US firms lowball earnings to avoid higher health insurance costs, says study

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American companies tend to report lower profits when dealing with monolithic health insurance providers, a new study shows.

The finding underscores previous research suggesting the U.S. health insurance market is not as competitive as it could be because corporate customers who show rising profits are subsequently hit with higher health benefit premiums.

Given that those premiums can represent close to one third of U.S. companies' net incomes, "it's a non-trivial economic issue," says Ole-Kristian Hope, Deloitte Professor of Accounting at the University of Toronto's Rotman School of Management. He co-wrote the study with Prof. Francesco Bova of the Rotman School and Prof. Yiwei Dou of New York University, who is a graduate of the Rotman PhD program.

The researchers looked at federal disclosure data on benefit plans from a large sample of fully-insured U.S. firms between 1999 and 2011.

They found a higher use of discretionary accounting practices, such as write-downs, among companies dealing with health insurers that enjoyed strong bargaining power. The effect was highest among companies with labour- intensive businesses and with low employee turnover. Mergers between health insurers were especially likely to lead to downward earnings reporting.

A 1999 merger between Prudential and Aetna was followed by downward earnings reporting among corporate customers in six states. The exception was Texas, which forced Aetna to give up some of its business to competitors as part of the merger.

But did the downward trend on earnings reports actually work to reduce subsequent healthcare insurance costs? The study found preliminary evidence that it did. And that, say the researchers, has its own downside, potentially hurting such things as stock price, accounting quality and the cost of capital.

The U.S. healthcare system is largely underpinned by private insurance. Premiums for private health insurance were $917 billion in 2012. This is the first time that health insurers' influence on corporate financial reporting has been studied.

More information: The complete study is available at: papers.ssrn.com/sol3/papers.cf … ?abstract_id=2438716

Provided by University of Toronto

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