



Blue Cross  
Blue Shield  
of Michigan

A nonprofit corporation and independent licensee  
of the Blue Cross and Blue Shield Association

Blue Cross Blue Shield of Michigan  
and Subsidiaries

**✓**  
**VALUE**  
**DEFINED**

An Explanation  
of Accounting Principles

# An Explanation of Accounting Principles

Blue Cross Blue Shield of Michigan prepares audited financial statements using both generally accepted accounting principles and statutory accounting principles. Statutory accounting principles, commonly abbreviated as SAP, are a set of accounting rules for insurance companies set forth by the National Association of Insurance Commissioners. They are used to prepare the statutory financial statements of insurance companies. With minor state-by-state variations, they are the basis for state regulation of insurance company solvency throughout the United States. In the U.S., generally accepted accounting principles, commonly abbreviated as U.S. GAAP or simply GAAP, are accounting rules used to prepare, present and report financial statements for a wide variety of entities, including publicly traded and privately held companies, nonprofit organizations and governments. Currently, the Financial Accounting Standards Board is the highest authority in establishing GAAP for public and private companies, as well as nonprofit entities.

SAP is, in general, a more conservative set of accounting principles, as regulators are concerned with an insurance company's solvency and ability to pay claims in the near-term, while GAAP takes a long-term and going concern approach as a basis for the financial statements. Because SAP is more limited in use and the general public is more familiar with GAAP financial statements, many insurance companies, including BCBSM, report financial results on both a GAAP and SAP basis. Most differences between GAAP and SAP are direct reductions to reserves, because certain assets may not be easily or quickly converted to cash to pay claims. In other words, selling or liquidating those assets would take too long to be considered near-term, available-and on-demand capital.

Another significant difference between GAAP and SAP is how an entity incorporates the financial information of its subsidiaries. GAAP utilizes a full-consolidation approach, which reports the financial results for the total enterprise as if it were a single company. Because an insurance company cannot simply take the assets of its subsidiaries to pay claims, SAP does not use consolidated financial statements, but instead treats investments in subsidiaries as investments in common stock, using the equity method. Under the equity method, subsidiary earnings and other changes in value are not reported in the income statement of the parent company, but are reported as an unrealized gain or loss in reserves.

SAP also precludes the accounting for amounts from administrative service contracts (contracts that do not transfer insurance risk) as revenue; as a result more than one half of the total revenue reported in the GAAP financial statements is excluded from the SAP income statement.

There are also a number of other specific and unique differences related to asset valuation, amortization expense, investment accounting, expense classifications and income statement presentation formats that differ between the two sets of financial statements.

An unaudited reconciliation of BCBSM's GAAP and SAP net income and GAAP subscriber reserves to SAP subscriber reserves for 2010 and 2009 is provided here. Please refer to the appropriate GAAP or SAP financial statements for the full, detailed 2010 report.

In Millions	<u>12/31/2010</u>	<u>12/31/2009</u>
GAAP consolidated addition to reserves	\$ 222.2	\$ 233.1
Less: Subsidiaries' addition to reserves	(56.1)	(143.6)
Subtotal	166.1	89.5
Add (Deduct) Income adjustments as required under statutory accounting principles (SAP):		
Operating expense differences	(10.6)	1.5
Changes in unrealized gain or losses for trading securities	(72.4)	(163.8)
Other investment differences	19.2	8.5
Statutory (SAP) PDR changes -adjustment required to record 2-year PDR	(33.8)	51.9
Deferred tax expense transferred to surplus	136.7	24.9
Parent statutory (SAP) net income as prescribed by OFIR	205.2	12.5
GAAP consolidated ending subscribers' reserves	\$ 2,920.1	\$ 2,823.1
Add (Deduct) statutory (SAP) adjustments permitted by OFIR:		
Investment in subsidiaries	(342.7)	(322.9)
Other investment differences	(90.8)	(65.8)
2-year PDR adjustment	171.7	198.7
Pension and retiree health obligation differences	230.7	102.7
Other asset differences	(129.5)	(173.6)
	(160.6)	(260.9)
Statutory (SAP) reserves as prescribed by OFIR	\$ 2,759.5	\$ 2,562.2