

Independence Blue Cross and Subsidiaries

***Consolidated Financial Statements for the
Years Ended December 31, 2001, 2000 and 1999
and Independent Auditors' Report***

INDEPENDENT AUDITORS' REPORT

To the Members and the Board of Directors
of Independence Blue Cross:

We have audited the accompanying consolidated balance sheets of Independence Blue Cross and subsidiaries ("IBC") as of December 31, 2001 and 2000, and the related consolidated statements of income and comprehensive income, changes in reserves, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of IBC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Independence Blue Cross and subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 5, 2002

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (Dollars in thousands)

	Years Ended December 31,		
	2001	2000	1999
Underwriting income	\$7,555,661	\$6,864,441	\$5,963,295
Underwriting costs:			
Claims incurred	6,653,289	6,060,819	5,290,273
Medical management	178,585	157,212	141,337
Operating expenses	603,986	579,673	544,838
Total underwriting costs	<u>7,435,860</u>	<u>6,797,704</u>	<u>5,976,448</u>
Net underwriting income (loss)	119,801	66,737	(13,153)
Investment income, net	55,260	60,796	54,519
Equity in net income of affiliates	4,746	965	8,202
Amortization of intangibles	(20,820)	(21,118)	(17,581)
Other (expenses) income, net	<u>(5,677)</u>	<u>(2,576)</u>	<u>5,344</u>
Income before income taxes	153,310	104,804	37,331
Provision for income taxes	<u>59,300</u>	<u>33,600</u>	<u>3,700</u>
Net income	<u>94,010</u>	<u>71,204</u>	<u>33,631</u>
Other comprehensive income (loss), net of income taxes:			
Unrealized holding gain (loss) on investments arising during the period, net of reclassification adjustment	<u>8,219</u>	<u>14,256</u>	<u>(26,311)</u>
COMPREHENSIVE INCOME	<u>\$ 102,229</u>	<u>\$ 85,460</u>	<u>\$ 7,320</u>

See accompanying notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN RESERVES (Dollars in thousands)

	Years Ended December 31,		
	2001	2000	1999
Beginning balance	\$ 661,001	\$ 575,541	\$ 568,221
Comprehensive income	<u>102,229</u>	<u>85,460</u>	<u>7,320</u>
Ending balance	<u>\$ 763,230</u>	<u>\$ 661,001</u>	<u>\$ 575,541</u>

See accompanying notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years Ended December 31,		
	2001	2000	1999
OPERATING ACTIVITIES:			
Net income	\$ 94,010	\$ 71,204	\$ 33,631
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	41,035	33,906	28,396
Equity in net income of affiliates, net of dividends received	(5,258)	(965)	(8,202)
Loss (gain) on sale of investments	4,684	(559)	(422)
Deferred income taxes	(6,899)	(10,999)	17,294
Change in assets and liabilities, net of effects from acquisition of businesses:			
Premiums receivable	8,803	(65,451)	(49,075)
Other receivables	(2,500)	(19,877)	(14,469)
Prepaid expenses and other	15,615	3,386	(27,331)
Claims liabilities	213,326	(43,743)	158,401
Accounts payable and accrued expenses	1,416	25,667	(6,311)
Unearned income	61,362	(9,531)	32,680
Net cash provided by (used in) operating activities	<u>425,594</u>	<u>(16,962)</u>	<u>164,592</u>
INVESTING ACTIVITIES:			
Purchase of investments available for sale	(1,526,379)	(524,122)	(416,382)
Sale or maturity of investments available for sale	1,408,666	414,789	302,041
Purchase of other invested assets	(6,186)	(5,661)	(6,409)
Redemption of other invested assets	-	-	4,813
Purchase of property and equipment	(82,588)	(57,823)	(53,618)
Proceeds from sale of property and equipment	79,977	21,996	85,474
Payments for acquisitions, net of cash acquired	756	-	-
Receipts for dispositions, net of cash disposed	-	1,151	-
Net cash used in investing activities	<u>(125,754)</u>	<u>(149,670)</u>	<u>(84,081)</u>
FINANCING ACTIVITIES:			
Repayment of notes receivable	-	-	3,000
Issuance of notes receivable	(175)	(15)	(60)
Payment on long-term debt	(15,392)	(720)	(5,890)
Issuance of long-term debt	5,191	14,848	40,000
Net cash (used in) provided by financing activities	<u>(10,376)</u>	<u>14,113</u>	<u>37,050</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	289,464	(152,519)	117,561
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>118,649</u>	<u>271,168</u>	<u>153,607</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 408,113</u>	<u>\$ 118,649</u>	<u>\$ 271,168</u>

See accompanying notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2001, 2000 AND 1999 (Dollars in thousands, except per share data)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business - Independence Blue Cross (the "Company" or "IBC") is a non-profit corporation in the Commonwealth of Pennsylvania and is subject to regulation by the Commonwealth of Pennsylvania Insurance Department ("PID"). Health benefits are provided under contracts with members through hospitals, skilled nursing facilities and other organizations. The Company contracts with providers of health care to provide health services to members and also performs administrative services such as billing, collection, and marketing for Pennsylvania Blue Shield d/b/a Highmark ("PBS") and processes claims for other Blue Cross plans' members and for programs such as the Federal Employee Health Benefits Program and the BlueCard Program. The Company and PBS jointly participate in lines of business to provide Major Medical and Comprehensive Major Medical benefits. The Company provides its Preferred Provider Organization and Point-of-Service programs in the five-county Philadelphia area through its wholly owned subsidiary, QCC Insurance Company ("QCC"). The Company provides health insurance coverage to New Jersey residents through AmeriHealth Insurance Company of New Jersey and to Delaware residents through QCC d/b/a AmeriHealth Insurance Company. Health insurance is provided by the Company for Puerto Rico residents through its 51% owned subsidiary, La Cruz Azul de Puerto Rico, Inc. ("La Cruz Azul"). Through September 2001, the Company also provided health insurance to U.S. Virgin Island residents through QCC d/b/a Blue Cross/Blue Shield of the U.S. Virgin Islands. The Company provides workers' compensation claims management services and third-party administrative services through CompServices, Inc. and AmeriHealth Administrators, Inc., respectively. In addition, the Company provides HMO coverage through its wholly owned subsidiaries, AmeriHealth HMO, Inc. and Keystone Health Plan East ("KHPE"). The Company and PBS provide hospitalization and medical/surgical coverages through Inter-County Hospitalization Plan, Inc. and Inter-County Health Plan, Inc., which are jointly owned subsidiaries. Through its 93% owned subsidiary, NewSeasons Assisted Living Communities, Inc. ("NewSeasons"), the Company acquires, constructs, owns and operates assisted living facilities. Through DePaul Health Care Company ("DePaul"), the Company participates in a joint venture to acquire, construct, own and operate assisted living facilities.

Service Marks - The Blue Cross and Blue Shield Association (the "Association") licenses Independence Blue Cross to offer certain products and services under the BLUE CROSS® brand name. Independence Blue Cross is an independent organization governed by its own Board of Directors and is solely responsible for its own debts and other obligations. Neither the Association nor any other organization using the BLUE CROSS® or BLUE SHIELD® brand name acts as a guarantor of Independence Blue Cross' obligations, except as discussed in Note 15.

Principles of Consolidation - The accompanying consolidated financial statements include the accounts of the Company and all of its majority owned subsidiaries, hereafter referred to as IBC, and IBC's share of assets, liabilities, reserves and operating results of the lines of business it participates in with PBS. All significant intercompany transactions have been eliminated in consolidation.

Cash and Cash Equivalents - IBC considers cash and cash equivalents to be all highly liquid investments with original issue maturities of three months or less.

Investments - IBC has categorized its investment portfolio as "available for sale" ("AFS") and has reported the portfolio at fair value with unrealized gains and losses, net of tax, as a separate component of reserves. Gross realized gains and losses are calculated based upon the specific cost of the investments sold. The fair value of IBC's AFS investment portfolio is estimated based on quoted market prices for the same or similar issues.

National Accounts - In order to provide service to employers with employees located in more than one geographical area, IBC participates in numerous syndicated contracts, known as National Accounts, with other Blue Cross plans throughout the country. On an interim basis, income, claims and administrative costs incurred in servicing National Account members are recorded in the consolidated statements of income and comprehensive income and changes in reserves. Underwriting gains and losses are recorded at settlement which normally occurs within nine months following the end of the annual contract period. Past experience indicates that underwriting gains and losses recorded on settlement of National Account contract periods are not significant.

Member Premiums and Unearned Income - Member premiums are billed in advance of their respective coverage periods. Receivables and income from such premiums are recorded during the coverage period. The unearned portion of premiums for a coverage period is recorded in the consolidated balance sheet as unearned income and later reported as underwriting income when earned.

Property and Equipment - Property and equipment are recorded at cost, which includes expenditures for significant improvements. Maintenance, repairs and minor improvements are expensed as incurred. When property or equipment is retired or otherwise disposed of, cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations. Depreciation is computed on the straight-line method over the estimated useful life of the asset (three to ten years for office furniture and equipment, twelve to forty years for building and improvements).

Software costs are capitalized for purchased software including costs incurred to develop new systems. Developmental costs are accumulated until the software is put into use, at which time amortization commences. Amortization is computed on a straight-line basis over the expected useful life of the software (three to five years).

Claims Liabilities - Claims liabilities include the estimated amounts to be paid for member benefits based on accumulated financial and statistical data. Processing expenses related to such claims are accrued currently based on an estimate of expenses necessary to process such claims. Claims liabilities are presented net of advances to providers.

Merit Rating Refunds - Merit rating refunds are the estimated premiums refundable to eligible retrospectively rated groups based on accumulated financial and statistical data.

Risk Sharing Arrangements - IBC's HMO operations have certain arrangements for their Commercial and Medicare lines of business with independent physician and managed care groups to share in any deficit or surplus generated against established target medical budgets in the hospital, referral and pharmacy service categories. A liability or a receivable is recorded based upon each arrangement's estimated experience.

Retirement Benefits - Pension expense related to IBC's defined-benefit pension plan is recorded based on actuarially determined net periodic pension costs using a year-end measurement date. The actuarial cost method used is the projected unit credit method.

Health care and life insurance benefits are also provided for retirees. IBC recognizes, as a liability, the actuarial present value of postretirement benefits expected to be paid to employees. The related expense

reflects benefits attributed to services rendered by eligible employees during the period and interest on the liability.

Medical Management - Medical management activities include provider network creation and maintenance, credentialing and recredentialing, precertification and concurrent review, discharge planning and case management, claim payment review, medical cost analysis, medical information management and quality management. Costs of these activities are expensed as incurred.

Expense Reimbursement - Operating expenses are allocated to various lines of business in order to determine the expense reimbursement due from other Blue Cross plans and other health programs for which IBC processed claims. Expense reimbursement is also calculated for operating expenses incurred on behalf of PBS. The method by which IBC is reimbursed is either actual cost or a predetermined amount.

Income Taxes - The Company is subject to federal income taxes under provisions of Section 1012.b of the Tax Reform Act of 1986. Since the Company is a non-profit corporation, it is exempt from Pennsylvania corporate taxes. All of the Company's subsidiaries are subject to federal and state income or premium taxes.

The Company files a consolidated federal income tax return including all of its wholly owned subsidiaries. Deferred income taxes are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts.

Comprehensive Income (Loss) - Total comprehensive income (loss) includes net income (loss) and unrealized gains (losses) on AFS investments arising during the period, net of reclassification adjustments.

Intangible Assets - Intangible assets include the excess of acquisition cost over fair value of net assets acquired in the purchase of subsidiaries and lines of business, which are being amortized on a straight-line basis over periods ranging from five to twenty years.

Basis of Presentation - The financial statements of the Company and certain subsidiaries are reported to their domiciliary State Insurance Departments on the basis of statutory accounting practices in a format established by the National Association of Insurance Commissioners ("NAIC") and are presented herein in conformity with accounting principles generally accepted in the United States of America ("GAAP").

The principal differences relate to certain assets and liabilities designated as non-admitted (primarily capitalized software, office furniture, equipment, certain receivables, certain intangibles, certain accrued and prepaid expenses and certain deferred income taxes) that are excluded from the balance sheet and reserves for statutory reporting purposes. As a result of these differences, statutory reserves at December 31, 2001 and 2000 were \$689,628 and \$613,085, respectively. Statutory net gain (loss) for 2001, 2000 and 1999 was \$56,116, \$(10,793) and \$18,247, respectively.

Fair Value of Financial Instruments - In accordance with Statement of Financial Accounting Standards ("SFAS") No. 107, *Disclosure about Fair Value of Financial Instruments*, IBC has calculated the fair values of its notes receivable and long-term debt at the discounted amount of future cash flows using IBC's current incremental lending/borrowing rate for similar financial instruments. Such fair values approximate IBC's carrying amounts. In addition, the carrying amount of cash and cash equivalents approximates its fair value due to the short-term nature of these financial instruments.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Reclassifications - Certain prior year amounts have been reclassified to conform to the current year's presentation.

New Accounting Pronouncements - In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and in June 1999 and 2000, FASB issued SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, respectively, all of which became effective January 1, 2001. These statements establish accounting and reporting standards for derivative instruments, including those embedded in other contracts, and for hedging activities. It requires recognizing derivatives as assets or liabilities at fair value on the balance sheet. IBC adopted SFAS No. 133 in its fiscal year 2001. The adoption of SFAS No. 133 did not have a material impact on IBC's financial position or results of operations.

In June 2001, FASB issued SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method and addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. SFAS No. 142 addresses the initial recognition and measurement of goodwill and intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives will not be amortized, but will rather be evaluated at least annually for impairment. IBC is required to adopt SFAS No. 142 in its fiscal year 2002. Management has not yet determined the impact that the adoption of SFAS No. 142 will have on its financial position or results of operations when such statement is adopted.

In August 2001, FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement addresses accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121, *Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequent Occurring Events and Transactions*. This statement is effective for fiscal years beginning after December 15, 2001. Management has not yet determined the impact that the adoption of SFAS No. 144 will have on its financial position or results of operations when such statement is adopted.

2. AGENCY CONTRACTS

Claims processed for others and excluded from the consolidated financial statements amounted to \$213,106 in 2001, \$176,158 in 2000 and \$140,266 in 1999. Reimbursements for the administrative cost of services performed for PBS, governmental agencies, and other plans in the amount of \$30,359, \$32,357 and \$31,433 in 2001, 2000 and 1999, respectively, have been offset against operating expenses.

3. INVESTMENTS

The amortized cost and estimated fair value of investments at December 31, 2001 and 2000 are as follows:

	Available for Sale December 31, 2001			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury notes and federal agencies	\$ 207,809	\$ 3,806	\$ 799	\$ 210,816
Mortgage-backed securities	274,261	3,241	4,135	273,367
Corporate debt securities	500,582	12,166	7,198	505,550
Other	119,935	625	3,283	117,277
Total debt securities	1,102,587	19,838	15,415	1,107,010
Common stock	99,599	2,985	22,905	79,679
Total investments	<u>\$ 1,202,186</u>	<u>\$ 22,823</u>	<u>\$ 38,320</u>	<u>\$ 1,186,689</u>

	Available for Sale December 31, 2000			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury notes and federal agencies	\$ 388,090	\$ 1,551	\$ 4,209	\$ 385,432
Mortgage-backed securities	299,607	1,083	8,211	292,479
Corporate debt securities	237,105	2,275	9,356	230,024
Other	84,096	3,808	4	87,900
Total debt securities	1,008,898	8,717	21,780	995,835
Common stock	83,484	4,013	22,188	65,309
Total investments	<u>\$ 1,092,382</u>	<u>\$ 12,730</u>	<u>\$ 43,968</u>	<u>\$ 1,061,144</u>

The amortized cost and estimated fair value of debt securities by maturity date at December 31, 2001 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 27,759	\$ 28,262
Due after one year through five years	399,414	408,378
Due after five years through ten years	326,050	324,002
Due after ten years	<u>75,103</u>	<u>73,001</u>
	828,326	833,643
Mortgage-backed securities	<u>274,261</u>	<u>273,367</u>
Total debt securities	<u>\$ 1,102,587</u>	<u>\$ 1,107,010</u>

Gross realized gains and losses from sales of investments were as follows:

	2001	2000	1999
Realized gains	\$ 17,338	\$ 9,789	\$ 2,269
Realized losses	<u>(22,022)</u>	<u>(9,230)</u>	<u>(1,847)</u>
	<u>\$ (4,684)</u>	<u>\$ 559</u>	<u>\$ 422</u>

The net change in the unrealized appreciation (depreciation) on investments classified as AFS included as a component of other comprehensive income (loss) was \$15,741, \$28,477 and \$(46,929) for the years ended December 31, 2001, 2000 and 1999, respectively. In addition, the Company's share of the unrealized gains (losses) included in the equity of its investment in affiliates accounted for under the equity method is included as a component of IBC's other comprehensive income (loss).

In order to comply with statutory requirements, the Company has placed on deposit with various State Insurance Departments investments with an estimated fair value of \$64,590 and \$47,919 at December 31, 2001 and 2000, respectively.

4. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

IBC has a non-contributory defined benefit pension plan for the benefit of all its employees hired prior to January 1, 2000. For those employees hired after January 1, 2000, benefits are calculated on a cash balance formula. IBC's funding policy is to contribute annually the maximum amount that can be deducted for federal income tax purposes. Contributions are intended to provide for benefits attributed to service to date and for those expected to be earned in the future.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retirees. Under the current program, substantially all of IBC's employees may become eligible for these benefits if they are working for IBC when they reach age 55 and they have completed at least 10 years of service. Therefore, IBC begins accruing an obligation for active participants at the later of age 45 or date of hire.

	Pension Benefits		Health/Life Benefits	
	2001	2000	2001	2000
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 188,488	\$ 143,530	\$ 26,151	\$ 21,680
Service cost	16,282	13,366	3,271	2,783
Interest cost	13,864	11,895	2,120	1,685
Actuarial loss	2,795	23,757	3,837	1,680
Settlements/curtailments	-	(1,474)	-	(305)
Acquisition	5,200	-	-	-
Benefits paid	(2,984)	(2,586)	(1,470)	(1,372)
Benefit obligation at end of year	<u>\$ 223,645</u>	<u>\$ 188,488</u>	<u>\$ 33,909</u>	<u>\$ 26,151</u>

	Pension Benefits		Health/Life Benefits	
	2001	2000	2001	2000
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 151,589	\$ 152,092	\$ -	\$ -
Actual return on plan assets	(15,818)	(5,958)	-	-
Acquisition	5,200	-	-	-
Employer contribution	11,262	6,819	-	-
Actuarial (loss) gain	(1,948)	1,222	-	-
Benefits paid	(2,984)	(2,586)	-	-
Fair value of plan assets at end of year	<u>147,301</u>	<u>151,589</u>	<u>-</u>	<u>-</u>
Funded status	(76,344)	(36,899)	\$ (33,909)	\$ (26,151)
Unrecognized net actuarial loss (gain)	56,656	20,849	659	(3,178)
Unrecognized prior service cost (benefit)	1,515	1,653	(927)	(991)
Unrecognized transition asset	-	(377)	-	-
Accrued benefit cost	<u>\$ (18,173)</u>	<u>\$ (14,774)</u>	<u>\$ (34,177)</u>	<u>\$ (30,320)</u>

	Pension Benefits		Health/Life Benefits	
	2001	2000	2001	2000
Weighted-average assumptions as of December 31				
Discount rate	7.25 %	7.50 %	7.25 %	7.50 %
Expected return on plan assets	10.00	10.00	-	-
Rate of compensation increase	4.00	4.00	4.00	4.00

The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation was 9% grading down to 5% over eight years. Increasing or decreasing the health care cost trend rate by 1% each year has a minimal impact on the accumulated postretirement benefit obligation as of December 31, 2001 and the aggregate of service and interest cost components of expense due to the cap (presently 200% of the premium rates as of January 1, 1993) on IBC's portion of medical benefits.

	Pension Benefits		
	2001	2000	1999
Component of net periodic benefit cost			
Service cost	\$ 16,282	\$ 13,366	\$ 15,622
Interest cost	13,864	11,895	10,593
Expected return on plan assets	(15,664)	(15,411)	(13,506)
Amortization of prior service cost	138	156	156
Amortization of transition asset	(377)	(504)	(504)
Recognized net actuarial loss (gain)	<u>418</u>	<u>(95)</u>	<u>503</u>
Net periodic benefit cost	<u>\$ 14,661</u>	<u>\$ 9,407</u>	<u>\$ 12,864</u>
	Health/Life Benefits		
	2001	2000	1999
Component of net periodic benefit cost			
Service cost	\$ 3,271	\$ 2,783	\$ 2,816
Interest cost	2,120	1,685	1,430
Expected return on plan assets	-	-	-
Amortization of prior service cost	(312)	(287)	(2,479)
Recognized net actuarial gain	<u>-</u>	<u>(112)</u>	<u>-</u>
Net periodic benefit cost	<u>\$ 5,079</u>	<u>\$ 4,069</u>	<u>\$ 1,767</u>

5. COMPREHENSIVE INCOME (LOSS)

The components of IBC's other comprehensive income (loss) as of December 31, 2001, 2000 and 1999 are as follows:

	2001		
	Before-Tax	Tax Benefit (Expense)	Net
Unrealized gains on investments:			
Unrealized holding gains arising during the period	\$ 10,434	\$ (4,761)	\$ 5,673
Less: reclassification adjustment for losses realized in net income	<u>(4,684)</u>	<u>2,138</u>	<u>(2,546)</u>
Other comprehensive income	<u>\$ 15,118</u>	<u>\$ (6,899)</u>	<u>\$ 8,219</u>

	2000		
	Before-Tax	Tax Benefit (Expense)	Net
Unrealized gains on investments:			
Unrealized holding gains arising during the period	\$ 25,814	\$ (11,242)	\$ 14,572
Less: reclassification adjustment for gains realized in net income	<u>559</u>	<u>(243)</u>	<u>316</u>
Other comprehensive income	<u>\$ 25,255</u>	<u>\$ (10,999)</u>	<u>\$ 14,256</u>

	1999		
	Before-Tax	Tax Benefit (Expense)	Net
Unrealized losses on investments:			
Unrealized holding losses arising during the period	\$ (43,183)	\$ 17,127	\$ (26,056)
Less: reclassification adjustment for gains realized in net income	<u>422</u>	<u>(167)</u>	<u>255</u>
Other comprehensive loss	<u>\$ (43,605)</u>	<u>\$ 17,294</u>	<u>\$ (26,311)</u>

6. INCOME TAXES

The components of the provision for income taxes are as follows:

	Years Ended December 31,		
	2001	2000	1999
Federal:			
Current	\$ 44,000	\$ 21,500	\$ (5,800)
Deferred	(100)	500	(4,700)
State and local	<u>15,400</u>	<u>11,600</u>	<u>14,200</u>
	<u>\$ 59,300</u>	<u>\$ 33,600</u>	<u>\$ 3,700</u>

IBC paid \$54,400, \$33,500 and \$11,700 in federal income taxes in 2001, 2000 and 1999, respectively. The Company paid \$14,074, \$17,938 and \$14,874 in state income taxes in 2001, 2000 and 1999, respectively.

The net deferred taxes as of December 31, 2001 and 2000, included in *Other assets* on the consolidated balance sheets, include the following amounts of deferred tax assets and liabilities:

	2001	2000
Deferred tax asset	\$ 76,900	\$ 66,300
Deferred tax liability	(38,400)	(27,700)
Deferred tax asset - investments available for sale	4,400	10,000
Valuation allowance for deferred tax asset	(9,100)	(9,300)
	<u>\$ 33,800</u>	<u>\$ 39,300</u>

The deferred tax asset results primarily from nondeductible accruals for postretirement employee benefits, the discounting of claims liabilities and unearned income required for tax purposes, and an allowance for doubtful accounts that is not deductible for tax purposes until losses are identified, quantified and written off. The deferred tax liability results from the use of accelerated methods of depreciation for tax purposes and the required accounting for pension funding.

7. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2001 and 2000 is as follows:

	2001	2000
Land	\$ 13,626	\$ 2,112
Building and improvements	101,213	15,517
Office furniture and equipment	21,510	26,817
Capitalized software	12,899	30,054
Property and equipment, gross	149,248	74,500
Accumulated depreciation and amortization	(18,864)	(14,577)
Property and equipment, net	<u>\$ 130,384</u>	<u>\$ 59,923</u>

Depreciation and amortization expense related to property and equipment was \$17,578, \$7,068 and \$5,757 for the years ended December 31, 2001, 2000 and 1999, respectively.

8. INDEBTEDNESS

Indebtedness outstanding at December 31, 2001 and 2000 is as follows:

	2001	2000
Mortgage and construction loans	\$ 101,310	\$ -
Industrial Revenue Bonds	4,480	5,240
Subordinated capital note	40,000	40,000
Capital lease obligation	216	14,848
	<u>\$ 146,006</u>	<u>\$ 60,088</u>

In June 1999, the Company, through its wholly owned subsidiary, KHPE, entered into a \$40,000 subordinated capital note agreement with a third party. Under the terms of the note, interest accrues at 9.6% per annum and is paid quarterly. The principal balance is payable on June 30, 2014.

The Industrial Revenue Bonds were issued to finance the land and building of the Company's Puerto Rico affiliate, La Cruz Azul, and are secured by the land and building of the affiliate. Under the debt terms, the principal balance is payable in quarterly payments ranging from \$150 to \$250 plus interest at 7.5% through July 18, 2006.

In December 2000, the Company, through its wholly owned subsidiary, KHPE, entered into a sale and leaseback transaction for software. The resulting lease qualified as a capital lease. The obligation was for \$14,848, at an annual interest rate of 10.18%. The obligation was paid off in 2001.

Effective January 31, 2001, the Company, through a wholly owned subsidiary, increased its ownership in NewSeasons to 93%. As the majority owner, the Company is required to consolidate NewSeasons in its financial statements. NewSeasons' mortgage and construction loans are included in the maturity schedule below.

Maturities of mortgage and construction loans, bonds, notes payable and capital lease obligations for each of the next five years and thereafter are as follows:

Year	Amount
2002	\$ 30,887
2003	31,570
2004	1,749
2005	6,676
2006	1,586
Thereafter	<u>73,538</u>
	<u>\$ 146,006</u>

Interest paid amounted to \$10,254 in 2001, \$4,267 in 2000 and \$2,832 in 1999.

IBC has an available line of credit with an area bank in the amount of \$10,000, which expires in 2002. Borrowings under the line of credit bear interest at LIBOR plus 60 basis points, and are payable upon demand. As of December 31, 2001 and 2000, no amounts were outstanding under this agreement.

IBC has established Reverse Repurchase Agreements with a financial institution in the amount of \$100,000. Borrowings under these agreements bear interest at the prevailing repurchase rate. As of December 31, 2001 and 2000, no amounts were outstanding under these agreements.

9. COMMITMENTS

IBC leases certain facilities and equipment under long-term leases. As of December 31, 2001, future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are as follows:

Years Ended December 31,	Facilities	Equipment	Total
2002	\$ 26,240	\$ 68,424	\$ 94,664
2003	25,214	42,443	67,657
2004	25,399	34,324	59,723
2005	23,770	657	24,427
2006	23,101	275	23,376
Thereafter	271,306	1	271,307

Total rental expense amounted to \$67,045, \$68,445 and \$62,382 for 2001, 2000 and 1999, respectively.

During 2001, 2000 and 1999, IBC entered into agreements for the sale and leaseback of a portion of the Company's office furniture, capitalized software and equipment. The leases have terms of 30 through 42 months. These leases are accounted for as either operating or capital leases.

The book value and associated depreciation of the office furniture, capitalized software and equipment have been removed from the accounts. The proceeds from the 2001 and 1999 sales of \$79,977 and \$85,474, respectively, approximated the net book values of the disposed items; therefore, no gain or loss was realized on these sales. The proceeds from the 2000 sale of \$36,844 were more than the net book value of the disposed items. The Company realized a gain of \$321 on this sale in 2000. Annual payments under the operating leases are \$24,987, \$6,737 and \$26,046 for the 2001, 2000 and 1999 leases, respectively. The commitment for the capital lease is disclosed in Note 8.

In June of 1998, the Company entered into a \$10,000 surplus note agreement with Blue Cross and Blue Shield of Vermont ("BCBS of VT"). Under the terms of the agreement, if the Company reimburses any draws on a BCBS of VT letter of credit, such amounts will become a principal advance under the surplus note agreement. As of December 31, 2001, there have not been any advances under this surplus note agreement.

10. MEDICAID JOINT VENTURES

The Company, through its wholly owned subsidiaries KHPE and AmeriHealth HMO, Inc., is a 50-50 partner in two joint ventures with Mercy Health Plan, Keystone Mercy Health Plan and AmeriHealth Mercy Health Plan (the "Medicaid Joint Ventures") (see Note 11). The Medicaid Joint Ventures provide medical services to certain persons eligible for participation in the Pennsylvania and South Carolina Medical Assistance Programs pursuant to agreements with the States' Departments of Welfare. Under the terms of the current Pennsylvania agreements, the capitation payments received by KHPE and AmeriHealth HMO, Inc. are remitted to the Medicaid Joint Ventures and it is the responsibility of the Medicaid Joint Ventures, through their providers, to provide defined program benefits. The South Carolina payments are received directly by Select Health, a licensed HMO in the state. The consolidated statements of income and comprehensive income include the following activity related to the agreements:

	Years Ended December 31,		
	2001	2000	1999
Underwriting income	\$ 796,102	\$ 687,583	\$ 627,575
Claims incurred	(796,102)	(687,583)	(626,870)
Operating expenses	-	-	(705)
Net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The accompanying consolidated financial statements do not include any liabilities for outstanding claims under this program.

11. INVESTMENTS IN AFFILIATES

The Company is a 50-50 partner in Keystone Mercy Health Plan.

Summary financial data for Keystone Mercy Health Plan is as follows:

	2001	2000	1999
Revenues	\$ 773,199	\$ 695,891	\$ 626,459
Net income	12,730	6,468	16,484
Total assets	178,620	166,546	174,117
Partners' equity	37,756	31,986	31,148

The Company is a 50-50 partner in AmeriHealth Mercy Health Plan.

Summary financial data for AmeriHealth Mercy Health Plan is as follows:

	2001	2000	1999
Revenues	\$ 137,934	\$ 94,771	\$ 68,824
Net income	8,884	8,220	5,478
Total assets	45,906	27,460	15,179
Partners' equity	18,028	13,806	5,558

Summary financial data for the Company's remaining equity investees is immaterial.

12. ACQUISITIONS AND DISPOSITIONS

In December 1998, the Company, through a wholly owned subsidiary, entered into an agreement to sell its New Jersey Medicaid business for \$8,381, contingent upon a final enrollment count as of May 1, 1999. A pre-tax gain of \$7,186 was recognized on the sale in 1998. The members transferred to the purchaser effective February 1, 1999. The May 1, 1999 final enrollment count resulted in an additional pre-tax gain of \$2,573 being recognized in 1999.

On November 25, 1998, the Company, through a wholly owned subsidiary, purchased 51% of the common stock of La Cruz Azul for \$18,000. The excess of acquisition cost over the fair value of net assets acquired of \$8,718 was fully amortized as of December 31, 2001.

On June 30, 1998, the Company, through a wholly owned subsidiary, purchased 100% of the stock of Anthem Health Plan of Florida, Inc. for \$2,828. The company is a health maintenance organization that provides services to Florida residents. The company was renamed AmeriHealth of Florida, Inc. The excess of cost over the fair value of net assets acquired of \$1,277 was fully amortized by December 31, 1999. The Company has decided to formally exit the Florida market by not renewing any of its current member contracts, all of which have expired in 2001.

On June 30, 1998, the Company, through a wholly owned subsidiary, purchased 100% of the stock of Anthem Health Plan of Texas, Inc. for \$7,281. The company is a health maintenance organization that provides services to Texas residents. The company was renamed AmeriHealth HMO of North Texas, Inc. In June 1999, the Company merged AmeriHealth HMO of Texas, Inc. into AmeriHealth HMO of North Texas, Inc. The surviving company has been renamed AmeriHealth of Texas, Inc. The excess of cost over the fair value of net assets acquired of \$5,392 was fully amortized by December 31, 2000. On

August 31, 2000, the Company entered into an agreement to sell AmeriHealth of Texas, Inc. In November 2001, the Company paid the purchaser \$3,500 as a final settlement.

On April 4, 1996, the Company, through a wholly owned subsidiary, entered into a 50-50 joint venture with Pitcairn Properties Health Care Group of Jenkintown, Pennsylvania, to form a new venture called NewSeasons for an initial contribution of \$300 cash. Effective January 31, 2001, the Company increased its ownership in NewSeasons to 93%. As of December 31, 2001, NewSeasons is consolidated in the Company's financial statements.

13. UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES LIABILITY

	2001	2000
Balance, January 1	\$ 990,906	\$ 1,044,649
Incurred related to:		
Current year	6,811,823	6,157,204
Prior years	(158,534)	(96,385)
Total incurred	<u>6,653,289</u>	<u>6,060,819</u>
Paid related to:		
Current year	(5,715,497)	(5,284,256)
Prior years	(724,466)	(820,306)
Total paid	<u>(6,439,963)</u>	<u>(6,104,562)</u>
Claims liabilities released as a result of a business sale	<u>-</u>	<u>(10,000)</u>
Balance, December 31	<u>\$ 1,204,232</u>	<u>\$ 990,906</u>

The claims and claims adjustment expenses for prior years decreased by a total of \$158,534 in 2001 because of lower than anticipated claims costs and favorable utilization trends.

The claims and claims adjustment expenses for prior years decreased by a total of \$96,385 in 2000 because of lower than anticipated claims costs and favorable utilization trends.

14. PERMITTED PRACTICES

The Company and certain of its subsidiaries, including AmeriHealth HMO, Inc. and QCC, prepare their statutory financial statements in accordance with the accounting practices prescribed or permitted by the PID. Prescribed statutory accounting practices include a variety of publications of the NAIC, as well as state laws, regulations and general administrative rules. Permitted statutory practices encompass all accounting practices not so prescribed.

The Company, AmeriHealth HMO, Inc. and QCC received written approval from the PID to admit, for statutory purposes, additional goodwill related to the purchase of PBS's interest in KHPE and the jointly underwritten managed care lines of business, which treatment differs from prescribed statutory accounting practices. Statutory accounting practices prescribed by the PID limit admitted goodwill to 10% of adjusted capital and surplus of an insurer, as reported in its next preceding Annual Statement. As of December 31, 2001 and 2000, this permitted practice increased statutory surplus by \$73,391 and \$103,938, respectively, over what it would have been had prescribed accounting practices been followed.

The Company and its Pennsylvania domiciled insurance subsidiaries received written approval from the PID to early adopt, for statutory purposes, the NAIC Codification of Statutory Accounting Principles (the "Codification") in 1998. The Codification is intended to standardize regulatory accounting and reporting for the insurance industry. The effective date of the Codification was January 1, 2001. The Codification differs from previous statutory accounting practices prescribed by the PID. The most significant difference, as it relates to the Company, is the treatment of deferred tax assets, which under the Codification can be admitted within certain limitations. As of December 31, 2000, this permitted practice increased statutory surplus by \$35,818 over what it could have been had prescribed accounting practices been followed.

15. CONTINGENCIES

Claims Liability Guaranty - During 2000, the Company established an Insolvency Protection Trust Fund (the "Trust") to comply with the Blue Cross and Blue Shield membership standards, which require plans to take steps to ensure the payment of claims liabilities and the continuation of coverage. The Trust replaces a similar arrangement that was put in effect pursuant to the Participation Agreement with Pennsylvania plans (Capital Blue Cross, Blue Cross of Northeastern Pennsylvania, Blue Cross of Western Pennsylvania and PBS) dated December 31, 1995. The Participation Agreement terminated by the mutual consent of all of the participants on October 2, 2000. As of December 31, 2001 and 2000, the funded amount required for the Trust was \$12,104 and \$9,783, respectively, and the estimated fair value of investments on deposit was \$13,148 and \$10,663, respectively.

Litigation - In the course of ordinary business, IBC is involved in and is subject to claims, contractual disputes and other uncertainties. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on IBC's financial condition or results of operations.

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