

Report of Independent Auditors

Board of Directors of CareFirst, Inc.

Board of Directors of CareFirst of Maryland, Inc.

Board of Trustees of Group Hospitalization
and Medical Services, Inc.

Board of Directors of BCBSD, Inc.

We have audited the accompanying consolidated balance sheet of CareFirst, Inc. and affiliates (collectively, referred to as the Company) as of December 31, 2002, and the related consolidated statements of operations, changes in reserves and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of the Company, as of December 31, 2001 and for the year then ended, were audited by other auditors who have ceased operations and whose report dated January 26, 2002 expressed an unqualified opinion on those financial statements before the restatement adjustment described in Note 2.

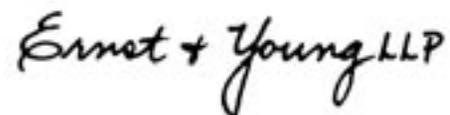
We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2002, and the consolidated results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company changed its method of accounting for goodwill.

As discussed above, the consolidated financial statements of the Company as of December 31, 2001, and for the year then ended were audited by other auditors who have ceased operations. As described in Note 2, these financial statements have been revised to include the transitional disclosures required by Statement of Financial Accounting Standards (Statement) No. 142, *Goodwill and Other Intangible Assets*, which was adopted by the Company as of January 1, 2002. Our audit procedures with respect to the disclosures in Note 2 with respect to 2001 included (a) agreeing the previously reported net income to the previously issued financial statements and the adjustments to reported net income representing amortization expense recognized in those periods related to goodwill, to the Company's underlying records obtained from management, and (b) testing the mathematical accuracy of the reconciliation of

adjusted net income to reported net income. In our opinion, the disclosures for 2001 in Note 2 are appropriate. However, we were not engaged to audit, review, or apply any procedures to the 2001 consolidated financial statements of the Company other than with respect to such disclosures and, accordingly, we do not express an opinion or any other form of assurance on the 2001 consolidated financial statements taken as a whole.

The image shows a handwritten signature in black ink that reads "Ernst + Young LLP". The signature is written in a cursive, flowing style.

February 1, 2003

Except for Note 1, as to which the date is

March 5, 2003

Consolidated Balance Sheets

(in thousands)

Assets

Current assets:

	December 31	
	2002	2001
Cash and cash equivalents	\$ 272,351	\$ 162,390
Short-term investments	21,778	18,073
Advances to providers	149,600	139,841
Accounts receivable, less allowance for doubtful accounts of \$16,643 and \$14,549 as of December 31, 2002 and 2001, respectively	743,896	699,380
Interest income receivable	10,277	10,875
Other current assets	413,926	317,421
Deferred tax assets, net	24,305	15,835
Total current assets	1,636,133	1,363,815
Long-term investments	1,045,752	955,911
Property and equipment, net	170,204	170,487
Goodwill and other assets, net	62,501	53,432
Deferred tax assets, net	2,923	22,046
Total assets	\$ 2,917,513	\$ 2,565,691

Liabilities and reserves

Current liabilities:

Short-term borrowings	\$ 108,656	\$ 94,908
Medical claims payable	898,526	775,771
Accounts payable and accrued expenses	274,050	299,617
Unearned revenues	446,992	391,663
Group experience funds and advances	185,378	146,849
Current portion of note payable	-	8,937
Net current liabilities of discontinued operations	2,252	411
Total current liabilities	1,915,854	1,718,156
Long-term debt	81	162
Obligations under capital lease	1,987	2,563
Other liabilities	125,247	60,126
Total liabilities	2,043,169	1,781,007

Reserves:

Retained earnings	866,460	781,479
Accumulated other comprehensive income	7,884	3,205
Total reserves	874,344	784,684
Total liabilities and reserves	\$ 2,917,513	\$ 2,565,691

See accompanying notes.

Consolidated Statements of Operations

(in thousands)

	Years ended December 31	
	2002	2001
Revenues	\$ 6,707,693	\$ 5,954,771
Operating expenses:		
Cost of care	6,078,398	5,371,288
General and administrative	564,571	543,514
Affiliation costs	6,488	4,134
Total operating expenses	6,649,457	5,918,936
Income from operations	58,236	35,835
Investment income, net	65,346	67,476
Other than temporary impairment of investments	(28,077)	–
Other income, net	3,670	9,480
Income from continuing operations before provision for income taxes	99,175	112,791
Provision for income taxes	17,079	20,383
Income from continuing operations	82,096	92,408
Discontinued operations:		
Income from discontinued operations, net of applicable income tax provision of \$993 and \$2,755 as of December 31, 2002 and 2001, respectively	2,885	7,448
Loss on disposal of discontinued operations, net of applicable income tax benefit of \$0 and \$(290) as of December 31, 2002 and 2001, respectively	–	(1,160)
Net income	\$ 84,981	\$ 98,696

See accompanying notes.

Consolidated Statements of Changes in Reserves

Years ended December 31, 2002 and 2001 (in thousands)

	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Reserves
Balance, as of December 31, 2000	\$ 682,783	\$ 9,000	\$ 691,783
Net income	98,696	–	98,696
Other comprehensive income (loss), net of tax:			
Change in net unrealized gains and losses on investments, net of reclassification adjustments	–	2,578	2,578
Minimum pension liability adjustment	–	(8,460)	(8,460)
Foreign currency translation adjustment	–	87	87
Total comprehensive income			92,901
Balance, as of December 31, 2001	781,479	3,205	784,684
Net income	84,981		84,981
Other comprehensive income (loss), net of tax:			
Change in net unrealized gains and losses on investments, net of reclassification adjustments	–	28,630	28,630
Minimum pension liability adjustment	–	(23,951)	(23,951)
Total comprehensive income			89,660
Balance, as of December 31, 2002	\$ 866,460	\$ 7,884	\$ 874,344

See accompanying notes.

Consolidated Statements of Cash Flows

(in thousands)

	Years ended December 31	
	2002	2001
Operating activities		
Net income	\$ 84,981	\$ 98,696
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	45,747	39,201
Other than temporary impairment of investments	28,077	-
Loss on disposal of property and equipment	-	77
Benefit for deferred income taxes	(13,226)	(6,387)
Gain on sale of assets	-	(1,644)
Changes in operating assets and liabilities:		
Increase in accounts receivable, net	(44,516)	(90,077)
Decrease (increase) in interest income receivable	598	(1,092)
Increase in other current assets	(96,505)	(1,877)
Increase in other assets	(9,095)	(10,030)
Increase in medical claims payable	122,755	50,637
(Decrease) increase in accounts payable and accrued expenses	(1,688)	21,933
Increase in unearned revenues	55,329	30,317
Increase in group experience funds and advances	38,529	25,004
Increase (decrease) in other liabilities	65,121	(1,790)
Changes in net assets and liabilities of discontinued operations	1,841	537
Net cash provided by operating activities	277,948	153,505
Investing activities		
Net purchases of investments	(116,944)	(128,549)
Net purchases of property and equipment	(45,464)	(63,295)
Decrease (increase) in other assets, net	26	(480)
Net cash used in investing activities	(162,382)	(192,324)

	Years ended December 31	
	2002	2001
Financing activities		
Increase (decrease) in short-term borrowings	\$ 13,748	\$ (1,641)
Payments on obligation under capital lease	(576)	(434)
Increase in advances to providers	(9,759)	(18,591)
Repayment on long-term debt	(9,018)	(8,995)
Net cash used in financing activities	(5,605)	(29,661)
Net increase (decrease) in cash and cash equivalents	109,961	(68,480)
Cash and cash equivalents at beginning of year	162,390	230,870
Cash and cash equivalents at end of year	\$ 272,351	\$ 162,390
Supplemental disclosures		
Cash paid for income taxes	\$ 26,828	\$ 11,128
Cash paid for interest	\$ 1,275	\$ 1,864

See accompanying notes.

Notes to Consolidated Financial Statements

December 31, 2002 (in thousands)

1. Organization

CareFirst, Inc. and affiliates (collectively, the Company) provide a comprehensive array of health insurance and managed care products and services primarily through indemnity health insurance, health benefits administration and health maintenance organizations (HMOs). These products and services are provided to individuals, businesses and governmental agencies primarily in the states of Maryland and Delaware and in the Washington, D.C., metropolitan area.

CareFirst, Inc. was incorporated on January 16, 1998 to become the not-for-profit parent of CareFirst of Maryland, Inc. (CFMI) and Group Hospitalization and Medical Services, Inc. (GHMSI). These affiliates do business as CareFirst BlueCross BlueShield. CareFirst, Inc., has also entered into a business affiliation with BCBSD, Inc. (BCBSD). CareFirst, Inc. maintains full control over the governance of CFMI, GHMSI and BCBSD.

On November 20, 2001, WellPoint Health Networks, Inc. (WellPoint) and CareFirst, Inc. signed a definitive agreement to merge. Under the agreement, as amended in January 2003, WellPoint agreed to acquire CareFirst, Inc. for \$1.37 billion following CareFirst, Inc.'s conversion to for-profit status and pending approval from various regulatory agencies. The purchase price would be provided to benefit residents in CareFirst, Inc.'s three principal operating areas: Maryland, Delaware and the District of Columbia. The Company expensed costs related to the proposed merger, consisting primarily of legal, investment banking and consulting fees, of \$6,488 and \$4,134 during the years ended December 31, 2002 and 2001, respectively. As of December 31, 2002, the merger was subject to ongoing regulatory review.

On March 5, 2003, the application for conversion to for-profit status and to merge with WellPoint was denied by the Maryland Insurance Administration in an order that becomes effective in June 2003. This order is subject to review and/or revision by the Maryland legislature.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of CareFirst, Inc. and its affiliates. All intercompany transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The carrying amounts of financial instruments, including cash and cash equivalents, advances to providers, accounts receivable, interest income receivable, other current assets, investments, short-term borrowings, medical claims payable, accounts payable and accrued expenses, unearned revenues and group experience funds and advances, approximate fair value.

Cash and Cash Equivalents and Short-Term Borrowings

Cash and cash equivalents include amounts invested in accounts that are readily convertible to cash. Investments with contractual maturities of 90 days or less from the date of original purchase are classified as cash and cash equivalents. In accordance with the Company's cash management policy of

maximizing the amount of funds invested in income-earning assets, the Company routinely anticipates the timing and amount of future cash flows. This policy frequently results in the existence of negative book cash balances, which are reflected as short-term borrowings in the accompanying consolidated financial statements.

Accounts Receivable

Accounts receivable primarily represent unpaid amounts earned from employer groups and individuals for health benefits and amounts offsetting the estimate of self-funded medical claims payable and accrued claims processing expenses. Provision is made for accounts considered uncollectible and/or potential adjustments, that arise as a result of a review by management or a third party.

Investments

Investments consist primarily of U.S. Treasury and agency securities, foreign government bonds, corporate bonds, equity securities and mortgage-backed securities.

The Company has determined that its debt and equity securities are available-for-sale. Debt and equity securities are carried at estimated fair value based on quoted market prices for the same or similar instruments. The Company's policy is to classify all investments with contractual maturities within one year as current. Investment income is recognized when earned and reported net of investment expenses. Unrealized holding gains and losses are excluded from earnings and are reported as a separate component of other comprehensive income until realized, unless the losses are deemed to be other than temporary. Realized gains or losses, including any provision for other than temporary declines in value, are included in the consolidated statements of operations.

The Company periodically evaluates whether any declines in the fair value of investments are other than temporary. This evaluation consists of a review of several factors, including but not limited to: length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near term prospects for recovery of the market value of a security; and the intent and ability of the Company to hold the security until the market value recovers. Declines in fair value below cost that are deemed to be other than temporary are recorded as realized losses and are included in "other than temporary impairment of investments" in the accompanying consolidated statements of operations. Based on its evaluation, the Company has recorded an other than temporary impairment of investments of \$28,077 for the year ended December 31, 2002.

Property and Equipment

Property and equipment are recorded at cost and are depreciated using the straight-line method over useful lives ranging from three to five years for purchased computer equipment and software, three to five years for capitalized software, four to twelve years for furniture and equipment, and fifteen to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases or over the estimated useful life of the improvements, if shorter than the lease term.

Certain costs related to the development or purchase of internal-use software are capitalized and amortized over the estimated useful life of the software. Computer software costs that are incurred in the preliminary project stage are expensed as incurred. Direct consulting costs, payroll and payroll-related costs for employees incurred during the development stage that are directly associated with each project are capitalized and amortized over the estimated useful life of the software once placed into operation.

Advances to Providers

The Company has advances on deposit with certain hospitals in the state of Maryland. These advances permit the Company to earn differentials of 2.25% and 2.00% of allowed inpatient and outpatient charges, respectively, by these hospitals.

Goodwill and Other Assets

Goodwill represents the excess of the cost of businesses acquired over the fair value of the net identifiable assets at the date of acquisition. At December 31, 2002, the Company has goodwill of \$27,856 related to certain acquisitions of HMOs and a company that performs third party administrative services.

As of January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), and, accordingly, the Company no longer amortizes goodwill. SFAS No. 142 requires an evaluation of goodwill for impairment (at the reporting unit level) upon adoption of this standard, as well as subsequent evaluations on an annual basis, and more frequently if circumstances indicate a possible impairment. If this review indicates that goodwill may not be recoverable, the Company's carrying value of this goodwill would be reduced to its estimated fair value.

In connection with the adoption of SFAS No. 142, the Company allocated goodwill to its reporting units as required. The Company completed its evaluation of goodwill as of January 1, 2002 and December 31, 2002, utilizing accepted valuation approaches, which indicated that the estimated fair value of goodwill exceeded its carrying value. As a result, no impairment loss has been recognized.

The following table shows net income adjusted to reflect the adoption of the nonamortization provisions of SFAS No. 142 for the years ended December 31, 2002 and 2001:

	2002	2001
Reported net income	\$ 84,981	\$ 98,696
Add back—Goodwill amortization	—	3,209
Adjusted net income	\$ 84,981	\$ 101,905

Prior to the adoption of SFAS No. 142, goodwill was amortized over estimated useful lives, which ranged from 10 to 30 years.

Other assets include a note receivable, an investment in a real estate joint venture which is accounted for under the equity method and cash surrender value of life insurance policies.

Medical Claims Payable

The liability for medical claims payable is computed in accordance with generally accepted actuarial practices and is based upon authorized health care services and past claims payment experience, together with current factors which, in management's judgment, require recognition in the calculation to determine its best estimate of amounts to be paid. These estimates are reviewed periodically and any adjustments are reflected in current operations.

Revenue Recognition

Revenues are recognized when earned on a monthly basis for the period the health care coverage is in effect. Unearned revenues represent prepayments of premiums for future health care coverage and Federal Employee Program (FEP) unearned premiums.

The Company has administrative service contracts with certain customers under which the Company earns fees for processing medical claims and is reimbursed for the cost of such claims. Claims incurred and fees earned under these contracts are reported as revenues. The Company also provides coverage for certain groups whose contracts provide for payments based on group experience factors. Under these contracts, revenue is generally recorded on the basis of incurred claims, plus retention. In certain cases, maximum rates are

established by contract, and losses can result if claims and retention exceed these maximum rates. Any such losses are recorded in the year incurred and may, in many cases, be recouped against subsequent years' gains.

The Company participates with other Blue Cross and Blue Shield plans in administering the health care benefit plans of various national accounts. Administrative fees are generally recognized when earned on a monthly basis for the period the participating agreement is in effect and are recorded as a reduction of general and administrative expenses.

Certain claim payments, premium rates, administrative expense reimbursements and provider discounts are subject to review and potential retroactive adjustment by third parties. Reserves are established for potential obligations arising from such reviews. While claims for such adjustments have been asserted against the Company, management believes that the resolution of these claims will not be materially different from amounts recorded in the accompanying consolidated financial statements.

Cost of Care

Cost of care is recognized in the period in which members receive medical services. In addition to actual benefits paid, cost of care includes the change in estimates of reported and unreported claims and accrued capitation fees and adjustments, which are unpaid as of the balance sheet date.

Income Taxes

The Company's provision for income taxes reflects the estimated current and future tax consequences of all events that have been recognized in the consolidated financial statements as measured by the provisions of currently enacted tax laws and rates applicable to future periods.

Comprehensive Income

Comprehensive income encompasses all changes in reserves and includes net income, net unrealized gains or losses on available-for-sale securities, and minimum pension liability adjustments. Comprehensive income is net of reclassification adjustments to adjust for items currently included in net income, such as realized gains on investment securities.

Federal Employee Program

The Company participates in the Blue Cross and Blue Shield FEP, which is one of the plans offered through the Federal Employee Health Benefits Program (FEHBP), administered by the Office of Personnel Management (OPM). Claims incurred on behalf of FEP are reported as revenues during the period in which the claims are incurred. The related administrative fees are recognized as revenues as they are earned during the contract period. The Blue Cross and Blue Shield Association (BCBSA) contracts directly with OPM to administer FEP and subcontracts with CFMI, GHMSI and BCBSD. BCBSA also provides information to the Company for inclusion in the accompanying consolidated financial statements.

OPM holds certain reserves on behalf of the Company to provide funding, if necessary, for excess claims costs, subject to certain limitations. The Company records its allocable share of amounts held by OPM as an asset, with an equivalent amount recorded as unearned revenues. These amounts are \$364,144 and \$291,445 as of December 31, 2002 and 2001, respectively, and are included in other current assets and unearned revenues, respectively, in the accompanying consolidated balance sheets. Amounts incurred in excess of these reserves would not be reimbursed to the Company. The current BCBSA contract expires on December 31, 2003.

FEP represented approximately 26% and 23% of accounts receivable as of December 31, 2002 and 2001, respectively. FEP represented approximately 23% of revenues for the years ended December 31, 2002 and 2001.

Reimbursement of FEP Operations Center Expenses

GHMSI performs certain administrative functions as the national operations center for FEP under a cost reimbursement contract with BCBSA. The reimbursement of allocable costs under this contract is recorded as a reduction to general and administrative expenses. FEP reimbursed GHMSI for costs incurred in connection with this agreement totaling \$77,173 and \$48,382 for the years ended December 31, 2002 and 2001, respectively.

Reimbursement of Medicare Claims Cost and Expenses

CFMI acted as a fiscal intermediary under contract with BCBSA for Part A of the Medicare program in 2002 and 2001. Under this contract, CFMI processed claims of approximately \$3.9 billion and \$3.5 billion in 2002 and 2001, respectively. Payment and reimbursement of Medicare claims are not included in the accompanying consolidated financial statements.

Administrative expense reimbursements received from the Medicare program were approximately \$11,322 and \$11,633 for the years ended December 31, 2002 and 2001, respectively. Operating expenses in the accompanying consolidated statements of operations are recorded net of these reimbursements.

Recent Accounting Pronouncements

In July 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146). SFAS No. 146 replaces current accounting literature and requires the recognition of 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. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

Reclassifications

Certain amounts from the prior year financial statements have been reclassified in order to conform with the current year presentation.

3. Discontinued Operations

Public HMO Segments – FSHP

In July 2000, management and the Board of Directors of the Company adopted a formal plan for one of the Company's HMO's, Free State Health Plan, Inc. (FSHP), to fully exit its Medicare HMO segment effective December 31, 2000. In December 2000, management and the Board of Directors also adopted a formal plan for FSHP to fully exit its Medicaid HMO segment effective March 31, 2001. These segments included all of the operations surrounding FSHP's Medicare and Medicaid risk products. As of December 31, 2001, the Company had completed its exit from these businesses.

The Company has accounted for the disposal of the segments under 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 Infrequently Occurring Events and Transactions* (APB 30). APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a discontinued business segment be reported in conjunction with the related results of the discontinued operations.

The results of operations of the FSHP discontinued segments are as follows:

	December 31	
	2002	2001
Revenues	\$ 14	\$ 34,331
Operating expenses:		
Cost of care	(3,120)	22,803
General and administrative	28	1,325
Total operating expenses	(3,092)	24,128
Income from discontinued operations before provision for income taxes	3,106	10,203
Provision for income taxes	839	2,755
Income from discontinued operations	\$ 2,267	\$ 7,448

The 2002 and 2001 results of operations for discontinued segments were positively impacted by changes in estimates of \$3,120 and \$7,611, respectively, related to reserves on certain provider settlement receivables and medical claims payable.

The following is a summary of the current assets and (liabilities) of the FSHP discontinued segments as of December 31, 2002 and 2001, respectively, which are reflected in the accompanying consolidated balance sheets.

	2002	2001
Advances to providers	\$ 486	\$ 8,165
Medical claims payable	(1,394)	(4,145)
Other	(968)	(3,089)
Net current (liabilities) assets of discontinued operations	\$ (1,876)	\$ 931

International Operations – BCBSD

During 2000, BCBSD entered into transactions that effectively resulted in a discontinuance of its international operations through the sale of foreign subsidiaries.

In November 2001, the Company finalized these sales transactions, and additional charges were recorded in 2001 against discontinued operations to reflect the finalization of the sales.

The following is a summary of the net current liabilities of the discontinued BCBSD segment as of December 31, 2002 and 2001, respectively, which are reflected in the accompanying consolidated balance sheets.

	2002	2001
Reinsurance receivables, net	\$ -	\$ 62
Medical claims payable	(376)	(1,404)
Net current liabilities of discontinued operations	\$ (376)	\$ (1,342)

For the year ended December 31, 2002, income from discontinued operations was \$618, net of provision for income taxes of \$154, and was related to changes in estimated liabilities under reinsurance contracts.

4. Regulatory Matters

The Company is subject to regulation and supervision by regulatory authorities of the various jurisdictions in which they are licensed to conduct business. These jurisdictions mandate the maintenance of minimum statutory reserves and unassigned funds and prohibit certain transactions between the Company and its affiliates without prior regulatory approval. In addition, the Company also must comply with various conditions, restricting certain operations and financial transactions, that were contained in regulatory orders approving the affiliation of CFMI and GHMSI and the affiliation of the Company and BCBSD.

Financial statements filed by CareFirst, Inc. and its affiliates with their respective state insurance regulators are prepared in accordance with statutory accounting practices which differ from GAAP. The most significant differences result from the exclusion of certain assets from statutory reserves, recording the note payable as a component of reserves and unassigned funds for statutory accounting and as a liability for GAAP, differences in the carrying value of investments, valuation of investments in subsidiaries, treatment of subsidiary net income (losses) as an unrealized capital gain (loss), and the modification or exclusion of certain Statements of Financial Accounting Standards.

At December 31, 2002 and 2001, the Company's statutory reserves and unassigned funds exceed the minimum statutory requirements as determined by each of the jurisdictions in which the Company conducts business.

5. Investments

The Company's investments consist of the following:

	Amortized Cost Basis	Gross Unrealized Losses	Gross Unrealized Gains	Estimated Fair Value
December 31, 2002:				
Debt securities issued by the U.S. Treasury and other U.S. government agencies	\$ 149,556	\$ 16	\$ 11,102	\$ 160,642
Foreign government debt securities	2,898	—	278	3,176
Corporate debt securities	424,658	3,710	28,558	449,506
Equity securities	135,598	11,372	7,606	131,832
Mortgage-backed securities	311,767	607	11,214	322,374
Total investments	\$ 1,024,477	\$ 15,705	\$ 58,758	\$ 1,067,530

	Amortized Cost Basis	Gross Unrealized Losses	Gross Unrealized Gains	Estimated Fair Value
December 31, 2001:				
Debt securities issued by the U.S. Treasury and other U.S. government agencies	\$ 379,501	\$ 996	\$ 7,844	\$ 386,349
Foreign government debt securities	2,304	6	126	2,424
Corporate debt securities	425,099	7,290	14,282	432,091
Equity securities	121,983	11,339	11,705	122,349
Mortgage-backed securities	30,368	186	589	30,771
Total investments	\$ 959,255	\$ 19,817	\$ 34,546	\$ 973,984

The amortized cost and estimated fair value of debt securities at December 31, 2002, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost Basis	Estimated Fair Value
Within 1 year	\$ 21,528	\$ 21,778
After 1 year through 5 years	201,162	213,627
After 5 years through 10 years	214,331	231,991
After 10 years	140,091	145,928
Mortgage-backed securities	311,767	322,374
Total	\$ 888,879	\$ 935,698

Available-for-sale securities were sold as follows for the years ended December 31:

	2002	2001
Proceeds from sales	\$ 535,114	\$ 335,764
Gross realized gains	19,342	18,339
Gross realized losses	7,221	5,152

For purposes of computing realized gains and losses, the specific identification method of determining cost was used.

One of the Company's affiliates has pledged \$3,129 of U.S. government securities to secure their obligations under two operating leases.

6. Property and Equipment

Property and equipment are comprised of the following as of December 31:

	2002	2001
Land	\$ 8,114	\$ 8,114
Buildings and building improvements	36,444	33,976
Leasehold improvements	20,570	21,310
Purchased computer equipment and software	84,849	85,642
Capitalized software	159,520	132,813
Furniture and equipment	62,143	64,890
	371,640	346,745
Less accumulated depreciation and amortization	201,436	176,258
Property and equipment, net	\$170,204	\$ 170,487

Depreciation and amortization expense on property and equipment was \$45,747 and \$35,991 for the years ended December 31, 2002 and 2001, respectively, and is included as a component of cost of care and general and administrative expenses in the accompanying consolidated statements of operations.

7. Sale/Leaseback of Building

On December 3, 1998, GHMSI sold its headquarters building in Washington, D.C. The sale resulted in a realized gain, based on depreciated cost of \$41,079. In connection with the sale, GHMSI entered into a five-year leaseback for all of the net rentable space in the building. The purchaser has the right to recapture a portion of the space upon notice to GHMSI at various points in time during the leaseback period. Due to the leaseback arrangement, approximately \$25,019 of the realized gain from the sale of the building was originally recorded as a deferred liability in the accompanying consolidated balance sheets and is being amortized over the leaseback period in proportion to the lease payments. In 2002 and 2001, \$2,818 and \$3,624, respectively, of the deferred liability was amortized against rent expense.

The originally recorded deferred gain was equal to the net present value of the future lease payments, using a discount rate of 6.5%. The deferred gain has been adjusted downward through other income in periods in which the purchaser exercises its recapture rights. As of December 31, 2002 and 2001, the deferred gain liability was \$2,853 and \$5,671, respectively, and is included in other liabilities in the accompanying consolidated balance sheets.

On January 3, 2001, pursuant to the lease recapture provision, the purchaser gave notice that additional space would be recaptured on May 31, 2001. Resulting from this notice, \$5,302 of the deferred gain was recognized as other income in the 2001 accompanying consolidated statement of operations, reflecting the period in which the lease modification was received.

8. Medical Claims Payable

On January 1, 2001, a related professional association transferred its medical claims payable to FSHP, primarily in exchange for forgiveness of an obligation to the related professional association.

Activity in the liability accounts for medical claims is summarized as follows:

	2002	2001
Balance as of January 1	\$ 775,771	\$ 725,134
Liability transferred from a related professional association as of January 1	-	19,412
Adjusted balance	775,771	744,546
Incurred related to:		
Current year	6,088,133	5,361,069
Prior years	(9,735)	10,219
Total incurred	6,078,398	5,371,288
Paid related to:		
Current year	5,212,380	4,631,679
Prior years	743,263	708,384
Total paid	5,955,643	5,340,063
Balance at December 31	\$ 898,526	\$ 775,771

Changes in the estimates associated with medical claims payable are recorded prospectively as changes in claims payment patterns, membership and utilization trends are identified and quantified.

The Company accrues estimated claims processing expenses relating to the liability for unpaid claims. These accruals totaled \$29,403 and \$24,729 as of December 31, 2002 and 2001, respectively, and are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

9. Note Payable

GHMSI had a note payable held by BCS Plan Investors Corporation (BPIC), an affiliate of BCBSA, that was fully paid in April 2002. The outstanding balance on the note was \$8,937 as of December 31, 2001. The note was unsecured and bore interest at 6% per annum. The note was guaranteed by CFMI and CareFirst, Inc. Interest was payable out of 50% of the previous calendar year's statutory earnings and profits generated by GHMSI and CFMI (as determined by reference to GHMSI's and CFMI's audited statutory financial statements ended on December 31 of such calendar year) and was due annually on April 30. Both interest and principal payments required the prior approval of the District of Columbia Department of Insurance and Securities Regulation.

GHMSI incurred interest expense of \$179 and \$715 on the note payable for the years ended December 31, 2002 and 2001, respectively.

10. Lease Commitments

Operating Lease Obligations

The Company leases certain administrative offices and medical facilities and equipment under operating leases. Some of these lease agreements contain escalation clauses for increases in real estate taxes and operating costs over

base year amounts. These leases expire on various dates with renewal options available on many of the leases.

Future noncancelable minimum payments for leases are as follows:

2003	\$ 35,813
2004	34,844
2005	32,721
2006	32,195
2007	30,794
Thereafter	91,855
	<u>\$ 258,222</u>

Rent expense for the years ended December 31, 2002 and 2001 for all operating leases was \$30,424 and \$31,982, respectively, and has been included within general and administrative expenses in the accompanying consolidated statements of operations.

Capital Lease Obligations

BCBSD leases a building under a capital lease; the property has a cost of \$7,700 and accumulated depreciation of \$6,019 as of December 31, 2002. Minimum future lease payments are as follows:

2003	\$ 1,167
2004	1,167
2005	1,167
2006	582
	<u>4,083</u>
Less: amounts representing interest and executory costs	<u>1,615</u>
	<u>\$ 2,468</u>

11. Pension Benefits

Prior to December 31, 2002, CFMI and GHMSI maintained qualified non-contributory defined benefit retirement plans covering substantially all full-time employees. Effective December 31, 2002, these plans merged to become the CareFirst, Inc. Retirement Plan. Although the Company merged the CFMI and GHMSI plans, it has committed to maintain separate record keeping of plan assets and benefit obligations so that it will comply with certain regulatory restrictions that apply to CFMI and GHMSI. As a result, CFMI and GHMSI have accounted for their net pension obligation as if the plans had remained separate. BCBSD also has a qualified noncontributory defined benefit retirement plan covering substantially all full-time employees.

The annual contributions are not less than the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended. The plans provide for eligible employees to receive benefits based principally on years of service with the Company and a percentage of certain compensation prior to normal retirement.

For financial reporting purposes under SFAS No. 87, *Employers' Accounting for Pensions*, a pension plan is considered underfunded when the fair value of plan assets is less than the accumulated benefit obligation. When that is the case, an additional pension liability must be recognized for the difference between the accrued pension cost and the minimum liability which represents the amount of the unfunded accumulated benefit obligation. In recognizing such a liability, an intangible asset may also be recorded up to the amount of the prior service cost not yet recognized. When the liability is greater than the intangible asset limit, a charge is recorded to accumulated other comprehensive income for the excess amount, net of any tax effects. As of December 31, 2002 and 2001, the Company has recorded charges to other comprehensive income as the result of certain unfunded pension liabilities for its qualified plans.

The following tables set forth the Company's plans' funded status and amounts recognized in the accompanying consolidated financial statements as of December 31:

	CFMI	2002 GHMSI	BCBSD
Accumulated benefit obligation	\$ 138,376	\$ 190,675	\$ 50,566
Change in projected benefit obligation:			
Benefit obligation at beginning of year	\$ 163,637	\$ 189,457	\$ 53,687
Service cost	8,972	6,330	1,672
Interest cost	10,663	13,379	3,982
Actuarial (gain) loss	(3,582)	7,676	5,028
Plan amendments	165	67	(3,591)
Benefits paid	(8,196)	(5,723)	(3,031)
Benefit obligation at end of year	\$ 171,659	\$ 211,186	\$ 57,747
Change in plan assets of the qualified pension plans:			
Fair value of plan assets at beginning of year	\$ 103,200	\$ 222,981	\$ 41,009
Actual return on plan assets	(14,542)	(14,348)	(3,517)
Employer contributions	10,868	-	-
Benefits paid	(8,196)	(5,723)	(3,031)
Fair value of plan assets at end of year	\$ 91,330	\$ 202,910	\$ 34,461

	CFMI	2002 GHMSI	BCBSD
Funded status	\$(80,329)	\$(8,276)	\$(23,286)
Unrecognized transition asset	-	-	(24)
Unrecognized actuarial loss	76,333	42,667	20,236
Unrecognized prior service asset	(14,053)	(17,853)	(3,627)
Net amount recognized—accrued pension (cost) or prepaid pension asset	<u>\$(18,049)</u>	<u>\$16,538</u>	<u>\$(6,701)</u>
Amounts recognized in the consolidated balance sheet consist of:			
Accrued pension (cost) or prepaid pension asset	\$(18,049)	<u>\$16,538</u>	\$(6,701)
Additional liability—other comprehensive loss	<u>(28,997)</u>		<u>(9,404)</u>
Required minimum liability	<u>\$(47,046)</u>		<u>\$(16,105)</u>
Weighted-average assumptions:			
Discount rate	6.75%	6.75%	6.75%
Expected return on plan assets	9.00	9.00	9.00
Rate of compensation increase	5.00	5.00	4.75

	CFMI	2002 GHMSI	BCBSD
Components of net periodic benefit cost (credit) for the year ended December 31, 2002, are as follows:			
Service cost	\$ 8,972	\$ 6,330	\$ 1,672
Interest cost	10,663	13,379	3,982
Expected return on plan assets	(10,046)	(21,605)	(4,020)
Amortization of transition asset	(207)	-	(84)
Amortization of prior service (asset) cost	(2,082)	(2,236)	52
Recognized actuarial loss (gain)	1,190	(424)	-
Net periodic benefit cost (credit)	<u>\$ 8,490</u>	<u>\$ (4,556)</u>	<u>\$ 1,602</u>
	CFMI	2001 GHMSI	BCBSD
Accumulated benefit obligation	<u>\$ 131,592</u>	<u>\$ 171,715</u>	<u>\$ 43,569</u>
Change in benefit obligation:			
Benefit obligation at beginning of year	\$ 135,380	\$ 179,198	\$ 48,910
Service cost	8,047	5,634	1,548
Interest cost	9,795	12,743	3,653
Actuarial loss (gain)	19,997	(1,564)	1,998
Benefits paid	(9,582)	(6,554)	(2,422)
Benefit obligation at end of year	<u>\$ 163,637</u>	<u>\$ 189,457</u>	<u>\$ 53,687</u>
Change in plan assets of the qualified pension plans:			
Fair value of plan assets at beginning of year	\$ 108,688	\$ 232,341	\$ 45,253
Actual return on plan assets	(2,214)	(2,806)	(2,939)
Employer contributions	6,308	-	1,118
Benefit paid	(9,582)	(6,554)	(2,422)
Fair value of plan assets at end of year	<u>\$ 103,200</u>	<u>\$ 222,981</u>	<u>\$ 41,010</u>

	CFMI	2001 GHMSI	BCBSD
Funded status	\$(60,437)	\$33,524	\$(12,677)
Unrecognized transition asset	(207)	-	(109)
Unrecognized actuarial loss (gain)	56,518	(1,386)	7,670
Unrecognized prior service (asset) cost	(16,301)	(20,156)	17
Net amount recognized—accrued pension (cost) or prepaid pension asset	<u>\$(20,427)</u>	<u>\$ 11,982</u>	<u>\$ (5,099)</u>
Amounts recognized in the consolidated balance sheet consist of:			
Accrued pension (cost) or prepaid pension asset	\$(20,427)	<u>\$ 11,982</u>	<u>\$ (5,099)</u>
Additional liability—other comprehensive loss	(7,965)		
Required minimum liability	<u>\$(28,392)</u>		
Weighted-average assumptions:			
Discount rate	7.25%	7.25%	7.25%
Expected return on plan assets	9.00	9.00	9.00
Rate of compensation increase	5.00	5.00	4.75

	CFMI	2001 GHMSI	BCBSD
Components of net periodic benefit cost (credit) for the year ended December 31, 2001, are as follows:			
Service cost	\$ 8,047	\$ 5,634	\$ 1,548
Interest cost	9,795	12,743	3,653
Expected return on plan assets	(9,433)	(20,631)	(4,196)
Amortization of transition asset	(372)	-	(84)
Amortization of prior service (asset) cost	(2,095)	(2,241)	5
Recognized actual loss (gain)	598	(1,047)	-
Net periodic benefit cost (credit)	<u>\$ 6,540</u>	<u>\$ (5,542)</u>	<u>\$ 926</u>

CFMI has nonqualified supplemental retirement benefit plans covering certain officers which provide for eligible employees to receive additional benefits based principally on compensation and years of service. These plans provide for incremental benefit payments from CFMI's funds so that total benefit payments equal amounts that would have been payable from CFMI's principal retirement plan if it were not for limitations imposed by income tax regulations. As of December 31, 2002 and 2001, CFMI has accrued \$11,546 and \$8,757, respectively, for these benefits. Supplemental retirement benefit plan expense for the years ended December 31, 2002 and 2001, was \$2,788 and \$2,390, respectively.

At December 31, 2002 and 2001, an additional pension liability of \$4,428 and \$5,722, respectively, was recognized for CFMI's supplemental retirement plan. In accordance with SFAS 87, as of December 31, 2002 and 2001, respectively, an intangible asset of \$1,221 and \$1,960 was also recorded. In addition, other comprehensive income in 2002 includes income of \$443, net of tax.

GHMSI has nonqualified supplemental retirement benefit plans covering certain officers, which provide for eligible employees (and former employees) to receive additional benefits based principally on compensation and years of service. These plans provide for incremental benefit payments from GHMSI's funds so that total benefit payments equal amounts that would have been payable from GHMSI's principal retirement plans if it were not for limitations imposed by income tax regulations. As of December 31, 2002 and 2001, respectively, GHMSI has accrued \$4,734 and \$5,102, respectively, for these benefits. Supplemental retirement benefit plan expense for the years ended December 31, 2002 and 2001, was \$187 and \$240, respectively.

BCBSD also provides for retirement benefits through nonqualified retirement plans covering certain employees. These plans provide for incremental pension payments from BCBSD's funds so that total pension payments equal amounts that would have been payable from BCBSD's principal pension

plans if it were not for limitations imposed by income tax regulations. Under these plans, the annual lifetime benefit is based upon a percentage of compensation during the final ten years of service, offset by several other sources of retirement income including benefits payable under the qualified retirement plan. The estimated amounts to be paid under these plans are accrued over the period of active employment of covered employees. As of December 31, 2002 and 2001, respectively, BCBSD has accrued \$2,792 and \$4,369 for these benefits. Supplemental retirement benefit plan expense for the years ended December 31, 2002 and 2001, was \$576 and \$1,019, respectively.

In addition, the Company sponsors 401(k) plans for the benefit of all eligible employees. The Company contributes to certain of these plans and recognized expenses of \$5,075 and \$4,387 for the years ended December 31, 2002 and 2001, respectively.

12. Postretirement Benefits

CFMI and GHMSI provide certain healthcare benefits for retired employees. Substantially all employees become eligible for these benefits if they reach early retirement age while working for the Company and meet certain eligibility requirements. The Company's postretirement benefit programs provide for specific benefits based primarily on the retiree's age and years of service with the Company. The health care coverage is available provided that such retiree had CFMI and GHMSI's health insurance coverage in effect during the last five years of employment.

BCBSD sponsors two defined benefit postretirement plans that provide health benefits and a life insurance plan for retirees and their dependents who meet plan eligibility requirements. Qualified retirees are eligible to continue health and life insurance benefits upon meeting certain age and service require-

ments. These benefits provide for a percentage of cost sharing between the retiree and BCBSD. The health care coverage is available provided that such retiree had BCBSD's health insurance coverage in effect during the last five years of employment.

In accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," the Company records the expected cost of these benefits as expense during the years that employees render service.

The Company funds postretirement benefits as benefits are paid. The following tables show the funded status of the postretirement plans and the amounts recognized in the accompanying consolidated financial statements as of December 31:

	CFMI	2002 GHMSI	BCBSD
Change in benefit obligation:			
Benefit obligation at beginning of year	\$ 30,001	\$ 16,071	\$ 17,350
Service cost	1,031	514	983
Interest cost	2,120	1,032	1,289
Actuarial loss (gain)	1,945	(567)	2,148
Benefits paid	(2,018)	(516)	(860)
Benefit obligation at end of year	<u>\$ 33,079</u>	<u>\$ 16,534</u>	<u>\$ 20,910</u>

Liabilities recognized in the accompanying consolidated balance sheets consist of:

	CFMI	2002 GHMSI	BCBSD
Funded status	\$ (33,079)	\$ (16,534)	\$ (20,910)
Unrecognized transition liability	-	5,890	4,535
Unrecognized actuarial loss (gain)	11,000	(5,299)	1,843
Unrecognized prior service (asset) cost	(908)	398	111
Net amount recognized—accrued benefit cost	<u>\$ (22,987)</u>	<u>\$ (15,545)</u>	<u>\$ (14,421)</u>
Components of net periodic postretirement benefit cost for the year ended December 31, 2002, are as follows:			
Service cost	\$ 1,031	\$ 514	\$ 983
Interest cost	2,120	1,032	1,289
Amortization of prior service (asset) cost	(207)	40	12
Amortization of transition obligation	-	589	376
Recognized actuarial loss (gain)	534	(417)	-
Net periodic postretirement benefit cost	<u>\$ 3,478</u>	<u>\$ 1,758</u>	<u>\$ 2,660</u>

For measurement purposes, a 6.75% to 7.25% discount rate and a 5.00% to 6.00% annual rate of increase in the per capita cost of covered health care benefits were assumed.

	CFMI	2001 GHMSI	BCBSD
Change in benefit obligation:			
Benefit obligation at beginning of year	\$ 23,059	\$ 14,546	\$16,404
Service cost	977	453	837
Interest cost	2,051	1,080	1,136
Actuarial loss (gain)	5,864	607	(330)
Benefits paid	(1,950)	(615)	(706)
Plan amendments	-	-	9
Benefit obligation at end of year	<u>\$ 30,001</u>	<u>\$ 16,071</u>	<u>\$17,350</u>

Amounts recognized in the consolidated balance sheet consist of:

	CFMI	2001 GHMSI	BCBSD
Funded status	\$(30,001)	\$(16,071)	\$(17,350)
Unrecognized transition liability	-	6,478	4,911
Unrecognized actuarial loss (gain)	9,590	(5,148)	(307)
Unrecognized prior service (asset) cost	(1,114)	438	123
Net amount recognized—accrued benefit cost	<u>\$(21,525)</u>	<u>\$(14,303)</u>	<u>\$(12,623)</u>

	CFMI	2001 GHMSI	BCBSD
Components of net periodic postretirement benefit cost for the year ended December 31, 2001, are as follows:			
Service cost	\$ 977	\$ 453	\$ 837
Interest cost	2,051	1,080	1,136
Net amortization and deferral of prior service (asset) cost	(207)	40	12
Amortization of transition obligation	-	589	376
Recognized actuarial loss (gain)	515	(345)	(18)
Net periodic postretirement benefit cost	<u>\$ 3,336</u>	<u>\$ 1,817</u>	<u>\$ 2,343</u>

For measurement purposes, a 7.25% to 7.50% discount rate and a 5.00% to 6.00% annual rate of increase in the per capita cost of covered health care benefits were assumed.

13. Income Taxes

The Company files a consolidated federal income tax return. For federal taxes, the Company benefits from a special deduction provided to certain BlueCross plans under Internal Revenue Code Section 833(b) (the 833(b) deduction). Due to the 833(b) deduction, the Company has effectively incurred federal taxes at Alternative Minimum Tax (AMT) rates. The Company could lose the benefit of the 833(b) deduction in the future if the Company ceases to be not-for-profit, if the Company's reserves reach certain levels or if certain other events occur. The statutory AMT rate was 20% during 2002 and 2001. The Company has regular tax loss carryforwards of approximately \$114,508 as of December 31, 2002, which expire between 2003 and 2020, and accumulated AMT credits of approximately \$130,806 as of December 31, 2002. Both the carryforwards and the credits can be used, in certain circumstances, to offset future regular taxable income and tax, respectively.

CFMI is exempt from Maryland income tax under Title 10, Subtitle 1, Section 10-104(2) of the Maryland Code and is governed by Title 14, Subtitle 1, Section 14-102 of the Maryland Insurance Code. GHMSI is exempt from all income taxes in the District of Columbia, Maryland and Virginia. BCBSD is exempt from Delaware State income taxes. Subsidiary operations are subject to the applicable state or District of Columbia income taxes.

Provision for income taxes includes deferred income taxes resulting primarily from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. The principal sources of temporary differences include nondeductible accruals, accounts receivable, property and equipment and medical claims payable.

The provision (benefit) for income taxes for the years ended December 31, 2002 and 2001, consist of the following components:

	2002	2001
Current:		
Federal	\$ 24,509	\$ 25,553
State	5,796	1,217
	<u>30,305</u>	<u>26,770</u>
Deferred:		
Federal	(12,780)	(4,261)
State	(446)	(2,126)
	<u>(13,226)</u>	<u>(6,387)</u>
Provision for income taxes	<u>\$ 17,079</u>	<u>\$ 20,383</u>

As of December 31, 2002 and 2001, the Company had deferred tax assets of \$213,903 and \$177,253, respectively, and deferred tax liabilities of \$26,844 and \$9,567, respectively. Valuation reserves of \$159,831 and \$129,805, primarily against the regular tax loss carryforwards and AMT credits, have been recorded against the net deferred tax assets in the accompanying consolidated balance sheets as of December 31, 2002 and 2001, respectively. In the absence of a for-profit conversion, management does not believe the Company will be subject to regular tax prior to the expiration of these carryforwards. Management has determined, based on the Company's long-term history of operating earnings and its expectations for the future, that operating income of the Company will more likely than not be sufficient to fully realize the net recorded deferred tax assets.

14. Other Comprehensive Income

The components of other comprehensive income, including the reconciliation of net unrealized holding gains and losses to net unrealized holding gains and losses, net of reclassification adjustments and taxes, are as follows for the years ended December 31:

	Before-Tax Amount	2002 Tax (Expense) Benefit	Net-of-Tax Amount
Net unrealized gains and losses arising during the period	\$ 19,094	\$ (3,839)	\$ 15,255
Less: reclassification adjustments for net gains and losses realized or recognized in net income	(16,719)	3,344	(13,375)
Net unrealized gains and losses	35,813	(7,183)	28,630
Minimum pension liability adjustment	(29,945)	5,994	(23,951)
Total other comprehensive income (loss)	<u>\$ 5,868</u>	<u>\$ (1,189)</u>	<u>\$ 4,679</u>

	Before-Tax Amount	2001 Tax (Expense) Benefit	Net-of-Tax Amount
Net unrealized gains and losses arising during the period	\$ 13,479	\$ (2,612)	\$ 10,867
Less: reclassification adjustments for net gains and losses realized in net income	10,292	(2,003)	8,289
Net unrealized gains and losses	3,187	(609)	2,578
Minimum pension liability adjustment	(10,575)	2,115	(8,460)
Foreign currency translation adjustment	109	(22)	87
Total other comprehensive income (loss)	<u>\$ (7,279)</u>	<u>\$ 1,484</u>	<u>\$ (5,795)</u>

15. Related Party Transactions

CFMI maintains a commitment to support the operations and liquidity of a related professional association. Net loss of the related professional association of \$8,088 for the year ended December 31, 2002 is included in the accompa-

nying consolidated statements of operations. Due to the nature of the commitment, it is not possible to estimate the future maximum potential amount of the commitment.

16. Commitments and Contingencies

The health care and health insurance industries are subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care insurers and providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Company is in compliance with fraud and abuse as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

In the jurisdictions in which the Company is licensed to conduct business, associations have been created for the purpose, among others, of protecting insured parties under health insurance policies. The Company is contingently liable for assessments in any calendar year, in order to provide any required funds to carry out the power and duties of the association.

The Company operates under licensing agreements with BCBSA whereby the Company uses the service marks of BCBSA in the course of its business. The Company files periodic reports with BCBSA.

One of CFMI's subsidiaries entered into employment agreements with certain physicians with terms through 2006. Early termination of the contracts by the subsidiary is allowable with two years prior written notice. Upon such termination, the employer would pay to each physician two years salary and benefits, along with other defined compensation. Approximate compensation due under the contracts is \$10,000 to \$12,000 annually through March 2006, subject to allowable consumer price index or market rate changes. Additionally, certain compensation is guaranteed to these physicians during the remaining term of their contracts. Total wages paid under these agreements in 2002 and 2001 were \$9,988 and \$11,137, respectively. CFMI and one of CFMI's subsidiaries are jointly and severally liable for payments under these agreements.

The Company has employment contracts with certain executives, which contain provisions that could trigger the payment of additional compensation benefits upon a "change in control" of the Company. Some of the aforementioned payments would be payable based on a "change of control" only, while others would be payable upon termination of employment following "change of control." Accordingly, these aforementioned potential payments have not been accrued at December 31, 2002, as the triggering events have not occurred.

The Company also has a retention bonus plan whereby certain officers and other employees are entitled to certain payments following a sale or disposition of the Company or under certain other circumstances. The payment of any of these amounts is subject to regulatory and legislative approval of such a transaction and/or the resolution of other legal issues. As such, no portion of the aforementioned potential retention bonus payments, which have been estimated at \$8,400 in total for the Company, have been accrued at December 31, 2002.

Various lawsuits, including class action lawsuits and other claims, occur in the normal course of business and are pending against the Company. Management, after consultation with legal counsel, is of the opinion that the lawsuits and other claims, when resolved, will not have a material effect on the accompanying consolidated financial statements.

The Company's professional liability coverage is on a claims-made basis. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured. The claims-made policy has been renewed through April 30, 2003. The Company also purchases extended reporting period endorsements to ensure that claims made against physicians no longer employed by the Company are insured.

The Company has a commitment for a credit facility with a commercial bank under which certain of its affiliates may borrow up to a maximum amount of \$60,000. There have been no draws made on this line of credit during 2002 or 2001.