

***Independence Blue Cross
and Subsidiaries***

*Consolidated Financial Statements for the Years
Ended December 31, 2002, 2001, and 2000,
and Independent Auditors' Report*



INDEPENDENT AUDITORS' REPORT

Members and the Board of Directors
of Independence Blue Cross
Philadelphia, Pennsylvania

We have audited the accompanying consolidated balance sheets of Independence Blue Cross and subsidiaries ("IBC") as of December 31, 2002 and 2001, 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, 2002. 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, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, in 2002 the Company changed its method of accounting for goodwill to conform to Statement of Financial Accounting Standards No. 142.

Deloitte + Touche LLP

March 7, 2003

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2002 AND 2001
(Dollars in thousands)

ASSETS	2002	2001	LIABILITIES AND RESERVES	2002	2001
Cash and cash equivalents	\$ 548,675	\$ 416,319	Claims liabilities		
Investments available for sale	1,432,476	1,257,837	Accounts payable and accrued expenses:	\$ 1,382,601	\$ 1,204,232
Receivables:			Merit rating refunds	19,164	14,054
Member and National Account premiums	485,097	400,645	Accrued expenses	216,049	160,221
Federal Employee Health Benefits Program	50,585	42,463	Accrued postretirement benefits	28,385	34,177
BlueCard Program	73,745	69,839	Income taxes	28,255	23,121
Interest	18,082	16,554	Other	145,414	151,465
Other	32,831	48,410			
	<u>660,340</u>	<u>577,911</u>	Total accounts payable and accrued expenses	<u>437,267</u>	<u>383,038</u>
Total receivables					
Prepaid expenses	10,254	11,438	Unearned income	333,319	241,655
Property and equipment, net	173,255	130,384	Long-term debt	134,637	146,006
Other assets	86,235	75,128	Commitments and contingencies		
Investments in affiliates	52,030	42,473	Reserves:		
Goodwill	211,946	226,671	Unallocated	893,240	773,069
			Accumulated other comprehensive loss, net of income taxes	<u>(5,853)</u>	<u>(9,839)</u>
			Total reserves	<u>887,387</u>	<u>763,230</u>
TOTAL ASSETS	<u>\$ 3,175,211</u>	<u>\$ 2,738,161</u>	TOTAL LIABILITIES AND RESERVES	<u>\$ 3,175,211</u>	<u>\$ 2,738,161</u>

See notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

(Dollars in thousands)

	2002	2001	2000
Underwriting income	\$ 8,451,801	\$ 7,555,661	\$ 6,864,441
Underwriting costs:			
Claims incurred	7,398,594	6,653,289	6,060,819
Medical management	196,135	178,585	157,212
Operating expenses	<u>683,971</u>	<u>603,986</u>	<u>579,673</u>
Total underwriting costs	<u>8,278,700</u>	<u>7,435,860</u>	<u>6,797,704</u>
Net underwriting income	173,101	119,801	66,737
Investment income, net	38,006	55,260	60,796
Equity in net income of affiliates	12,670	4,746	965
Amortization of intangibles	-	(20,820)	(21,118)
Other expenses, net	<u>(10,671)</u>	<u>(5,677)</u>	<u>(2,576)</u>
Income before income taxes	213,106	153,310	104,804
Provision for income taxes	<u>84,100</u>	<u>59,300</u>	<u>33,600</u>
Income before cumulative effect of a change in accounting principle	129,006	94,010	71,204
Cumulative effect of a change in accounting principle, net of taxes of \$5,800 (Note 1)	<u>(8,835)</u>	<u>-</u>	<u>-</u>
Net income	120,171	94,010	71,204
Other comprehensive income, net of income taxes:			
Unrealized holding gain (loss) on investments arising during the period, net of reclassification adjustment, and additional minimum pension obligation	<u>3,986</u>	<u>8,219</u>	<u>14,256</u>
COMPREHENSIVE INCOME	<u>\$ 124,157</u>	<u>\$ 102,229</u>	<u>\$ 85,460</u>

See notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN RESERVES YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

(Dollars in thousands)

	2002	2001	2000
Beginning balance	\$ 763,230	\$ 661,001	\$ 575,541
Comprehensive income	<u>124,157</u>	<u>102,229</u>	<u>85,460</u>
Ending balance	<u>\$ 887,387</u>	<u>\$ 763,230</u>	<u>\$ 661,001</u>

See notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Dollars in thousands)

	2002	2001	2000
OPERATING ACTIVITIES:			
Net income	\$ 120,171	\$ 94,010	\$ 71,204
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	29,830	41,035	33,906
Equity in net income of affiliates, net of dividends received	(12,670)	(5,258)	(965)
Loss (gain) on sale of investments	35,237	4,684	(559)
Deferred income taxes	(8,355)	(6,899)	(10,999)
Change in assets and liabilities, net of effects from acquisition of businesses:			
Premiums receivable	(92,574)	8,803	(65,451)
Other receivables	9,939	(2,500)	(19,877)
Prepaid expenses and other	(9,745)	15,615	3,386
Claims liabilities	178,369	213,326	(43,743)
Accounts payable and accrued expenses	53,536	80,747	(4,387)
Unearned income	91,493	61,362	(9,531)
Net cash provided by (used in) operating activities	<u>395,231</u>	<u>504,925</u>	<u>(47,016)</u>
INVESTING ACTIVITIES:			
Purchase of investments available for sale	(1,638,729)	(1,526,379)	(524,122)
Sale or maturity of investments available for sale	1,440,915	1,337,541	444,843
Purchase of other invested assets	-	(6,186)	(5,661)
Purchase of property and equipment	(94,829)	(82,588)	(57,823)
Proceeds from sale of property and equipment	41,837	79,977	21,996
Payments for acquisitions, net of cash acquired	-	756	-
Receipts for dispositions, net of cash disposed	-	-	1,151
Net cash used in investing activities	<u>(250,806)</u>	<u>(196,879)</u>	<u>(119,616)</u>
FINANCING ACTIVITIES:			
Repayment of notes receivable	21	-	-
Issuance of notes receivable	-	(175)	(15)
Payment on long-term debt	(12,090)	(15,392)	(720)
Issuance of long-term debt	-	5,191	14,848
Net cash (used in) provided by financing activities	<u>(12,069)</u>	<u>(10,376)</u>	<u>14,113</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	132,356	297,670	(152,519)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>416,319</u>	<u>118,649</u>	<u>271,168</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 548,675</u>	<u>\$ 416,319</u>	<u>\$ 118,649</u>

See notes to consolidated financial statements.

INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002, 2001, AND 2000

(Dollars in thousands, except per share data)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business—Independence Blue Cross (the “Company” or “IBC”) is a nonprofit 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 offers 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”). During the year, 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 the consolidated statement of income. 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).

In accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, certain 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 nonprofit 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—Total comprehensive income includes net income, unrealized gains (losses) on AFS investments arising during the period, net of reclassification adjustments, and an additional minimum pension obligation.

Goodwill—IBC adopted Statement of Financial Accounting Standards (“SFAS”) No. 142, *Goodwill and Other Intangible Assets*, effective January 1, 2002. SFAS No. 142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 provides that intangible assets with finite lives be amortized and that goodwill and intangible assets with indefinite lives will not be amortized, but will rather be tested at least annually for impairment. In 2001 and 2000, adjusted net income, exclusive of amortization expense recognized in those periods related to goodwill, would have been \$106,773 and \$85,552, respectively.

Upon the adoption of SFAS No. 142, IBC recorded an impairment loss related to the goodwill recorded on its investments in NewSeasons and CorCell, Inc. in the amounts of \$7,769 and \$1,066, net of tax, respectively. The impairment loss is presented on the consolidated statements of income and comprehensive income as a cumulative effect of a change in accounting principle. IBC concluded such impairment existed given the recent operating results of both NewSeasons and CorCell, Inc. IBC used an income approach based on expected earnings to determine the fair value of each entity and to conclude on the impairment.

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 nonadmitted (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, 2002 and 2001 were \$707,106 and \$689,628, respectively. Statutory net gain (loss) for 2002, 2001, and 2000 was \$16,769, \$56,116, and \$(10,793), respectively.

Fair Value of Financial Instruments—In accordance with 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.

Derivative Instruments and Hedging Activities—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 consolidated financial statements.

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.

Recent Accounting Pronouncements—In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. IBC believes that the adoption of this standard will not have a material impact on its consolidated financial statements.

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. The adoption of SFAS No. 144 did not have a material impact on IBC's consolidated financial statements.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. The provisions of this statement related to the rescission of SFAS No. 4 are effective for fiscal years beginning after May 15, 2002.

Certain provisions of the statement relating to SFAS No. 13 are effective for transactions occurring after May 15, 2002. All other provisions of the statement are effective for financial statements issued on or after May 15, 2002. The provisions of this standard had no impact on IBC's consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The statement requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. IBC does not believe that adoption of this standard will have an impact on its consolidated financial statements.

In October 2002, the FASB issued SFAS No. 147, *Acquisitions of Certain Financial Institutions*, which addresses the financial accounting and reporting for the acquisition of all or part of a financial institution, except for a transaction between two or more mutual enterprises. The effective date of this statement is October 1, 2002. The adoption of this standard had no impact on IBC's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123*. SFAS No. 148 amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This statement is effective for financial statements for fiscal years ending after December 15, 2002. The adoption of this standard will have no impact on IBC's consolidated financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others*. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This Interpretation also incorporates, without change, the guidance in FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*, which is being superseded. The initial recognition and initial measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. As of December 31, 2002, IBC had issued a guarantee totaling \$3,700 related to a debt agreement of an affiliated entity.

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. The Interpretation clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. IBC is not a party to any variable interest entities covered by the Interpretation.

2. AGENCY CONTRACTS

Claims processed for others and excluded from the consolidated financial statements amounted to \$236,504 in 2002, \$213,106 in 2001, and \$176,158 in 2000. Reimbursements for the administrative cost of services performed for PBS, governmental agencies, and other plans in the amount of \$29,644, \$30,359, and \$32,357 in 2002, 2001, and 2000, respectively, have been offset against operating expenses.

3. INVESTMENTS

The amortized cost and estimated fair value of investments at December 31, 2002 and 2001 are as follows:

	Available for Sale December 31, 2002			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury notes and federal agencies	\$ 289,057	\$ 12,051	\$ 6	\$ 301,102
Mortgage-backed securities	194,017	8,520	227	202,310
Corporate debt securities	601,938	28,389	10,525	619,802
Other	170,257	5,063	1,828	173,492
Total debt securities	1,255,269	54,023	12,586	1,296,706
Common stock	161,388	2,820	28,438	135,770
Total investments	<u>\$ 1,416,657</u>	<u>\$ 56,843</u>	<u>\$ 41,024</u>	<u>\$ 1,432,476</u>

	Available for Sale December 31, 2001			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury notes and federal agencies	\$ 287,163	\$ 3,806	\$ 799	\$ 290,170
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	1,181,941	19,838	15,415	1,186,364
Common stock	91,393	2,985	22,905	71,473
Total investments	<u>\$ 1,273,334</u>	<u>\$ 22,823</u>	<u>\$ 38,320</u>	<u>\$ 1,257,837</u>

The amortized cost and estimated fair value of debt securities by maturity date at December 31, 2002 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	\$ 52,833	\$ 53,467
Due after one year through five years	482,501	500,241
Due after five years through ten years	406,898	420,188
Due after ten years	<u>119,020</u>	<u>120,500</u>
	1,061,252	1,094,396
Mortgage-backed securities	<u>194,017</u>	<u>202,310</u>
Total debt securities	<u>\$ 1,255,269</u>	<u>\$ 1,296,706</u>

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

	2002	2001	2000
Realized gains	\$ 25,333	\$ 17,338	\$ 9,789
Realized losses	<u>(60,570)</u>	<u>(22,022)</u>	<u>(9,230)</u>
	<u>\$ (35,237)</u>	<u>\$ (4,684)</u>	<u>\$ 559</u>

The net change in the unrealized appreciation (depreciation) on investments classified as AFS included as a component of other comprehensive income (loss) was \$31,316, \$15,741, and \$28,477 for the years ended December 31, 2002, 2001, and 2000, 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.

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 \$60,217 and \$64,590 at December 31, 2002 and 2001, 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.

Change in benefit obligation	Pension Benefits		Health/Life Benefits	
	2002	2001	2002	2001
Benefit obligation at beginning of year	\$ 216,606	\$ 188,488	\$ 33,909	\$ 26,151
Service cost	17,339	15,214	3,856	3,271
Interest cost	14,844	13,475	2,458	2,120
Amendments	925	-	366	-
Participant contributions	-	-	58	-
Actuarial (gain) loss	(763)	2,413	-	3,837
Benefits paid	<u>(6,692)</u>	<u>(2,984)</u>	<u>(1,932)</u>	<u>(1,470)</u>
Benefit obligation at end of year	<u>\$ 242,259</u>	<u>\$ 216,606</u>	<u>\$ 38,715</u>	<u>\$ 33,909</u>

Change in plan assets	Pension Benefits		Health/Life Benefits	
	2002	2001	2002	2001
Fair value of plan assets at beginning of year	\$ 142,801	\$ 151,589	\$ -	\$ -
Actual return on plan assets	(19,230)	(15,118)	115	-
Employer contribution	33,160	11,262	9,923	1,470
Participant contributions	-	-	58	-
Actuarial loss	-	(1,948)	-	-
Benefits paid	<u>(6,692)</u>	<u>(2,984)</u>	<u>(1,932)</u>	<u>(1,470)</u>
Fair value of plan assets at end of year	<u>\$ 150,039</u>	<u>\$ 142,801</u>	<u>\$ 8,164</u>	<u>\$ -</u>
Funded status	\$ (92,220)	\$ (73,805)	\$ (30,551)	\$ (33,909)
Unrecognized net actuarial loss	88,026	55,054	2,349	659
Unrecognized prior-service cost (benefit)	<u>2,233</u>	<u>1,515</u>	<u>(183)</u>	<u>(927)</u>
Accrued benefit cost	<u>\$ (1,961)</u>	<u>\$ (17,236)</u>	<u>\$ (28,385)</u>	<u>\$ (34,177)</u>

Weighted-average assumptions as of December 31	Pension Benefits		Health/Life Benefits	
	2002	2001	2002	2001
Discount rate	7.00 %	7.25 %	7.00 %	7.25 %
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 8.5% grading down to 5% over seven 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, 2002 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.

Component of net periodic benefit cost	Pension Benefits		
	2002	2001	2000
Service cost	\$ 17,339	\$ 15,214	\$ 13,366
Interest cost	14,844	13,475	11,895
Expected return on plan assets	(16,483)	(15,664)	(15,411)
Amortization of prior service cost	208	138	156
Amortization of transition asset	-	(377)	(504)
Recognized net actuarial loss (gain)	<u>1,979</u>	<u>418</u>	<u>(95)</u>
Net periodic benefit cost	<u>\$ 17,887</u>	<u>\$ 13,204</u>	<u>\$ 9,407</u>

Component of net periodic benefit cost	Health/Life Benefits		
	2002	2001	2000
Service cost	\$ 3,856	\$ 3,271	\$ 2,783
Interest cost	2,458	2,120	1,685
Expected return on plan assets	-	-	-
Amortization of prior service cost	(312)	(312)	(287)
Recognized net actuarial gain	<u>-</u>	<u>-</u>	<u>(112)</u>
Net periodic benefit cost	<u>\$ 6,002</u>	<u>\$ 5,079</u>	<u>\$ 4,069</u>

The net periodic benefit costs are recorded in the consolidated statements of income and comprehensive income as operating expenses.

5. COMPREHENSIVE INCOME

The components of IBC's other comprehensive income as of December 31, 2002, 2001, and 2000, are as follows:

	2002		
	Before-Tax	Tax Benefit (Expense)	Net
Additional minimum pension obligation	\$ (21,391)	\$ 7,487	\$ (13,904)
Unrealized holding losses arising during the period	(1,505)	702	(803)
Less: reclassification adjustment for losses realized in net income	<u>(35,237)</u>	<u>16,544</u>	<u>(18,693)</u>
Other comprehensive income	<u>\$ 12,341</u>	<u>\$ (8,355)</u>	<u>\$ 3,986</u>

	<u>2001</u>		
	Before-Tax	Tax Benefit (Expense)	Net
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>
	<u>2000</u>		
	Before-Tax	Tax Benefit (Expense)	Net
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>

6. INCOME TAXES

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

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Federal:			
Current	\$ 83,700	\$ 44,000	\$ 21,500
Deferred	(18,700)	(100)	500
State and local	<u>13,300</u>	<u>15,400</u>	<u>11,600</u>
	<u>\$ 78,300</u>	<u>\$ 59,300</u>	<u>\$ 33,600</u>

IBC paid \$65,100, \$54,400, and \$33,500 in federal income taxes in 2002, 2001, and 2000, respectively. The Company paid \$14,230, \$14,074, and \$17,938 in state income taxes in 2002, 2001, and 2000, respectively.

The net deferred taxes as of December 31, 2002 and 2001, included in other assets on the consolidated balance sheets, include the following amounts of deferred tax assets and liabilities:

	<u>2002</u>	<u>2001</u>
Deferred tax asset	\$ 96,400	\$ 76,900
Deferred tax liability	(42,600)	(38,400)
Deferred tax (liability) asset—investments available for sale	(7,700)	4,400
Deferred tax asset—additional minimum pension obligation	7,500	-
Valuation allowance for deferred tax asset	<u>(5,700)</u>	<u>(9,100)</u>
	<u>\$ 47,900</u>	<u>\$ 33,800</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.

In connection with the ownership increase in NewSeasons in 2001 (as discussed in Notes 8 and 12), IBC acquired \$13,500 of net operating loss carryforwards. As of December 31, 2002, the net operating loss carryforward will begin expiring in 2011. The net operating loss carryforward may only be utilized by NewSeasons.

SFAS No. 109, *Accounting for Income Taxes*, requires deferred tax assets to be reduced by a valuation allowance if it is more likely than not some portions or all of the deferred tax assets will not be realized. As of December 31, 2002 and 2001, IBC has recorded valuation allowances of \$5,700 and \$9,100, respectively. The amount as of December 31, 2002 relates to subsidiary net operating loss ("NOL") carryforwards which can only be utilized against subsidiary taxable income. The valuation allowance decrease in 2002 of \$3,400 is primarily due to the elimination of the need for a valuation allowance for amounts attributable to non-vested post-retirement benefits of \$6,200 and the addition of an allowance for New Season's NOL of \$4,700.

7. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2002 and 2001, is as follows:

	2002	2001
Land	\$ 13,925	\$ 13,626
Building and improvements	107,824	101,213
Office furniture and equipment	25,590	21,510
Capitalized software	<u>50,068</u>	<u>12,899</u>
Property and equipment, gross	197,407	149,248
Accumulated depreciation and amortization	<u>(24,152)</u>	<u>(18,864)</u>
Property and equipment, net	<u>\$ 173,255</u>	<u>\$ 130,384</u>

Depreciation and amortization expense related to property and equipment was \$10,180, \$17,578, and \$7,068 for the years ended December 31, 2002, 2001, and 2000, respectively.

8. INDEBTEDNESS

Indebtedness outstanding at December 31, 2002 and 2001, is as follows:

	2002	2001
Mortgage and construction loans	\$ 90,895	\$ 101,310
Industrial Revenue Bonds	3,600	4,480
Subordinated capital note	40,000	40,000
Capital lease obligation	<u>142</u>	<u>216</u>
	<u>\$ 134,637</u>	<u>\$ 146,006</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
2003	\$ 16,469
2004	21,803
2005	2,156
2006	1,980
2007	1,320
Thereafter	<u>90,909</u>
	<u>\$ 134,637</u>

Interest paid amounted to \$10,056 in 2002, \$10,254 in 2001, and \$4,267 in 2000.

IBC has an available line of credit with an area bank in the amount of \$10,000, which expires in 2003. Borrowings under the line of credit bear interest at LIBOR plus 60 basis points, and are payable upon demand. As of December 31, 2002 and 2001, no amounts were outstanding under this agreement.

IBC has established Reverse Repurchase Agreements with a financial institution with the amount not to exceed \$44,325 and \$40,521, which represent two percent of the statutory admitted assets of IBC and KHPE as of December 31, 2002 and 2001, respectively. Borrowings under these agreements bear interest at the prevailing repurchase rate. As of December 31, 2002 and 2001, no amounts were outstanding under these agreements.

9. COMMITMENTS

IBC leases certain facilities and equipment under long-term leases. As of December 31, 2002, 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
2003	\$ 26,062	\$ 64,349	\$ 90,411
2004	25,966	55,816	81,782
2005	24,088	12,666	36,754
2006	23,230	302	23,532
2007	23,403	76	23,479
Thereafter	248,560	-	248,560

Total rental expense amounted to \$71,773, \$67,045, and \$68,445 for 2002, 2001, and 2000, respectively.

During 2002, 2001 and 2000, 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 for those leases that qualified as operating. The proceeds from the 2002 and 2001 sales of \$41,837 and \$79,977, 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 \$38,294, \$24,987 and \$6,737 for the 2002, 2001, and 2000 leases, respectively. The commitment for the capital lease is disclosed in Note 8.

In June of 1998, IBC 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 BCBS VT draws on an IBC letter of credit, such amounts will become a principal advance under the surplus note agreement. As of December 31, 2002, 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,		
	2002	2001	2000
Underwriting income	\$ 1,008,722	\$ 796,102	\$ 687,583
Claims incurred	<u>(1,008,722)</u>	<u>(796,102)</u>	<u>(687,583)</u>
Net income	<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:

	2002	2001	2000
Revenues	\$ 915,042	\$ 773,199	\$ 695,891
Net income	22,164	12,730	6,468
Total assets	212,788	178,620	166,546
Partners' equity	56,514	37,756	31,986

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

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

	2002	2001	2000
Revenues	\$ 258,784	\$ 137,934	\$ 94,771
Net income	4,924	8,884	8,220
Total assets	58,494	45,906	27,460
Partners' equity	22,784	18,028	13,806

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

12. ACQUISITIONS AND DISPOSITIONS

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 member contracts, all of which 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% and began to consolidate NewSeasons in the Company's consolidated financial statements.

13. UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES LIABILITY

	2002	2001
Balance, January 1	\$ 1,204,232	\$ 990,906
Incurred related to:		
Current year	7,770,364	6,811,823
Prior years	(371,770)	(158,534)
Total incurred	7,398,594	6,653,289
Paid related to:		
Current year	(6,512,548)	(5,715,497)
Prior years	(707,677)	(724,466)
Total paid	(7,220,225)	(6,439,963)
Balance, December 31	\$ 1,382,601	\$ 1,204,232

The claims and claims adjustment expenses for prior years decreased by a total of \$371,770 and \$158,534 in 2002 and 2001, respectively, 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, 2002 and 2001, this permitted practice increased statutory surplus by \$39,986 and \$73,391, respectively, over what it would 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, 2002 and 2001, the funded amount required for the Trust was \$12,988 and \$12,104, respectively, and the estimated fair value of investments on deposit was \$12,979 and \$13,148, 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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