

# Selected Financial Data

(In millions, except for share and per-share amounts)

AFLAC Incorporated and Subsidiaries

For the Year	2001	2000	1999	1998
Revenues:				
Premiums, principally supplemental health insurance	\$ 8,061	\$ 8,222	\$ 7,264	\$ 5,943
Net investment income	1,550	1,550	1,369	1,138
Realized investment gains (losses)	(31)	(102)	(13)	(2)
Gain on sale of television business	—	—	—	—
Other income	18	33	20	25
Total revenues	9,598	9,703	8,640	7,104
Benefits and expenses:				
Benefits and claims	6,303	6,601	5,885	4,877
Expenses	2,214	2,090	1,977	1,676
Total benefits and expenses	8,517	8,691	7,862	6,553
Pretax earnings	1,081	1,012	778	551
Income taxes	394	325	207	64
Net earnings	\$ 687	\$ 687 <sup>(1)</sup>	\$ 571 <sup>(2)</sup>	\$ 487 <sup>(3)</sup>
<b>Per Common Share</b>				
Net earnings (basic)	\$ 1.31	\$ 1.30 <sup>(1)</sup>	\$ 1.07 <sup>(2)</sup>	\$ .91 <sup>(3)</sup>
Net earnings (diluted)	1.28	1.26 <sup>(1)</sup>	1.04 <sup>(2)</sup>	.88 <sup>(3)</sup>
Cash dividends	.193	.167	.147	.128
Shareholders' equity	10.40	8.87	7.28	7.09
Price range:				
High	36.10	37.47	28.38	22.66
Low	23.00	16.78	19.50	11.35
Close	24.56	36.10	23.60	21.94
Price/earnings ratio:*				
High	26.9x	31.2x	28.4x	29.1x
Low	17.2	14.0	19.5	14.6
Common shares used for basic EPS (In thousands)	525,098	530,607	531,737	532,609
Common shares used for diluted EPS (In thousands)	537,383	544,906	550,845	551,745
<b>At Year-End</b>				
Assets:				
Investments and cash	\$ 32,793	\$ 32,167	\$ 32,024	\$ 26,994
Other	5,067	5,064	5,017	4,228
Total assets	\$ 37,860	\$ 37,231	\$ 37,041	\$ 31,222
Liabilities and shareholders' equity:				
Policy liabilities	\$ 27,592	\$ 28,565	\$ 29,604	\$ 24,034
Notes payable	1,207	1,079	1,018	596
Income taxes	2,091	1,894	1,511	1,865
Other liabilities	1,545	999	1,040	957
Shareholders' equity	5,425	4,694	3,868	3,770
Total liabilities and shareholders' equity	\$ 37,860	\$ 37,231	\$ 37,041	\$ 31,222
<b>Supplemental Data</b>				
Operating earnings**	\$ 720	\$ 657	\$ 550	\$ 429
Operating earnings per share (basic)**	1.37	1.24	1.03	.81
Operating earnings per share (diluted)**	1.34	1.20	1.00	.78
Pretax profit margin***	11.5%	10.3%	9.9%	9.3%
After-tax profit margin***	7.5%	6.7%	6.4%	6.0%
Operating return on equity****	21.3%	21.7%	20.9%	18.7%
Yen/dollar exchange rate at year-end	¥ 131.95	¥ 114.75	¥ 102.40	¥ 115.70
Average yen/dollar exchange rate	121.54	107.83	113.96	130.89

(1) Includes a benefit of \$99 (\$.19 per basic share, \$.18 per diluted share) from the termination of a retirement liability; (2) Includes gain of \$67 (\$.13 per basic share, \$.12 per diluted share) due to a reduction in deferred tax liabilities from a tax rate cut in Japan and a charge of \$41 (\$.08 per basic share, \$.07 per diluted share) for the policyholder protection fund in 1999 in Japan; (3) Includes gain of \$121 (\$.23 per basic share, \$.22 per diluted share) due to a reduction in deferred income tax liabilities from a tax rate cut in Japan and a charge of \$65 (\$.12 per basic and diluted share) for the policyholder protection fund in Japan in 1998; (4) Includes gain of \$211 (\$.39 per basic share, \$.38 per diluted share) from the sale of the broadcast business in 1997; (5) Includes gain of \$48 (\$.09 per basic share, \$.08 per diluted share) from the sale of the broadcast business in 1996; (6) Excludes gain of \$11 (\$.02 per basic and diluted share) from cumulative effect of accounting changes in 1993. Certain reclassifications have been made to prior year amounts to conform to current reporting classifications. These reclassifications had no impact on net earnings.

1997	1996	1995	1994	1993	1992	1991
\$ 5,874	\$ 5,910	\$ 6,071	\$ 5,181	\$ 4,225	\$ 3,369	\$ 2,765
1,078	1,022	1,025	839	689	533	431
(5)	2	—	—	3	(3)	(1)
267	60	—	—	—	—	—
37	106	95	91	84	87	88
7,251	7,100	7,191	6,111	5,001	3,986	3,283
4,833	4,896	5,034	4,257	3,423	2,692	2,189
1,553	1,554	1,556	1,350	1,150	970	829
6,386	6,450	6,590	5,607	4,573	3,662	3,018
865	650	601	504	428	324	265
280	256	252	211	184	141	116
\$ 585 <sup>(4)</sup>	\$ 394 <sup>(5)</sup>	\$ 349	\$ 293	\$ 244 <sup>(6)</sup>	\$ 183	\$ 149
\$ 1.07 <sup>(4)</sup>	\$ .70 <sup>(5)</sup>	\$ .60	\$ .48	\$ .39 <sup>(6)</sup>	\$ .30	\$ .24
1.04 <sup>(4)</sup>	.68 <sup>(5)</sup>	.58	.47	.39 <sup>(6)</sup>	.29	.24
.112	.097	.085	.075	.065	.058	.05
6.44	3.85	3.76	2.93	2.20	1.75	1.51
14.47	11.00	7.46	6.02	5.67	4.65	4.15
9.38	7.07	5.32	4.21	4.13	3.20	2.39
12.78	10.69	7.25	5.34	4.75	4.60	3.99
21.9x	18.3x	12.9x	12.8x	14.9x	16.0x	17.3x
14.2	11.8	9.2	9.0	10.9	11.0	10.0
544,220	560,704	582,710	605,783	619,502	615,261	611,883
563,192	577,843	597,967	618,594	631,428	628,931	625,354
\$ 22,880	\$ 20,744	\$ 20,045	\$ 15,994	\$ 12,469	\$ 9,461	\$ 8,057
6,590	4,286	5,172	4,293	2,974	2,440	2,088
\$ 29,470	\$ 25,030	\$ 25,217	\$ 20,287	\$ 15,443	\$ 11,901	\$ 10,145
\$ 19,885	\$ 20,234	\$ 19,514	\$ 16,007	\$ 12,065	\$ 9,350	\$ 7,878
523	354	327	185	122	126	139
1,827	1,181	1,398	1,392	950	849	769
3,805	1,135	1,844	951	940	494	436
3,430	2,126	2,134	1,752	1,366	1,082	923
\$ 29,470	\$ 25,030	\$ 25,217	\$ 20,287	\$ 15,443	\$ 11,901	\$ 10,145
\$ 374	\$ 347	\$ 349	\$ 293	\$ 242 <sup>(6)</sup>	\$ 183	\$ 148
.69	.62	.60	.48	.39 <sup>(6)</sup>	.30	.24
.66	.60	.58	.47	.38 <sup>(6)</sup>	.29	.24
8.6%	8.4%	8.4%	8.3%	8.5%	8.2%	8.1%
5.4%	4.9%	4.8%	4.8%	4.8% <sup>(6)</sup>	4.6%	4.5%
18.8%	19.9%	22.0%	20.4%	19.9% <sup>(6)</sup>	18.4%	17.3%
¥ 130.10	¥ 116.10	¥ 102.95	¥ 99.85	¥ 112.00	¥ 124.70	¥ 125.25
121.07	108.84	94.10	102.26	111.21	126.67	134.52

(\*) Based on diluted operating earnings per share; (\*\*) Excludes realized investment gains/losses; gains from the sale of the television business in 1996 and 1997; charges for the policyholder protection fund in 1998 and 1999; benefits of tax rate reductions in 1998 and 1999; the gain from the termination of a retirement liability in 2000; the impact of SFAS No. 133 in 2001; (\*\*\*) Operating basis; (\*\*\*\*) Based on operating earnings and excluding unrealized gains on investment securities, net

# Consolidated Statements of Earnings

AFLAC Incorporated and Subsidiaries

(In millions, except for share and per-share amounts) Years Ended December 31,

	2001	2000	1999
<b>Revenues:</b>			
Premiums, principally supplemental health insurance	\$ 8,061	\$ 8,222	\$ 7,264
Net investment income	1,550	1,550	1,369
Realized investment losses	(31)	(102)	(13)
Other income	18	33	20
Total revenues	9,598	9,703	8,640
<b>Benefits and expenses:</b>			
Benefits and claims	6,303	6,601	5,885
Acquisition and operating expenses:			
Amortization of deferred policy acquisition costs	328	302	257
Insurance commissions	1,006	1,040	931
Insurance expenses	793	758	641
Interest expense	19	19	18
Termination of retirement liability	—	(101)	—
Provision for Japanese policyholder protection fund	—	—	64
Other operating expenses	68	72	66
Total acquisition and operating expenses	2,214	2,090	1,977
Total benefits and expenses	8,517	8,691	7,862
Earnings before income taxes	1,081	1,012	778
<b>Income tax expense (benefit):</b>			
Current	338	338	230
Deferred — operations	56	(13)	44
Deferred tax benefit from Japanese tax rate reduction	—	—	(67)
Total income taxes	394	325	207
Net earnings	\$ 687	\$ 687	\$ 571
<b>Net earnings per share:</b>			
Basic	\$ 1.31	\$ 1.30	\$ 1.07
Diluted	1.28	1.26	1.04
<b>Common shares used in computing earnings per share (In thousands):</b>			
Basic	525,098	530,607	531,737
Diluted	537,383	544,906	550,845

See the accompanying Notes to the Consolidated Financial Statements.

Certain reclassifications have been made to prior year amounts to conform to current reporting classifications. These reclassifications had no impact on net earnings.

## ASK ABOUT IT AT WORK.



The number of  
AFLAC's U.S. payroll  
accounts has  
increased by more  
than 80% in the  
past five years.

# Consolidated Balance Sheets

AFLAC Incorporated and Subsidiaries

(In millions, except for share amounts) December 31,

2001

2000

## Assets:

Investments and cash:

Securities available for sale, at fair value:

Fixed maturities (amortized cost \$18,048 in 2001 and \$20,405 in 2000)

\$ 20,400

\$ 22,172

Perpetual debentures (amortized cost \$2,497 in 2001 and \$2,347 in 2000)

2,554

2,046

Equity securities (cost \$215 in 2001 and \$161 in 2000)

245

236

Securities held to maturity, at amortized cost:

Fixed maturities (fair value \$5,262 in 2001 and \$3,702 in 2000)

5,417

3,645

Perpetual debentures (fair value \$3,267 in 2001 and \$3,323 in 2000)

3,306

3,442

Other investments

19

17

Cash and cash equivalents

852

609

Total investments and cash

32,793

32,167

Receivables, primarily premiums

347

300

Accrued investment income

381

380

Deferred policy acquisition costs

3,645

3,685

Property and equipment, at cost less accumulated depreciation

455

481

Other

239

218

Total assets

\$ 37,860

\$ 37,231

## Liabilities and shareholders' equity:

Liabilities:

Policy liabilities:

Future policy benefits

\$ 25,106

\$ 26,101

Unpaid policy claims

1,615

1,745

Unearned premiums

352

355

Other policyholders' funds

519

364

Total policy liabilities

27,592

28,565

Notes payable

1,207

1,079

Income taxes

2,091

1,894

Payables for security transactions

271

—

Payables for return of cash collateral on loaned securities

494

127

Other

780

872

Commitments and contingencies (Notes 10 and 11)

Total liabilities

32,435

32,537

Shareholders' equity:

Common stock of \$.10 par value. In thousands: authorized 1,000,000 shares; issued 646,559 shares in 2001 and 644,813 shares in 2000

65

32

Additional paid-in capital

338

336

Retained earnings

4,542

3,956

Accumulated other comprehensive income:

Unrealized foreign currency translation gains

213

194

Unrealized gains on investment securities

1,878

1,474

Treasury stock, at average cost

(1,611)

(1,298)

Total shareholders' equity

5,425

4,694

Total liabilities and shareholders' equity

\$ 37,860

\$ 37,231

See the accompanying Notes to the Consolidated Financial Statements.

Certain reclassifications have been made to prior year amounts to conform to current reporting classifications.

# Consolidated Statements of Shareholders' Equity

AFLAC Incorporated and Subsidiaries

(In millions, except for per-share amounts) Years Ended December 31,

	2001	2000	1999
<b>Common stock:</b>			
Balance at beginning of year	\$ 32	\$ 32	\$ 32
Exercise of stock options	1	—	—
Two-for-one stock split	32	—	—
Balance at end of year	65	32	32
<b>Additional paid-in capital:</b>			
Balance at beginning of year	336	310	235
Exercise of stock options, including income tax benefits	10	18	17
Gain on treasury stock reissued	24	8	58
Two-for-one stock split	(32)	—	—
Balance at end of year	338	336	310
<b>Retained earnings:</b>			
Balance at beginning of year	3,956	3,356	2,862
Net earnings	687	687	571
Dividends to shareholders (\$.193 per share in 2001, \$.167 in 2000, and \$.147 in 1999)	(101)	(87)	(77)
Balance at end of year	4,542	3,956	3,356
<b>Accumulated other comprehensive income:</b>			
Balance at beginning of year	1,668	1,264	1,551
Change in unrealized foreign currency translation gains (losses) during year, net of income taxes	19	(38)	13
Change in unrealized gains (losses) on investment securities during year, net of income taxes	404	442	(300)
Balance at end of year	2,091	1,668	1,264
<b>Treasury stock:</b>			
Balance at beginning of year	(1,298)	(1,094)	(910)
Purchases of treasury stock	(350)	(239)	(224)
Cost of shares issued	37	35	40
Balance at end of year	(1,611)	(1,298)	(1,094)
Total shareholders' equity	\$ 5,425	\$ 4,694	\$ 3,868

See the accompanying Notes to the Consolidated Financial Statements.

Certain reclassifications have been made to prior year amounts to conform to current reporting classifications.

● ASK ABOUT IT AT WORK.



More than 51 million  
members of Japan's  
workforce are  
employed at businesses  
with 300 or fewer  
people.

# Consolidated Statements of Cash Flows

AFLAC Incorporated and Subsidiaries

(In millions) Years Ended December 31,

2001

2000

1999

## Cash flows from operating activities:

Net earnings	\$ 687	\$ 687	\$ 571
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Change in receivables and advance premiums	(45)	(35)	(8)
Increase in deferred policy acquisition costs	(323)	(310)	(299)
Increase in policy liabilities	2,380	2,719	2,569
Deferred income taxes	56	(13)	(23)
Change in income taxes payable	(10)	308	(364)
Realized investment losses	31	102	13
Termination of retirement liability	—	(101)	—
Provision for policyholder protection fund	—	—	64
Other, net	73	(112)	280
Net cash provided by operating activities	2,849	3,245	2,803

## Cash flows from investing activities:

Proceeds from investments sold or matured:			
Securities available for sale:			
Fixed maturities sold	1,799	795	1,071
Fixed maturities matured	700	454	404
Equity securities and other	92	35	87
Fixed maturity securities held to maturity or called	128	18	36
Costs of investments acquired:			
Securities available for sale:			
Fixed maturities	(2,441)	(4,360)	(3,322)
Perpetual debentures	(495)	(26)	(862)
Equity securities	(152)	(67)	(82)
Securities held to maturity:			
Fixed maturities	(2,040)	—	(43)
Perpetual debentures	(416)	—	—
Cash received as collateral on loaned securities, net	416	127	—
Additions to property and equipment, net	(45)	(26)	(14)
Other, net	(19)	(9)	(13)
Net cash used by investing activities	(2,473)	(3,059)	(2,738)

## Cash flows from financing activities:

Proceeds from borrowings	333	294	446
Principal payments under debt obligations	(116)	(187)	(94)
Change in annuity deposit funds, net	138	38	5
Dividends paid to shareholders	(95)	(82)	(72)
Purchases of treasury stock	(350)	(239)	(224)
Treasury stock reissued	38	31	39
Other, net	10	15	17
Net cash provided (used) by financing activities	(42)	(130)	117
Effect of exchange rate changes on cash and cash equivalents	(91)	(63)	60
Net change in cash and cash equivalents	243	(7)	242
Cash and cash equivalents, beginning of year	609	616	374
Cash and cash equivalents, end of year	\$ 852	\$ 609	\$ 616

## Supplemental disclosures of cash flow information — See Note 12

See the accompanying Notes to the Consolidated Financial Statements.

Certain reclassifications have been made to prior year amounts to conform to current reporting classifications.

# Consolidated Statements of Comprehensive Income

(In millions) Years Ended December 31,

2001

AFLAC Incorporated and Subsidiaries

2000

1999

Net earnings	\$ 687	\$ 687	\$ 571
Other comprehensive income, before income taxes:			
Foreign currency translation adjustments:			
Change in unrealized foreign currency translation gains (losses) during year	119	97	(128)
Unrealized gains (losses) on investment securities:			
Unrealized holding gains (losses) arising during year	509	521	(379)
Reclassification adjustment for realized (gains) losses included in net earnings	3	101	13
Total other comprehensive income (loss), before income taxes	631	719	(494)
Income tax expense (benefit) related to items of other comprehensive income	207	315	(207)
Other comprehensive income (loss), net of income taxes	424	404	(287)
Total comprehensive income	\$ 1,111	\$ 1,091	\$ 284

See the accompanying Notes to the Consolidated Financial Statements.

## Notes to the Consolidated Financial Statements

### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Description of Business:** AFLAC Incorporated (the Parent Company) and its subsidiaries (the Company) primarily sell supplemental health and life insurance in Japan and the United States. The Company's insurance operations are conducted through American Family Life Assurance Company of Columbus (AFLAC), which operates in the United States (AFLAC U.S.) and as a branch in Japan (AFLAC Japan). Most of our insurance policies are individually underwritten and marketed at worksites through independent agents, with premiums paid by the employee. AFLAC Japan, which conducts its insurance operations in Japanese yen, accounted for 77% of the Company's total revenues for 2001 and 81% for both 2000 and 1999, and 84% and 86% of total assets at December 31, 2001 and 2000, respectively.

**Basis of Presentation:** We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). These principles are established primarily by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants. The preparation of financial statements in conformity with GAAP requires us to make estimates when recording transactions resulting from business operations based on information currently available. The most significant items on our balance sheet that involve a greater degree of accounting estimates and actuarial

determinations subject to changes in the future are deferred policy acquisition costs and liabilities for future policy benefits and unpaid policy claims. The estimates and actuarial determinations are sensitive to investment yields, mortality and morbidity, commission, and other acquisition expenses and terminations by policyholders. As additional information becomes available, or actual amounts are determinable, the recorded estimates will be revised and reflected in operating results. Although some variability is inherent in these estimates, we believe the amounts provided are adequate.

**Translation of Foreign Currencies:** The functional currency of AFLAC Japan's insurance operations is the Japanese yen. We translate financial statement accounts that are maintained in foreign currencies into U.S. dollars as follows. Assets and liabilities denominated in foreign currencies are translated at end-of-period exchange rates. Realized gains and losses on security transactions are translated at the exchange rate on the trade date of each transaction. Other revenues, expenses and cash flows are translated using average exchange rates for the year. The resulting currency translation adjustments are reported in accumulated other comprehensive income. We include in earnings the realized currency exchange gains and losses resulting from transactions. Realized currency exchange gains and losses were immaterial during the three-year period 1999 through 2001.

AFLAC Japan maintains an investment portfolio of dollar-denominated securities on behalf of AFLAC U.S.

The functional currency for these investments is the U.S. dollar. The related investment income and realized/unrealized investment gains and losses are also denominated in U.S. dollars.

We have designated the cross-currency swaps and the yen-denominated notes payable held by the Parent Company as a hedge of our net investment in AFLAC Japan (see the section in this note titled, "Derivatives"). Outstanding principal and related accrued interest payable on these items are translated into U.S. dollars at end-of-period exchange rates. Currency translation adjustments are reported in accumulated other comprehensive income.

**Insurance Revenue and Expense Recognition:** The supplemental health and life insurance policies we issue are classified as long-duration contracts. The contract provisions generally cannot be changed or canceled during the contract period; however, we may adjust premiums for supplemental health policies issued in the United States within prescribed guidelines and with the approval of state insurance regulatory authorities.

Insurance premiums for health and life policies are recognized as earned income ratably over the premium payment periods of the policies. When revenues are recorded, the related amounts of benefits and expenses are charged against such revenues, so that profits are recognized in proportion to premium revenues during the period the policies are expected to remain in force. This association is accomplished by means of annual additions to the liability for future policy benefits and the deferral and subsequent amortization of policy acquisition costs.

The calculation of deferred policy acquisition costs and the liability for future policy benefits requires the use of estimates consistent with sound actuarial valuation techniques. For new policy issues, we review our actuarial assumptions and deferrable acquisition costs each year and revise them when necessary to more closely reflect recent experience and studies of actual acquisition costs. For policies in force, we evaluate deferred policy acquisition costs by major product groupings to determine that they are recoverable from future revenues. We charge against earnings costs that are not recoverable.

**Cash and Cash Equivalents:** Cash and cash equivalents include cash on hand, money market instruments and other debt instruments with a maturity of 90 days or less when purchased.

**Investments:** Our fixed-maturity securities and perpetual debentures (debt securities) are classified as either held to

maturity or available for sale. Securities classified as held to maturity are securities that we have the ability and intent to hold to maturity or redemption and are carried at amortized cost. All other debt securities and our equity securities are classified as available for sale and are carried at fair value. If the fair value is higher than the amortized cost for debt securities or the purchase cost for equity securities, the excess is an unrealized gain; and if lower than cost, the difference is an unrealized loss.

For the Japanese reporting fiscal year ending March 31, 2002, new Japanese accounting principles and regulations are effective which impact investment classifications and solvency margin calculations on a Japanese accounting basis. As a result of these new requirements, we re-evaluated AFLAC Japan's investment portfolio and our intent related to the holding period of certain investment securities. In order to minimize potential fluctuations in solvency margin results in the future, we made certain reclassifications of debt securities between held-to-maturity and available-for-sale categories as of March 31, 2001.

The net unrealized gains and losses on securities available for sale, plus the unamortized unrealized gains and losses resulting from the reclassifications of debt securities, less deferred income taxes are reported in accumulated other comprehensive income.

Amortized cost of debt securities is based on our purchase price adjusted for accrual of discount or amortization of premium. The amortized cost of debt securities we purchased at a discount will equal the face or par value at maturity. Debt securities we purchased at a premium will have an amortized cost equal to face or par value at maturity or the call date, if applicable. Interest is recorded as income when earned and is adjusted for amortization of any premium or discount.

For the collateralized mortgage obligations held in our fixed-maturity securities portfolio, we recognize income using a constant effective yield based on anticipated prepayments and the estimated economic life of the securities. When estimates of prepayments change, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. The net investment in the securities is adjusted to the amount that would have existed had the new effective yield been applied at the time of acquisition. This adjustment is reflected in net investment income.



We use the specific identification method to determine the gain or loss from securities transactions and record the realized gain or loss in the consolidated statements of earnings.

Our portfolio managers periodically monitor and evaluate the difference between the cost and fair value of our investments. Additionally, credit analysis and/or credit rating issues related to specific investments may trigger management monitoring. If, after monitoring and analysis, management believes that the decline in fair value is other than temporary, we adjust the amortized cost of the security and record a realized loss in the consolidated statement of earnings.

We lend fixed-maturity securities to financial institutions in short-term security lending transactions. These securities continue to be carried as investment assets on our balance sheet during the terms of the loans and are not recorded as sales. We receive cash or other securities as collateral for such loans. For loans involving unrestricted cash collateral, the collateral is recorded as an asset with a corresponding liability for the return of the collateral. For loans collateralized by securities, the collateral is not recorded as an asset or liability.

**Deferred Policy Acquisition Costs:** The costs of acquiring new business are deferred and amortized, with interest, over the premium payment periods in proportion to the ratio of annual premium income to total anticipated premium income. Anticipated premium income is estimated by using the same mortality and withdrawal assumptions used in computing liabilities for future policy benefits. In this manner, the related acquisition expenses are matched with revenues. Costs deferred include first-year commissions in excess of renewal-year commissions and certain direct and allocated policy issue, underwriting and marketing expenses. All of these costs vary with and are primarily related to the production of new business.

**Insurance Liabilities:** The liabilities for future policy benefits are computed by a net level premium method using estimated future investment yields, withdrawals, and recognized morbidity and mortality tables modified to reflect our experience.

Unpaid policy claims are estimates computed on an undiscounted basis using statistical analyses of historical claim experience adjusted for current trends and changed conditions. The ultimate liability may vary significantly from such estimates. We regularly adjust these estimates as new claims experience emerges and reflect the changes in operating results in the year such adjustments are made.

We record provisions for possible future adverse deviations in experience for both the liabilities for future policy benefits and unpaid policy claims.

**Income Taxes:** Income tax provisions are generally based on pretax earnings reported for financial statement purposes, which differ from those amounts used in preparing our income tax returns. Deferred income taxes are recognized for temporary differences between the financial reporting basis and income tax basis of assets and liabilities, based on enacted tax laws and statutory tax rates applicable to the periods in which we expect the temporary differences to reverse.

**Derivatives:** We have only limited activity with derivative financial instruments. We do not use them for trading purposes nor do we engage in leveraged derivative transactions. We currently have contracts for cross-currency swaps and interest rate swaps. Effective January 1, 2001, we adopted Statement of Financial Accounting Standards (SFAS) No. 133, as amended, Accounting for Derivative Instruments and Hedging Activities (see the section in this note titled, "Accounting Changes Adopted").

The adoption of SFAS No. 133 changed the accounting and disclosure requirements of our derivative instruments. In accordance with SFAS No. 133, we are now required to recognize all derivatives at fair value as either assets or liabilities on the balance sheet. We document all relationships between hedging instruments and hedged items, as well as our risk-management objectives for undertaking various hedge transactions. This process includes linking all derivatives that are designated as hedges to specific assets or liabilities on the balance sheet. We also assess, both at inception and on an ongoing basis, whether the derivatives and nonderivatives used in hedging activities are highly effective in offsetting changes in fair values or cash flows of the hedged items.

The assessment of hedge effectiveness determines the noncash accounting treatment of changes in fair value. Our accounting for changes in the fair value of derivatives is as follows:

Nature of Hedge Designation	Derivative's Change in Fair Value Reflected in:
Cash flow	Other comprehensive income, with subsequent reclassifications to earnings when the hedged transaction impacts earnings
Net investment in foreign operations	Other comprehensive income as part of the cumulative translation adjustment; other income for the portions of the hedge that do not qualify for hedge accounting

We have cross-currency swaps outstanding related to the \$450 million of senior notes (see Notes 4 and 6). These swaps have been designated as a hedge of our net investment in AFLAC Japan. The fair value of the cross-currency swaps is affected by changes in the yen/dollar exchange rate and changes in yen and dollar interest rates.

Prior to 2001, we recorded the fair value of the currency portion of the cross-currency swaps on the balance sheet and the change in fair value was included in accumulated other comprehensive income. The change in the swaps' accrued interest receivable and the cash settlements of interest amounts were recorded as interest expense. The portion of the swaps' fair value related to the interest rate component was not recorded in the financial statements.

We began accounting for the cross-currency swaps in accordance with SFAS No. 133 in 2001. This standard requires that we record the total fair value of the swaps on the balance sheet. We record the currency portion as an asset or liability with changes in fair value recorded in other comprehensive income. We also record the fair value of the accrued interest portion and the interest rate component of the swaps on the balance sheet. The fair value of the accrued interest portion of the swaps is the net of the yen-denominated interest payable, translated at the respective period-end exchange rate, and the dollar-denominated interest receivable. The change in the swaps' accrued interest receivable and the cash settlements of interest amounts are recorded as interest expense. In accordance with the requirements for hedge accounting under SFAS No. 133, the change in fair value of the interest rate component of the swaps must be reflected in earnings and is therefore included in other income.

We also use interest rate swaps in connection with our variable-interest-rate yen-denominated bank borrowings. These interest rate swaps reduce the impact of changes in interest rates on our borrowing costs and effectively change our interest exposure from variable to fixed.

Prior to 2001, we used the accrual method to account for these interest rate swaps. The difference between the amounts paid and received under these contracts was reported in interest expense. Changes in the fair value of the swap agreements were not recognized in the financial statements.

In 2001, we began accounting for these interest rate swaps in accordance with SFAS No. 133. We now record the total fair value of the interest rate swaps as either an asset or liability. These swap agreements have been designated as cash flow hedges and the change in fair value is recorded in accumulated other comprehensive income. The difference between the amounts paid and received is recorded in interest expense in the consolidated statement of earnings.

### **Policyholder Protection Fund and State Guaranty**

**Associations:** In Japan, the government enacts funding legislation to determine the insurance industry's contribution to the policyholder protection fund. We recognize a charge for our estimated share of any assessment upon enactment. We review the estimated liability for policyholder protection fund assessments on an annual basis and report any adjustments in the consolidated statement of earnings.

In the United States, each state has a guaranty association that supports insolvent insurers operating in those states. To date, our state guaranty association assessments have not been material.

**Employee Stock Options:** Our stock option plan requires that the exercise price of stock options be equal to the fair market value of our stock at the date of grant; therefore, we do not recognize compensation expense.

**Treasury Shares:** Treasury shares we acquire are recorded at cost, which is the market value at the time of the transaction, and as a reduction of shareholders' equity. We use the weighted-average purchase cost to determine the cost of treasury shares that are reissued. We record any gains and losses in additional paid-in capital when treasury shares are reissued.

**Earnings Per Share:** We present two earnings per share (EPS) calculations: basic EPS and diluted EPS. Basic EPS is computed by dividing net earnings by the weighted-average number of shares outstanding for the period. Diluted EPS is computed by dividing net earnings by the weighted-average number of shares outstanding for the period plus the shares representing the dilutive effect of stock options.

**Accounting Changes Adopted:** We adopted SFAS No. 133 as amended, Accounting for Derivative Instruments and Hedging Activities, on January 1, 2001. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in investment securities and other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. The accounting for changes in the fair value of a derivative is included in either earnings or other comprehensive income depending on the intended use of the derivative instrument and the nature of any hedge designation thereon.

SFAS No. 133 did not affect the way we recognize the change in fair value of the accrued interest component or the currency portion of the cross-currency swaps. However, in accordance with SFAS No. 133, we now recognize in

other income the change in fair value of the interest rate component of our cross-currency swaps. The change in fair value of the interest rate swaps is included in accumulated other comprehensive income as an unrealized gain or loss until the hedged transaction terminates. The changes described above affect only the timing of noncash gains and losses. Prior to January 1, 2001, the fair value and changes therein for these swap components were not recognized in the financial statements.

The cumulative transition effect recorded on January 1, 2001, for this new accounting standard was a gain of approximately \$293,000. The effect of recording the fair value of the interest rate component of the cross-currency swaps increased net earnings by \$1 million for the year ended December 31, 2001. See Note 4 for additional information on our derivative and nonderivative financial instruments.

The FASB issued four new accounting standards in 2001. SFAS No. 141, SFAS No. 142, SFAS No. 143 and SFAS No. 144 primarily address the accounting for goodwill, business combinations, and the impairment and disposition of long-lived assets. The adoption of these standards in 2002 is not expected to have a material impact on the Company's financial position or results of operations.

**Reclassifications:** Certain reclassifications have been made to prior-year amounts to conform to current-year reporting classifications. These reclassifications had no impact on net earnings.

## (2) FOREIGN INFORMATION AND BUSINESS SEGMENT INFORMATION

The Company consists of two reportable business segments: AFLAC Japan insurance and AFLAC U.S. insurance. We sell supplemental health and life insurance through our AFLAC Japan and AFLAC U.S. operations. Most of our policies are individually underwritten and marketed at worksites through independent agents, with premiums paid by the employee.

Operating business segments that are not individually reportable are included in the "Other business segments" category. We evaluate our business segments based on pretax operating earnings. We do not allocate corporate overhead expenses to business segments.

Information regarding components of operations and lines of business for the years ended December 31 follows:

(In millions)	2001	2000	1999
<b>Revenues:</b>			
AFLAC Japan:			
Earned premiums:			
Cancer life	\$ 4,508	\$ 4,976	\$ 4,583
Other accident and health	1,075	1,037	730
Life insurance	634	655	593
Net investment income	1,234	1,261	1,111
Other income	1	7	4
Total AFLAC Japan	7,452	7,936	7,021
AFLAC U.S.:			
Earned premiums:			
Cancer expense	654	585	535
Accident/disability	713	565	447
Other health	416	360	344
Life insurance	61	44	32
Net investment income	303	277	245
Other income	8	5	3
Total AFLAC U.S.	2,155	1,836	1,606
Other business segments	32	31	23
Total business segments	9,639	9,803	8,650
Realized investment losses	(31)	(102)	(13)
Corporate*	31	32	39
Intercompany eliminations	(41)	(30)	(36)
Total revenues	\$ 9,598	\$ 9,703	\$ 8,640
<b>Earnings before income taxes:</b>			
AFLAC Japan	\$ 823	\$ 771	\$ 651
AFLAC U.S.	345	290	256
Other business segments	(8)	(6)	(4)
Total business segments	1,160	1,055	903
Realized investment losses	(31)	(102)	(13)
Termination of retirement liability	—	101	—
Provision for the policyholder protection fund	—	—	(64)
Interest expense, noninsurance operations	(16)	(16)	(15)
Corporate*	(32)	(26)	(33)
Total earnings before income taxes	\$ 1,081	\$ 1,012	\$ 778
<b>Advertising expense:</b>			
AFLAC Japan	\$ 60	\$ 62	\$ 46
AFLAC U.S.	45	38	33
Total advertising expense	\$ 105	\$ 100	\$ 79

\* Includes investment income of \$13 in 2001, \$12 in 2000, and \$13 in 1999. In 2001 includes a gain of \$1 related to the change in fair value of the interest rate component of the cross-currency swaps.

Assets at December 31 were as follows:

(In millions)	2001	2000
<b>Assets:</b>		
AFLAC Japan	\$ 31,729	\$ 31,881
AFLAC U.S.	5,729	4,964
Other business segments	43	46
Total business segments	37,501	36,891
Corporate	6,830	5,993
Intercompany eliminations	(6,471)	(5,653)
Total assets	\$ 37,860	\$ 37,231

Total depreciation and amortization expense was \$37 million in 2001, and \$33 million in both 2000 and 1999. AFLAC Japan accounted for \$21 million in 2001, and \$20 million in both 2000 and 1999.

Advertising and depreciation expenses are included in insurance expenses in the consolidated statements of earnings.

Net additions to property and equipment were \$62 million in 2001, \$51 million in 2000 and \$18 million in 1999.

Receivables consisted primarily of monthly insurance premiums due from individual policyholders or their employers for payroll deduction of premiums. At December 31, 2001, \$171 million, or 49.2% of total receivables were related to AFLAC Japan's operations (\$149 million, or 49.6%, at December 31, 2000).

**Yen-Translation Effects:** The following table shows the yen/dollar exchange rates used for the three-year period ended December 31, 2001, and their effect on selected financial data.

	2001	2000	1999
<b>Balance Sheets:</b>			
Yen/dollar exchange rate at December 31	131.95	114.75	102.40
Yen percent weakening (strengthening)	13.0%	10.8%	(13.0)%
Exchange effect on total assets (billions)*	\$ (4.4)	\$ (3.6)	\$ 3.5
Exchange effect on total liabilities (billions)*	\$ (4.3)	\$ (3.5)	\$ 3.5
<b>Statements of Earnings:</b>			
Average exchange rate for the year	121.54	107.83	113.96
Yen percent weakening (strengthening)	11.3%	(5.7)%	(14.9)%
Exchange effect on net earnings (millions)*	\$ (39)	\$ 11	\$ 54
Exchange effect on diluted net EPS*	\$ (.07)	\$ .02	\$ .10

\* Exchange effect amounts were determined using the same yen/dollar exchange rate for the current year as each respective prior year.

AFLAC Japan owns U.S. dollar-denominated securities, which serve as an economic currency hedge of a portion of our investment in AFLAC Japan. We have designated the Parent Company's yen-denominated notes payable and cross-currency swaps as a hedge of our investment in AFLAC Japan. The dollar values of our yen-denominated net assets subject to foreign currency translation fluctuations for financial reporting purposes are summarized as follows at December 31 (translated at end-of-year exchange rates):

(In millions)	2001	2000
AFLAC Japan net assets	\$ 4,128	\$ 3,648
Less:		
AFLAC Japan dollar-denominated net assets	2,193	1,969
Parent Company yen-denominated net liabilities	1,150	1,087
Consolidated yen-denominated net assets subject to foreign currency translation fluctuations	\$ 785	\$ 592

**Remittances From AFLAC Japan:** Payments are made from AFLAC Japan to the Parent Company for management fees and to AFLAC U.S. for allocated expenses and remittances of earnings. These payments totaled \$228 million in 2001, \$199 million in 2000 and \$282 million in 1999. See Note 9 for information concerning restrictions on remittances from AFLAC Japan.

**Policyholder Protection Fund:** In 1999, the Japanese government and the life insurance industry agreed to legislation that increased the life insurance industry's obligation to the policyholder protection fund. Our share of this obligation was recognized in 1999 and decreased pretax earnings by \$64 million (\$41 million after taxes, or \$.08 per basic share and \$.07 per diluted share). The total liability accrued for our remaining obligations to the Japanese policyholder protection fund was \$186 million (¥24.5 billion) and \$227 million (¥26.0 billion) at December 31, 2001 and 2000, respectively.



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With approximately 5.5 million businesses with fewer than 500 workers, the United States is a vast potential market for AFLAC's products.

### (3) INVESTMENTS

The amortized cost for debt securities, cost for equity securities and the fair values of these investments at December 31 are shown in the following table:

(In millions)	December 31, 2001				December 31, 2000			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Securities available for sale, carried at fair value:</b>								
Fixed maturities:								
Yen-denominated:								
Government and guaranteed	\$ 5,412	\$ 1,621	\$ 2	\$ 7,031	\$ 6,554	\$ 1,722	\$ 52	\$ 8,224
Municipalities	75	6	—	81	342	28	—	370
Public utilities	2,953	320	3	3,270	3,572	337	28	3,881
Sovereign and supranational	49	10	—	59	56	2	—	58
Banks/financial institutions	2,632	302	33	2,901	3,045	45	180	2,910
Other corporate	1,081	66	40	1,107	1,471	40	41	1,470
Total yen-denominated	12,202	2,325	78	14,449	15,040	2,174	301	16,913
Dollar-denominated:								
Government	130	8	—	138	260	7	1	266
Municipalities	42	3	—	45	41	2	—	43
Mortgage-backed securities	138	5	—	143	429	9	—	438
Public utilities	439	16	8	447	325	4	13	316
Sovereign and supranational	123	12	—	135	139	7	—	146
Banks/financial institutions	2,260	92	58	2,294	2,072	41	74	2,039
Other corporate	2,714	110	75	2,749	2,099	50	138	2,011
Total dollar-denominated	5,846	246	141	5,951	5,365	120	226	5,259
Total fixed maturities	18,048	2,571	219	20,400	20,405	2,294	527	22,172
Perpetual debentures:								
Yen-denominated:								
Primarily banks/financial institutions	2,167	137	94	2,210	2,010	1	299	1,712
Dollar-denominated:								
Banks/financial institutions	330	15	1	344	337	9	12	334
Total perpetual debentures	2,497	152	95	2,554	2,347	10	311	2,046
Equity securities	215	49	19	245	161	93	18	236
Total securities available for sale	\$ 20,760	\$ 2,772	\$ 333	\$ 23,199	\$ 22,913	\$ 2,397	\$ 856	\$ 24,454
<b>Securities held to maturity, carried at amortized cost:</b>								
Fixed maturities:								
Yen-denominated:								
Government	\$ 1,280	\$ 20	\$ 70	\$ 1,230	\$ 705	\$ 28	\$ 2	\$ 731
Municipalities	237	12	1	248	328	38	—	366
Public utilities	630	17	27	620	584	5	59	530
Banks/financial institutions	1,915	102	153	1,864	1,115	43	17	1,141
Other corporate	1,355	58	113	1,300	913	36	15	934
Total fixed maturities	5,417	209	364	5,262	3,645	150	93	3,702
Perpetual debentures:								
Yen-denominated:								
Banks/financial institutions	3,306	133	172	3,267	3,442	83	202	3,323
Total perpetual debentures	3,306	133	172	3,267	3,442	83	202	3,323
Total securities held to maturity	\$ 8,723	\$ 342	\$ 536	\$ 8,529	\$ 7,087	\$ 233	\$ 295	\$ 7,025

Fair values of debt securities were determined using quotations provided by outside securities pricing sources and/or compiled using data provided by external debt market sources. The data used in estimating fair value includes credit spreads of comparably credit-rated securities and market quotations of securities with similar characteristics of maturity and call structure. Fair values are then computed using standard industry models that provide pricing data based on a wide variety of inputs as noted above. The fair values provided by outside sources are verified internally for reasonableness. If a fair value appears unreasonable, the inputs are re-examined and the value is confirmed or revised. The fair values for equity securities were determined using market quotations on principal public exchange markets.

The amortized cost and fair values of our investments in fixed maturities at December 31, 2001, by contractual maturity are shown below:

(In millions)	AFLAC Japan		AFLAC U.S.	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>Available for sale:</b>				
Due in one year or less	\$ 811	\$ 839	\$ 34	\$ 34
Due after one year through five years	1,311	1,421	396	410
Due after five years through 10 years	3,231	4,322	433	451
Due after 10 years	8,598	9,675	3,097	3,106
U.S. mortgage-backed securities	81	85	56	57
Total fixed maturities available for sale	\$14,032	\$16,342	\$4,016	\$4,058
<b>Held to maturity:</b>				
Due after five years through 10 years	\$ 491	\$ 549	\$ –	\$ –
Due after 10 years	4,926	4,713	–	–
Total fixed maturities held to maturity	\$ 5,417	\$ 5,262	\$ –	\$ –

Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay obligations with or without call or prepayment penalties.

In recent years we have purchased subordinated perpetual debenture securities. These securities are subordinated to other debt obligations of the issuer, but rank higher than equity securities. Although these securities have no contractual maturity, the issue-date fixed-rate interest coupons subsequently increase to a market-interest rate plus 150 to 300 basis points and change to a variable-interest rate basis, generally by the 25th year after issuance, thereby creating an economic maturity date.

The economic maturities of the perpetual debentures owned at December 31, 2001, were as follows:

(In millions)	AFLAC Japan		AFLAC U.S.	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>Available for sale:</b>				
Due after one year through five years	\$ 138	\$ 151	\$ –	\$ –
Due after five years through 10 years	456	538	71	77
Due after 10 years through 15 years	227	271	–	–
Due after 15 years	1,532	1,439	73	78
Total perpetual debentures available for sale	\$ 2,353	\$ 2,399	\$ 144	\$ 155
<b>Held to maturity:</b>				
Due after five years through 10 years	\$ 704	\$ 724	\$ –	\$ –
Due after 10 years through 15 years	1,568	1,609	–	–
Due after 15 years	1,034	934	–	–
Total perpetual debentures held to maturity	\$ 3,306	\$ 3,267	\$ –	\$ –

Privately issued securities held by AFLAC Japan at amortized cost accounted for \$15.4 billion, or 52.5%, and \$14.3 billion, or 48.0%, of total debt securities at December 31, 2001 and 2000, respectively. Of the total privately issued securities, reverse-dual currency debt securities (principal payments in yen, interest payments in dollars) accounted for \$4.2 billion and \$4.8 billion at amortized cost as of December 31, 2001 and 2000, respectively.

The following debt securities individually exceeded 10% of shareholders' equity at December 31:

(In millions)	2001		2000	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Japan National Government	\$ 4,915	\$ 6,452	\$ 5,755	\$ 7,448
The Tokyo Electric Power Co., Inc.	744	844	857	979
The Israel Electric Corporation Limited	649	632	528	456
Credit Suisse First Boston	579	570	*	*
HBOS PLC	576	548	*	*
Chubu Electric Power Co., Inc.	*	*	655	712
Dai-ichi Kangyo Bank	*	*	457	487

\* Less than 10%

At December 31, 2001, we owned debt securities rated below investment grade in the amount of \$355 million at amortized cost (\$348 million at fair value), or 1.2% of total debt securities. The below investment-grade securities were investment grade at the time of purchase and were subsequently downgraded by credit rating agencies.

In March 2001, we recognized a pretax impairment loss of \$42 million on the corporate debt securities of a U.S. issuer when it experienced a credit rating downgrade. We also executed several bond sale and purchase transactions during the first quarter in an effort to increase investment income. The sales of these debt securities resulted in pretax realized gains of \$21 million. Also in the first quarter, we realized a

pretax gain of \$18 million related to the sale of a portion of our U.S. equity securities portfolio in connection with a change in outside investment managers. In September 2001, we recognized a pretax impairment loss of \$28 million related to the Company's investment in two human resource service companies. We also recognized in December 2001, a pretax impairment loss of \$13 million on the debt securities of a European issuer when it experienced a credit rating downgrade. These gains and losses, when included with other investment transactions in the normal course of business, decreased net earnings \$34 million.

During the first half of 2000, the North American issuers of two debt securities held in our portfolio experienced credit rating downgrades. In the second quarter, we sold one security reported as available for sale at a pretax loss of \$34 million. We also recorded a pretax impairment loss of \$57 million on the other security which was carried in the held-to-maturity category. These losses, when included with other investment transactions in the normal course of business, decreased net earnings \$69 million.

Information regarding realized and unrealized gains and losses from investments for the years ended December 31 follows:

(In millions)	2001	2000	1999
Realized investment gains (losses) on securities:			
Debt securities:			
Available for sale:			
Gross gains from sales	\$ 66	\$ 9	\$ 12
Gross losses from sales	(23)	(53)	(39)
Impairment losses	(55)	—	—
Net gains (losses) from redemptions	1	—	(8)
Held to maturity:			
Impairment losses	—	(57)	—
Gross gains from redemptions	—	—	1
Total debt securities	(11)	(101)	(34)
Equity securities:			
Gross gains from sales	29	9	27
Gross losses from sales	(18)	(10)	(6)
Impairment losses	(31)	—	—
Total equity securities	(20)	(1)	21
Net realized losses	\$ (31)	\$ (102)	\$ (13)
Changes in unrealized gains (losses):			
Debt securities:			
Available for sale	\$ 944	\$ 43	\$ (447)
Held to maturity	(387)	(257)	34
Equity securities	(46)	(3)	2
Net change in unrealized losses	\$ 511	\$ (217)	\$ (411)

The impairment losses on equity securities of \$31 million include \$3 million of impairment losses on Japanese securities and a \$28 million loss related to our investment in two human resource service companies.

The net effect on shareholders' equity of unrealized gains and losses from investment securities at December 31 was as follows:

(In millions)	2001	2000
Unrealized gains on securities available for sale	\$ 2,439	\$ 1,541
Unamortized unrealized gains on securities transferred to held to maturity	614	1,001
Deferred income taxes	(1,175)	(1,068)
Shareholders' equity, net unrealized gains on investment securities	\$ 1,878	\$ 1,474

For the Japanese reporting fiscal year ending March 31, 2002, new Japanese accounting principles and regulations are effective, which impact investment classifications and solvency margin calculations on a Japanese accounting basis. As a result of these new requirements, we re-evaluated AFLAC Japan's investment portfolio and our intent related to the holding period of certain investment securities. In order to minimize potential fluctuations in solvency margin results in the future, we reclassified debt securities with amortized cost of \$1.8 billion from the held-to-maturity category to the available-for-sale category as of March 31, 2001. Included in accumulated other comprehensive income immediately prior to the transfer was an unamortized unrealized gain of \$327 million related to these securities. This gain represented the remaining unamortized portion of a \$1.1 billion unrealized gain established in 1998 when we reclassified \$6.4 billion of debt securities from the held-to-maturity category to the available-for-sale category.

We also reclassified debt securities with a fair value of \$2.3 billion from the available-for-sale category to the held-to-maturity category as of March 31, 2001. The related unrealized gain of \$118 million is being amortized from accumulated other comprehensive income to investment income over the remaining term of the securities. The related premium in the carrying value of the debt securities that was created when the reclassification occurred is also being amortized as an offsetting charge to investment income.

We attempt to match the duration of our assets with the duration of our liabilities. For AFLAC Japan, the duration of policy benefits and related expenses to be paid in future years is longer than that of the related invested assets due to the unavailability of acceptable yen-denominated long-duration securities. The average duration of policy benefits and related expenses to be paid in future years was approximately 12 years for both 2001 and 2000. The average duration of the yen-denominated debt securities was approximately 10 years in both 2001 and 2000. The average duration of premiums to be received in the future was approximately nine years in both 2001 and 2000. Over the next five years, \$2.2 billion at amortized cost (with an

average yield of 5.63%) of AFLAC Japan's yen-denominated debt securities are scheduled to mature. Currently, when our debt securities mature, the proceeds may be reinvested at a yield below that of the interest required for the accretion of policy benefit liabilities on policies issued in earlier years. However, the investment yield on new investments exceeds interest requirements on policies issued in recent years. Since 1994, premium rates on new business have been increased several times to help offset the lower investment yields. Despite the shortfall in investment yields, adequate overall profit margins still exist in AFLAC Japan's aggregate block of business.

The components of net investment income for the years ended December 31 were as follows:

(In millions)	2001	2000	1999
Fixed-maturity securities	\$ 1,281	\$ 1,280	\$ 1,129
Perpetual debentures	277	278	248
Short-term investments and cash equivalents	9	7	7
Equity securities and other	2	4	2
Gross investment income	1,569	1,569	1,386
Less investment expenses	19	19	17
Net investment income	\$ 1,550	\$ 1,550	\$ 1,369

At December 31, 2001, debt securities with a fair value of \$9 million were on deposit with regulatory authorities. As of December 31, 2001, \$161 million, at fair value, of AFLAC Japan's debt securities had been pledged to Japan's policyholder protection fund. We retain ownership of all securities on deposit and receive the related investment income.

We lend fixed-maturity securities to financial institutions in short-term security lending transactions. These securities continue to be carried as investment assets on our balance sheet during the term of the loans and are not recorded as sales. We receive cash or other securities as collateral for such loans. These short-term security lending arrangements increase investment income with minimal risk. At December 31, 2001 and 2000, we had security loans outstanding in the amounts of \$480 million and \$123 million at fair value, respectively. At December 31, 2001 and 2000, we held cash in the amount of \$494 million and \$127 million, respectively, as collateral for loaned securities.

Our security lending policy requires that the fair value of the securities received as collateral and cash received as collateral be 102% and 100% or more, respectively, of the fair value of the loaned securities as of the date the securities are loaned and not less than 100% thereafter.

#### (4) FINANCIAL INSTRUMENTS

The carrying values and estimated fair values of the Company's financial instruments as of December 31 were as follows:

	2001		2000	
(In millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Assets:</b>				
Fixed-maturity securities	\$ 25,817	\$ 25,662	\$ 25,817	\$ 25,874
Perpetual debentures	5,860	5,821	5,488	5,369
Equity securities	245	245	236	236
<b>Liabilities:</b>				
Notes payable (excl. capitalized leases)	1,174	1,181	1,048	1,043
Derivatives:				
Cross-currency swaps:				
Currency portion	(27)	(27)	34	34
Accrued interest	(5)	(5)	(4)	(4)
Interest rate component*	(1)	(1)	—	—
Interest rate swaps*	—	—	—	2

\* Prior to January 1, 2001, these amounts were not recorded on the balance sheet.

The carrying amounts for cash and cash equivalents, receivables, accrued investment income, accounts payable, cash collateral and payables for security transactions approximated their fair values due to the short-term nature of these instruments. Consequently, such instruments are not included in the table presented above.

The methods of determining the fair values of our investments in debt and equity securities are described in Note 3. The fair values for notes payable with fixed interest rates were obtained from an independent financial information service.

The above table excludes liabilities for future policy benefits of \$25.1 billion and \$26.1 billion at December 31, 2001 and 2000, respectively, as these liabilities are not considered financial instruments.

As of December 31, 2001, we have outstanding cross-currency swap agreements related to the \$450 million senior notes (Note 6). These cross-currency swaps effectively convert the dollar-denominated principal and interest into yen-denominated obligations. The notional amounts and terms of the swaps match the principal amount and terms of the senior notes. These cross-currency swaps have been designated as a hedge of the foreign currency exposure of our net investment in AFLAC Japan.



Our risk management objectives are to minimize the exposure of our shareholders' equity to foreign currency translation fluctuations and also reduce our interest expense by converting the dollar-denominated principal and interest into yen-denominated obligations. In this instance, our interest expense is reduced from 6.50% in dollars to 1.67% in yen. We are subject to minimal foreign currency risk as the yen-denominated interest and principal payments are serviced by AFLAC Incorporated with yen-denominated profit repatriations received from AFLAC Japan. (See Note 1 for information on the accounting policy for cross-currency swaps.)

The components of the fair value of the cross-currency swaps as reflected as an asset or (liability) in the financial statements as of December 31 were as follows:

(In millions)	2001	2000	1999
Interest rate component*	\$ 1	\$ -	\$ (19)
Foreign currency component	27	(34)	(93)
Accrued interest component	5	4	4
Total fair value of cross-currency swaps	\$ 33	\$ (30)	\$ (108)

\*Amounts not recorded in financial statements prior to January 1, 2001.

The following is a reconciliation of the foreign currency component of the cross-currency swaps as included in accumulated other comprehensive income.

(In millions)	2001	2000	1999
Balance at beginning of year	\$ (34)	\$ (93)	\$ -
Increase (decrease) in fair value of cross-currency swaps	62	59	(93)
Interest rate component not qualifying for hedge accounting reclassified to net earnings*	(1)	-	-
Balance at end of year	\$ 27	\$ (34)	\$ (93)

\*Amounts not recorded in financial statements prior to January 1, 2001.

At December 31, 2001, we had outstanding interest rate swaps on ¥3.9 billion (\$29 million) of our variable-interest-rate yen-denominated bank borrowings (Note 6). We have designated these interest rate swaps as a cash flow hedge of our exposure to the variability in future cash flows attributable to the variable interest payments of the borrowings. Our risk management objective is to fix the net interest cash outflows on a portion of the debt obligations. These swap agreements expire in July 2002 and reduce the impact of changes in interest rates on our borrowing costs by effectively changing the interest rate from variable to fixed. We make fixed-rate payments at 1.24% and receive floating-rate payments (.08% at December 31, 2001, plus loan costs of 20 basis points) based on three-month Japanese yen LIBOR. The fair value of the interest rates swaps, included in other liabilities, was immaterial at December 31, 2001. (See Note 1 for information on the accounting policy for interest rate swaps.)

The fair values of the cross-currency and interest rate swaps are the estimated amounts that we would receive or pay to terminate the swap agreements as of that date. We are exposed to credit risk in the event of nonperformance by counterparties to these contracts. The counterparties to the swap agreements are U.S. and Japanese financial institutions with the following credit ratings as of December 31, 2001:

Counterparty Credit Rating	Notional Amount of Swaps (In millions)
AA	\$ 300
A	167
BBB	12
Total	\$ 479

We have designated our yen-denominated notes payable (Note 6) as hedges of the foreign currency exposure of our net investment in AFLAC Japan.

## (5) POLICY LIABILITIES

The liability for future policy benefits at December 31 consisted of the following:

		Liability Amounts		Interest Rates	
(In millions)	Policy Issue Year	2001	2000	Year of Issue	In 20 Years
Health insurance:					
Japan:	1999-01	\$ 559	\$ 242	3.0%	3.0%
	1997-99	1,412	1,298	3.5	3.5
	1994-96	2,486	2,590	4.0-4.5	4.0-4.5
	1974-94	16,126	17,755	5.25-7.0	5.0-5.65
U.S.:	1998-01	297	190	7.0	7.0
	1986-00	1,586	1,448	6.0-8.0	6.0
	1981-86	272	276	6.5-7.0	5.5-6.5
	Other	155	157		
Life insurance:					
Japan:	1999-01	120	44	1.85-3.0	1.85-3.0
	1997-99	313	292	3.5	3.5
	1994-96	573	580	4.0	4.0
	1985-93	1,159	1,188	5.25-5.65	5.25-5.65
U.S.:	1956-01	48	41	4.0-6.0	4.0-6.0
Total		\$ 25,106	\$ 26,101		

The weighted-average interest rates reflected in the consolidated statements of earnings for future policy benefits for Japanese policies were 5.1% in 2001, 5.2% in 2000, and 5.3% in 1999; and for U.S. policies, 6.4% for each year in the three-year period ended December 31, 2001.

Changes in the liability for unpaid policy claims are summarized as follows for the years ended December 31:

(In millions)	2001	2000	1999
Unpaid supplemental health claims – beginning of year	<b>\$ 1,670</b>	\$ 1,558	\$ 1,222
Add claims incurred during the year related to:			
Current year	<b>3,454</b>	3,663	3,081
Prior years	<b>(304)</b>	(285)	(212)
Total incurred	<b>3,150</b>	3,378	2,869
Less claims paid during the year:			
On claims incurred during current year	<b>2,285</b>	2,303	1,969
On claims incurred during prior years	<b>821</b>	813	709
Total paid	<b>3,106</b>	3,116	2,678
Effect of foreign exchange rate changes on unpaid claims	<b>(174)</b>	(150)	145
Unpaid supplemental health claims – end of year	<b>1,540</b>	1,670	1,558
Unpaid life claims – end of year	<b>75</b>	75	60
Total liability for unpaid policy claims	<b>\$ 1,615</b>	\$ 1,745	\$ 1,618

Amounts shown for prior-year claims incurred during the year primarily result from actual claim settlements at less than the original estimates, which included a provision for adverse deviation.

## (6) NOTES PAYABLE

A summary of notes payable at December 31 follows:

(In millions)	2001	2000
6.50% senior notes due April 2009 (principal amount \$450)	<b>\$ 449</b>	\$ 449
Yen-denominated Samurai notes:		
1.55% notes due October 2005 (principal amount ¥30 billion)	<b>227</b>	261
.87% notes due June 2006 (principal amount ¥40 billion)	<b>303</b>	–
Unsecured, yen-denominated notes payable to banks:		
Revolving credit agreement due November 2002 (principal amount of ¥25.8 billion):		
1.24% fixed interest rate	<b>29</b>	68
Variable interest rate (.29% at December 31, 2001)	<b>166</b>	157
Reducing revolving credit agreement:		
2.29% fixed interest rate	–	99
Variable interest rate	–	14
Obligations under capitalized leases, payable monthly through 2006, secured by computer equipment in Japan	<b>33</b>	31
Total notes payable	<b>\$ 1,207</b>	\$ 1,079

In April 1999, we issued \$450 million of 6.50% senior notes due April 15, 2009. The current outstanding balance after unamortized loan discount is \$449 million. The notes are redeemable at our option at any time with a redemption price equal to the principal amount of the notes being redeemed plus a make-whole amount. We have entered into cross-currency swaps that have the effect of converting the dollar-denominated principal and interest of these notes into yen-denominated obligations (see Note 4).

For the yen-denominated loans, the principal amount as stated in dollar terms will fluctuate from period to period due to changes in the yen/dollar exchange rate.

In September 2000, we filed a shelf registration statement with Japanese regulatory authorities to issue up to ¥100 billion of yen-denominated Samurai notes. These securities are not for sale to U.S. residents or entities. In October 2000, we issued in Japan ¥30 billion (\$227 million using the December 31, 2001, exchange rate) of 1.55% Samurai notes due October 2005. In June 2001, we issued in Japan ¥40 billion (\$303 million using the December 31, 2001, exchange rate) of .87% Samurai notes due June 2006. Both issues are redeemable at our option at any time with a redemption price equal to the principal amount of the notes being redeemed plus a premium.

We also have an unsecured revolving credit agreement that provides for bank borrowings through November 2002 in either U.S. dollars or Japanese yen. The borrowing limit is \$250 million. The current outstanding balance is ¥25.8 billion. At December 31, 2001, ¥21.9 billion (\$166 million) of the unsecured revolving credit agreement were outstanding at a variable interest rate and ¥3.9 billion (\$29 million) were outstanding at a fixed rate. The swaps related to the ¥3.9 billion fixed-rate portion of the credit agreement are scheduled to expire in July 2002 (see Note 4).

The aggregate contractual maturities of notes payable during each of the years after December 31, 2001, are: 2002, \$207 million; 2003, \$11 million; 2004, \$7 million; 2005, \$229 million; 2006, \$304 million; and 2009, \$449 million.

We were in compliance with all of the covenants of the credit agreements at December 31, 2001. No events of default or defaults occurred during 2001 and 2000.

## (7) INCOME TAXES

The components of income tax expense (benefit) applicable to pretax earnings for the years ended December 31 were as follows:

(In millions)	Japan	U.S.	Total
<b>2001:</b>			
Current	\$ 313	\$ 25	\$ 338
Deferred	(14)	70	56
<b>Total income tax expense</b>	<b>\$ 299</b>	<b>\$ 95</b>	<b>\$ 394</b>
<b>2000:</b>			
Current	\$ 319	\$ 19	\$ 338
Deferred	(73)	60	(13)
<b>Total income tax expense</b>	<b>\$ 246</b>	<b>\$ 79</b>	<b>\$ 325</b>
<b>1999:</b>			
Current	\$ 211	\$ 19	\$ 230
Deferred – operations	(1)	45	44
Deferred tax benefit from Japanese tax rate reduction	(185)	118	(67)
<b>Total income tax expense</b>	<b>\$ 25</b>	<b>\$ 182</b>	<b>\$ 207</b>

Income tax expense in the accompanying consolidated financial statements varies from the amount computed by applying the expected U.S. tax rate of 35% to pretax earnings. The principal reasons for the differences and the related tax effects for the years ended December 31 are summarized as follows:

(In millions)	2001	2000	1999
Income taxes based on U.S. statutory rates	\$ 378	\$ 354	\$ 272
Deferred tax benefit from Japanese tax rate reduction	–	–	(67)
Utilization of foreign tax credit carryforwards	(21)	(22)	(20)
Termination of retirement liability	–	(33)	–
Noninsurance losses generating no current tax benefit	12	–	3
Nondeductible expenses	11	14	12
Other, net	14	12	7
<b>Income tax expense</b>	<b>\$ 394</b>	<b>\$ 325</b>	<b>\$ 207</b>

Income tax expense (benefit) for the years ended December 31 was allocated as follows:

(In millions)	2001	2000	1999
Statements of earnings	\$ 394	\$ 325	\$ 207
Other comprehensive income:			
Changes in unrealized foreign currency translation gains	99	135	(141)
Unrealized gains on investment securities:			
Unrealized holding gains (losses) arising during the year	110	146	(75)
Reclassification adjustment for realized (gains) losses included in net earnings	(2)	34	9
<b>Total income taxes allocated to other comprehensive income</b>	<b>207</b>	<b>315</b>	<b>(207)</b>
Additional paid-in capital (exercise of stock options)	(1)	(2)	(2)
<b>Total income taxes</b>	<b>\$ 600</b>	<b>\$ 638</b>	<b>\$ (2)</b>

Changes in unrealized foreign currency translation gains/losses included deferred income tax expense of \$98 million in 2001 and \$76 million in 2000 and a deferred

income tax benefit of \$80 million in 1999 that represented Japanese income taxes on currency translation gains/losses that arose for Japanese tax purposes from the translation of AFLAC Japan's dollar-denominated investments into yen.

In March 1999, the Japanese government reduced the statutory corporate income tax rate, which lowered AFLAC Japan's rate from 41.7% to 36.2%, reducing the consolidated liability for deferred income taxes. The reduction was the net effect of applying the new tax rates to the temporary differences that existed between the Japanese tax basis and financial reporting basis of assets and liabilities, and the limitations imposed by the U.S. foreign tax credit provisions.

The reduction of the consolidated deferred income tax liability from the 1999 tax rate reduction increased net earnings in 1999 by \$67 million (\$.13 per basic share and \$.12 per diluted share). The 1999 reduction in the Japanese corporate income tax rate did not significantly change our combined U.S./Japan effective tax rate due to the operation of the U.S. foreign tax credit provisions.

The income tax effects of the temporary differences that gave rise to deferred income tax assets and liabilities as of December 31 were as follows:

(In millions)	2001	2000
<b>Deferred income tax liabilities:</b>		
Deferred acquisition costs	\$ 1,072	\$ 1,077
Unrealized gains on investment securities	699	455
Difference in tax basis of investment in AFLAC Japan	308	82
Other basis differences in investment securities	167	256
Premiums receivable	103	92
Unrealized exchange gain on yen-denominated notes payable	16	6
Other	10	3
<b>Total deferred income tax liabilities</b>	<b>2,375</b>	<b>1,971</b>
<b>Deferred income tax assets:</b>		
Policy benefit reserves	126	63
Policyholder protection fund	36	28
Unfunded retirement benefits	35	34
Other accrued expenses	132	74
Tax credit carryforwards	83	112
Other	257	187
<b>Total gross deferred income tax assets</b>	<b>669</b>	<b>498</b>
Less valuation allowance	126	149
<b>Total deferred income tax assets</b>	<b>543</b>	<b>349</b>
<b>Net deferred income tax liability</b>	<b>1,832</b>	<b>1,622</b>
Current income tax liability	259	272
<b>Total income tax liability</b>	<b>\$ 2,091</b>	<b>\$ 1,894</b>

A valuation allowance is provided when it is more likely than not that deferred tax assets will not be realized. We have established valuation allowances primarily for foreign tax credit and noninsurance loss carryforwards that exceed projected future offsets. Under U.S. income tax rules, only 35% of noninsurance losses can be offset against life

insurance taxable income each year. During 2001, the valuation allowance for deferred tax assets decreased by \$23 million (decreased by \$8 million in 2000) due to changes in carryforwards of foreign tax credits, alternative minimum tax credits and noninsurance losses. For current U.S. income tax purposes, alternative minimum tax credits of \$83 million were available at December 31, 2001.

## (8) SHAREHOLDERS' EQUITY

The following is a reconciliation of the number of shares of the Company's common stock for the years ended December 31:

(In thousands of shares)	2001	2000	1999
<b>Common stock - issued:</b>			
Balance at beginning of year	644,813	640,698	635,941
Exercise of stock options	1,746	4,115	4,757
Balance at end of year	646,559	644,813	640,698
<b>Treasury stock:</b>			
Balance at beginning of year	115,603	109,216	104,573
Purchases of treasury stock:			
Open market	12,219	9,657	8,633
Other	168	269	375
Shares issued to sales associate stock bonus plan and AFL Stock Plan	(1,830)	(1,182)	(1,664)
Exercise of stock options	(1,216)	(2,357)	(2,701)
Balance at end of year	124,944	115,603	109,216
Shares outstanding at end of year	521,615	529,210	531,482

**Share Repurchase Program:** As of December 31, 2001, we had approximately four million shares available for purchase under the share repurchase program authorized by the board of directors. On February 12, 2002, the board of directors authorized the purchase of up to an additional 25 million shares of our common stock, bringing the total number of shares available for purchase to approximately 29 million.

**Stock Split:** On February 13, 2001, the board of directors declared a two-for-one stock split, consisting of 323 million shares, payable to shareholders of record at the close of business on February 27, 2001. The stock split was distributed on March 16, 2001. Share and per-share amounts retroactively reflect this split. After the stock split, the par value remained at \$.10 per share. The adjustment to increase the common stock account was recorded on March 16, 2001.

**Stock Options:** The Company's stock option plan allows grants for both incentive stock options (ISO) and non-qualifying stock options (NQSO) to employees and NQSO to members of the board of directors. The options have a term of 10 years. The exercise price is equal to the fair market value at the date of grant. The options are

exercisable immediately unless they are subject to a vesting schedule as determined by the board of directors. At December 31, 2001, 11.1 million shares were available for future grants.

For the years ended December 31, 2001 and 2000, there were approximately 1,057,900 and 937,400 weighted average shares, respectively, for outstanding stock options that were not included in the calculation of weighted average shares used in the computation of diluted earnings per share because the exercise price for these options was greater than the average market price during these periods.

The following table summarizes stock option activity:

(In thousands of shares)	Option Shares	Weighted-Average Exercise Price Per Share
Outstanding at December 31, 1998	32,500	\$ 7.16
Granted in 1999	2,479	23.39
Canceled in 1999	(155)	15.21
Exercised in 1999	(7,665)	4.67
Outstanding at December 31, 1999	27,159	9.30
Granted in 2000	5,619	22.85
Canceled in 2000	(161)	14.39
Exercised in 2000	(6,636)	5.12
<b>Outstanding at December 31, 2000</b>	<b>25,981</b>	<b>13.27</b>
<b>Granted in 2001</b>	<b>2,442</b>	<b>28.29</b>
<b>Canceled in 2001</b>	<b>(123)</b>	<b>23.29</b>
<b>Exercised in 2001</b>	<b>(3,043)</b>	<b>6.89</b>
<b>Outstanding at December 31, 2001</b>	<b>25,257</b>	<b>\$ 15.44</b>

  

(In thousands of shares)	2001	2000	1999
Shares exercisable at end of year	16,329	16,782	22,168

The following table summarizes information about stock options outstanding at December 31, 2001:

(In thousands of shares)		Options Outstanding		Options Exercisable	
Range of Exercise Prices	Number Outstanding	Wgt'd.-Avg. Remaining Contractual Life (Yrs.)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$ 4.03 - \$ 4.71	3,796	1.4	\$ 4.67	3,796	\$ 4.67
4.80 - 7.92	4,185	3.7	7.39	4,185	7.39
8.48 - 13.31	3,512	5.2	11.35	3,512	11.35
13.66 - 15.05	3,396	6.4	14.86	3,396	14.86
15.22 - 22.92	2,574	7.9	21.77	841	22.32
23.23 - 23.23	3,878	8.5	23.23	507	23.23
23.41 - 34.48	3,916	8.8	26.77	92	24.99
<b>\$ 4.03 - \$ 34.48</b>	<b>25,257</b>	<b>5.9</b>	<b>\$ 15.44</b>	<b>16,329</b>	<b>\$ 10.53</b>

We grant stock options at market value; therefore, we do not recognize compensation cost in the consolidated statements of earnings for employee stock options. If we were required to record compensation expense related to stock options granted, the effect on our net earnings and net earnings per share would approximate the following pro forma amounts:

(In millions, except for per-share amounts)	2001	2000	1999
Net earnings:			
As reported	\$ 687	\$ 687	\$ 571
Effect of stock options	(33)	(27)	(13)
Pro forma net earnings	\$ 654	\$ 660	\$ 558
Net earnings per share - diluted:			
As reported	\$ 1.28	\$ 1.26	\$ 1.04
Effect of stock options	(.06)	(.05)	(.02)
Pro forma net earnings per share	\$ 1.22	\$ 1.21	\$ 1.02

The pro forma information presented above should not be considered indicative of future effects.

For the above pro forma information, the fair value of each option granted after 1994 was estimated on the date of grant using the Black-Scholes multiple option approach with the following assumptions for options granted during the three-year period ended December 31, 2001:

	2001	2000	1999
Expected life from vesting date (years)	4.4 - 5.6	4.2 - 5.8	3.7 - 4.7
Dividend yield	.8%	.5%	.6%
Expected volatility	32.4%	32.0%	30.3%
Risk-free interest rate	5.0%	6.0%	6.0%

**Voting Rights:** In accordance with the Parent Company's articles of incorporation, shares of common stock are generally entitled to one vote per share until they have been held by the same beneficial owner for a continuous period of 48 months, at which time they become entitled to 10 votes per share.

## (9) STATUTORY ACCOUNTING AND DIVIDEND RESTRICTIONS

Net assets of the insurance subsidiaries aggregated \$6.4 billion at December 31, 2001, on a GAAP basis. AFLAC Japan accounted for \$4.1 billion, or 64.5%, of these net assets.

Our insurance subsidiary is required to report its results of operations and financial position to state insurance regulatory authorities on the basis of statutory accounting practices prescribed or permitted by such authorities. Our branch in Japan, AFLAC Japan, must report to the Japanese Financial Services Agency (FSA).

As determined on a U.S. statutory accounting basis, AFLAC's net income, which includes realized investment gains and losses, was \$370 million in 2001, \$210 million in 2000 and \$344 million in 1999. Capital and surplus was \$2.2 billion and \$1.7 billion at December 31, 2001 and 2000, respectively.

Reconciliations of AFLAC's net assets on a GAAP basis to net assets determined on a U.S. statutory accounting basis as of December 31 were as follows:

(In millions)	2001	2000
Net assets on GAAP basis	\$ 6,380	\$ 5,572
Adjustment of carrying values of investment securities	(3,023)	(2,113)
Elimination of deferred policy acquisition costs	(3,611)	(3,663)
Adjustment to policy liabilities	685	796
Adjustment to deferred income taxes	2,063	1,678
Other, net	(332)	(597)
Net assets on U.S. statutory accounting basis	\$ 2,162	\$ 1,673

The National Association of Insurance Commissioners has recodified statutory accounting principles to promote standardization throughout the industry. These new accounting principles were adopted January 1, 2001. We recorded the transition adjustments to reflect the prior years' effects, which increased AFLAC statutory capital and surplus by approximately \$130 million as of January 1, 2001.

The Parent Company depends on its subsidiaries for cash flow, primarily in the form of dividends and management fees. Consolidated retained earnings in the accompanying financial statements largely represent undistributed earnings of our insurance subsidiary. Amounts available for dividends, management fees and other payments to the Parent Company by its insurance subsidiary may fluctuate due to different accounting methods required by regulatory authorities. These payments are also subject to various regulatory restrictions and approvals related to safeguarding the interests of insurance policyholders. One of the primary considerations is that our insurance subsidiary must maintain adequate risk-based capital for U.S. regulatory authorities and adequate solvency margins for Japanese regulatory authorities. Also, the maximum amount of dividends that can be paid to shareholders by insurance companies domiciled in the state of Nebraska without prior approval of the director of insurance is the greater of the net gain from operations, which excludes realized investment gains and losses, for the previous year determined under statutory accounting principles or 10% of statutory capital and surplus as of the previous year-end. Dividend payments by AFLAC during 2002 in excess of \$409 million would require such approval. Dividends paid by AFLAC during 2001 were \$204 million.

A portion of AFLAC Japan annual earnings, as determined on a Japanese statutory accounting basis, can be remitted each year to AFLAC U.S. after complying with solvency margin provisions and satisfying various conditions imposed by Japanese regulatory authorities for protecting policyholders. Profit remittances to the United States can fluctuate due to changes in the amounts of

Japanese regulatory earnings. Among other items, factors affecting regulatory earnings include Japanese regulatory accounting practices and fluctuations in currency translations of AFLAC Japan's dollar-denominated investments into yen. Earnings were remitted from AFLAC Japan to AFLAC U.S. in the amount of \$185 million in 2001, \$157 million in 2000 and \$243 million in 1999. In light of the deregulation of the insurance market, we elected to repatriate less than the maximum amounts in both 2001 and 2000 in order to maintain a strong solvency margin in Japan. The maximum amount we could have repatriated was \$290 million and \$351 million in 2001 and 2000, respectively. We repatriated the maximum amount in 1999.

Net assets (unaudited) of AFLAC Japan, based on Japanese statutory accounting practices, aggregated \$2.6 billion and \$777 million at December 31, 2001 and 2000, respectively. Japanese statutory accounting practices differ in many respects from U.S. GAAP. Under Japanese statutory accounting practices, policy acquisition costs are charged off immediately, policy benefit and claim reserving methods and assumptions are different, policyholder protection fund obligations are not accrued, and deferred income tax liabilities are recognized on a different basis.

For the Japanese reporting fiscal year ending March 31, 2002, AFLAC Japan was required to adopt a new Japanese statutory accounting standard regarding fair value accounting for investments. Previously, investment securities were generally reported at amortized cost for FSA purposes. Under the new accounting standard, AFLAC Japan now classifies investment securities in two categories: in an available-for-sale category at fair value and in a held-to-maturity category at amortized cost. Unrealized gains and losses on investment securities available for sale are reported in FSA capital and surplus and reflected in solvency margin calculations. This new accounting standard may result in significant fluctuations in FSA equity, AFLAC Japan's solvency margin, and amounts available for annual profit repatriation.

## (10) BENEFIT PLANS

Reconciliations of the funded status of the basic employee defined-benefit pension plans with amounts recognized in the consolidated balance sheets as of December 31 were as follows:

	2001		2000	
(In thousands)	Japan	U.S.	Japan	U.S.
<b>Projected benefit obligation:</b>				
Benefit obligation at beginning of year	\$ 72,929	\$ 73,409	\$ 74,186	\$ 62,358
Service cost	4,132	3,583	4,458	2,891
Interest cost	1,784	5,072	2,093	4,314
Actuarial loss (gain)	1,468	(1,727)	1,647	5,172
Benefits paid	(1,118)	(1,290)	(1,039)	(1,326)
Effect of foreign exchange rate changes	(10,001)	—	(8,416)	—
Benefit obligation at end of year	69,194	79,047	72,929	73,409
<b>Plan assets:</b>				
Fair value of plan assets at beginning of year	48,669	63,307	49,830	56,425
Actual return on plan assets	(7,815)	(14,520)	(628)	8,208
Employer contribution	5,778	1,264	6,138	—
Benefits paid	(1,118)	(1,290)	(1,039)	(1,326)
Effect of foreign exchange rate changes	(6,095)	—	(5,632)	—
Fair value of plan assets at end of year	39,419	48,761	48,669	63,307
Funded status	(29,775)	(30,286)	(24,260)	(10,102)
Unrecognized net actuarial loss (gain)	15,228	19,677	8,455	1,273
Unrecognized transition obligation (asset)	3,009	(475)	3,772	(597)
Unrecognized prior service cost	654	1,616	828	1,754
Accrued benefit cost	\$ (10,884)	\$ (9,468)	\$ (11,205)	\$ (7,672)

The components of retirement expense and actuarial assumptions for the years ended December 31 were as follows:

	2001		2000		1999	
(In thousands)	Japan	U.S.	Japan	U.S.	Japan	U.S.
<b>Components of net periodic benefit cost:</b>						
Service cost	\$ 4,132	\$ 3,583	\$ 4,458	\$ 2,891	\$ 4,675	\$ 2,938
Interest cost	1,784	5,072	2,093	4,314	1,658	4,311
Expected return on plan assets	(1,152)	(5,612)	(1,470)	(5,013)	(1,516)	(4,313)
Recognized net actuarial loss	225	—	202	—	363	265
Amortization of transition obligation (asset)	295	(122)	333	(121)	258	(122)
Amortization of prior service cost	72	138	81	138	77	138
Net periodic benefit cost	\$ 5,356	\$ 3,059	\$ 5,697	\$ 2,209	\$ 5,515	\$ 3,217
<b>Weighted-average actuarial assumptions used in the calculations:</b>						
Discount rate – net periodic benefit cost	2.5%	7.0%	3.0%	7.0%	3.0%	6.5%
Discount rate – benefit obligations	2.5	7.0	3.0	7.0	3.0	7.0
Expected long-term return on plan assets	2.5	9.0	2.5	9.0	4.5	9.0
Rate of compensation increase	3.5	4.0	3.5	4.0	3.5	4.0

Plan assets consist of a diverse portfolio of debt and equity securities. Our U.S. plan included \$1 million (or 3% of plan assets) and \$2 million (or 4% of plan assets) of AFLAC Incorporated common stock at December 31, 2001 and 2000, respectively. The substantial decrease in the fair value of assets of both plans during 2001 was primarily attributable to general market conditions. We do not expect

pension expense to increase substantially in 2002 as a result of the decline in fair value of plan assets during 2001.

In addition to the benefit obligations for funded employee plans, we also maintain unfunded supplemental retirement plans for certain officers and beneficiaries. In May 2000, the surviving spouse of John B. Amos, former chairman of the board, unexpectedly passed away. We had accrued an unfunded liability under a shareholder-approved employment contract for projected retirement payments based on a normal life expectancy. The release of the remaining accrued liability increased net earnings by \$99 million (\$.19 per basic share and \$.18 per diluted share) for the year ended December 31, 2000.

Retirement expense for the supplemental unfunded plans, excluding the termination of the retirement liability in 2000, was \$15 million in 2001, \$5 million in 2000, and \$39 million in 1999. The accrued retirement liability for the unfunded supplemental retirement plans at December 31, 2001 and 2000, was \$157 million and \$151 million, respectively. The actuarial present value of projected benefit obligations was \$162 million and \$150 million at December 31, 2001 and 2000, respectively. The discount rates used were the same as for the funded plans.

Reconciliations of the benefit obligation of the unfunded retiree medical program and other postretirement benefits for U.S. employees with amounts recognized in the accompanying consolidated balance sheets as of December 31 were as follows:

(In thousands)	2001	2000
<b>Benefit obligation:</b>		
Benefit obligation at beginning of year	\$ 14,565	\$ 12,488
Service cost	522	408
Interest cost	1,020	874
Actuarial loss (gain)	(88)	1,610
Benefits paid	(1,009)	(815)
Unfunded benefit obligation at end of year	15,010	14,565
Unrecognized net actuarial gain (loss)	(993)	(1,080)
Unrecognized prior service cost	(316)	(342)
Accrued benefit cost	\$ 13,701	\$ 13,143

The components of expenses for the retiree medical program and other postretirement benefits, along with actuarial assumptions, were as follows for the years ended December 31:

(In thousands)	2001	2000	1999
Service cost	\$ 522	\$ 408	\$ 361
Interest cost	1,020	874	752
Amortization of prior service cost	25	25	26
Net periodic benefit cost	\$ 1,567	\$ 1,307	\$ 1,139
Discount rate:			
Net periodic cost	7.0%	7.0%	6.5%
Benefit obligations	7.0	7.0	7.0
Effect of 1-percentage point increase in health care cost trend rate:			
On total of service and interest cost components	\$ 168	\$ 136	\$ 119
On postretirement benefit obligation	1,070	1,180	991
Effect of 1-percentage point decrease in health care cost trend rate:			
On total of service and interest cost components	(143)	(116)	(101)
On postretirement benefit obligation	(919)	(1,010)	(846)

The projected health care cost trend rate used in 2001 was 12%, graded to 6% over five years.

**Stock Bonus Plan:** AFLAC U.S. maintains a stock bonus plan for eligible U.S. sales associates. Plan participants receive shares of AFLAC Incorporated common stock, based on their sales and persistency of substantially all insurance policies. The cost of these shares, which is included in deferred policy acquisition costs, amounted to \$24 million in 2001, and \$18 million in both 2000 and 1999. Prior to July 1999, participants received the shares of stock after satisfying various vesting requirements and other conditions. This stock bonus program was revised effective July 1, 1999, to substantially eliminate the vesting requirements and to make various other modifications. As a result of this change, plan participants became 100% vested in their accumulated shares under the original program, and the related shares of stock held in a trust were distributed. The market value of the distributed shares was charged against a liability for accrued stock compensation and the excess of market value over share cost (\$42 million) was recognized as additional paid-in capital.

## (11) COMMITMENTS AND CONTINGENCIES

**Commitments:** We lease office space and equipment under various agreements that expire in various years through 2021. Future minimum lease payments due under non-cancelable operating leases at December 31, 2001, were as follows: 2002, \$34 million; 2003, \$16 million; 2004, \$10 million; 2005, \$9 million; 2006, \$8 million; and thereafter, \$77 million.

**Litigation:** We are a defendant in various litigation considered to be in the normal course of business. Some of this litigation is pending in states where large punitive damages bearing little relation to the actual damages sustained by plaintiffs have been awarded against other companies, including insurers, in recent years. Although the

final results of any litigation cannot be predicted with certainty, we believe the outcome of pending litigation will not have a material adverse effect on our financial position, results of operations, or cash flows.

## (12) SUPPLEMENTARY INFORMATION

	2001	2000	1999
<b>Weighted-average shares used in calculating earnings per share (in thousands):</b>			
Average outstanding shares used for calculating basic EPS	525,098	530,607	531,737
Dilutive effect of stock options	12,285	14,299	19,108
Average outstanding shares used for calculating diluted EPS	537,383	544,906	550,845
<b>Other:</b>			
Policy acquisition costs deferred during the year (in millions)	\$ 651	\$ 612	\$ 556
Commissions deferred as a percentage of total acquisition costs deferred	71%	71%	72%
Personnel compensation and benefits as a percentage of insurance expenses	44%	42%	40%

	2001	2000	1999
<b>Supplemental disclosures of cash flow information (in millions):</b>			
Income taxes paid	\$ 347	\$ 215	\$ 411
Interest paid	23	21	17
Impairment losses included in realized investment losses	88	57	—
Noncash financing activities:			
Capitalized lease obligations	17	25	4
Treasury shares issued to AFL Stock Plan for:			
Shareholder dividend reinvestment	6	5	5
Associate stock bonus	17	7	54
<b>Property and equipment (in millions):</b>			
Land	\$ 138	\$ 132	\$ 147
Buildings	317	355	374
Equipment	186	169	156
	641	656	677
Less accumulated depreciation	186	175	168
Net property and equipment	\$ 455	\$ 481	\$ 509

## Management's Responsibility for Financial Statements

Management is responsible for the consolidated financial statements of AFLAC Incorporated and subsidiaries. The statements have been prepared in accordance with generally accepted accounting principles and include amounts based upon management's best estimates and judgments. Informed judgments and estimates are used for those transactions not yet complete or for which the ultimate effects cannot be measured precisely. Financial information elsewhere in this annual report is consistent with the information in the financial statements.

The Company's internal controls are designed to reasonably assure that AFLAC Incorporated's books and records reflect the transactions of the Company, that assets are safeguarded, and that the Company's established policies and procedures are followed. The effectiveness of the controls system is supported by the selection and training of qualified personnel, an organizational structure that provides an appropriate division of responsibility, and a comprehensive internal audit program.

The Company engages KPMG LLP as independent auditors to audit its financial statements and express their opinion thereon. Their audits include reviews and tests of the Company's internal controls to the extent they believe necessary to determine the audit procedures to be performed that will support their opinion. Members of that firm also have the right of full access to each member of management in conducting their

audits. The report of KPMG LLP appears on the following page.

The audit committee of the board of directors, which comprises outside directors, serves in an oversight role to assure the integrity and objectivity of the Company's financial reporting process. The committee meets periodically with representatives of management, as well as with the independent and internal auditors, to review matters of a material nature related to financial reporting and the planning, results and recommendations of audits. The independent and internal auditors have free access to the audit committee, without management present, to discuss any matter they believe should be brought to the attention of the committee. The committee is also responsible for making recommendations to the board of directors concerning the selection of the independent auditors.



Daniel P. Amos  
Chairman and Chief Executive Officer



Kriss Cloninger III  
President and Chief Financial Officer



# Independent Auditors' Report

The shareholders and board of directors of AFLAC Incorporated:

We have audited the accompanying consolidated balance sheets of AFLAC Incorporated and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of earnings, shareholders' equity, cash flows, and comprehensive income for each of the years in the three-year period ended December 31, 2001. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

assessing accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

**KPMG LLP**

Atlanta, Georgia

January 31, 2002, except as to Note 8, which is as of February 12, 2002

## Unaudited Consolidated Quarterly Financial Data

(In millions, except for per-share amounts)

Three Months ended,	March 31, 2001	June 30, 2001	September 30, 2001	December 31, 2001
<b>Total revenues</b>	<b>\$ 2,401</b>	<b>\$ 2,348</b>	<b>\$ 2,446</b>	<b>\$ 2,404</b>
<b>Net earnings</b>	<b>178<sup>(1)</sup></b>	<b>153<sup>(2)</sup></b>	<b>193<sup>(3)</sup></b>	<b>163<sup>(4)</sup></b>
<b>Net earnings per basic share</b>	<b>\$ .34<sup>(1)</sup></b>	<b>\$ .29<sup>(2)</sup></b>	<b>\$ .37<sup>(3)</sup></b>	<b>\$ .31<sup>(4)</sup></b>
<b>Net earnings per diluted share</b>	<b>.33<sup>(1)</sup></b>	<b>.28<sup>(2)</sup></b>	<b>.36<sup>(3)</sup></b>	<b>.31<sup>(4)</sup></b>
<b>Cash dividends per share</b>	<b>.043</b>	<b>.05</b>	<b>.05</b>	<b>.05</b>

Three Months ended,	March 31, 2000	June 30, 2000	September 30, 2000	December 31, 2000
Total revenues	\$ 2,398	\$ 2,355	\$ 2,472	\$ 2,480
Net earnings	156	202 <sup>(5)</sup>	163	166
Net earnings per basic share	\$ .29	\$ .38 <sup>(5)</sup>	\$ .31	\$ .31
Net earnings per diluted share	.29	.37 <sup>(5)</sup>	.30	.30
Cash dividends per share	.038	.043	.043	.043

(1) Includes a gain of \$3 (\$.01 per diluted share) related to the change in fair value of the interest rate component of the cross-currency swaps, an impairment loss of approximately \$36 (\$.07 per diluted share) related to an investment in corporate debt securities, and gain of approximately \$39 (\$.07 per diluted share) related to portfolio repositioning; (2) Includes a loss of \$21 (\$.04 per diluted share) related to the change in fair value of the interest rate component of the cross-currency swaps; (3) Includes a gain of \$37 (\$.07 per diluted share) related to the change in fair value of the interest rate component of the cross-currency swaps and an impairment loss of approximately \$28 (\$.05 per diluted share) related to investments in two human resource service companies; (4) Includes a loss of \$18 (\$.03 per diluted share) related to the change in fair value of the interest rate component of the cross-currency swaps and an impairment loss of approximately \$13 (\$.02 per diluted share) related to an investment in corporate debt securities; (5) Includes a loss of \$69 (\$.12 per diluted share) related to an impairment in corporate debt securities and a gain of \$99 (\$.18 per diluted share) related to the termination of a retirement liability.

*Certain reclassifications have been made to prior year amounts to conform to current reporting classifications. These reclassifications had no impact on net earnings.*