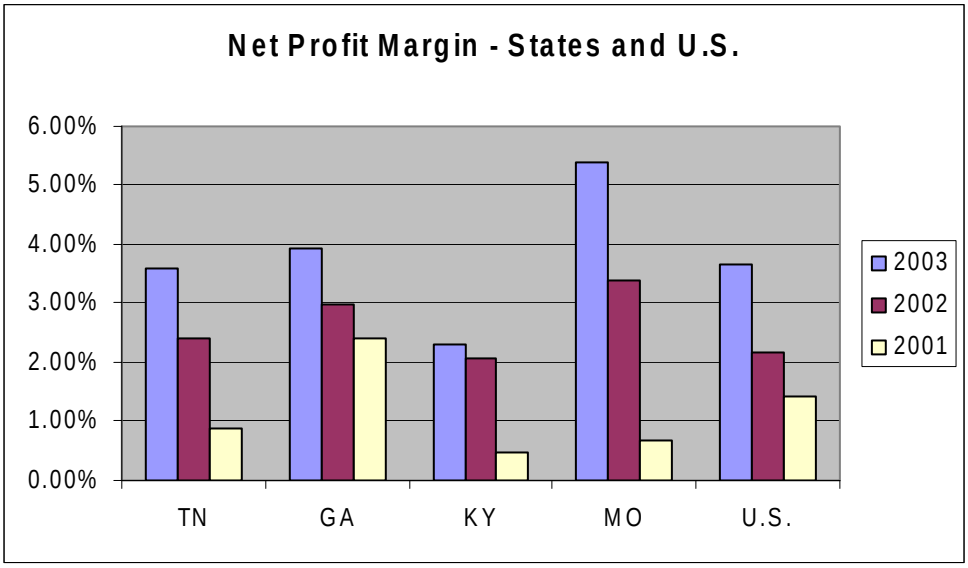


Figure 8:



The three most profitable Tennessee companies in 2003 in terms of net profit margin are Aetna Health Inc. TN Corp. (9.92 percent), United Healthcare of TN (7.11 percent), and BCBS of TN Inc. (7.10 percent). Cariten Ins. Co. and Cigna Healthcare of TN Inc. have negative net profit margins in 2003 of -3.07 percent and -1.50 percent respectively. Net profit margins for Tennessee companies increase 2.33 percent from 2001 to 2003. However, this net profit margin increase is not equally distributed across the eight Tennessee health insurers. From 2001 to 2003, Aetna Health Inc. TN Corp. and United Healthcare of TN have increased net profit margins of 17.14 percent and 6.67 percent respectively. Over the same period, Cariten Health Plan and Cariten Ins. Co.'s net profit margins decrease -8.74 percent and -5.22 percent respectively.

Tennessee firms have a lower net profit margin than the overall US average for 2003 and the average across the three years. Tennessee and US firms average 3.18 percent and 3.66 percent for 2003 and average 2.12 percent and 2.42 percent over the 2001 to 2003 period. Compared with their state counterparts for 2003, Missouri appears to be on the high end at 5.40 percent and Kentucky on the low end at 2.29 percent. For the three-year period, Missouri and Georgia have the highest overall net profit margin average at 3.15 percent and 3.12 percent respectively. Kentucky has the lowest net profit margin average of 1.61 percent over the same period. Missouri has the highest net profit margin average annual increase from 2001 to 2003 of 357.94 percent. In general, it appears that TN health insurers' net profit margins are lower than the average US health insurer and less than its state counterparts (except for Kentucky); however, the Tennessee organizations vary widely.

Return on Assets

Return on Assets is defined as net income after taxes divided by total assets. It measures the overall efficiency of the organization in managing its total investment in assets by examining how much revenue can be generated for each dollar of assets employed. Below are numeric and graphical depictions of return on assets for the Tennessee health insurers, along with various state and US averages.

Table 9:
Return on Assets

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	17.97%	4.10%	-27.48%
BCBS of TN Inc.	10.47%	9.61%	4.04%
Cariten Health Plan	3.66%	10.34%	16.70%
Cariten Ins. Co.	-10.31%	-14.63%	4.29%
Cigna Healthcare of TN Inc.	-6.13%	17.65%	-0.22%
Humana Health Plan Inc.	7.55%	-0.38%	-3.53%
John Deere Health Plan Inc.	1.05%	3.51%	4.20%
United Healthcare of TN.	27.11%	5.10%	1.97%
Tennessee, Other States and US			
TN	8.17%	6.14%	2.20%
GA	11.19%	9.90%	8.29%
KY	8.29%	7.21%	6.63%
MO	15.13%	10.64%	2.26%
US	8.85%	5.99%	3.85%

Figure 9:

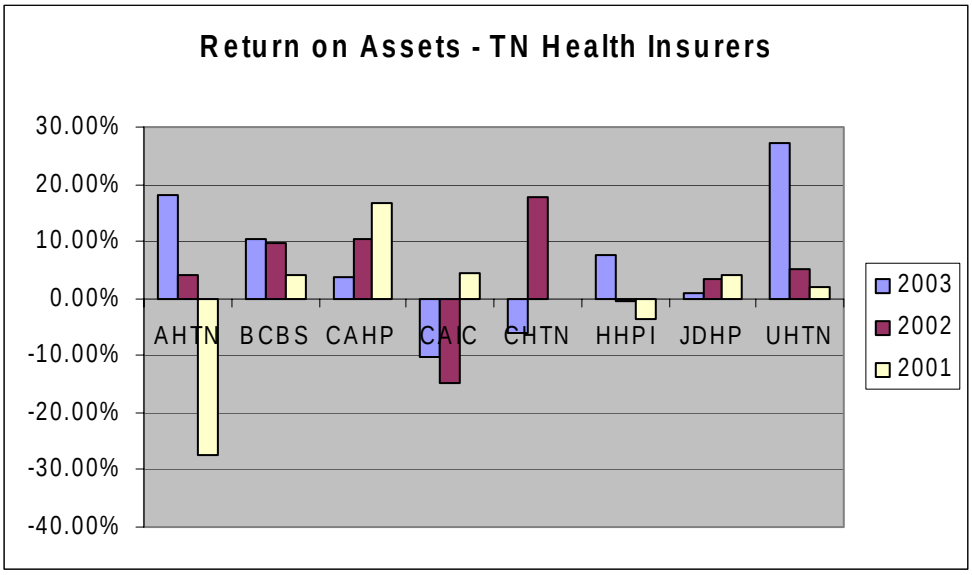
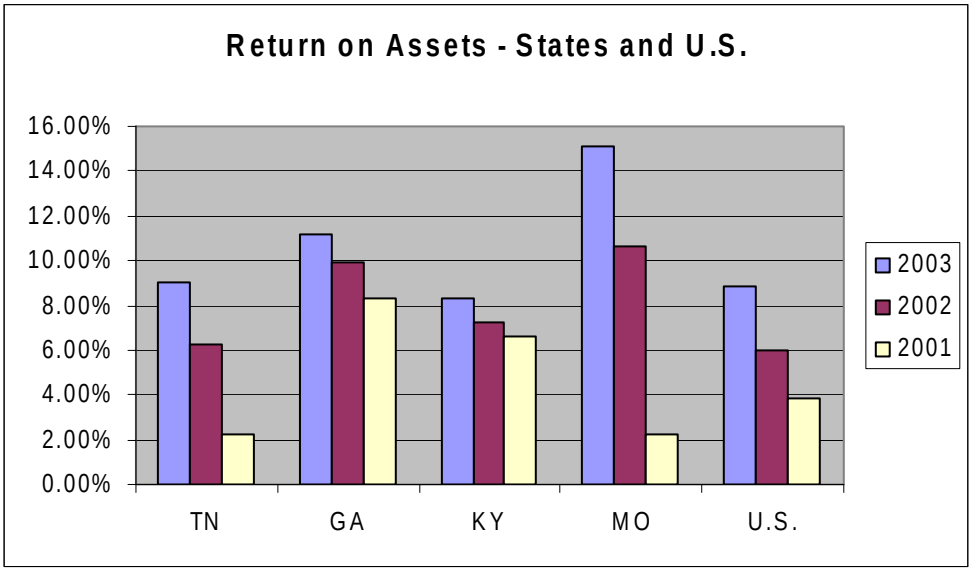


Figure 10:



The three most profitable Tennessee companies in 2003 in terms of return on assets are United Healthcare of TN (27.11 percent), Aetna Health Inc. TN Corp. (17.97 percent), , and BCBS of TN Inc. (10.47 percent). Cariten Ins. Co. and Cigna Healthcare of TN Inc. have negative return on assets in 2003 of -10.31 percent and -6.13 percent respectively. Return on assets for Tennessee companies increases 5.97 percent from 2001 to 2003. However, this return on assets is not equally distributed across the eight Tennessee health insurers. From 2001 to 2003, Aetna Health Inc. TN Corp. and United Healthcare of TN increase their return on assets 45.45 percent and 25.14 percent respectively. Over the same period, Cariten Ins. Co. and Cariten Health Plan's return on assets decreases -14.60 percent and -13.04 percent respectively.

Tennessee has a lower return on assets than the overall US average for 2003 and the average across the three years. Tennessee and US firms have an average return on assets of 8.17 percent and 8.85 percent for 2003 and 5.50 percent and 6.23 percent over the 2001 to 2003 period. Compared with their state counterparts for 2003, Missouri appears to be on the high end at 15.13 percent and Tennessee on the low end at 8.17 percent. For the three-year period, Georgia and Missouri have the highest overall return on assets average at 9.79 percent and 9.34 percent respectively. Tennessee has the lowest return on asset average of 5.50 percent over this same period while Missouri has the highest return on asset average annual increase from 2001 to 2003 of 285.17 percent. Overall, it appears that TN health insurers' return on assets percentages are improving (i.e., showing better management of their assets), but they are worse than their regional counterparts and the US national averages for the three-year period.

VI. Liquidity Ratio Analysis

Liquidity measures the ability of a health insurer to cover its current obligations and relative amount of claims outstanding. In this section, two liquidity measures are highlighted: claims payment period and current ratio. From a liquidity standpoint, lower values are preferred for claims payment period and higher values are preferred for the current ratio. Deterioration in these measures can indicate potential cash flow problems and financial difficulty.

Claims Payment Period

Claims Payment Period is defined as claims payable divided by medical expenses (divided by 365). It provides a relative measure of how long it would take to pay off outstanding medical claims at the current average rate of reimbursement. Lower numbers are preferred to indicate the soundness of health insurers from a pure liquidity standpoint (and the point of a typical provider). However, as long as health insurers can maintain good provider relationships, they would probably want to extend these terms (e.g. higher numbers are preferred). Below are numeric and graphical depictions of the claims payment period for the Tennessee health insurers, along with various state and US averages.

Table 10:
Claims Payment Period

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	48.71	61.41	49.32
BCBS of TN Inc.	45.26	45.73	46.46
Cariten Health Plan	50.57	78.38	109.19
Cariten Ins. Co.	37.74	53.47	77.26
Cigna Healthcare of TN Inc.	68.85	47.66	40.08
Humana Health Plan Inc.	30.52	31.39	31.79
John Deere Health Plan Inc.	31.79	61.01	59.44
United Healthcare of TN.	41.97	49.19	48.85
Tennessee, Other States and US			
TN	41.92	42.27	42.95
GA	40.63	44.34	45.81
KY	39.31	43.44	47.20
MO	43.91	47.29	52.98
US	45.07	46.42	49.11

Figure 11:

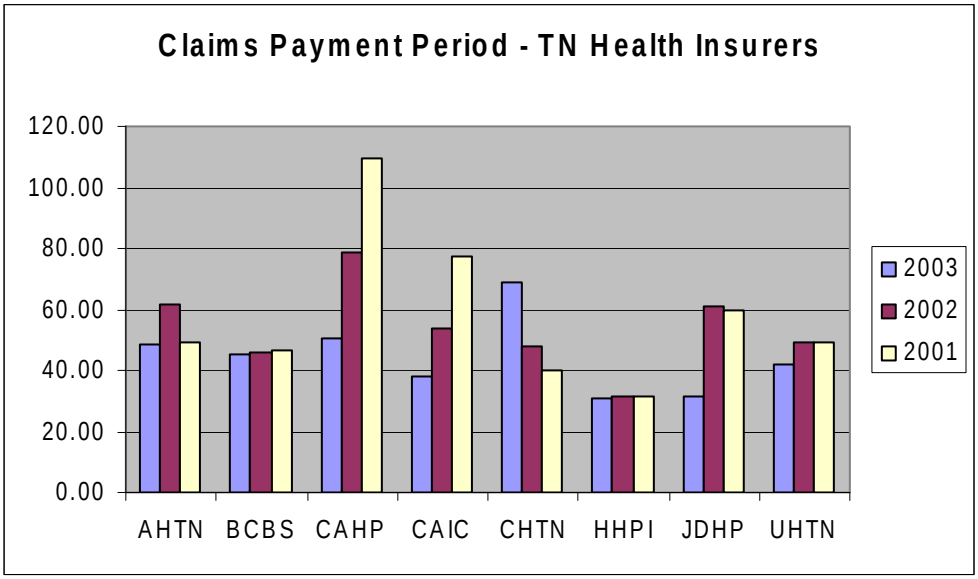
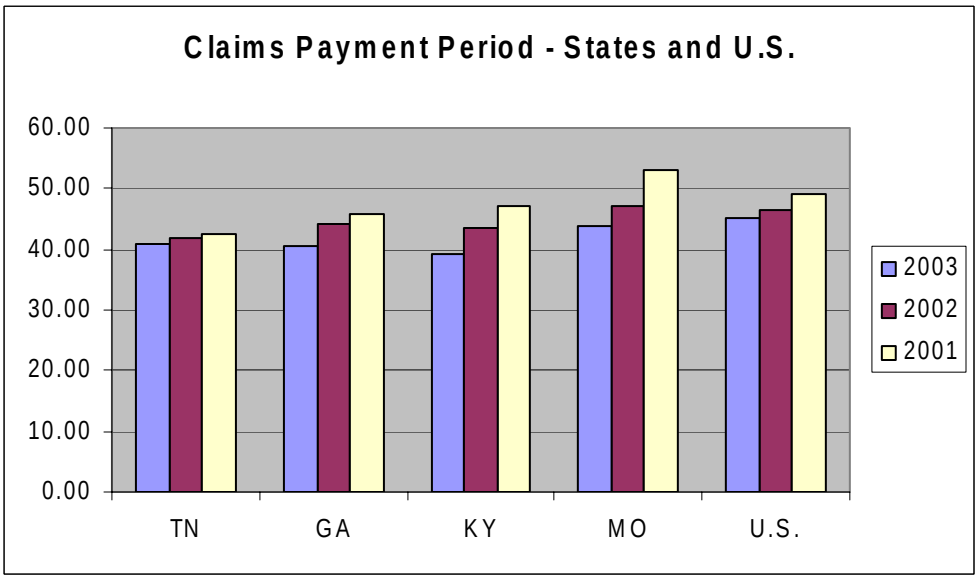


Figure 12:



The three Tennessee companies in 2003 with the lowest values in terms of claims payment period are Humana Health Plan Inc. (30.52 days), John Deere Health Plan Inc. (31.79 days) and Cariten Ins. Co. (37.74 days). Cigna Healthcare of TN Inc. and Cariten Health Plan have the highest numbers in terms of claims payment period in 2003 of 68.85 days and 50.57 days respectively. The claims payment period for Tennessee companies decreases 1.03 days from 2001 to 2003. However, this claim payment period change is not equally distributed across the eight Tennessee health insurers. From 2001 to 2003, Cariten Health Plan and Cariten Ins. Co. decrease the claims payment period -58.62 days and -39.52 days respectively. Over the same period, Cigna Healthcare of TN Inc.'s claims payment period increases 28.77 days.

Tennessee has a lower claims payment period than the overall US average for 2003 and across the three years. Tennessee and US firms averaged 41.92 days and 45.07 days for 2003 and averaged 42.38 days and 46.87 from 2001 to 2003. Compared with their state counterparts for 2003, Missouri appears to be on the high end at 43.91 days and Kentucky on the low end at 39.31 days. For the three-year period, Missouri and Georgia have the highest claims payment period average at 48.06 days and 43.60 days respectively. Tennessee has the lowest claims payment period average of 42.38 days over this same period. Missouri has the most significant decrease in average annual claims payment period 2001 to 2003 of -8.56 percent. It appears that Tennessee health insurers' claims payment period days are lower (e.g., in a better liquidity position) than their regional counterparts and national averages.

Current Ratio

Current ratio is defined as cash & short-term investments and premium receivables divided by claims payable and unearned premiums. This term can be used as a measure of short-run solvency, the ability of firm to meet its obligations as they come due. The availability of cash resources to satisfy these short-term obligations can be important in analyzing an insurer's financial health. From a liquidity standpoint, higher numbers are preferred. However, as with claims payment period, as long as health insurers can maintain good relationships with their vendors (and providers), health insurers would probably want to extend these terms (e.g. lower numbers are preferred). Below are numeric and graphical depictions of the current ratios for the Tennessee health insurers, along with various state and US averages.

Table 11:
Current Ratio

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	3.57	3.43	1.73
BCBS of TN Inc.	1.02	1.23	1.12
Cariten Health Plan	0.49	0.25	0.27
Cariten Ins. Co.	0.26	0.40	0.38
Cigna Healthcare of TN Inc.	0.72	0.84	0.40
Humana Health Plan Inc.	0.73	0.55	0.55
John Deere Health Plan Inc.	0.21	0.44	0.33
United Healthcare of TN.	0.45	0.01	0.02
Tennessee, Other States and US			
TN	0.72	0.76	0.63
GA	0.38	0.37	0.57
KY	0.60	0.60	0.54
MO	0.70	0.75	0.67
US	0.88	0.78	0.74

Figure 13:

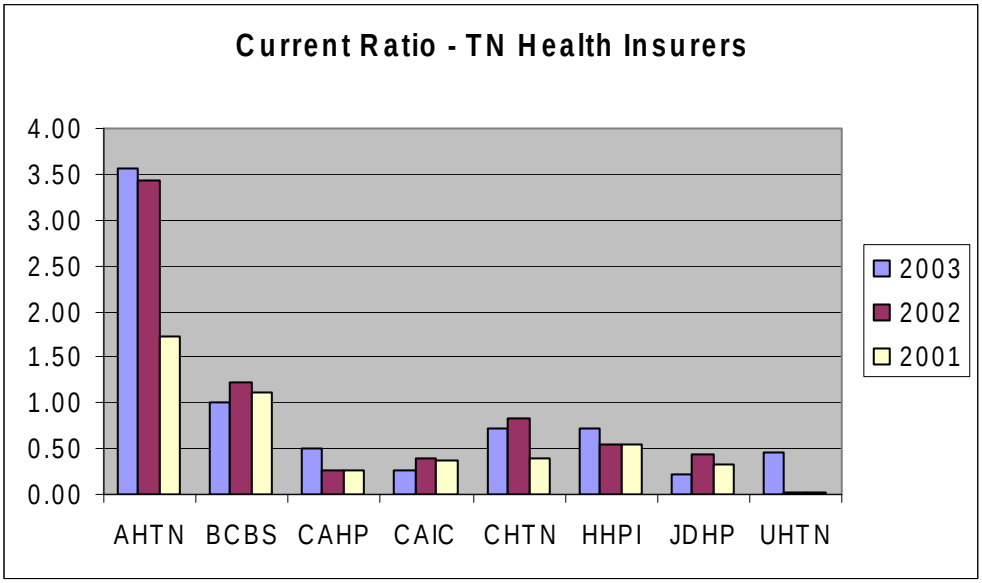
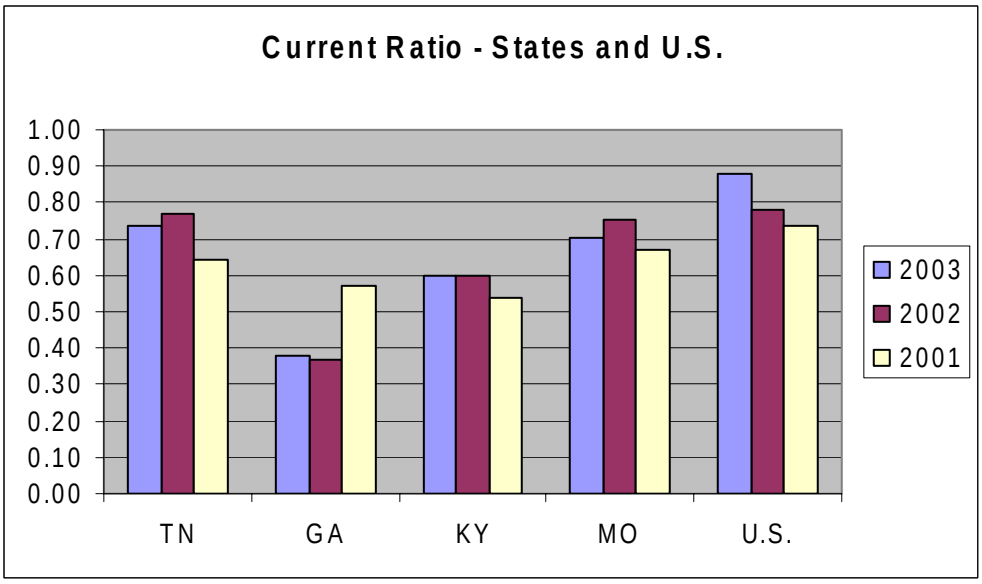


Figure 14:



The two Tennessee companies in 2003 with the highest current ratios are Aetna Health Inc. TN Corp. (3.57) and BCBS of TN Inc. (1.02). John Deere Health Plan Inc. and Cariten Ins. Co. have the lowest current ratios in 2003 of .21 and .26 respectively. Current ratios for Tennessee companies have increased .09 from 2001 to 2003. However, this current ratio change is not equally distributed across the eight Tennessee health insurers. Aetna Health Inc. TN Corp. and United Healthcare of TN. have increased the current ratio 1.84 and .43 from 2001 to 2003, respectively. Over the same period, John Deere Health Plan Inc. and Cariten Ins. Co.'s current ratios decrease -.12.

Tennessee has a lower current ratio than the overall US average for 2003 and across the three years. Tennessee and US firms have an average current ratio of .72 and .88 for 2003 and average

.70 and .80 over the 2001 to 2003 period. Compared to their state counterparts for 2003, Tennessee appears to be on the high end at .72 and Georgia on the low end at .38. For the three-year period, Missouri has the highest current ratio average at .71 while Georgia has the lowest current ratio average of .44 over this same period. Tennessee has the most significant average annual increase in current ratio period 2001 to 2003 of 6.95 percent. Georgia has the most significant average annual decrease in current ratio period 2001 to 2003 of -17.19 percent. Overall, it appears that Tennessee health insurers have a lower current ratio than the US average but higher current ratios than their state counterparts. Consequently, Tennessee health insurers seem to be in a better liquidity position than their state counterparts, but are still lower than an average US health insurer.

VII. Leverage Ratio Analysis

Leverage measures the extent of the firm's financing with debt and current liabilities. The amount and proportion of debt (current and long-term) are important in analyzing the potential risk of an organization. In this section, two leverage measures are highlighted: months reserves and debt ratio. From a leverage standpoint, higher values are preferred for months reserves and lower values are preferred for the debt ratio. Deterioration in these measures can indicate that an organization may have difficulty meeting its fixed commitments and therefore increase its enterprise risk.

Months reserves is defined as total assets divided by total underwriting expenses divided by twelve. It measures the number of months normal underwriting operations could be supported with existing assets. Below are numeric and graphical depictions of the months reserves of the Tennessee health insurers, along with various state and US averages.

Table 12:
Months Reserves

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	6.25	1.17	0.59
BCBS of TN Inc.	5.32	5.37	5.96
Cariten Health Plan	2.18	2.05	3.02
Cariten Ins. Co.	1.39	0.69	2.37
Cigna Healthcare of TN Inc.	0.65	1.12	1.17
Humana Health Plan Inc.	1.20	0.91	0.80
John Deere Health Plan Inc.	1.36	1.63	1.56
United Healthcare of TN.	2.10	1.30	0.96
Tennessee, Other States and US			
TN	2.54	2.30	2.33
GA	1.84	1.74	1.67
KY	1.75	1.61	1.53
MO	2.29	1.72	1.43
US	2.30	1.76	1.70

Figure 15:

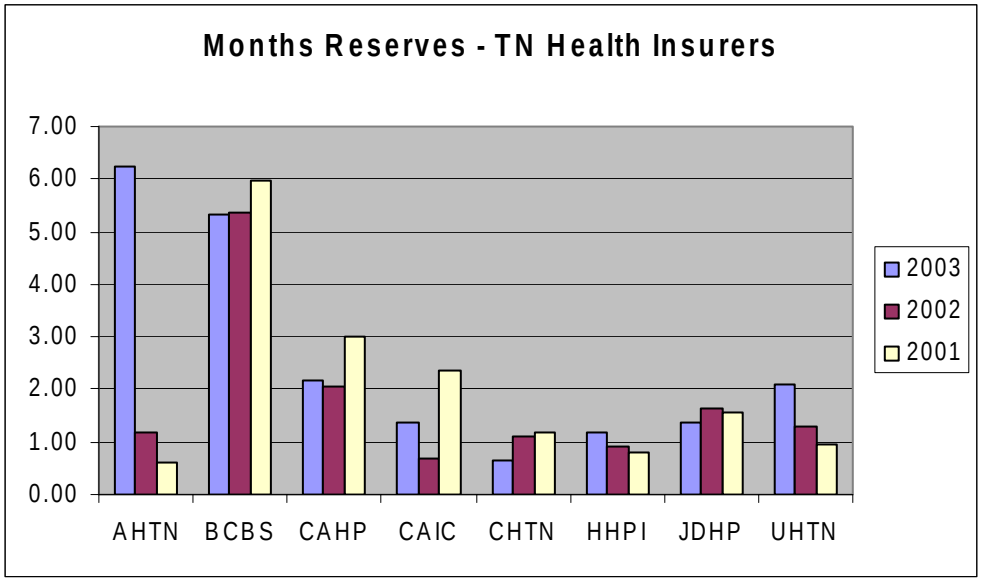
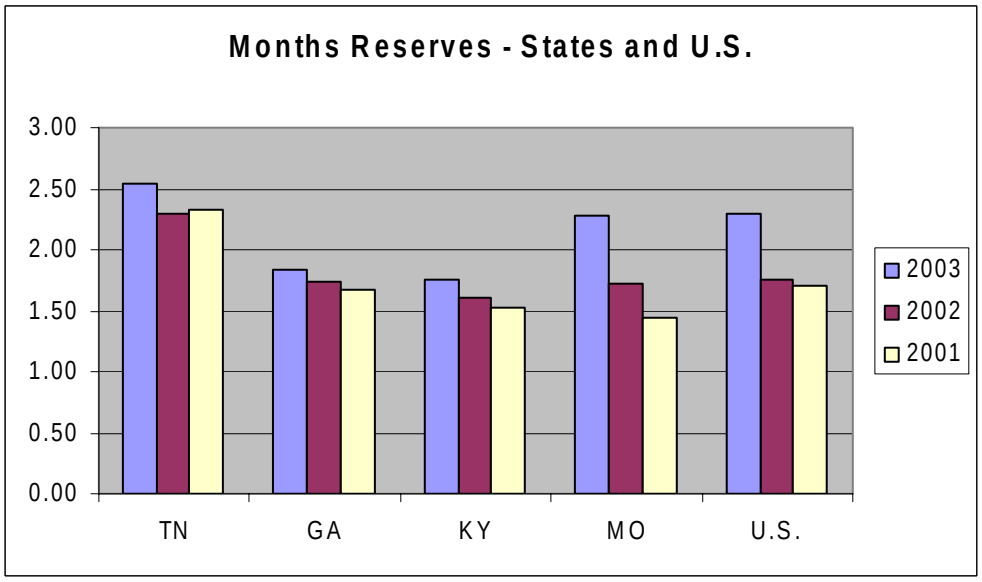


Figure 16:



The two Tennessee companies in 2003 with the highest months reserves are Aetna Health Inc. TN Corp. (6.25) and BCBS of TN Inc. (5.32). Cigna Healthcare of TN Inc. has the lowest months reserves in 2003 of .65. Months reserves for TN companies increase .21 from 2001 to 2003. However, this months reserves change is not equally distributed across the eight Tennessee health insurers. Aetna Health Inc. TN Corp. increases its months reserves 5.66 from 2001 to 2003. Over the same period, Cariten Ins. Co.'s months reserves decreases -.98.

Tennessee has a higher months reserves than the overall US average for 2003 and across the three years. Tennessee and US firms have an average months reserves of 2.54 and 2.30 for 2003 and average 2.39 and 1.92 during the 2001 to 2003 period. Compared with their state counterparts for 2003, Tennessee appears to be on the high end at 2.54 and Kentucky on the low

end at 1.75. For the three-year period, Tennessee has the highest months reserves average at 2.39 while Kentucky has the lowest months reserves average of 1.63. Missouri has the most significant average annual increase in months reserves from 2001 to 2003 of 29.63 percent. Tennessee has the smallest increase in months reserves from 2001 to 2003 of 4.47 percent. Overall, it appears that Tennessee health insurers have higher months reserves than the US average and are in a strong months reserves position compared with state counterparts.

Debt Ratio

Debt ratio is defined as total liabilities divided by total assets. The amount and proportion of company debt (both short and long-term) can be useful in analyzing organizational risk. Higher debt levels can present issues because debt represents fixed commitments that must be met through existing assets or future earnings. Lower ratios are preferred as an indication of the soundness of the health insurers from a leverage standpoint. Below are numeric and graphical depictions of the debt ratios for the Tennessee health insurers, along with various state and US averages.

Table 13:
Overall Debt Ratio

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	20.29%	82.90%	79.13%
BCBS of TN Inc.	39.31%	40.15%	38.42%
Cariten Health Plan	59.34%	65.40%	62.24%
Cariten Ins. Co.	59.59%	80.14%	60.36%
Cigna Healthcare of TN Inc.	77.17%	65.63%	65.66%
Humana Health Plan Inc.	56.40%	60.88%	64.60%
John Deere Health Plan Inc.	62.36%	56.96%	60.56%
United Healthcare of TN.	38.58%	56.12%	63.54%
Tennessee, Other States and US			
TN	47.38%	50.26%	49.65%
GA	58.07%	57.09%	60.26%
KY	55.19%	57.76%	59.01%
MO	52.08%	57.44%	62.73%
US	57.46%	61.90%	63.35%

Figure 17:

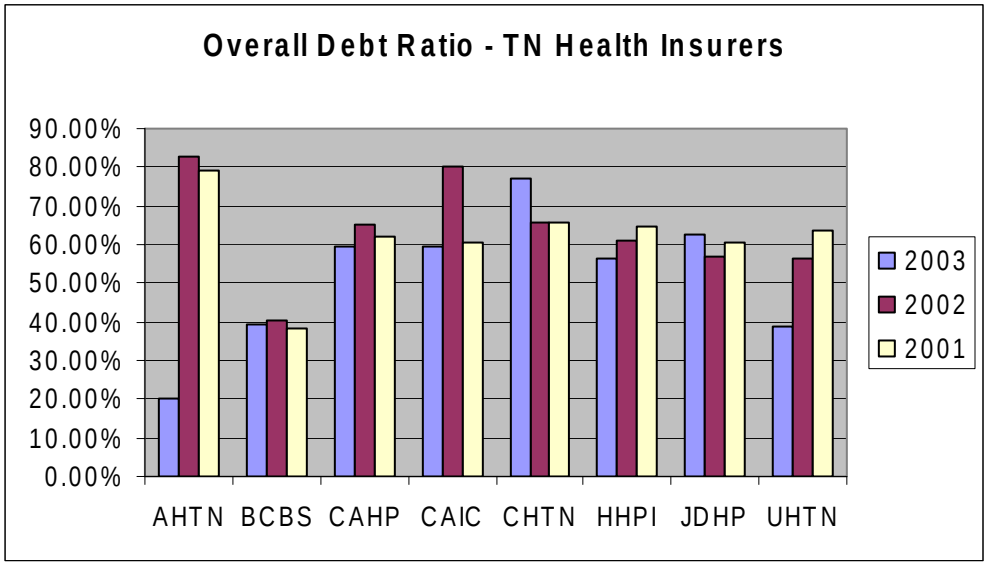
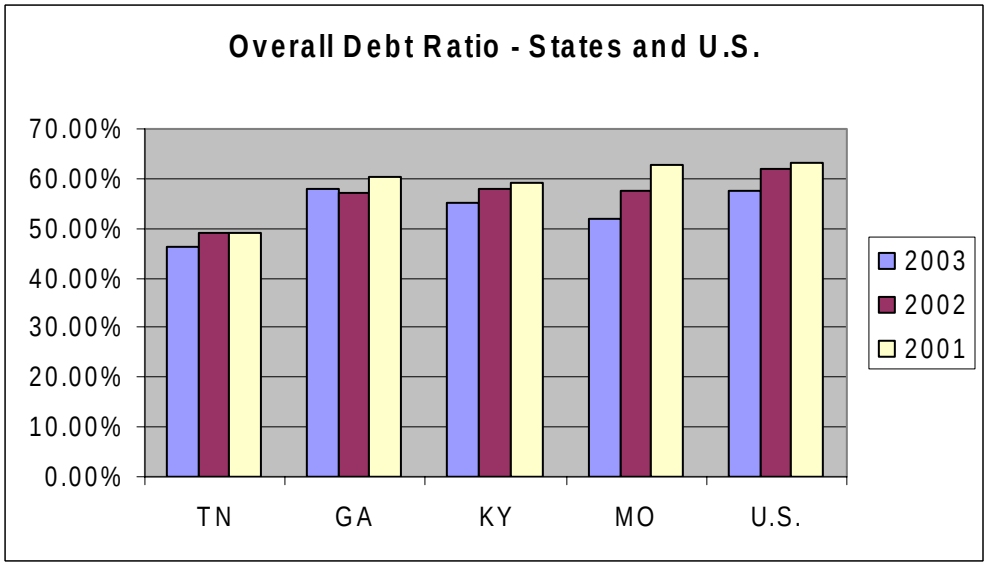


Figure 18:



The three Tennessee companies in 2003 with the lowest debt ratios are Aetna Health Inc. TN Corp. (20.29 percent), United Healthcare of TN. (38.58 percent), and BCBS of TN Inc. (39.31 percent). Cigna Healthcare of TN Inc. and John Deere Health Plan Inc. have the highest debt ratios in 2003 of 77.17 percent and 62.36 percent respectively. Debt ratios for Tennessee companies decrease -2.27 percent from 2001 to 2003. However, this debt ratio change is not equally distributed across the eight Tennessee health insurers. From 2001 to 2003, Aetna Health Inc. TN Corp. and United Healthcare of TN decrease their debt ratios -58.84 percent and -24.95 percent respectively. Over the same period, Cigna Healthcare of TN Inc.'s debt ratio increases 11.51 percent.

Tennessee has a lower debt ratio than the US average for 2003 and across the three years. Tennessee and US firms have debt ratios of 47.38 percent and 57.46 percent for 2003 and

average 49.10 percent and 60.91 percent over the 2001 to 2003 period. Compared with their state counterparts for 2003, Georgia appears to be on the high end at 58.07 percent and Tennessee on the low end at 47.38 percent. For the three-year period, Georgia and Missouri have the highest debt ratio at 58.46 percent and 57.41 percent respectively. Tennessee has the lowest debt ratio of 49.10 percent over this same period while Missouri has the most significant average annual decrease in debt ratio from 2001 to 2003 of -8.49 percent. In general, it appears that Tennessee health insurers have lower debt ratios than the US average and are in a stronger leverage position than state counterparts.

VIII. Efficiency Ratio Analysis

Efficiency refers to how the health insurer is managing its business. Two efficiency measures are examined: total asset turnover and general administrative expense ratio. Total asset turnover measures how efficient the organization is in terms of generating revenues from the existing assets. Administrative expense ratio measures how efficiently an organization's administrative activities generate revenue

Asset Turnover

Asset turnover is defined as total revenue divided by total assets. It measures the overall efficiency of the organization in managing its total investment in assets. Below are numeric and graphical depictions of asset turnover for the Tennessee health insurers, along with various state and US averages.

Table 14:
Asset Turnover

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	1.81	1.79	3.81
BCBS of TN Inc.	1.47	1.44	1.26
Cariten Health Plan	2.27	2.08	1.61
Cariten Ins. Co.	3.36	3.26	2.00
Cigna Healthcare of TN Inc.	2.00	4.08	3.84
Humana Health Plan Inc.	4.46	5.09	5.22
John Deere Health Plan Inc.	3.29	3.17	3.04
United Healthcare of TN.	3.81	4.05	4.50
Tennessee, Other States and US			
TN	2.57	2.65	2.57
GA	2.84	3.32	3.42
KY	3.15	3.21	3.19
MO	2.80	3.12	3.41
US	2.42	2.75	2.69

Figure 19:

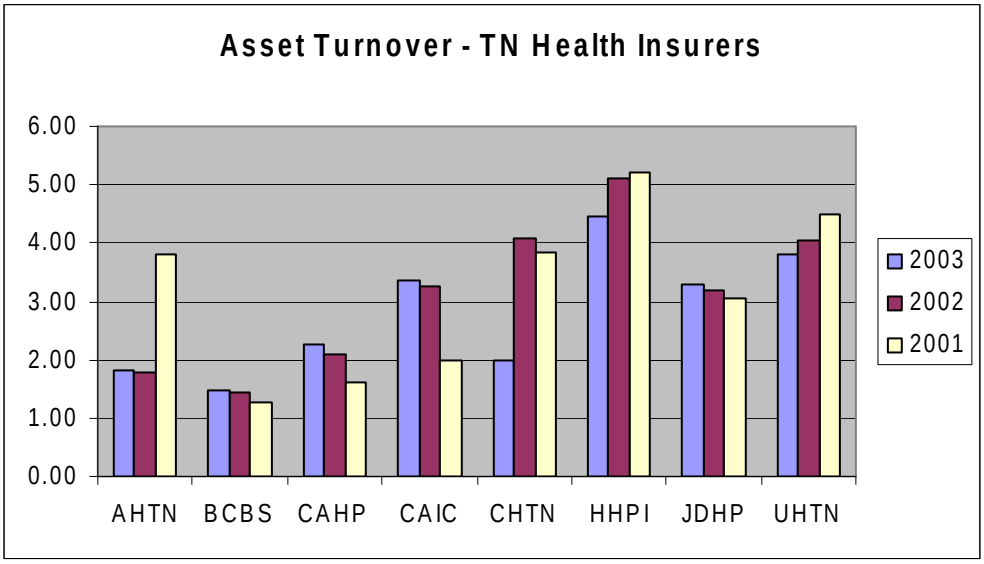
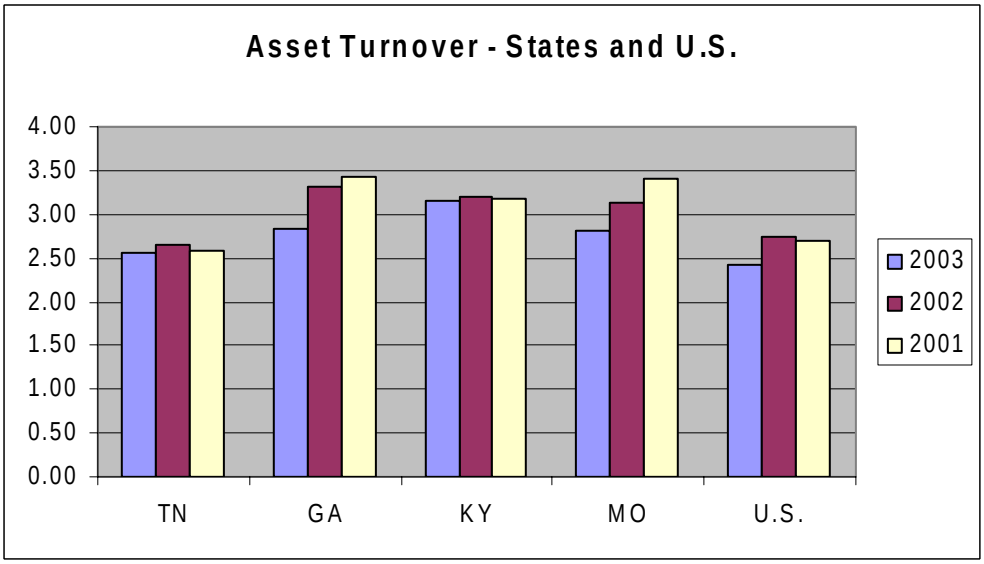


Figure 20:



The two Tennessee companies in 2003 with the highest asset turnover are Humana Health Plan Inc. (4.46) and United Healthcare of TN. (3.81). BCBS of TN Inc. has the lowest asset turnover in 2003 of 1.47. Asset turnover for TN companies remained the same from 2001 to 2003. However, this asset turnover change is not equally distributed across the eight Tennessee health insurers. Cariten Ins. Co. has increased its asset turnover 1.36 from 2001 to 2003. Over the same period, Aetna Health Inc. TN Corp. and Cigna Healthcare of TN Inc.'s asset turnover decrease -1.99 and -1.84 respectively.

Tennessee has a higher asset turnover than the overall US average for 2003 but has a lower turnover across the three years. Tennessee and US firms have an average asset turnover of 2.57 and 2.42 for 2003 and average 2.60 and 2.62 for the 2001 to 2003 period. Compared with their state counterparts for 2003, Kentucky appears to be on the high end at 3.15 and Tennessee on the

low end at 2.57. For the three-year period, Georgia has the highest asset turnover average at 3.19 while Tennessee has the lowest asset turnover average of 2.60. Missouri has the most significant average annual decrease in asset turnover period 2001 to 2003 of -8.92 percent. Overall, it appears that Tennessee health insurers' asset turnover is similar to the US average but lower than their state counterparts over the three years. However, in terms of percentage annual changes from 2001 to 2003 it appears that Tennessee firms are doing better compared to US national averages (i.e., TN average did not change while the US has an average annual decrease of -5.05 percent).

Administrative Overhead

Administrative Overhead is defined as general administrative expenses divided by total revenue. It measures how much a health insurer spends for administrative expenses for each dollar of revenues received. Lower percentages are preferred. Below is a numeric and graphical depiction of administrative overhead ratios for the Tennessee health insurers, along with various state and US averages.

Table 15:
Administrative Overhead

	2003	2002	2001
Tennessee Health Insurers			
Aetna Health Inc. TN Corp.	12.61%	11.89%	11.68%
BCBS of TN Inc.	8.53%	7.39%	7.74%
Cariten Health Plan	4.96%	6.58%	10.10%
Cariten Ins. Co.	12.50%	14.94%	19.02%
Cigna Healthcare of TN Inc.	10.51%	12.58%	7.70%
Humana Health Plan Inc.	10.60%	13.05%	11.49%
John Deere Health Plan Inc.	11.96%	11.13%	11.51%
United Healthcare of TN.	15.98%	15.78%	12.70%
Tennessee, Other States and US			
TN	10.22%	11.11%	10.45%
GA	8.94%	8.63%	8.12%
KY	9.53%	11.45%	10.76%
MO	9.76%	10.98%	10.43%
US	8.28%	8.60%	9.12%

Figure 21:

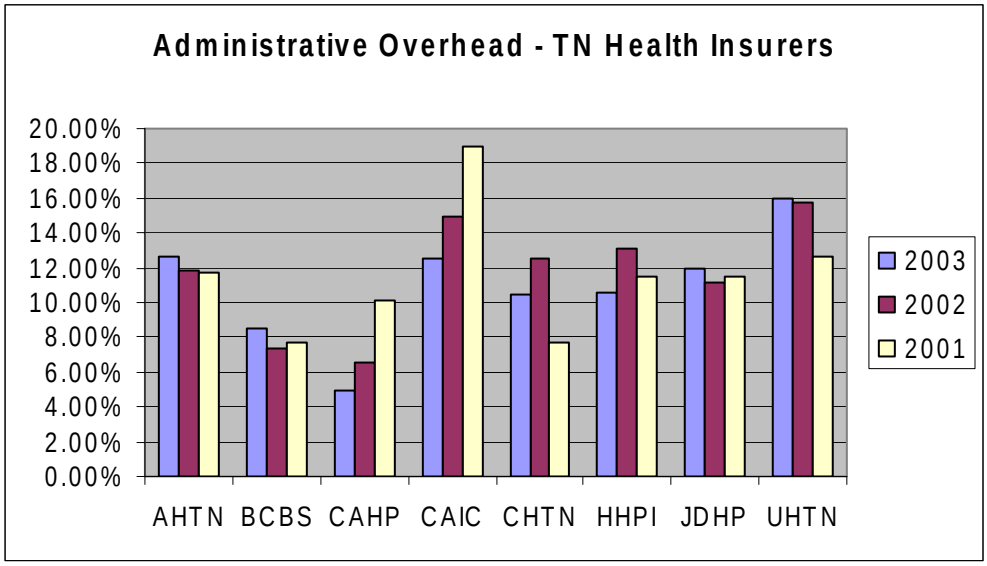
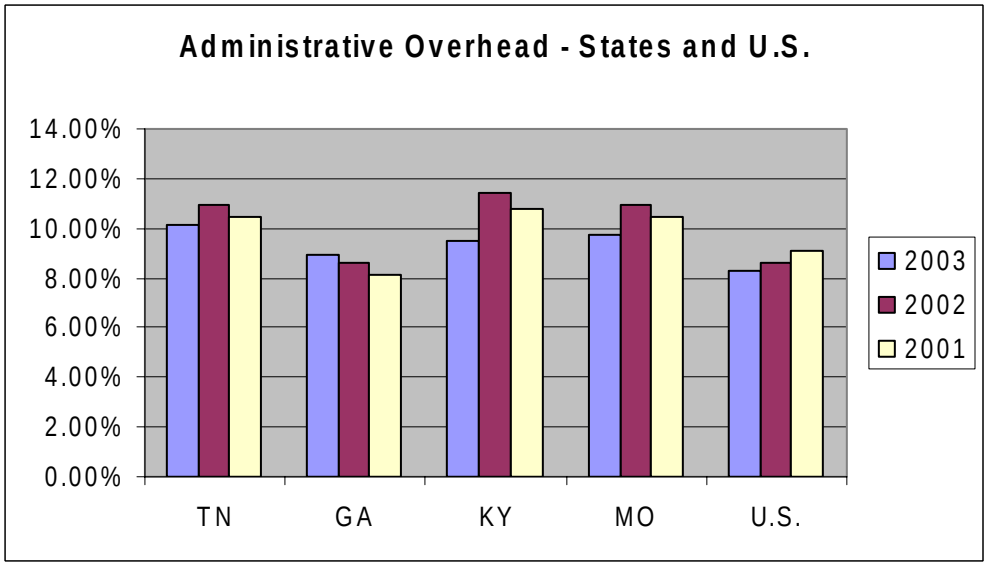


Figure 22:



The two Tennessee companies in 2003 with the lowest administrative overhead ratios are Cariten Health Plan (4.96 percent) and BCBS of TN Inc. (8.55 percent). United Healthcare of TN has the highest administrative overhead ratio in 2003 of 15.79 percent. The administrative overhead ratio for Tennessee companies decreases -.23 percent from 2001 to 2003. However, this administrative overhead ratio change is not equally distributed across the eight Tennessee health insurers. From 2001 to 2003, Cariten Ins. Co. and Cariten Health Plan decrease their administrative overhead ratio -6.38 percent and -5.11 percent respectively. Over the same period, United Healthcare of TN and Humana Health Plan Inc.'s administrative overhead ratios increase 3.09 percent and 2.81 percent respectively.

Tennessee has a higher administrative overhead ratio than the overall US average for 2003 and across the three years. Tennessee and US firms have an average administrative overhead ratio of

10.22 percent and 8.23 percent for 2003 and average 10.60 percent and 8.65 percent for the 2001 to 2003 period. For 2003, compared with their state counterparts, Tennessee appears to be on the high end at 10.22 percent and Georgia on the low end at 8.66 percent. For the three-year period, Tennessee has the highest administrative overhead average of 10.60 percent. For the same time, Georgia has the lowest administrative overhead average of 8.31 percent. Georgia also has the most significant average annual increase in administrative overhead ratio from 2001 to 2003 of 4.88 percent while Kentucky has the most significant decrease in administrative overhead ratio from 2001 to 2003 of -5.84 percent. In general, it appears that Tennessee health insurers have the highest administrative overhead ratios for 2003 as well as higher ratios than their US and state counterparts over the 2001 to 2003 period. In other words, it seems that Tennessee firms spend more, per dollar of revenue, on administrative services than US and state counterparts.

References

Cryan, B. 2003. "The Health of RI's Health Insurers (2002) – A Financial Analysis." Rhode Island Department of Health: 1 - 14.

Appendix A

Ms. Katherine A. Hossofsky of the Corporation Tax Division
Rev. Proc. 87-51, 1987-2 C.B. 650

SECTION 1. PURPOSE

This revenue procedure provides an administrative procedure for existing Blue Cross or Blue Shield organizations, as defined in section 833(c)(2) of the Internal Revenue Code, and certain other organizations described in section 501(m)(1) and (m)(2) to expeditiously obtain the consent of the Commissioner to change their methods of accounting for federal income tax purposes.

SEC. 2. BACKGROUND

01 Prior to 1987, certain organizations that provided commercial-type insurance were exempt from tax as charitable or social welfare organizations under section 501(c)(3) or (c)(4) of the Code, respectively. Congress was concerned that these organizations were engaged in insurance activities the nature and scope of which were inherently commercial rather than tax exempt.

The Tax Reform Act of 1986 ('Act'), section 1012(a), 1986-3 (Vol. 1) C.B. 307, dealt with these concerns by adding section 501(m) to the Code. Section 501(m)(1) provides that, for taxable years beginning after December 31, 1986, an organization described in section 501(c)(3) or (c)(4) is exempt under section 501(a) only if no substantial part of the organization's activities consists of providing 'commercial-type insurance' as defined in section 501(m)(3) and (m)(4). Thus, for taxable years beginning after December 31, 1986, an organization described in section 501(c)(3) and (c)(4) is not exempt under section 501(a) if a substantial part of the organization's activities consists of providing commercial-type insurance. Under section 501(m)(2), if an organization is described in section 501(c)(3) or (c)(4) and is exempt from tax under section 501(a) after the application of section 501(m)(1) (because no substantial part of its activities consists of providing commercial-type insurance), then the activity of providing commercial-type insurance is treated as an unrelated trade or business, and the organization is treated as an insurance company for purposes of applying subchapter L of chapter 1 with respect to
that activity.

02 For taxable years beginning before January 1, 1987, existing Blue Cross or Blue Shield organizations and other organizations described in section 501(m)(1) and (m)(2) of the Code filed returns as tax-exempt organizations on Form 990 (Return of Organization Exempt From Tax Under Section 501(c)). (In some cases, income from the activity of providing commercial-type insurance was reported on Form 990T (Exempt Organization Business Income Tax Return).) In accordance with the instructions for Form 990, these organizations were required to use the same method of accounting on that return that they regularly used to keep their books and records.

Generally they used either Generally Accepted Accounting Principles or statutory accounting principles established by the states for this purpose.
Section 1012 of the Act also added section 833 to the Code. Section 833(a)(1) provides that for taxable years beginning after December 31, 1986, existing Blue Cross or Blue Shield organizations and other organizations described in section 833(c)(3) are taxable as if they were stock property and casualty insurance companies. Property and casualty insurance companies are taxed under provisions of the Code contained in part II of subchapter L of chapter 1. These provisions contain a number of special tax accounting rules. Because they are subject to the provisions of subchapter L of chapter 1, existing Blue Cross or Blue Shield organizations and the other organizations described in section 501(m)(1) and (m)(2) of the Code may be required to use tax accounting methods different from those used in the past for reporting their insurance activity. For organizations subject to part II of subchapter L, section 832 generally requires the use of an accrual method of accounting with respect to their income and deductions. See Rev.
Rul. 77-266, 1977-2 C.B. 236. For any organization described in section 501(m)(1) or (m)(2) whose insurance activities are subject to part I of subchapter L, section 811(a) states that all computations entering into the determination of the taxes imposed by part I shall be made (1) under the accrual method of accounting, or (2) to the extent prescribed by the Secretary, under a combination of an accrual method of accounting with any other method permitted by chapter 1 (other than the cash receipts and disbursements method).

To the extent not inconsistent with the preceding sentence or any other provision of part I, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners. In addition, organizations affected by section 501(m) may want to make other changes to existing methods of accounting, even though those changes are unrelated to the Act.

03 Section 446(e) of the Code and section 1.446-1(e) of the Income Tax Regulations state that, except as otherwise provided, in order to change a method of accounting for federal income tax purposes, the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that, in order to obtain such consent, generally an application, Form 3115 (Application for Change in Accounting Method), must be filed within 180 days after the beginning of the tax year for which the proposed change is to be made. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e). These requirements, generally, are applicable to taxable and tax-exempt organizations.
04 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year.

(1) Section 1012(c)(3)(A)(i) of the Act provides that an existing Blue Cross or Blue Shield organization (as defined in section 833(c)(2) of the Code) shall not make any adjustment under section 481 (or any other provision) on account of a change in its method of accounting for its first taxable year beginning after December 31, 1986. According to the legislative history, 'such organizations are given a fresh start with respect to changes in accounting methods resulting from the change from tax-exempt to taxable status.' 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-349 (1986), 1986-3 (Vol. 4) C.B. 349.

(2) As is described more fully below, similar treatment regarding the adjustment under section 481(a) of the Code and the regulations thereunder (section 481(a) adjustment) generally applies to other organizations that are described in section 501(m)(1) or (m)(2) and that, for their 1st taxable year beginning before January 1, 1987, treated the provision of commercial-type insurance as other than an unrelated trade or business.

SEC. 3. SCOPE

This revenue procedure applies to -- (1) existing Blue Cross or Blue Shield organizations (as defined in section 833(c)(2) of the Code), (2) other organizations that are described in section 501(m)(1), and (3) organizations described in section 501(m)(2) that, for their last taxable year beginning before January 1, 1987, treated the provision of commercial-type insurance as other than an unrelated trade or business.

For any organization to which this revenue procedure applies, it applies (subject to the limitations stated below) with respect to changes in method of accounting for the taxpayer's first taxable year (year of change) beginning after December 31, 1986. This revenue procedure applies only with respect to a change in the method of accounting or an activity that was treated in the year immediately preceding the year of change as other than an unrelated trade or business. For organizations described in section 501(m)(2) of the Code, this revenue procedure applies only with respect to a change in the method of accounting for the provision of commercial-type insurance.

Taxpayers to which this revenue procedure applies may not use Rev. Proc. 84-74, 1984-2 C.B. 736, for changes with respect to which this revenue procedure applies.

SEC. 4. APPLICATION

01 In accordance with section 1.446-1(e)(3)(ii) of the regulations, for taxpayers to which this revenue procedure applies and changes with respect to which it applies, the 180-day time period for filing requests to change a method of accounting is extended for the year of change to the earlier of (a) the date the taxpayer files its return for the year of change or (b) the 1st day of the 11th month following the close of the year of change. Under section 1.446-1(e)(2)(i), consent is hereby provisionally granted to an organization to which this revenue procedure applies to change methods of accounting if this revenue procedure applies with respect to that change.

This provisional consent is granted to a taxpayer that files a Form 3115 in the manner described in section 5 of this revenue procedure and that otherwise complies with the provisions of this revenue procedure. The consent becomes final on the date one year from the date the Form 3115 is filed, unless the Service sends notification to the taxpayer on or before that later date.

02 In reviewing the Form 3115, the National Office of the Service will consider all facts and circumstances, including: (1) whether the method of accounting requested is consistent with the Code, regulations, revenue rulings, revenue procedures, and decisions of the courts; (2) whether the use of the new method will clearly reflect income; and (3) whether the taxpayer's books and records will conform with the proposed method of accounting.

03 The Service will notify the taxpayer within one year from the date the Form 3115 is filed if the Service has initial questions concerning whether the taxpayer has adopted a new accounting method that is not a proper accounting method for federal income tax purposes. If a taxpayer complies with the provisions of this revenue procedure and the Service does not send notification to the taxpayer in the one-year period, the taxpayer has obtained the consent of the Commissioner to change its methods of accounting. If in the course of review the Service makes an initial determination that a method of accounting to which the taxpayer desires to change is not acceptable for tax purposes, the taxpayer will be granted the opportunity of a conference in the National Office before the Service makes a final adverse determination.

04 If a taxpayer obtains consent under this revenue procedure to change its method of accounting for a trade or business but the Service determines that the trade or business was an unrelated trade or business in the tax year before the year of change, then (notwithstanding section 5.06 below) the Service may require an appropriate section 481(a) adjustment with respect to that trade or business.

SEC. 5. MANNER OF EFFECTING THE CHANGE

01 If this revenue procedure applies to a taxpayer and if it applies with respect to a change in method of accounting, then the taxpayer must effect the change by filing a Form 3115 in duplicate. The original shall be attached to the taxpayer's federal income tax return for the year of change, and, at the time the federal income tax return is filed, the duplicate shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: CC:C:2:9, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. If it is found that the taxpayer has not complied with the requirements for the automatic change in method of accounting under this revenue procedure, the National Office or the district director will so advise the taxpayer.

02 In order to assist in the processing of these changes in methods of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: 'FILED UNDER REV. PROC. 87-51.' In the case of a change in the method of accounting for a trade or business that the taxpayer was not conducting on or before August 16, 1986, then, notwithstanding the preceding sentence, the statement to be placed at the top of page 1 of the Form 3115 shall be: 'FILED UNDER REV. PROC. 87-51 -- NEW BUSINESS.'

03 In completing Form 3115, the taxpayer should check the box labeled 'Other (specify)' and insert the following: 'Tax exempt organization (subject to section 501(m)) to taxable insurance company.' The taxpayer should complete the identifying information at the beginning of the form as well as the signature section. The taxpayer need not complete sections other than sections A (Applicable to All Filers Other Than Those Answering 'Yes' to 'Note' Above) and J (Change in Method of Accounting Not Listed Above).

04 In section J of the Form 3115, the taxpayer must also describe the accounting methods to which it is changing and the authority for using those methods. The taxpayer need not describe the methods of accounting from which it is changing.

05 The taxpayer must file its tax return for the year of change on the basis of the methods of accounting to which it proposes to change.

06 If the change in method of accounting is made under the provisions of this revenue procedure, the taxpayer is not required to compute the amount of any section 481(a) adjustment. In the event that the taxpayer subsequently changes a method of accounting from the method adopted under this revenue procedure, the section 481(a) adjustment with respect to any such subsequent change in method of accounting may take into account the fact that the activity being accounted for was not subject to tax prior to the year of change.

07 The signature of the person preparing the request for the change in method of accounting must appear in the space provided for it on the Form 3115. The application must be signed for the taxpayer requesting the change. The individual signing for a corporate taxpayer must be the president, vice president, treasurer, or chief accounting officer (such as the tax officer) who is authorized to sign for the corporation. See the signature requirements set forth in the General Instructions attached to a Form 3115 regarding those who are to sign. If the agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of the correspondence concerning the request, or to perform any other act(s) regarding the application on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application.

Taxpayer's representatives without a power of attorney to represent the taxpayer as

indicated in this subsection will not be given any information about the application. If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. (See section 1.1502-77 of the regulations.)

SEC. 6. EFFECTIVE DATE

This revenue procedure shall be effective October 13, 1987, the date of its publication in the Internal Revenue Bulletin. If a change in method of accounting qualifies under this revenue procedure, any request for permission to make that change must comply with section 5 of this revenue procedure, and all noncomplying requests that are received in the National Office after the effective date will be returned to the taxpayer. A taxpayer that has filed a Form 3115 with the National Office prior to the effective date of this revenue procedure may use the automatic provisions of this revenue procedure and will be notified to this effect by the National Office.

SEC. 7. CHANGES IN METHOD OF ACCOUNTING TO WHICH THIS REVENUE PROCEDURE DOES NOT APPLY

If an organization described in section 501(m)(1) or (m)(2) of the Code wishes to make a change in method of accounting for the year of change but this revenue procedure does not apply with respect to the desired change, the organization is required to follow Rev. Proc. 84-74. See, however, Announcement 87-89, this Bulletin, which in many cases provides an extension of time for filing the Form 3115 that is required by Rev. Proc. 84-74.

SEC. 8. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention: CC:C:2:9, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

DRAFTING INFORMATION

The principal author of this revenue procedure is Ms. Katherine A. Hossofsky of the Corporation Tax Division. For further information regarding this revenue procedure contact Ms. Hossofsky on (202) 566-4463 (not a toll-free call).

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