NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

WELLCHOICE, INC. AND SUBSIDIARIES

(dollars in thousands, except share and per share data)

NOTE 1

Organization and For-Profit Conversion

WellChoice, Inc. ("WellChoice") was formed in August 2002 as a Delaware Corporation to be the for-profit parent holding company for Empire HealthChoice, Inc. ("EHC") following the conversion. WellChoice owns a Health Maintenance Organization ("HMO") and two health insurance companies through its investment in WellChoice Holdings of New York, Inc. ("WellChoice Holdings").

On November 7, 2002, EHC converted from a not-for-profit health service corporation to a for-profit accident and health insurer under the New York State insurance laws and the converted EHC issued all its authorized capital stock to the New York Public Asset Fund (the "Fund") and The New York Charitable Asset Foundation (the "Foundation"). The Fund and the Foundation then received their respective shares of WellChoice common stock in exchange for the transfer of all the outstanding shares of EHC to WellChoice Holdings. Pursuant to the plan of conversion, WellChoice issued 82,300,000 shares to the Fund and the Foundation and completed an initial public offering of 19,199,000 shares of common stock, consisting of 18,008,523 shares that were sold by the Fund and Foundation and 1,190,477 newly issued shares of common stock sold by WellChoice. After deducting the underwriting discount, net proceeds to WellChoice were approximately $27,990.

WellChoice Holdings is a non-insurance holding company which wholly-owns Empire HealthChoice Assurance Inc. ("EHCA") dba, Empire Blue Cross Blue Shield. In connection with EHC's conversion to a for-profit entity, EHC merged with EHCA. EHCA wholly-owns Empire HealthChoice HMO, Inc. ("EHC HMO") and WellChoice Insurance of New Jersey, Inc. ("WCINJ"). EHC HMO is an HMO licensed under Article 44 of the New York Public Health Law and is also licensed to operate an HMO in the State of New Jersey. WCINJ is a credit, life, accident and health insurance company licensed in eleven states, which currently writes business only in New Jersey. Prior to its dissolution in February 2002, NexxtHealth, Inc. was a wholly-owned subsidiary of EHC primarily engaged in the development of software to link health care systems to the Internet.

EHCA and its subsidiaries offer a comprehensive array of insurance products to employer groups and individuals. Products include traditional comprehensive indemnity health coverage and managed care products and services offered through an HMO, preferred provider organization ("PPO") and exclusive provider organization ("EPO"). EHCA and its subsidiaries also process claims for self-insured employers and government programs. EHCA and EHC HMO are members of the Blue Cross Blue Shield Association ("BCBSA") which provides EHCA and EHC HMO the ability to participate with other Blue Cross Blue Shield plans in BCBSA sponsored programs and entitles it to use the Blue Cross and Blue Shield names and marks in the New York City metropolitan area and one or both of these names and marks in select upstate New York counties.

WellChoice also owns Empire National Accounts Services Corporation ("ENASCO"). ENASCO has a 24.975% interest in National Accounts Service Company, LLC ("NASCO"), a limited liability company, which processes national account claims for the Company and other Blue Cross Blue Shield plans.

NOTE 2

Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The consolidated financial statements include the accounts of WellChoice and its wholly-owned subsidiaries (collectively, the "Company"). All significant intercompany transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

(dollars in thousands, except share and per share data)

Conversion

The conversion was accounted for as a reorganization using the historical carrying values of EHC and its subsidiaries' assets and liabilities. Immediately following the conversion, EHC's unassigned reserves were reclassified to par value of common stock and additional paid-in capital. The costs of the conversion were recognized as an expense.

Investments—Fixed Maturities and Marketable Equity Securities

The Company has classified all of its fixed maturity and marketable equity security investments as available for sale and, accordingly, they are carried at fair value. The fair value of investments in fixed maturities and marketable equity securities are based on quoted market prices. Unrealized gains and losses are reported as a separate component of other comprehensive income, net of deferred income taxes. The amortized cost of fixed maturities, including certain trust preferred securities, is adjusted for amortization of premiums and accretion of discounts to maturity, which is included in investment income. Amortization of premiums and discounts on collateralized mortgage obligations are adjusted for prepayment patterns using the retrospective method. Investment income is shown net of investment expenses. The cost of securities sold is based on the specific identification method. When the fair value of an investment is lower than its cost and such a decline is determined to be other than temporary, the cost of the investment is written down to fair value and the amount of the write down is charged to net income as a realized loss.

Short-Term Investments

Short-term investments are carried at fair value and consist principally of U.S. treasury bills, commercial paper and money market investments. The Company considers securities with maturities greater than three months and less than one year at the date of purchase as short-term investments. The fair value of short-term investments is based on quoted market prices.

Other Long-Term Equity Investments

Other long-term equity investments include joint ventures and warrants. Joint ventures are accounted for under the equity method. The Company's warrants are considered derivatives and are carried at fair value. The warrants are not classified as hedging instruments. Fair values of warrants are determined using the Black-Scholes Options Valuation Model. Changes in the fair values of warrants are recorded as realized gains or losses.

Cash and Cash Equivalents

The Company considers all bank deposits, highly liquid securities and certificates of deposit with maturities of three months or less at the date of purchase to be cash equivalents. These cash equivalents are carried at cost which approximates fair value.

Pharmaceutical Rebate Sharing Program

The Company participates in pharmaceutical rebate sharing programs with drug manufacturers through a third party pharmacy benefit manager. Rebates for fully-insured groups are recorded as a reduction to the cost of benefits provided. Rebates for self-funded groups are recorded as administrative service fee revenue. The Company records an estimate for pharmacy rebates earned but not yet received. These estimates are adjusted as new information becomes known and such adjustments are included in current period operations. Pharmacy rebates included in miscellaneous receivables were $19,004 and $10,912 at December 31, 2002 and 2001, respectively.

Market Stabilization and Stop Loss Pools

The Company is required to participate in Market Stabilization and Stop Loss Pools ("Pools") as established by the State of New York. Contributions and recoveries under the Pools are estimated based on interpretations of applicable regulations and are recorded as an addition or a reduction to cost of benefits provided. These estimates are adjusted as new information becomes known and such adjustments are included in current period operations. Pool recoverables included in miscellaneous receivables were $18,390 and $18,310 at December 31, 2002 and 2001, respectively.

Receivables

Receivables are reported net of allowance for doubtful accounts of $13,724 and $12,440 at December 31, 2002 and 2001, respectively.

Property, Equipment and Information Systems

Property, equipment and information systems are reported at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are not greater than twenty-one years for property and improvements and three to ten years for equipment and furniture. Purchased software is capitalized and depreciated for a period not to exceed three years. The Company capitalizes certain costs incurred during the application development stage related to developing internal use software. These capitalized costs are amortized over a three-year period beginning when the software is placed into production. Computer software costs that are incurred in the preliminary project stages and post-implementation/operation stages, are expensed as incurred.

Unpaid Claims and Claims Adjustment Expenses

The cost of unpaid claims, both for reported claims and claims incurred but not yet reported to the Company, is calculated based upon claim history, claim inventory, number of claims received, changes in product mix, number of contracts in force, recent trend experience, unit costs and the regulatory environment. The estimated expense of processing these claims is also included in the consolidated financial statements as a component of administrative expense. These estimates are subject to the effects of medical claim trends and other uncertainties. Although considerable variability is inherent in such estimates, management believes that the reserves for claims and claims adjustment expenses are adequate. The estimates are continually reviewed and adjusted as experience develops or new information becomes known. Such adjustments are included in current period operations.

Advance Deposits

Under certain funding arrangements, customers are contractually obligated to remit funds on a paid claims basis. Funds received prior to payment of claims are classified as advance deposits.

Revenue

Membership contracts are generally for a period of one year and are subject to cancellation by the employer group upon 60 days written notice. Premiums are normally due monthly and are recognized as revenue during the period in which the Company is obligated to provide services to members. Premiums received prior to such periods are recorded as unearned premiums. Premiums on retrospectively rated group contracts are accrued by making estimates based on past claims experience on such contracts. Premiums collected on retrospectively rated group contracts in excess of premiums earned are classified as group and other contract liabilities.

Administrative service fees are recognized in the period the related services are performed. All benefit payments under these programs are excluded from revenue and cost of benefits provided.

Cost of Benefits Provided

Cost of benefits provided includes claims paid, claims in process and pending, and an estimate of unreported claims for healthcare service provided to enrolled members during the period. Costs of benefits are reported net of pharmacy rebates, coordination of benefits and pool recoveries.

Acquisition Costs

Marketing and other costs associated with the acquisition of membership contracts are expensed as incurred.

Income Taxes

The Company accounts for income taxes using the liability method. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the financial reporting and tax bases of assets and liabilities.

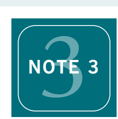
(dollars in thousands, except share and per share data)

Premium Deficiency

A premium deficiency reserve is established when expected claim payments or incurred costs, claim adjustment expenses and administrative costs exceed the premiums to be collected for the remainder of a contract period. For purposes of determining if a premium deficiency reserve exists, contracts are grouped in a manner consistent with how policies are marketed, serviced and measured. Anticipated investment income is not utilized in the premium deficiency reserve calculation. For the years ended December 31, 2002 and 2001, a premium deficiency reserve of $3,300 and $0, respectively, is included in group and other contract liabilities.

Recent Accounting Pronouncements

In July 2002, the Financial Accounting Standards Board issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities,* which supersedes Emerging Issues Task Force (EITF) Issue 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. SFAS 146 requires that a liability for costs associated with exit or disposal activities first be recognized when the liability is irrevocably incurred rather than at the date of management's commitment to an exit or disposal plan. The provisions of the new standard are effective prospectively for exit or disposal activities initiated after December 31, 2002. The Company does not anticipate that the adoption of SFAS 146 will materially affect the financial statements.



Investments

Available for sale investments are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2002				
Fixed maturities:				
U.S. Treasury Notes	$ 76,042	$ 2,081	$ —	$ 78,123
U.S. Government Agency obligations	234,300	2,011	(156)	236,155
U.S. Government Agency mortgage-backed securities	129,522	1,299	(127)	130,694
Public utility bonds	20,000	368	(4)	20,364
Corporate securities	386,753	13,059	(1,858)	397,954
Total fixed maturities	846,617	18,818	(2,145)	863,290
Marketable equity securities:				
Common stock	31,966	—	(2,724)	29,242
Nonredeemable preferred stock	15,056	250	—	15,306
Total marketable equity securities	47,022	250	(2,724)	44,548
Total fixed maturities and marketable equity securities investments	$893,639	$19,068	$(4,869)	$907,838

(continued)

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2001				
Fixed maturities:				
U.S. Treasury Notes	$ 95,757	$ 2,142	$ —	$ 97,899
U.S. Government Agency obligations	243,808	1,212	(2,922)	242,098
U.S. Government Agency mortgage-backed securities	80,893	1,328	(366)	81,855
Public utility bonds	37,128	772	(150)	37,750
Corporate securities	451,911	10,745	(2,394)	460,262
Total fixed maturities	909,497	16,199	(5,832)	919,864
Marketable equity securities:				
Common stock	8,426	—	—	8,426
Nonredeemable preferred stock	15,056	—	(64)	14,992
Total marketable equity securities	23,482	—	(64)	23,418
Total fixed maturities and marketable equity securities investments	$932,979	$16,199	$(5,896)	$943,282

The amortized cost and fair value of fixed maturities, by contractual maturity, are shown below:

December 31, 2002	Amortized Cost	Fair Value
Due in 1 year or less	$ 29,222	$ 29,561
Due after 1 year through 5 years	246,979	256,825
Due after 5 years through 10 years	54,408	56,124
Due after 10 years	516,008	520,780
Total	$846,617	$863,290

Mortgage-backed securities do not have a single maturity date and have been included in the above table based on the year of final maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of available for sale securities for the years ended December 31, 2002, 2001 and 2000 were $231,840, $154,137 and $181,900, respectively. The Company's investment portfolio is not significantly concentrated in any particular industry or geographic region.

Investment income, net is summarized as follows:

Year ended December 31	2002	2001	2000
Fixed maturities	$57,507	$61,690	$ 62,282
Marketable equity securities	1,081	1,200	1,198
Short-term investments and cash equivalents	7,775	15,583	19,952
Other long-term equity investments	117	—	—
Interest and dividend income	66,480	78,743	83,432
Equity in earnings (losses) of joint ventures	(229)	(571)	(6,378)
Less investment expenses including interest on advance deposits	(1,445)	(8,546)	(11,557)
Investment income, net	$64,806	$69,356	$ 65,497

Realized and unrealized gains and losses on investments were as follows:

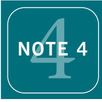
Year ended December 31	2002	2001	2000
Realized gains:			
Fixed maturities	$ 4,447	$ 2,351	$ 1,457
Equity securities	375	—	20,993
Short-term investments and cash equivalents	6	3,994	—
Total realized gains	4,828	6,345	22,450
Realized losses:			
Fixed maturities	(1,747)	(2,402)	(415)
Equity securities	(476)	(10,816)	—
Short-term investments and cash equivalents	(1)	(5,530)	—
Total realized losses	(2,224)	(18,748)	(415)
Net realized gains (losses)	2,604	(12,403)	22,035
Changes in unrealized gains (losses):			
Fixed maturities	6,305	23,249	43,893
Equity securities	(2,531)	11,193	(70,304)
Short-term investments	23	(9)	67
Net unrealized gains (losses)	3,797	34,433	(26,344)
Total realized and unrealized gains (losses)	$ 6,401	$ 22,030	$ (4,309)

The components of other comprehensive income are as follows:

Year ended December 31	2002	2001	2000
Unrealized gains (losses) from investments, net of taxes of $(2,186), $(6,503) and $309	$ 4,059	$15,527	$ (4,000)
Reclassification adjustment for (gains) losses included in net income, net of taxes of $857, $(4,341) and $7,711	(1,591)	8,062	(14,323)
Other comprehensive income (loss)	$ 2,468	$23,589	$(18,323)

In 2001, the Company participated in a securities lending program whereby certain securities from its portfolio are loaned to qualified brokers in exchange for cash collateral, equal to at least 102% of the market value of the securities loaned. The securities lending agent indemnified the Company against loss in the event of default by the borrower. Income generated by the securities lending program is reported as a component of net investment income. As of December 31, 2001, $321,421 of fixed-maturity securities were loaned under the program. In November 2002, the Company transferred its investment portfolio to a new custodial agent and is in the process of entering into a similar securities lending agreement. As of December 31, 2002, the terms of the agreement were not finalized as such no fixed securities were on loan.

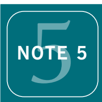
The Company is required by BCBSA to maintain a deposit for the benefit and security of out-of-state policyholders. At December 31, 2002, the fair value and amortized cost of the investment on deposit were $8,364 and $7,919, respectively. The Company also maintains a deposit to satisfy the requirements of its workers' compensation insurance carrier. At December 31, 2002, the fair value and amortized cost of the investment on deposit were $1,848 and $1,846, respectively.



Investment in WebMD

The Health Information Network Connection, LLC ("THINC") was organized as a 20% owned joint venture. In January 1999, CareInsite, Inc. ("CareInsite"), a publicly-held company, acquired a 20% ownership interest in THINC in exchange for cash and a warrant to purchase CareInsite common stock. In January 2000, CareInsite agreed to acquire the remainder of THINC. The Company received its pro rata portion of the warrant to purchase shares of CareInsite held by THINC and a new warrant to purchase additional shares of CareInsite stock. Pursuant to a cashless exercise, the Company exercised its warrants and received 918,004 unregistered shares of CareInsite common stock. The Company recognized a realized gain of $13,157 in 2000 on this transaction.

In September 2000, Healtheon/WebMD Corp. ("WebMD"), a publicly-held company, purchased CareInsite and its parent, Medical Manager Corp., and the Company received 1,193,535 shares of WebMD common stock. The Company recognized a realized gain of $7,836 in 2000 on this transaction. At December 31, 2000, the Company recorded an unrealized loss of $9,473 on its investment in WebMD common stock. In 2001, the Company recorded a realized loss of $10,521 due to management's determination that the decline in WebMD common stock was other than temporary. For the year ended December 31, 2002, the Company's unrealized gain in WebMD common stock was $1,470. During December 2002, 206,900 shares were sold resulting in a gain of $375.



Property and Equipment

Property and equipment, including capitalized lease arrangements, are as follows:

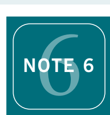
December 31	2002	2001
Buildings and improvements	$102,600	$ 91,576
Equipment and furniture	52,575	41,497
Software systems	57,807	46,728
Total property and equipment	212,982	179,801
Less accumulated depreciation and amortization	112,192	76,852
Net property and equipment	$100,790	$102,949

All property and equipment is used by the Company for its operations and includes two facilities leased under agreements which are accounted for as capital leases. Depreciation expense, including depreciation on properties held under capital leases, totaled $33,270, $27,332 and $14,189 for the years ended December 31, 2002, 2001 and 2000, respectively.

For the year ended December 31, 2002, the cost and accumulated depreciation of assets retired were $2,278 and $1,077, respectively. Of these retirements, cost and accumulated depreciation of $2,213 and $1,036, respectively, was for information system equipment and personal computers.

For the year ended December 31, 2001, the cost and accumulated depreciation of assets retired were $16,463 and $6,770, respectively. Of these, the cost and accumulated depreciation of the World Trade Center assets that were written-off were $14,703 and $5,761, respectively. The cost and accumulated depreciation of all other assets retired, all of which was for information systems equipment and personal computers, was $1,760 and $1,009, respectively.

For the year ended December 31, 2000, the cost and accumulated depreciation of assets retired were $50,626 and $50,374, respectively. Of these retirements, cost and accumulated depreciation of $27,621 and $27,541, respectively, was for information system equipment and personal computers.



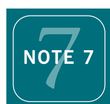
Claim Reserves

Activity in unpaid claims and certain claim adjustment expenses is summarized as follows:

Year ended December 31	2002	2001	2000
Balance as of January 1	$ 634,130	$ 672,419	$ 590,950
Incurred related to:			
Current period	3,993,607	3,792,241	3,445,559
Prior periods	(46,225)	(53,420)	(19,142)
Total incurred	3,947,382	3,738,821	3,426,417
Paid related to:			
Current period	3,493,244	3,257,090	2,863,345
Prior periods	525,044	520,020	481,603
Total paid	4,018,288	3,777,110	3,344,948
Balance at end of periods	$ 563,224*	$ 634,130	$ 672,419

**Includes $3,300 of premium deficiency reserve in WCINJ recorded in group and other contract liabilities.*

The provision for claims and claim adjustment expenses attributable to prior year incurrals had a favorable development of $46,225 in 2002, $53,420 in 2001 and $19,142 in 2000 due to health care trends being lower than anticipated when the reserves were established. Moreover, actual claim payment lags were shorter than assumed in determining the reserves due to continued improvement in the claim adjudication process. Additionally, the development of the prior years' claim liability impacts premiums for retrospectively rated contracts. Accordingly, the Company's favorable (unfavorable) development of ($1,532), $46,416 and ($13,919) in 2002, 2001 and 2000, respectively, on such contracts, was largely offset by decreases (increases) in premiums.



Income Taxes

The significant components of the provision for income tax benefit (expense) are as follows:

Year ended December 31	2002	2001	2000
Current tax expense	$ (83,526)	$(34,963)	$(12,362)
Deferred tax benefit	151,373	34,828	86,902
Income tax benefit (expense)	$ 67,847	$ (135)	$ 74,540

A reconciliation of income tax computed at the federal statutory tax rate of 35% to total income tax is as follows:

Year ended December 31	2002	2001	2000
Income tax at prevailing corporate tax rate applied to pre-tax income	$(108,049)	$(45,890)	$(40,544)
Increase (decrease):			
Change in valuation allowance	195,698	1,147	71,860
IRC Sec. 833(b) special deduction	—	54,249	36,427
State and local income taxes, net of federal income tax benefit	(5,077)	(88)	(88)
Other	(14,725)	(9,553)	6,885
Income tax benefit (expense)	$ 67,847	$ (135)	$ 74,540

WellChoice and its subsidiaries file a consolidated federal income tax return. WellChoice currently has a tax sharing agreement in place with all of its subsidiaries. In accordance with the Company's tax sharing agreement, the Company's subsidiaries pay federal income taxes to WellChoice based on a separate company calculation.

Prior to 2002, EHC maintained a valuation allowance on its regular tax net operating loss carryforwards and certain other temporary differences due to uncertainty in its ability to utilize these assets within an appropriate period. The use of these assets was largely dependent on the conversion and future positive taxable income. Because the approval of EHC's plan of conversion by the New York State Insurance Department (the "Department") removed the uncertainty of the conversion, the Company concluded in the third quarter that the valuation allowance related to these assets was no longer necessary. Accordingly, the income tax benefit for 2002 includes the reversal of the valuation allowance of $174,977 related to the Company's regular tax operating loss carryforwards.

Because EHC converted to a for-profit insurer in 2002, the Company adjusted its deferred tax assets for temporary differences related to EHCA's liability for state and local taxes which resulted in the recognition of a $5,374 deferred tax benefit.

Prior to January 1, 1987, EHC was exempt from federal income taxes. With the enactment of the Tax Reform Act of 1986, EHC, and all other Blue Cross and Blue Shield plans, became subject to federal income tax. Among other provisions of the Internal Revenue Code, these plans were granted a special deduction (the "833(b) deduction") for regular tax calculation purposes. EHC's position with regard to ordering is that the special deduction must be taken before any regular tax loss carryforward deduction. This is consistent with recent Internal Revenue Service ("IRS") rulings. The Company has followed this position and the related deduction ordering methodology in all its federal income tax return filings. As a result of the 833(b) deduction, EHC has incurred no regular tax liability, but in profitable years, has paid taxes at the alternative minimum tax rate of 20%.

The 833(b) deduction is calculated as the excess of 25% of the incurred claim and claim adjustment expenses for the tax year over adjusted surplus, as defined, limited to taxable income. The amount of 833(b) deductions utilized in each tax year is accumulated in an adjusted surplus balance. Once the cumulative adjusted surplus balance exceeds the 833(b) deduction for the current taxable year, the deduction is eliminated.

During the fourth quarter of 2002, the Company reevaluated its tax position for financial statement purposes related to EHC's ability to utilize the Section 833(b) deduction and determined that when EHC converted to a for-profit entity, its ability to utilize the Section 833(b) deduction was uncertain. No authority directly addresses whether a conversion transaction will render the 833(b) deduction unavailable. The Company is aware, however, that the IRS has taken the position related to other Blue Cross Blue Shield plans that a conversion could result in the inability of a Blue Cross Blue Shield plan to utilize the 833(b) deduction. In light of the absence of governing authority, while the Company intends to continue to take the deduction on its tax returns after the conversion, the Company will assume, for financial statement reporting purposes, that the deduction will be disallowed. Accordingly, the Company's income tax provision for 2002 assumes the utilization of approximately $145,000 regular operating loss carryforwards for financial reporting purposes in excess of those utilized for tax purposes. Because the conversion occurred in the fourth quarter and the tax provisions for the first three quarters had assumed the availability of the section 833(b) deduction, the Company recorded additional tax expense of $50,744 in the fourth quarter representing the utilization of regular operating loss carryforwards rather than the 833(b) deduction.

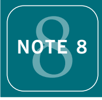
The Company's position with gross deferred tax assets and liabilities and the related valuation allowance are as follows:

December 31	2002	2001
Deferred tax assets:		
Regular tax operating loss carryforwards	$ 57,593	$ 174,977
Alternative minimum tax credit carryforward	134,064	68,010
Fixed assets	4,807	10,420
Loss reserve discounting	4,933	6,689
Post-retirement benefits other than pensions	50,308	48,372
Post-employment benefits	3,901	2,372
Bad debts	5,621	4,354
Deferred compensation	6,250	4,199
Unpaid expense accruals	10,858	11,054
Other temporary differences	21,366	11,218
Total deferred tax assets	299,701	341,665
Valuation allowance for deferred tax assets	—	(195,698)
Deferred tax assets, net of allowance	299,701	145,967
Deferred tax liabilities:		
Unrealized gain on investments	12,339	11,521
Pension income adjustment	17,264	14,670
Bonds and bond discount	1,150	872
Total deferred tax liabilities	30,753	27,063
Net deferred tax assets	$268,948	$ 118,904

The Company's regular tax loss carryforwards for income tax purposes of $310,000 expire between the years 2003 and 2022. For financial reporting purposes, the Company's regular net operating loss carryforwards are $165,000. The Company fully utilized its remaining alternative minimum tax loss carryforward in 2000. The Company's alternative minimum tax credit carryforward of $134,000 has no expiration date.

The Company completed a study of the intangible assets which existed at January 1, 1987 and has filed amended returns for 1989 and 1990 claiming a refund for taxes paid. The Company is aware that the IRS and other Blue Cross Blue Shield plans are currently in litigation to determine whether intangible assets that existed at January 1, 1987 are entitled to tax basis and, therefore, are deductible in future years' tax returns. If the Company prevails, these potential future tax benefits of up to $100,000 will be available to the Company. As of December 31, 2002, the Company has not recognized this potential benefit in its financial statements.

The Company paid federal income taxes of $84,000, $13,349 and $14,195 in 2002, 2001 and 2000, respectively. Included in accounts payable and accrued expenses are $917 and $18,863 of federal income taxes payable at December 31, 2002 and December 31, 2001, respectively.



Information Technology Outsourcing

In June 2002, the Company entered into a ten-year outsourcing agreement with International Business Machines Corporation ("IBM"). Under the terms of the contract, IBM is responsible for operating the Company's data center, technical help desk and applications development. IBM has entered into a separate agreement to sublease the Company's data center. IBM's charges under the contract include personnel, calculated as a function of IBM's cost for personnel dedicated to the outsourcing; computer equipment, based on equipment usage rates; space, based on actual usage rates; and certain other costs.

IBM is expected to invoice the Company approximately $681,000 over the remaining term of the agreement for operating the Company's data center and technical help desk as follows:

2003	$ 94,900
2004	84,900
2005	88,000
2006	74,800
2007	67,200
2008	65,200
2009	62,900
2010	60,400
2011	58,600
2012	24,100
	$681,000

The agreement provides for IBM to assist the Company in developing new IT systems. In connection with these services, the Company is obligated to purchase $60,823, in additional modernization services and equipment from IBM, with a target purchase rate as follows:

2003	$ 31,423
2004	19,000
2005	7,200
2006	3,200
Total	$ 60,823

The Company may defer the purchase of services beyond the target date, provided that to the extent purchases are delayed more than one year beyond the target year, the Company shall pay a premium to IBM of 10% per annum of the contract price. At December 31, 2002, other liabilities include $11,143 of cash flow concessions the Company has taken on monthly invoices from IBM. In accordance with the terms of the IBM contract, the Company is required to repay these amounts in the future.

Additionally, IBM, in coordination with deNovis, Inc. ("deNovis"), has agreed to develop a new claims payment software system and to license it to the Company. Subject to the successful completion and acceptance of the claims payment system, the Company will pay a development and license fee of $50,000. Under the terms of the contract with IBM, the Company will pay $25,000 of this fee in four equal installments upon the achievement of specified milestones, the last of which is the Company's acceptance of the claims payment system. The achievement of these milestones is anticipated to occur during 2004 and 2005. The remaining $25,000 will be paid one year following the date the Company accepts the claims payment system. Following the expiration of the one-year warranty period that begins upon the payment of the final installment, the Company will pay IBM an annual fee of $10,000 for maintenance and support services. Under the terms of the contract, the Company is entitled to 2% of IBM's gross revenues from licensing the claims payment system to third parties for the term of the IBM outsourcing contract, including any extensions. The Company will have no obligation to pay the development and license fee and the annual fee if the successful completion and delivery of the claims payment system does not occur.

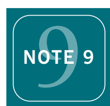
(dollars in thousands, except share and per share data)

The Company will own all software developed by IBM under the agreement, other than the claims payment system. All such software in which the Company will have all rights, title and interest will be accounted for in accordance with SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use."

In connection with the agreement, the Company sold computer equipment with a net book value of $1,736 to IBM. No gain or loss on the sale of the computer equipment was recognized. Also in connection with the agreement, the Company licensed to IBM its Internet portal technology for an upfront initial license fee of $2,000. In accordance with SOP 98-1, the Company applied the proceeds from the license of the Internet portal technology to the book value of the assets and no gain or loss was recorded. Under the agreement, IBM has the right to sublicense the Internet portal technology to third parties and the Company will receive 4% of IBM's gross revenues from its licensing for fifteen years. The Company received no licensing revenue in 2002.

The outsourcing agreement can be terminated by either the Company or IBM in certain circumstances for cause without penalty. The Company can terminate the contract without cause after two years or if it experiences a change in control and, in such instances, would be obligated to pay certain termination costs, which vary based on the duration of the contract but are significant in the early years, to IBM.

During the second quarter of 2002, in connection with the IBM outsourcing, the Company began the implementation of a restructuring plan relating to its information technology personnel. Certain employees were involuntarily terminated in accordance with a plan of termination, certain employees were retained by the Company and certain employees were transitioned to IBM. Severance and other costs accrued at June 30, 2002 relating to the plan of termination were $5,351. Payments related to these costs of approximately $1,239 were made during the six months ended December 31, 2002. To help retain its employees and to help IBM retain its newly transitioned employees, the Company offered stay bonuses for these individuals. The estimated maximum cost of these bonuses assuming all individuals remain with the Company or IBM through the required dates, which range from 2003 to 2004, is approximately $8,518. At December 31, 2002, approximately $3,716 was accrued for these bonuses. The Company will recognize the cost of these stay bonuses in future periods as these employees provide service.



Restructuring

In November 2002, as part of the Company's continuing focus on increasing overall productivity, and in part as a result of the implementation of the technology outsourcing strategy, the Company continued streamlining certain operations and adopted a plan to terminate approximately 500 employees across all segments of its business. Severance and other costs of $13,715 were accrued relating to the plan. As of December 31, 2002, payments related to these costs of $639 were made.

Statutory Information

Insurance companies, including HMOs, are subject to certain Risk-Based Capital ("RBC") requirements as specified by the National Association of Insurance Commissioners (the "NAIC"). Under those requirements, the amount of capital and statutory-basis surplus maintained by an insurance company is to be determined based on the various risk factors related to it. At December 31, 2002, EHCA and each of its wholly-owned insurance subsidiaries met the RBC requirements.

EHCA and its subsidiaries are subject to minimum capital requirements under the state insurance laws. Combined statutory-basis surplus of EHCA and its subsidiaries at December 31, 2002 and 2001 of $819,756 and $610,779, respectively, exceeded their respective requirements. Combined statutory-basis net income of EHCA and its subsidiaries was $316,936, $114,462 and $73,971, for the years ended December 31, 2002, 2001 and 2000, respectively.

In accordance with the rules of the Department, the maximum amount of dividends which can be paid by the Company's subsidiaries without approval of the Department is subject to restrictions relating to statutory surplus and adjusted net income or adjusted net investment income.

On November 7, 2002, the Department approved the payment of a dividend to WellChoice from its subsidiary, EHCA, in the amount of $225,000, which was paid on November 8, 2002. No dividends were received or paid during the years ended December 31, 2001 and 2000.

EHCA made cash contributions to its HMO and insurance subsidiaries of approximately $65,000, $10,000 and $1,000 during 2002, 2001 and 2000, respectively. The capital contributions were made to ensure that each subsidiary had sufficient surplus under applicable BCBSA and state licensing requirements.

Contingencies

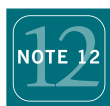
The Company is subject to a number of lawsuits, investigations and claims, some of which are class actions arising out of the conduct of its business. The Company believes that it has meritorious defenses in all of these matters and intends to vigorously defend its respective positions. The outcome of these matters is not currently predictable and the damages, if any, are also uncertain. The Company is also involved in and is subject to numerous claims, contractual disputes and uncertainties in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial condition or results of operations.

In June 2002, the Company settled a class action lawsuit for an estimated $23,000 in claims and legal fees. During the period from June 2002 to September 2002, the members of the class were informed of their right to receive payment, were required to respond, and the payments due to respondents were determined. Based on the number of respondents to the class action mailing through August 24, 2002 and the Company's estimate of the number of late respondents to the mailing, the Company has revised its best estimate of the ultimate liability for this action to $14,600. This change in estimate has been recorded in the consolidated financial statements for year ended December 31, 2002.

The Company entered into a credit and guaranty agreement, effective as of November 7, 2002, with The Bank of New York, as Issuing Bank and Administrative Agent, and several other financial institutions as agents and lenders, which will provide the Company with a credit facility. The Company is able to borrow under the credit facility for general working capital purposes. The total outstanding amounts under the credit facility cannot exceed $100,000. The facility has a term of 364 days, subject to extension for additional periods of 364 days with the consent of the lenders. Borrowings under the facility will bear interest, at the Company's option, at The Bank of New York's prime commercial rate (or, if greater, the federal funds rate plus 0.50%) as in effect from time to time plus a margin of between zero and 1.0%, or LIBOR plus a margin of between 1.125% and 2.250%, with the applicable margin to be determined based on the Company's financial strength rating. As of December 31, 2002, there are no funds drawn against this credit facility.

The Company also maintains a $607 secured letter of credit from HSBC Bank USA to support its rental lease obligation with Digitas LLC.

(dollars in thousands, except share and per share data)



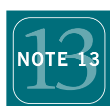
Commitments

The Company leases office facilities and equipment under capital and operating lease arrangements. Future minimum payments for capital leases and noncancelable operating leases, including escalation clauses, as of December 31, 2002 are as follows:

	Capital Leases	Operating Leases
2003	$11,094	$ 49,881
2004	11,378	43,812
2005	11,663	39,903
2006	11,950	33,475
2007	12,240	31,116
Future years	36,069	357,558
Net minimum lease payment	94,394	$555,745
Less:		
Interest	31,590	
Maintenance, taxes, etc.	15,104	
Present value of minimum lease payments	$47,700	

The average imputed interest rate on the capital leases was 14% in 2002. Rent expense under operating leases was $54,082, $50,540 and $48,340 for the years ended December 31, 2002, 2001 and 2000, respectively.

The schedule above includes rent commitments for the Company's Staten Island facility. However, as part of the information technology outsourcing agreement with IBM (see footnote 8), the Company entered into a sublease agreement with IBM for this property. The Company expects to receive net sublease income of approximately $1,000 per year for the next ten years.



Related Party Transactions

Administrative expenses incurred related to NASCO services totaled $14,673, $13,281 and $11,988 for the years ended December 31, 2002, 2001 and 2000, respectively. Accounts payable for the year ended December 31, 2002 and 2001 includes amounts due to NASCO of $3,515 and $2,634, respectively.

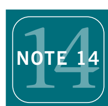
Active Health Management, Inc., ("AHM") an entity in which the Company has a 0.8% ownership interest, provides certain medical management services to the Company. Administrative expenses incurred related to AHM services totaled $5,882, $4,869 and $3,624 for the years ended December 31, 2002, 2001 and 2000, respectively. Accounts payable for the year ended December 31, 2002 and 2001 includes amounts due to AHM of $0 and $340, respectively.

A member of the Company's Board of Directors is an Executive Vice President of a labor union account. For the years ended December 31, 2002, 2001 and 2000, the Company earned premium revenue $18,030, $16,245 and $13,250, respectively, from the union. Billed premiums receivable at December 31, 2002 and 2001 includes amounts due from the union of $1,655 and $1,618, respectively. In addition, the Company recorded administrative service fees revenue of $2,918, $2,834 and $2,111 for the years ended December 31, 2002, 2001 and 2000. Other amounts due from customers at December 31, 2002 and 2001 includes $1,074 and $1,372 for service fees due from the union.

A member of the Company's Board of Directors is an Executive Vice President and Chief Operating Officer of a provider in our network. For the years ended December 31, 2002, 2001 and 2000, the Company made payments to the provider in the amount of $97,936, $72,308 and $69,239, respectively, for the reimbursement of claims to this provider.

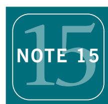
A member of the Company's Board of Directors is a physician in a group practice, which is a provider in our network. For the years ended December 31, 2002, 2001 and 2000, the Company made payments in the amount of $1,180, $1,230 and $1,359, respectively, to this group practice for the reimbursement of claims.

A member of the Company's Board of Directors served as Chairman of the Board of a provider in our network during 2000. For the year ended December 31, 2000, the Company made payments to this provider in the amount of $90,700 for the reimbursement of claims.



Insurance Proceeds

In December 2002, the Company and its insurance carrier settled the Company's business property protection and blanket earnings and extra expense claim related to loss of the Company's offices located at the World Trade Center for $74,000. During 2002 and 2001, the Company recorded gains related to the business property portion of the claim of $7,959 and $6,784, respectively, which are included in other income. Administrative expense for the year ended December 31, 2002 includes a gain of $19,300 representing extra expense settlement proceeds for items expensed in 2001 and extra expenses that have not yet been incurred. Administrative expense for the year ended December 31, 2001 includes expenses of $3,535 related to the Company's recovery efforts.



Pension Benefits

The Company had several noncontributory, defined benefit pension plans covering substantially all of its employees. In May 1998, the Company's Board of Directors approved a consolidation of the Company's defined benefit pension plans into one "cash balance" defined benefit plan (the "Cash Balance Plan"). The redesigned plan, effective January 1, 1999, provides employees with an opening balance based on the previous benefits attributed to the employee under prior plans with increases through contributions by the Company based on the employee's age and length of service. The benefit provided at retirement is the sum of all contributions and interest earned.

Prior to the redesign, the Company's pension benefits were provided through three plans. Although the manner in which these plans were funded differed, the benefits relating to each were similar.

As part of the consolidation of the plans, the Cash Balance Plan assumed the assets and benefit obligations of the previous plans, some of which were previously retained by an insurer under an annuity purchase contract. As a result of the consolidation of the plans, the Company is amortizing the amount of the plan assets in excess of the benefit obligation assumed from the insurer, $116,865 over the average remaining service life of plan participants (10.5 years).

The effect of the change in pension benefits reduced the benefit obligation by $20,606 which will be amortized over the remaining service life of the Cash Balance Plan members (13 years).

The Company also has an unfunded, nonqualified supplemental plan to provide benefits in excess of ERISA limitations on recognized salary or benefits payable from the qualified pension plans and the Company's Deferred Compensation Plan and Executive Savings Plan. This supplemental plan is accounted for using the projected unit credit actuarial cost method.

The following table sets forth the plans' change in the actuarially determined benefit obligation, plan assets and information on the plan's funded status.

December 31	2002	2001
Change in benefit obligation		
Benefit obligation at beginning of period	$368,042	$319,622
Service cost	15,977	14,443
Interest cost	26,144	23,783
Plan amendments	11	3,276
Actuarial loss	33,563	27,165
Benefits paid	(43,469)	(20,247)
Benefit obligation at end of period	$400,268	$368,042
Change in plan assets		
Fair value of plan assets at beginning of period	$467,523	$417,352
Actual (loss) return on plan assets	(10,523)	69,914
Employer contributions	182	504
Benefits paid	(43,469)	(20,247)
Fair value of plan assets at end of period	$413,713	$467,523
Information on funded status and amounts recognized		
Funded status	$ 13,445	$ 99,481
Unrecognized net transition asset	(715)	(905)
Unrecognized prior service credits	(70,951)	(83,646)
Unrecognized net loss from past experience different from that assumed	103,430	24,323
Prepaid benefit cost	$ 45,209	$ 39,253

Actuarial assumptions used were as follows:

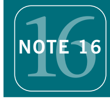
December 31	2002	2001
Discount rate	7.0%	7.5%
Rate of increase in future compensation levels	4.0%	4.0%
Expected long-term rate of return	8.0%	8.0%

Net pension income for the actuarially developed plans included the following components:

Year ended December 31	2002	2001	2000
Service cost	$ 15,977	$ 14,443	$ 13,709
Interest cost on projected benefit obligation	26,144	23,783	22,195
Expected return on plan assets	(36,054)	(33,984)	(33,616)
Net amortization and deferral	(12,070)	(12,894)	(13,059)
Net pension income	$ (6,003)	$ (8,652)	$(10,771)

The Company administers two noncontributory defined contribution plans offering employees the opportunity to accumulate funds for their retirement. The Deferred Compensation Plan, which is closed to new contributions, and the Executive Savings Plan are nonqualified plans designed to provide executives with an opportunity to defer a portion of their base salary and/or incentive compensation.

The Company also administers a contributory 401(k) Deferred Savings Plan which is offered to all eligible employees. The Company matches contributions of participating employees; 50% of the first 6% of employee contributions or $5,921, $5,880 and $5,678 for the years ended December 31, 2002, 2001 and 2000, respectively.



Other Postretirement Employee Benefits

In addition to pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all employees may become eligible for those benefits if they reach retirement age while working for the Company.

The change in benefit obligation, plan assets and information on the plans' funded status and the components of the net periodic benefit cost are as follows:

December 31	2002	2001
Change in benefit obligation		
Benefit obligation at beginning of period	$ 124,481	$ 96,121
Service cost	1,500	1,639
Interest cost	7,686	8,434
Actuarial (gain) loss	(7,154)	25,858
Benefits paid	(5,787)	(7,571)
Benefit obligation at end of period	$ 120,726	$ 124,481
Change in plan assets		
Fair value of plan assets at beginning of period	$ —	$ —
Employer contributions	5,787	7,571
Benefits paid	(5,787)	(7,571)
Fair value of plan assets at end of period	$ —	$ —
Information on funded status and amounts recognized		
Funded status	$(120,726)	$(124,481)
Unrecognized net actuarial gain	(66,027)	(61,043)
Unrecognized transition obligation	43,017	47,318
Accrued postretirement benefit cost	$(143,736)	$(138,206)

December 31	2002	2001	2000
Components of net periodic benefit cost			
Service cost	$ 1,500	$ 1,639	$ 1,516
Interest cost	7,686	8,434	6,845
Amortization of transition obligation	4,301	4,302	4,302
Amortization of actuarial gain	(4,699)	(4,738)	(5,923)
Net periodic postretirement benefit cost	$ 8,788	$ 9,637	$ 6,740

Actuarial gains or losses for postretirement life and health benefits are recorded separately when they exceed 10% of their respective accumulated postretirement benefit obligations and, at that time, the entire amount of the gain is amortized over the period in which eligibility requirements are fulfilled (20 years).

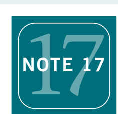
(dollars in thousands, except share and per share data)

The actuarial assumptions used for determining the accumulated postretirement benefit obligation as measured on December 31, 2002 and 2001 are as follows:

December 31	2002	2001
Weighted average discount rate	7.0%	7.5%
Health care trend rates:		
Participants under age 65 in EPO and PPO Plans	11.0%–4.5%	10.0%–4.5%
Participants under age 65 in other plans	11.0%–4.5%	10.0%–4.5%
Participants age 65 and over in Medicare HMOs	21.9%–4.5%	55.1%–4.5%
Participants age 65 and over in Indemnity Plans	10.0%–4.5%	13.0%–4.5%
Caps on Company-paid portion of health care premiums for participants who retire on or after May 1, 1996 (in whole dollars):		
Participants age 65 and older with Medicare Carve-out Plans	$2,358	$2,358
Participants under age 65 with POS—Point of Service Plans	$4,926	$4,926

The trend rate ranges shown indicate the trend rates will decrease 1.0% annually, other than the Medicare HMO and the Indemnity Plan, until ultimately leveling out at 4.5%. The annual trend rate for the Medicare HMO is 21.9%, 9.0% and 8.0% for the next three years and then decreases 1% annually until ultimately leveling out at 4.5%. The annual trend rate for the Indemnity Plan is 10.0% and 9.0% for the next two years and then decreases 1.0% annually until ultimately leveling out at 4.5%.

The health care cost trend rate assumptions have a significant effect on the amounts reported. Increasing and decreasing the assumed health care cost trend rates by one percentage point in each year would increase and decrease the postretirement benefit obligation as of December 31, 2002 by $12,899 and $7,676, respectively, and increase and decrease the service and interest cost components of net periodic postretirement benefit cost for December 31, 2002 by $1,060 and $556, respectively.



Concentration of Business

The Company's business is concentrated in New York and New Jersey, with more than 98% of its premium revenue received from New York business. As a result, future acts of terrorism, changes in regulatory, market or healthcare provider conditions in either of these states, particularly New York, could have a material adverse effect on the Company's business, financial condition or results of operations.

The Company earns revenue from its contracts with the Center for Medicare and Medicaid Services (CMS), the federal agency that administers the Medicare program. Specifically, the Company has a contract with CMS to provide HMO Medicare+Choice coverage to Medicare beneficiaries in certain New York counties and the Company has a contract to serve as fiscal intermediary for the Medicare Part A program and a carrier for the Medicare Part B program (collectively, referred to as "Medicare Services"). The Company's Medicare+Choice product and Medicare Services represented 10% and 32% of total premium earned and administrative service fee revenue, respectively, during 2002.

The Company earns revenue from its contracts to provide healthcare services to New York State and New York City employees. The New York State and New York City account represented 17% and 13% of total premium earned, respectively, during 2002.

Segment Information

The Company has two reportable segments: commercial managed care and other insurance products and services. The commercial managed care segment includes group PPO, HMO (including Medicare+Choice), EPO and other products as well as the Company's New York City and New York State PPO business. The other insurance products and services segment consists of the Company's traditional indemnity products, Medicare supplemental, individual hospital only, state sponsored individual plans, government mandated individual plans and government contracts with CMS to act as a fiscal intermediary for Medicare Part A program beneficiaries and as a carrier for Medicare Part B program beneficiaries.

The reportable segments follow the Company's method of internal reporting by products and services. The financial results of the Company's segment are presented consistent with the accounting policies described in Note 2. Administrative expenses, investment income and other income, but not assets, are allocated to the segments. There are no intersegment sales or expenses.

The following table presents information by reportable segment:

	Commercial Managed Care	Other Insurance Products and Services	Total
Year ended December 31, 2002			
Revenues from external customers	$3,935,234	$1,089,004	$5,024,238
Investment income and net realized gains	54,047	13,363	67,410
Other revenue	11,272	2,740	14,012
Income from continuing operations before income tax expense	253,424	56,344	309,768
Year ended December 31, 2001			
Revenues from external customers	$3,401,900	$1,166,252	$4,568,152
Investment income and net realized gains	41,704	15,249	56,953
Other revenue	4,667	1,434	6,101
Income from continuing operations before income tax expense	121,113	26,452	147,565
Year ended December 31, 2000			
Revenues from external customers	$2,885,870	$1,255,984	$4,141,854
Investment income and net realized gains	59,861	27,671	87,532
Other revenue	3,089	1,209	4,298
Income from continuing operations before income tax expense	95,066	25,421	120,487

The following table presents our revenue from external customers by products and services:

Year ended December 31	2002	2001	2000
Revenues from external customers:			
Commercial managed care:			
Premiums earned:			
PPO	$2,349,911	$2,016,580	$1,908,591
HMO	1,133,637	948,865	664,463
EPO	234,112	250,651	179,468
Other	5,343	31,719	33,709
Administrative service fees	212,231	154,085	99,639
Total commercial managed care	3,935,234	3,401,900	2,885,870
Other insurance products and services			
Premiums earned:			
Indemnity	397,175	489,947	584,848
Individual	507,857	508,406	505,848
Administrative service fees	183,972	167,899	165,288
Total other insurance products and services	1,089,004	1,166,252	1,255,984
Total revenues from external customers	$5,024,238	$4,568,152	$4,141,854

Quarterly Financial Data (Unaudited)

The following unaudited quarterly financial data are presented on a consolidated basis for each of the years ended December 31, 2002 and 2001.

Quarter ended	March 31	June 30	September 30	December 31
2002 Data				
Total revenues	$1,280,100	$1,321,642	$1,221,204	$1,282,714
Income from continuing operations before income tax expense	79,704	60,092	87,224	82,748
Income (loss) from continuing operations	79,681	60,095	254,409	(16,570)
Loss from discontinued operations	(1,050)	(6)	—	—
Net income (loss)	78,631	60,089	254,409	(16,570)
Net loss for the period from November 7, 2002 (date of initial public offering) to December 31, 2002				$ (38,542)
Basic and diluted net loss per common share for the period from November 7, 2002 (date of initial public offering) to December 31, 2002				$ (0.46)
Shares used to compute earnings per share, based on weighted average shares outstanding November 7, 2002 (date of conversion and initial public offering) to December 31, 2002				83,333,244
2001 Data				
Total revenues	$1,123,194	$1,233,845	$1,141,624	$1,132,543
Income from continuing operations before income tax expense	39,631	29,902	36,630	41,402
Income from continuing operations	39,586	29,899	36,540	41,405
Loss from discontinued operations	(4,485)	(2,526)	(5,552)	(3,889)
Net income	35,101	27,373	30,988	37,516

For the quarter ended September 30, 2002, income from continuing operations includes a deferred tax benefit of $167,185 primarily resulting from the reversal of the valuation allowance for deferred tax assets. For the quarter ended December 31, 2002, loss from continuing operations includes income tax expense of $99,318 primarily resulting from the elimination of the section 833(b) deduction that had previously been assumed during the first three quarters of 2002. Refer to footnote 7.