

# ***Independence Blue Cross and Subsidiaries***

*Consolidated Financial Statements for the Years  
Ended December 31, 2003, 2002, and 2001,  
and Independent Auditors' Report*

## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of Independence Blue Cross and subsidiaries (the "Company" or "IBC") as of December 31, 2003 and 2002, 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, 2003. 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, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, 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*

April 27, 2004

## INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2003 AND 2002

(Dollars in thousands)

ASSETS	2003	2002	LIABILITIES AND RESERVES	2003	2002
CASH AND CASH EQUIVALENTS	\$ 766,363	\$ 548,675	CLAIMS LIABILITIES	\$ 1,525,813	\$ 1,382,601
INVESTMENTS AVAILABLE FOR SALE	1,618,365	1,439,885	ACCOUNTS PAYABLE AND ACCRUED EXPENSES:		
RECEIVABLES:			Merit rating refunds	18,433	19,164
Member and national account premiums	478,422	485,097	Accrued expenses	238,244	216,049
Federal Employee Health Benefits Program	54,882	50,585	Accrued postretirement benefits	32,104	28,385
BlueCard Program	86,302	73,745	Income taxes	96,461	28,255
Interest	17,719	18,082	Other	<u>156,508</u>	<u>145,414</u>
Other	<u>41,846</u>	<u>32,831</u>			
Total receivables	<u>679,171</u>	<u>660,340</u>	Total accounts payable and accrued expenses	<u>541,750</u>	<u>437,267</u>
Prepaid expenses	14,204	10,254	UNEARNED INCOME	384,984	333,319
Property and equipment—net	139,659	173,255	LONG-TERM DEBT	70,172	134,637
Other assets	132,878	85,351	COMMITMENTS AND CONTINGENCIES (Notes 9 and 15)		
Investments in affiliates	46,493	45,505	RESERVES:		
Goodwill	208,183	211,946	Unallocated	1,082,113	893,240
			Accumulated other comprehensive income (loss)— net of income taxes	<u>484</u>	<u>(5,853)</u>
			Total reserves	<u>1,082,597</u>	<u>887,387</u>
TOTAL ASSETS	<u>\$ 3,605,316</u>	<u>\$ 3,175,211</u>	TOTAL LIABILITIES AND RESERVES	<u>\$ 3,605,316</u>	<u>\$ 3,175,211</u>

See notes to consolidated financial statements.

# INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001 (Dollars in thousands)

	2003	2002	2001
UNDERWRITING INCOME	<u>\$9,149,359</u>	<u>\$8,451,801</u>	<u>\$7,555,661</u>
UNDERWRITING COSTS:			
Claims incurred	8,007,912	7,398,594	6,653,289
Medical management	208,572	196,135	178,585
Operating expenses	<u>690,852</u>	<u>683,971</u>	<u>603,986</u>
Total underwriting costs	<u>8,907,336</u>	<u>8,278,700</u>	<u>7,435,860</u>
Net underwriting income	242,023	173,101	119,801
Investment income—net	70,790	38,006	55,260
Equity in net income of affiliates	10,657	12,670	4,746
Amortization of intangibles	-	-	(20,820)
Other expenses—net	<u>(12,697)</u>	<u>(10,671)</u>	<u>(5,677)</u>
Income before income taxes	310,773	213,106	153,310
PROVISION FOR INCOME TAXES	<u>121,900</u>	<u>84,100</u>	<u>59,300</u>
Income before cumulative effect of a change in accounting principle	188,873	129,006	94,010
Cumulative effect of a change in accounting principle in 2002, net of taxes of \$5,800 (Note 1)	<u>-</u>	<u>(8,835)</u>	<u>-</u>
NET INCOME	188,873	120,171	94,010
OTHER COMPREHENSIVE INCOME— NET OF INCOME TAXES:			
Unrealized holding gain on investments arising during the period, net of reclassification adjustment, and the change in additional minimum pension obligation	<u>6,337</u>	<u>3,986</u>	<u>8,219</u>
COMPREHENSIVE INCOME	<u>\$ 195,210</u>	<u>\$ 124,157</u>	<u>\$ 102,229</u>

See notes to consolidated financial statements.

# INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN RESERVES YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001

(Dollars in thousands)

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	2003	2002	2001
BEGINNING BALANCE	\$ 887,387	\$ 763,230	\$ 661,001
Comprehensive income	<u>195,210</u>	<u>124,157</u>	<u>102,229</u>
ENDING BALANCE	<u>\$ 1,082,597</u>	<u>\$ 887,387</u>	<u>\$ 763,230</u>

See notes to consolidated financial statements.

# INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001 (Dollars in thousands)

	2003	2002	2001
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 188,873	\$ 120,171	\$ 94,010
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	24,678	29,830	41,035
Equity in net income of affiliates—net of dividends received	3,743	(12,670)	(5,258)
(Gain) loss on sale of investments	(26,041)	35,237	4,684
Deferred income taxes	(6,643)	(5,549)	(6,899)
Change in assets and liabilities—net of effects from acquisition of businesses:			
Premiums receivable	2,378	(92,574)	8,803
Other receivables	(21,209)	9,939	(2,500)
Prepaid expenses and other	(51,477)	(8,861)	15,615
Claims liabilities	143,212	178,369	213,326
Accounts payable and accrued expenses	104,483	53,536	80,747
Unearned income	51,665	91,493	61,362
Net cash provided by operating activities	<u>413,662</u>	<u>398,921</u>	<u>504,925</u>
<b>INVESTING ACTIVITIES:</b>			
Purchase of investments available for sale	(2,086,608)	(1,642,419)	(1,526,379)
Sale or maturity of investments available for sale	1,938,901	1,440,915	1,337,541
Purchase of other invested assets	(1,400)	-	(6,186)
Purchase of property and equipment	(83,095)	(94,829)	(82,588)
Proceeds from sale of property and equipment	100,693	41,837	79,977
Payments for acquisitions—net of cash acquired	-	-	756
Net cash used in investing activities	<u>(131,509)</u>	<u>(254,496)</u>	<u>(196,879)</u>
<b>FINANCING ACTIVITIES:</b>			
Repayment of notes receivable	-	21	-
Issuance of notes receivable	-	-	(175)
Payment on long-term debt	(64,465)	(12,090)	(15,392)
Issuance of long-term debt	-	-	5,191
Net cash used in financing activities	<u>(64,465)</u>	<u>(12,069)</u>	<u>(10,376)</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>217,688</b>	<b>132,356</b>	<b>297,670</b>
<b>CASH AND CASH EQUIVALENTS—Beginning of year</b>	<b><u>548,675</u></b>	<b><u>416,319</u></b>	<b><u>118,649</u></b>
<b>CASH AND CASH EQUIVALENTS—End of year</b>	<b><u>\$ 766,363</u></b>	<b><u>\$ 548,675</u></b>	<b><u>\$ 416,319</u></b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash paid during year for:			
Interest	<u>\$ 8,869</u>	<u>\$ 10,056</u>	<u>\$ 10,254</u>
Income taxes	<u>\$ 123,799</u>	<u>\$ 79,330</u>	<u>\$ 68,474</u>

See notes to consolidated financial statements.

# INDEPENDENCE BLUE CROSS AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2003, 2002, AND 2001

(Dollars in thousands, except per share data)

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### 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 Pennsylvania 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 82.7% 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 participated 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<sup>®</sup> 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<sup>®</sup> or BLUE SHIELD<sup>®</sup> 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 Available for Sale***—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.

***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 lives of the assets (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 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 the change in the 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, adjusted net income, exclusive of amortization expense recognized in that period related to goodwill, would have been \$106,773.

In 2002, 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 amount 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. In 2003, IBC recorded an impairment loss related to the goodwill recorded on its investment in NewSeasons in the amount of \$3,763. The impairment loss is presented on the consolidated statements of income and comprehensive income as a component of other expenses. IBC concluded such impairment existed given

the recent operating results of NewSeasons. In 2003 and 2002, 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, 2003 and 2002 were \$840,917 and \$707,106, respectively. Statutory net gain for 2003, 2002, and 2001 was \$53,189, \$16,769 and \$56,116, 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. See Note 3 for additional disclosures about the fair value of *Investments Available for Sale*.

**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. 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 was effective for financial statements issued for fiscal years beginning after June 15, 2002. The adoption of this standard did not have a material impact on IBC’s 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 was 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 were effective for fiscal years beginning after May 15, 2002. Certain provisions of the statement relating to SFAS No. 13 were effective for transactions occurring after May 15, 2002. All other provisions of the statement were effective for financial statements issued on or after May 15, 2002. The provisions of this standard did not have an 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. The adoption of this standard did not have an impact on IBC's 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 was October 1, 2002. The adoption of this standard did not have an 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 was superseded. The initial recognition and initial measurement provisions of this Interpretation were 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 were effective for financial statements of interim or annual periods ending after December 15, 2002. As of December 31, 2003 and 2002, IBC had a guarantee totaling \$3,700 related to a debt agreement with DePaul, an affiliated entity. See Note 9 for disclosure of additional guarantees and commitments.

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 was effective for financial statements for

fiscal years ending after December 15, 2002. The adoption of this standard did not have an impact on IBC's consolidated financial statements.

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. In December 2003, FIN 46 was revised in FIN 46R. A nonpublic entity with an interest in an entity that is subject to this Interpretation and that is created after December 31, 2003, shall apply this Interpretation to that entity immediately. A nonpublic enterprise shall apply this Interpretation to all entities that are subject to this Interpretation by the beginning of the first annual period beginning after December 15, 2004. IBC is not a party to any variable interest entities covered by the Interpretation. In management's opinion, this Interpretation will have no impact on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement amends certain paragraphs of FASB Statements No. 128 and No. 133 and was effective for financial instruments entered into or modified after May 31, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires an issuer to classify a financial instrument that is within its scope as a liability (or an asset, in some circumstances). This Statement has not had a material impact on the Company's financial statements. The FASB is addressing certain implementation issues associated with the application of SFAS No. 150. In October 2003, the FASB decided to defer certain provisions of SFAS No. 150 related to mandatorily redeemable financial instruments representing noncontrolling interests in subsidiaries included in consolidated financial statements. The Company does not believe that these actions will have a material impact on the Company's financial statements.

In November 2003, the Emerging Issues Task Force ("EITF") reached a consensus on certain disclosures required for securities accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. EITF issue 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* requires additional disclosure of quantitative and qualitative information for investments with unrealized losses at the balance sheet date that have not been recognized as other-than-temporary impairments. The Company has included the required disclosures in the Notes to Consolidated Financial Statements (see Note 3).

In December 2003, the FASB revised SFAS No. 132 *Employers' Disclosures about Pensions and Other Postretirement Benefits*. This revision is intended to improve financial statement disclosures for defined benefit plans. The standard requires that companies give more details about their plan assets, benefit obligations, cash flows, benefit costs and other relevant information. This standard is effective for fiscal years ending on or after June 15, 2004. The Company has included the additional disclosures in the Notes to Consolidated Financial Statements (see Note 4).

## **2. AGENCY CONTRACTS**

Claims processed for others and excluded from the consolidated financial statements amounted to \$284,308 in 2003, \$236,504 in 2002 and \$213,106 in 2001. Reimbursements for the administrative cost of services performed for PBS, governmental agencies, and other plans in the amount of \$34,877 in 2003, \$29,644 in 2002 and \$30,359 in 2001, respectively, have been offset against operating expenses.

### 3. INVESTMENTS

The cost or amortized cost and estimated fair value of investments at December 31, 2003 and 2002, are as follows:

	Available for Sale December 31, 2003			Estimated Fair Value
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. Treasury notes and federal agencies	\$ 277,068	\$ 1,354	\$ 571	\$ 277,851
Mortgage-backed securities	167,911	3,465	989	170,387
Asset-backed securities	98,936	1,190	887	99,239
Corporate debt securities	644,404	33,295	1,286	676,413
Other	96,674	1,998	293	98,379
Total debt securities	<u>1,284,993</u>	<u>41,302</u>	<u>4,026</u>	<u>1,322,269</u>
Common stock	164,839	20,495	7,996	177,338
Preferred stock	114,080	5,087	409	118,758
Total equity securities	<u>278,919</u>	<u>25,582</u>	<u>8,405</u>	<u>296,096</u>
Total investments	<u>\$ 1,563,912</u>	<u>\$ 66,884</u>	<u>\$ 12,431</u>	<u>\$ 1,618,365</u>

  

	Available for Sale December 31, 2002			Estimated Fair Value
	Cost or 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
Asset-backed securities	54,306	1,439	1,826	53,919
Corporate debt securities	601,938	28,389	10,525	619,802
Other	115,951	3,624	2	119,573
Total debt securities	<u>1,255,269</u>	<u>54,023</u>	<u>12,586</u>	<u>1,296,706</u>
Common stock	155,346	2,400	28,137	129,609
Preferred stock	13,451	420	301	13,570
Total equity securities	<u>168,797</u>	<u>2,820</u>	<u>28,438</u>	<u>143,179</u>
Total investments	<u>\$ 1,424,066</u>	<u>\$ 56,843</u>	<u>\$ 41,024</u>	<u>\$ 1,439,885</u>

The amortized cost and estimated fair value of debt securities by maturity date at December 31, 2003 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.

	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
Due in one year or less	\$ 148,728	\$ 149,767
Due after one year through five years	379,535	391,800
Due after five years through ten years	405,688	424,772
Due after ten years	<u>84,195</u>	<u>86,304</u>
	1,018,146	1,052,643
Mortgage-backed securities	167,911	170,387
Asset-backed securities	<u>98,936</u>	<u>99,239</u>
Total debt securities	<u><u>\$1,284,993</u></u>	<u><u>\$1,322,269</u></u>

Gross realized gains and losses from sales of investments recorded in *Investment income – net* were as follows:

	<b>2003</b>	<b>2002</b>	<b>2001</b>
Realized gains	\$ 48,797	\$ 25,333	\$ 17,338
Realized losses	<u>(22,756)</u>	<u>(60,570)</u>	<u>(22,022)</u>
	<u><u>\$ 26,041</u></u>	<u><u>\$ (35,237)</u></u>	<u><u>\$ (4,684)</u></u>

The net change in the unrealized appreciation (depreciation) on investments classified as AFS included as a component of other comprehensive income was \$38,634, \$31,316, and \$15,741 for the years ended December 31, 2003, 2002, and 2001, 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.

As of December 31, 2003 and 2002, the investment portfolio had gross unrealized losses of \$12,431 and \$41,024, respectively. Estimated fair values and unrealized losses for securities that were in an unrealized loss position for more than 12 months totaled \$51,528 and \$5,824, respectively, at December 31, 2003 and \$47,711 and \$9,267, respectively, at December 31, 2002. For all securities that are in an unrealized loss position for an extended period of time, the Company performs an evaluation of the specific events attributable to the market decline of the security. When it is determined that a security's unrealized loss is other than temporary, a realized loss is recognized in the period in which the decline in value is determined to be other than temporary.

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 \$65,646 and \$60,217 at December 31, 2003 and 2002, respectively. Deposits are included in *Investments available for sale* on the consolidated balance sheets.

#### **4. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS**

IBC has a noncontributory 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.

A summary of assets, obligations and assumptions of the pension and health/life benefit plans are as follows at December 31, 2003 and 2002:

	<b>Pension Benefits</b>		<b>Health/Life Benefits</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 242,259	\$ 216,606	\$ 38,715	\$ 33,909
Service cost	20,528	17,339	4,399	3,856
Interest cost	19,870	14,844	3,086	2,458
Participant contribution	-	-	-	58
Actuarial loss (gain)	71,790	(763)	7,409	-
Benefits paid	(5,748)	(6,692)	(2,857)	(1,932)
Amendments	<u>1,544</u>	<u>925</u>	<u>(740)</u>	<u>366</u>
Benefit obligation at end of year	<u>\$ 350,243</u>	<u>\$ 242,259</u>	<u>\$ 50,012</u>	<u>\$ 38,715</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 150,039	\$ 142,801	\$ 8,165	\$ -
Actual return on plan assets	34,831	(19,230)	474	115
Employer contribution	53,385	33,160	2,857	9,923
Participant contribution	-	-	-	58
Benefits paid	<u>(5,748)</u>	<u>(6,692)</u>	<u>(2,857)</u>	<u>(1,932)</u>
Fair value of plan assets at end of year	<u>\$ 232,507</u>	<u>\$ 150,039</u>	<u>\$ 8,639</u>	<u>\$ 8,164</u>
Funded status:				
Funded status	\$ (117,736)	\$ (92,220)	\$ (41,373)	\$ (30,551)
Unrecognized net loss	135,062	88,026	9,897	2,349
Unamortized prior-service cost (benefit)	<u>3,442</u>	<u>2,233</u>	<u>(628)</u>	<u>(183)</u>
Prepaid asset (benefit obligation) for nonvested employees	<u>\$ 20,768</u>	<u>\$ (1,961)</u>	<u>\$ (32,104)</u>	<u>\$ (28,385)</u>
Components of net periodic benefit cost:				
Service cost	\$ 20,528	\$ 17,339	\$ 4,399	\$ 3,856
Interest cost	19,870	14,844	3,086	2,458
Expected return on plan assets	(17,215)	(16,483)	(714)	-
Amortization of unrecognized:				
Prior-service cost (benefit)	335	208	(295)	(312)
Actuarial loss	6,926	1,979	100	-
Special termination benefit charge	<u>212</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net periodic benefit cost	<u>\$ 30,656</u>	<u>\$ 17,887</u>	<u>\$ 6,576</u>	<u>\$ 6,002</u>

## Additional Information

	<u>Pension Benefits</u>		<u>Health/Life Benefits</u>	
	2003	2002	2003	2002
Increase in minimum liability included in other comprehensive income, net of income tax	\$16,978	\$13,904	N/A	N/A

The assumptions used in determining the actuarial present value of the projected benefit obligations were as follows:

<b>Weighted-average assumptions as of December 31</b>	<u>Pension Benefits</u>		<u>Health/Life Benefits</u>	
	2003	2002	2003	2002
Discount rate	6.5 %	7.0 %	6.5 %	7.0 %
Rate of compensation increase	4.0	4.0	4.0	4.0
Expected long-term rate of return on plan assets	10.0	10.0	10.0	10.0

The expected rate of return on plan assets was estimated utilizing a variety of factors including the historical investment return achieved over a long-term period, the targeted allocation of plan assets and expectation concerning future returns in the marketplace for both equity and debt securities.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retirees. The related trend rate information is as follows:

<b>Assumed health care cost trend rates at December 31</b>	2003	2002
Health care cost trend rate assumed for next year	9.0 %	8.5 %
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0	5.0
Year that the rate reaches the ultimate trend rate	2009	2009

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would not significantly change results.

IBC's pension plan weighted-average asset allocations at December 31, 2003 and 2002, by asset category are as follows:

<b>Asset Category</b>	<b>Plan Assets at December 31</b>	
	<b>2003</b>	<b>2002</b>
Equity securities	60 %	59 %
Debt securities	27	33
Money market	8	7
Other	<u>5</u>	<u>1</u>
Total	<u>100 %</u>	<u>100 %</u>

The investment strategy of the Company's funded defined benefits plans is to achieve consistent positive returns, after adjusting for inflation, and to maximize long-term total return within prudent levels of risk through a combination of income and capital appreciation. Risk to capital is minimized through the diversification of investments across and within various asset categories.

IBC's health/life benefit plan weighted-average asset allocations at December 31, 2003 and 2002, by asset category are as follows:

<b>Asset Category</b>	<b>Plan Assets at December 31</b>	
	<b>2003</b>	<b>2002</b>
Debt securities	<u>100 %</u>	<u>100 %</u>
Total	<u>100 %</u>	<u>100 %</u>

**Contributions**—The Company expects to contribute in excess of \$65,000 to its pension plan in 2004. The Company does not expect to make any contributions to its postretirement benefit plan in 2004.

The Company sponsors a qualified 401(k) Savings Plan available to all full-time employees of the Company and its subsidiaries and affiliates. The Company contributes fifty percent of a participant's contribution up to a maximum of three percent of a participant's compensation. The Company's contribution for the plan was \$7,780 and \$7,012 for 2003 and 2002, respectively. The fair value of plan assets was \$225,300 and \$169,531 at December 31, 2003 and 2002, respectively.

## 5. COMPREHENSIVE INCOME

The components of IBC's other comprehensive income as of December 31, 2003, 2002, and 2001, are as follows:

	<b>2003</b>		
	<b>Before-Tax</b>	<b>Tax Benefit (Expense)</b>	<b>Net</b>
Change in additional minimum pension obligation	\$ (26,120)	\$ 9,142	\$ (16,978)
Unrealized holding gains arising during the period	65,141	(26,298)	38,843
Less: reclassification adjustment for gains realized in net income	<u>26,041</u>	<u>(10,513)</u>	<u>15,528</u>
Other comprehensive income	<u>\$ 12,980</u>	<u>\$ (6,643)</u>	<u>\$ 6,337</u>
	<b>2002</b>		
	<b>Before-Tax</b>	<b>Tax Benefit (Expense)</b>	<b>Net</b>
Change in additional minimum pension obligation	\$ (21,391)	\$ 7,487	\$ (13,904)
Unrealized holding losses arising during the period	(4,311)	1,817	(2,494)
Less: reclassification adjustment for losses realized in net income	<u>(35,237)</u>	<u>14,853</u>	<u>(20,384)</u>
Other comprehensive income	<u>\$ 9,535</u>	<u>\$ (5,549)</u>	<u>\$ 3,986</u>
	<b>2001</b>		
	<b>Before-Tax</b>	<b>Tax Benefit (Expense)</b>	<b>Net</b>
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>

## 6. INCOME TAXES

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

	<u>Years Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Federal:			
Current	\$ 126,000	\$ 83,700	\$ 44,000
Deferred	(36,500)	(18,700)	(100)
State and local	<u>32,400</u>	<u>13,300</u>	<u>15,400</u>
	<u>\$ 121,900</u>	<u>\$ 78,300</u>	<u>\$ 59,300</u>

IBC paid \$104,600, \$65,100, and \$54,400 in federal income taxes in 2003, 2002, and 2001, respectively. The Company paid \$19,199, \$14,230, and \$14,074 in state and local income taxes in 2003, 2002, and 2001, respectively.

The net deferred taxes as of December 31, 2003 and 2002, included in other assets on the consolidated balance sheets, include the following amounts of deferred tax assets and liabilities:

	<u>2003</u>	<u>2002</u>
Deferred tax asset	\$ 131,800	\$ 96,400
Deferred tax asset—additional minimum pension obligation	16,600	7,500
Valuation allowance for deferred tax asset	<u>(4,800)</u>	<u>(5,700)</u>
	<u>143,600</u>	<u>98,200</u>
Deferred tax liability	(42,400)	(42,600)
Deferred tax liability—investments available for sale	<u>(20,700)</u>	<u>(7,700)</u>
	<u>(63,100)</u>	<u>(50,300)</u>
	<u>\$ 80,500</u>	<u>\$ 47,900</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, IBC acquired \$13,500 of net operating loss carryforwards. As of December 31, 2003, 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, 2003 and 2002, IBC has recorded valuation allowances of \$4,800 and \$5,700, respectively. The amounts as of December 31, 2003 relate to subsidiary net operating loss ("NOL") carryforwards which can only be utilized against subsidiary taxable income. The valuation allowance

decrease in 2003 of \$900 is primarily due to the realization of part of the deferred tax asset on the net operating loss for NewSeasons.

## 7. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2003 and 2002, is as follows:

	<b>2003</b>	<b>2002</b>
Land	\$ 3,091	\$ 13,925
Building and improvements	37,603	107,824
Office furniture and equipment	30,117	25,590
Capitalized software	<u>98,784</u>	<u>50,068</u>
Property and equipment—gross	169,595	197,407
Accumulated depreciation and amortization	<u>(29,936)</u>	<u>(24,152)</u>
Property and equipment—net	<u>\$ 139,659</u>	<u>\$ 173,255</u>

Depreciation and amortization expense related to property and equipment was \$15,998, \$10,180, and \$17,578 for the years ended December 31, 2003, 2002, and 2001, respectively.

## 8. INDEBTEDNESS

Indebtedness outstanding at December 31, 2003 and 2002 is as follows:

	<b>2003</b>	<b>2002</b>
Mortgage and construction loans and notes payable	\$ 29,962	\$ 90,895
Industrial Revenue Bonds	-	3,600
Subordinated capital note	40,000	40,000
Capital lease obligation	<u>210</u>	<u>142</u>
	<u>\$ 70,172</u>	<u>\$ 134,637</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 purchase of the land and building of the Company's Puerto Rico affiliate, La Cruz Azul, and were secured by the land and building of the affiliate. On June 27, 2003, the affiliate sold the land and building and paid off all outstanding principal and interest related to these bonds.

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

<b>Year</b>	<b>Amount</b>
2004	\$ 5,375
2005	576
2006	611
2007	650
2008	707
Thereafter	<u>62,253</u>
Total	<u>\$ 70,172</u>

Interest paid amounted to \$8,869 in 2003, \$10,056 in 2002, and \$10,254 in 2001.

IBC has an available line of credit with an area bank in the amount of \$10,000, which expires on June 30, 2004. Borrowings under the line of credit bear interest at LIBOR plus 60 basis points, and are payable upon demand. As of December 31, 2003 and 2002, no amounts were outstanding under this agreement.

IBC has established Reverse Repurchase Agreements with a financial institution with the amount not to exceed \$49,727 and \$44,325, which represent two percent of the statutory admitted assets of IBC and KHPE as of December 31, 2003 and 2002, respectively. Borrowings under these agreements bear interest at the prevailing repurchase rate. As of December 31, 2003 and 2002, no amounts were outstanding under these agreements.

## 9. COMMITMENTS

IBC leases certain facilities and equipment under long-term leases. As of December 31, 2003, future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year are as follows:

<b>Years Ended December 31</b>	<b>Facilities</b>	<b>Equipment</b>	<b>Total</b>
2004	\$ 35,997	\$ 64,202	\$ 100,199
2005	33,552	23,371	56,923
2006	32,563	4,050	36,613
2007	32,720	170	32,890
2008	30,775	9	30,784
Thereafter	<u>314,990</u>	<u>-</u>	<u>314,990</u>
Total	<u>\$ 480,597</u>	<u>\$ 91,802</u>	<u>\$ 572,399</u>

Total rental expense amounted to \$73,552, \$71,773, and \$67,045 for 2003, 2002, and 2001, respectively.

During 2003, IBC's subsidiary, NewSeasons, entered into agreements for the sale and leaseback of several of its buildings to a Maryland real estate investment trust (the "Trust"). The net proceeds from the sale were \$69,832. Deferred gains of \$8,527 are being amortized over 160 months, the life of the respective leases. NewSeasons provided a Guaranty on lease payments for certain properties leased from the Trust. Under the terms of the Guaranty, IBC will guarantee the rental payments and monetary

obligations of NewSeasons over the term of the lease up to a maximum of 16 years. As of December 31, 2003, no payments have been made by IBC in connection with this agreement.

During 2003, IBC's subsidiary, La Cruz Azul, entered into an agreement for the sale and leaseback of its building. The net proceeds from the sale were \$15,018. Deferred gains of \$1,627 are being amortized over 24 months, the life of the lease. La Cruz Azul provided a Guaranty on lease payments for the leased property. Under the terms of the Guaranty, IBC will guarantee the rental payments and monetary obligations of La Cruz Azul over the term of the lease. As of December 31, 2003, no payments have been made by IBC in connection with this agreement.

During 2003, 2002, and 2001, 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 2003, 2002, and 2001 sales of \$15,843, \$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. Annual payments under the operating leases are \$7,219, \$38,294, and \$24,987 for the 2003, 2002, and 2001 leases, respectively.

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, 2003 and 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 ("KMHP") and AmeriHealth Mercy Health Plan ("AMHP") (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:

	<u>Years Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Underwriting income	\$ 1,165,130	\$ 1,008,722	\$ 796,102
Claims incurred	<u>(1,165,130)</u>	<u>(1,008,722)</u>	<u>(796,102)</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 KMHP and records their portion of equity in KMHP earnings in accordance with the equity method of accounting.

Summary financial data for KMHP is as follows:

	2003	2002	2001
Revenues	\$ 1,022,404	\$ 915,042	\$ 773,199
Net income	20,140	22,164	12,730
Total assets	214,138	212,788	178,620
Partners' equity	63,154	56,514	37,756

The Company is a 50-50 partner in AMHP and records their portion of equity in AMHP earnings in accordance with the equity method of accounting.

Summary financial data for AMHP is as follows:

	2003	2002	2001
Revenues	\$ 298,803	\$ 258,784	\$ 137,934
Net income	5,898	4,924	8,884
Total assets	58,739	58,494	45,906
Partners' equity	20,334	22,784	18,028

## 12. ACQUISITIONS AND DISPOSITIONS

On December 31, 2003, the Company, through a wholly owned subsidiary, sold AmeriHealth Health Plan, Inc., a health maintenance organization that provides services to New York residents. IBC recorded a gain of \$265 related to this sale.

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 October 29, 2003, \$38,500 of La Cruz Azul capital notes owned by the Company were converted to 365,132 shares of La Cruz Azul common stock. The conversion increased the Company's common stock ownership to 82.7%.

### 13. UNPAID CLAIMS AND CLAIMS ADJUSTMENT EXPENSES LIABILITY

	2003	2002
Balance, January 1	\$ <u>1,382,601</u>	\$ <u>1,204,232</u>
Incurred related to:		
Current year	8,381,679	7,770,364
Prior years	<u>(373,767)</u>	<u>(371,770)</u>
Total incurred	<u>8,007,912</u>	<u>7,398,594</u>
Paid related to:		
Current year	(6,958,547)	(6,512,548)
Prior years	<u>(906,153)</u>	<u>(707,677)</u>
Total paid	<u>(7,864,700)</u>	<u>(7,220,225)</u>
Balance, December 31	<u>\$ 1,525,813</u>	<u>\$ 1,382,601</u>

The claims and claims adjustment expenses for prior years decreased by a total of \$373,767 in 2003 and \$371,770 in 2002, 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.

For the year ended December 31, 2002, 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 most recently filed statement with the PID. As of December 31, 2002, this permitted practice increased statutory surplus by \$39,986 over what it would have been had prescribed accounting practices been followed. As of December 31, 2003, the Company did not renew this permitted practice with the PID.

The Company received written approval from the PID to include in its valuation of investment in AmeriHealth, Inc., for statutory purposes, a surplus note issued by KHPE (an indirect wholly owned subsidiary of AmeriHealth, Inc.), which treatment differs from prescribed statutory accounting practices. Statutory accounting practices prescribed by the PID do not allow an insurer to include surplus notes in valuing its investment in subsidiary. As of December 31, 2003 and 2002, this permitted practice increased statutory surplus by \$40,000 over what it would have been had prescribed accounting practices been followed.

## 15. CONTINGENCIES

**Trust Fund**—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, 2003 and 2002, the funded amount required for the Trust was \$9,881 and \$12,988, respectively, and the estimated fair value of investments on deposit was \$14,402 and \$12,979, 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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