UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 OR 15(d) of The Securities Exchange Act of 1934

Date of Report (Date of earliest event reported) **May 24, 2006**

Humana Inc.

(Exact name of registrant as specified in its charter)

Delaware	**1-5975**	**61-0647538**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

500 West Main Street, Louisville, KY	**40202**
(Address of principal executive offices)	(Zip Code)

502-580-1000
Registrant’s telephone number, including area code

(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 8.01 Other Events

Humana Inc. (also referred to as "Humana", "we", "us" and "our") is filing this Current Report on Form 8-K (this "Form 8-K") solely to show the effects of our adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R") on historical annual financial information included in our Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 10-K") as if SFAS 123R had been adopted on January 1, 1995, the initial effective date of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"). SFAS 123R requires that the cost of stock awards, as determined by their fair value on the date of grant, be recognized over the period during which an employee is required to provide service in exchange for the stock award (usually the vesting period). We adopted SFAS 123R on January 1, 2006, and therefore our treatment in the 2005 10-K of stock-based compensation was based on SFAS 123, with the notes to the consolidated financial statements disclosing on a pro forma basis the stock compensation expense. The information in this Form 8-K is not an amendment to or restatement of our 2005 10-K.

We adopted SFAS 123R under the modified retrospective transition method. Accordingly, we are filing this Form 8-K so that our annual financial statement information for years prior to January 1, 2006 incorporated by reference in any registration statement (including our Registration Statement on Form S-3 (No. 333-132878)) and related prospectus supplements that we have filed or may file from time to time would reflect our adoption of SFAS 123R.

The following historical annual financial information reflecting the retrospective application of SFAS 123R is attached as exhibits to, and included in, this Form 8-K and supersedes in its entirety the information in Item 6, Item 7, and Item 8 of the 2005 10-K and Exhibit 12 to the 2005 10-K:

- Selected financial data for the years ended December 31, 2001 through 2005 (Item 6);
- Management's discussion and analysis of financial condition and results of operations for the years ended December 31, 2005 and 2004 (Item 7);
- Consolidated financial statements as of December 31, 2005 and 2004 and for the years ended December 31, 2005, 2004 and 2003 and notes to the consolidated financial statements as well as related supplemental data and financial statement schedules (Item 8); and
- Computation of ratio of earnings to fixed charges for the years ended December 31, 2001 through 2005 (Exhibit 12).

Changes to our historical financial information due to the retrospective application of SFAS 123R provided in these exhibits have been highlighted in blue.

The information in this Form 8-K does not reflect any event or development occurring after March 3, 2006, the date we filed the 2005 10-K. For a discussion of events and developments subsequent to the filing of the 2005 10-K, please refer to our Securities and Exchange Commission ("SEC") filings since that date. In our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, we adjusted the unaudited condensed consolidated financial statements for the quarter ended March 31, 2005 to reflect the retrospective application of SFAS 123R.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits:

Exhibit No.	Description
12	Computation of Ratio of Earnings to Fixed Charges with Retrospective Application of SFAS 123R
23	Consent of Independent Registered Public Accounting Firm
99.1	Selected Financial Data with Retrospective Application of SFAS 123R
99.2	Management's Discussion and Analysis of Financial Condition and Results of Operations with Retrospective Application of SFAS 123R
99.3	Financial Statements and Supplementary Data with Retrospective Application of SFAS 123R
99.4	Financial Statement Schedules with Retrospective Application of SFAS 123R

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned hereunto duly authorized.

HUMANA INC.

BY: /s/ Arthur P. Hipwell
Arthur P. Hipwell
Senior Vice President
and General Counsel

Dated: May 24, 2006

INDEX TO EXHIBITS

Exhibit No.	Description
12	Computation of Ratio of Earnings to Fixed Charges with Retrospective Application of SFAS 123R
23	Consent of Independent Registered Public Accounting Firm
99.1	Selected Financial Data with Retrospective Application of SFAS 123R
99.2	Management's Discussion and Analysis of Financial Condition and Results of Operations with Retrospective Application of SFAS 123R
99.3	Financial Statements and Supplementary Data with Retrospective Application of SFAS 123R
99.4	Financial Statement Schedules with Retrospective Application of SFAS 123R

Exhibit 12

The computation of ratio of earnings to fixed charges set forth in this Exhibit 12 has been revised from the computation of ratio of earnings to fixed charges included in Humana's Annual Report on Form 10-K for the year ended December 31, 2005 to reflect the retrospective application of Humana's adoption of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R. Revisions are highlighted in blue.

Humana Inc.
Computation of Ratio of Earnings to Fixed Charges with Retrospective Application of SFAS 123R

	For the year ended December 31,				
	2005	2004	2003	2002	2001
	(Dollars in thousands)				
Income before income taxes	$ 402,880	$ 399,378	$ 336,213	$ 203,546	$ 176,952
Fixed charges	66,434	49,246	40,972	44,349	52,010
Total earnings	$ 469,314	$ 448,624	$ 377,185	$ 247,895	$ 228,962
Interest charged to expense	$ 39,315	$ 23,172	$ 17,367	$ 17,252	$ 25,302
One-third of rent expense	27,119	26,074	23,605	27,097	26,708
Total fixed charges	$ 66,434	$ 49,246	$ 40,972	$ 44,349	$ 52,010
Ratio of earnings to fixed charges (1)(2)	7.1x	9.1x	9.2x	5.6x	4.4x

Notes

(1) For the purposes of determining the ratio of earnings to fixed charges, earnings consist of income before income taxes and fixed charges. Fixed charges include gross interest expense, amortization of deferred financing expenses and an amount equivalent to interest included in rental charges. One-third of rental expense represents a reasonable approximation of the interest amount.

(2) There are no shares of preferred stock outstanding.

Exhibit 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-8 (No. 33-33072, No. 33-49305, No. 33-54455, No. 333-04435, No. 333-57095, No. 333-86801, No. 333-41408, No. 333-86280, and No. 333-105622) and S-3 (No. 333-132878) of Humana Inc. of our report dated March 3, 2006, except for Notes 2, 8 and 11 for which the date is May 24, 2006, relating to the financial statements, financial statement schedules, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in this Current Report on Form 8-K.

/s/ PricewaterhouseCoopers LLP

Louisville, Kentucky
May 24, 2006

Exhibit 99.1

Selected Financial Data set forth in this Exhibit 99.1 has been revised from the Selected Financial Data included in Item 6 to Humana's Annual Report on Form 10-K for the year ended December 31, 2005 to reflect the retrospective application of Humana's adoption of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123. Revisions are highlighted in blue.

SELECTED FINANCIAL DATA WITH RETROSPECTIVE APPLICATION OF SFAS 123R

	2005 (a)	2004 (b)	2003(c)	2002 (d)(e)	2001 (e)
Summary of Operations:	(in thousands, except per common share results and ratios)				
Revenues:					
Premiums	$ 14,001,591	$ 12,689,432	$ 11,825,283	$ 10,930,397	$ 9,938,961
Administrative services fees	259,437	272,796	271,676	244,396	137,090
Investment and other income	157,099	142,097	129,352	86,388	118,835
Total revenues	14,418,127	13,104,325	12,226,311	11,261,181	10,194,886
Operating expenses:					
Medical	11,651,470	10,669,647	9,879,421	9,138,196	8,279,844
Selling, general and administrative	2,195,604	1,894,336	1,866,531	1,781,457	1,551,257
Depreciation and amortization	128,858	117,792	126,779	120,730	161,531
Total operating expenses	13,975,932	12,681,775	11,872,731	11,040,383	9,992,632
Income from operations	442,195	422,550	353,580	220,798	202,254
Interest expense	39,315	23,172	17,367	17,252	25,302
Income before income taxes	402,880	399,378	336,213	203,546	176,952
Provision for income taxes	106,150	129,431	112,474	64,694	63,525
Net income	$ 296,730	$ 269,947	$ 223,739	$ 138,852	$ 113,427
Basic earnings per common share	$ 1.83	$ 1.68	$ 1.41	$ 0.85	$ 0.69
Diluted earnings per common share	$ 1.79	$ 1.66	$ 1.38	$ 0.83	$ 0.68
Financial Position:					
Cash and investments	$ 3,477,955	$ 3,074,189	$ 2,927,213	$ 2,415,914	$ 2,327,139
Total assets	6,869,614	5,657,617	5,379,814	4,977,029	4,715,445
Medical and other expenses payable	1,909,682	1,422,010	1,272,156	1,142,131	1,086,386
Debt	815,044	636,696	642,638	604,913	578,489
Stockholders' equity	2,508,874	2,124,248	1,868,972	1,641,115	1,541,701
Key Financial Indicators:					
Medical expense ratio	83.2%	84.1%	83.5%	83.6%	83.3%
SG&A expense ratio	15.4%	14.6%	15.4%	15.9%	15.4%

	2005 (a)	2004 (b)	2003	2002	2001
Medical Membership by Segment:					
Government:					
Medicare Advantage	557,800	377,200	328,600	344,100	393,900
Medicaid	457,900	478,600	468,900	506,000	490,800
TRICARE	1,750,900	1,789,400	1,849,700	1,755,800	1,714,600
TRICARE ASO	1,138,200	1,082,400	1,057,200	1,048,700	942,700
Total Government	3,904,800	3,727,600	3,704,400	3,654,600	3,542,000
Commercial:					
Fully insured	1,999,800	2,286,500	2,352,800	2,340,300	2,301,300
Administrative services only	1,171,000	1,018,600	712,400	652,200	592,500
Total Commercial	3,170,800	3,305,100	3,065,200	2,992,500	2,893,800
Total Medical Membership	7,075,600	7,032,700	6,769,600	6,647,100	6,435,800
Commercial Specialty Membership:					
Dental	1,456,500	1,246,700	1,147,400	1,094,600	1,123,300
Other	445,600	461,500	520,700	545,400	571,300
Total specialty membership	1,902,100	1,708,200	1,668,100	1,640,000	1,694,600

(a) Includes the acquired operations of CarePlus Health Plans of Florida from February 16, 2005, and the acquired operations of Corphealth, Inc. from December 20, 2005. Also includes expenses of $71.9 million ($44.8 million after tax, or $0.27 per diluted common share) for a class action litigation settlement, as well as expenses of $27.0 million ($16.9 million after tax, or $0.10 per diluted common share) related to Hurricane Katrina. These expenses were partially offset by the realization of a tax gain contingency of $22.8 million, or $0.14 per diluted common share.

(b) Includes the acquired operations of Ochsner Health Plan from April 1, 2004.

(c) Includes expenses of $30.8 million pretax ($18.8 million after tax, or $0.12 per diluted common share) for the writedown of building and equipment and software abandonment expenses. These expenses were partially offset by a gain of $15.2 million pretax ($10.1 million after tax, or $0.06 per diluted common share) for the sale of a venture capital investment. The net impact of these items reduced pretax income by $15.6 million ($8.7 million after tax, or $0.05 per diluted common share).

(d) Includes expenses of $85.6 million pretax ($58.2 million after tax, or $0.35 per diluted common share) for severance and facility costs related to reducing our administrative cost structure with the elimination of three customer service centers and an enterprise-wide workforce reduction, reserves for liabilities related to a previous acquisition and the impairment in the fair value of certain private debt and equity investments.

(e) We ceased amortizing goodwill upon adopting Statement of Financial Accounting Standards (SFAS) No. 142, or SFAS 142, on January 1, 2002. Assuming the non-amortization provisions of SFAS 142 were in effect as of January 1, 2001, diluted earnings per common share would have increased $0.31 in 2001.

Management's discussion and analysis set forth in this Exhibit 99.2 has been revised from the management's discussion and analysis included in Item 7 to Humana's Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Form 10-K") to reflect the retrospective application of Humana's adoption of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R. Management's discussion and analysis set forth below has not been revised to reflect events or developments subsequent to March 3, 2006, the date that Humana filed the 2005 Form 10-K. Revisions are highlighted in blue. For a discussion of events and developments subsequent to the filing date of the 2005 Form 10-K, please refer to the reports and other information Humana has filed with the Securities and Exchange Commission since that date, including Humana's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS WITH RETROSPECTIVE APPLICATION OF SFAS 123R

The consolidated financial statements of Humana Inc. in this document present the Company's financial position, results of operations and cash flows, and should be read in conjunction with the following discussion and analysis. References to "we," "us," "our," "Company," and "Humana" mean Humana Inc. and its subsidiaries. This discussion includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in filings with the Securities and Exchange Commission, in our press releases, investor presentations, and in oral statements made by or with the approval of one of our executive officers, the words or phrases like "expects," "anticipates," "intends," "likely will result," "estimates," "projects" or variations of such words and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions, including, among other things, information set forth in Item 1A. — Risk Factors in the 2005 Form 10-K. In making these statements, we are not undertaking to address or update these factors in future filings or communications regarding our business or results. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this document might not occur. There may also be other risks that we are unable to predict at this time. Any of these risks and uncertainties may cause actual results to differ materially from the results discussed in the forward-looking statements.

Overview

Headquartered in Louisville, Kentucky, Humana Inc. is one of the nation's largest publicly traded health benefits companies, based on our 2005 revenues of $14.4 billion. We offer coordinated health insurance coverage and related services through a variety of traditional and Internet-based plans for employer groups, government-sponsored programs, and individuals. As of December 31, 2005, we had approximately 7.1 million members in our medical insurance programs, as well as approximately 1.9 million members in our specialty products programs.

We manage our business with two segments: Government and Commercial. The Government segment consists of members enrolled in government-sponsored programs, and includes three lines of business: Medicare Advantage, TRICARE, and Medicaid. The Commercial segment consists of members enrolled in products marketed to employer groups and individuals, and includes three lines of business: fully insured medical, ASO, and specialty. We identified our segments in accordance with the aggregation provisions of SFAS 131, which is consistent with information used by our Chief Executive Officer in managing our business. The segment information aggregates products with similar economic characteristics. These characteristics include the nature of customer groups and pricing, benefits and underwriting requirements.

The results of each segment are measured by income before income taxes. We allocate all selling, general and administrative expenses, investment and other income, interest expense, and goodwill, but no other assets or liabilities, to our segments. Members served by our two segments often utilize the same medical provider networks, enabling us to obtain more favorable contract terms with providers. Our segments also share overhead costs and assets. As a result, the profitability of each segment is interdependent. We believe our customer, membership, revenue and pretax income diversification across segments and products allows us to increase our chances of success.

Our results are impacted by many factors, but most notably are influenced by our ability to establish and maintain a competitive and efficient cost structure and to accurately and consistently establish competitive premium, ASO fee, and plan benefit levels that are commensurate with our medical and administrative costs. Medical costs are subject to a high rate of inflation due to many forces, including new higher priced technologies and medical procedures, increasing capacity and supply of medical services, new prescription drugs and therapies, an aging population, lifestyle challenges including obesity and smoking, the tort liability system, and government regulations.

Government Segment

In our Government segment, the passage of the MMA in December 2003 demonstrated the federal government's commitment to providing health benefits and options to seniors by creating new product choices for Medicare-eligible individuals sold through the private sector. These new products include PFFS plans and local PPOs, with coverage effective in 2005, and regional PPOs and PDPs, with coverage effective in 2006. The PFFS plans generally offer additional benefits compared to traditional Medicare in exchange for a monthly premium paid by the member. These plans typically include a prescription drug benefit with no provider network restrictions. Local and regional PPO plans typically offer an even higher level of benefits to members, including a prescription drug benefit and a lower level of member cost-sharing on many benefits when the member uses medical services from in-network providers.

As a long-time participant in the Medicare program, we believe that we possess (1) business competencies and management experience with senior product design, (2) a robust and scalable multi-channel distribution system, (3) an established and competitive network including a national retail pharmacy network, and (4) an established brand awareness with seniors. Accordingly, we have developed a strategy to take full advantage of these expanded programs. This resulted in significant expenditures and commitments of resources during 2005, including, among other items:

- increasing the number of markets where we sell our products,
- designing products that offer a compelling combination of price and benefits to capture market share,
- raising brand awareness with the launching of our "Let's Talk" education campaign, as well as substantial marketing and advertising increases,
- expanding the distribution network, including partnering with Wal-Mart Stores, Inc. and increasing our captive sales force,
- increasing the size and scope of our provider network, and
- adding employees to accommodate membership growth, including opening a dedicated Medicare service center in Tampa Bay, Florida.

Our strategy and commitment to these expanded Medicare Advantage programs has led to substantial growth during 2005. Medicare Advantage membership increased to 557,800 members at December 31, 2005, up 47.9% from 377,200 members at December 31, 2004, primarily due to sales of our new PFFS products and the addition of 50,400 members from our acquisition of CarePlus Health Plans of Florida in February 2005. Likewise, Medicare premium revenues have increased 48.7% to $4.6 billion for 2005 from $3.1 billion in 2004. We expect the Medicare line of business to continue to grow during 2006 from continued geographic expansions of our Medicare Advantage offerings and our new PDP plans. As of February 1, 2006, Medicare Advantage membership totaled more than 700,000 members and PDP membership totaled approximately 1.7 million members. We expect 2006 Medicare premium revenues to more than double from 2005 from sales of our Medicare Advantage and PDP plans and for selling, general and administrative expenses to continue to increase in 2006. However, while our creation of the infrastructure related to our Medicare expansion will be nearly completed by the end of the first quarter of 2006, we do not believe the resulting expected revenues and membership will peak until Medicare enrollment is completed on July 1, 2006. We believe this will result in lower earnings and margins in the first half of 2006 relative to the second half of 2006, when we believe our consolidated revenues will reach the level contemplated by our selling, general, and administrative expenses.

In our TRICARE business, 2005 marked our first full fiscal year under the South Region contract. After being awarded the South Region contract in 2003, we transitioned our TRICARE business to one of three newly-created regions under the government's revised TRICARE program during 2004. We started the second option year under the South Region contract on April 1, 2005.

Commercial Segment

Our strategy to drive Commercial segment profitability focuses on providing solutions for employers to the rising cost of health care through the use of a variety of innovative and consumer-choice product designs. These products are supported by electronic informational capabilities, including education, tools, and technologies provided primarily through the Internet. To that end, we have developed an innovative suite of products styled as

“Smart” products. We believe that these Smart products offer the best solution for many employers to the problem of quickly rising health care costs for their employees. Membership in our Smart products and other consumer-choice health plans increased to 371,100 members at December 31, 2005, a 52% increase from December 31, 2004. We believe that growth in these products, which are offered both on a fully insured and ASO basis and competitively priced to produce higher margins, is a key component, among other items, for further improvement in the results of our Commercial segment. Additionally, we have increased the diversification of our commercial membership base, not only through our consumer-choice products, but also by (1) expanding our ASO membership in the mid-market group segment to take advantage of our network discounts and (2) launching our HumanaOne individual product to address an increasing migration of insureds from small group. While we expect our consumer-choice products to become a driver of growth in the years ahead as health care inflation persists, we also are enhancing the traditional products which comprise the bulk of our commercial portfolio today by applying our consumer-choice innovation.

Other important factors which impact our Commercial segment profitability are both the competitive pricing environment and market conditions. With respect to pricing, there is a tradeoff between sustaining or increasing underwriting margins versus increasing or decreasing enrollment. We have experienced a decline in our fully insured commercial membership as a result of pricing actions by some competitors who we perceive as desiring to gain market share in certain markets. With respect to market conditions, we are impacted by economies of scale on administrative overhead. As a result of a decline in preference for tightly-managed HMO products, medical costs have become increasingly comparable among our larger competitors. Product design and consumer involvement have become more important drivers of medical services consumption, and administrative expense efficiency is becoming a more significant driver of commercial margin sustainability. Consequently, we continually evaluate our administrative expense structure and realize administrative expense savings through productivity gains. Additionally, because our Commercial segment shares overhead costs with our Government segment, an increase or decrease in the size of our Government operations impacts our Commercial segment profitability.

Highlights

- In the Government segment, CMS approved all the 2006 Medicare contracts we applied for, giving us a wide array of products to sell and increasing the number of states where we sell them.
- Our Commercial segment reached an agreement to acquire CHA Service Company and completed the acquisition of Corphealth, Inc. Our Government segment completed the acquisition of CarePlus Health Plans of Florida. These transactions are more fully-described on the following page and in Note 3 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.
- Membership in Medicare Advantage products grew by 180,600 members, or 47.9%, from December 31, 2004, including 130,200 members from sales primarily related to our new PFFS offering, and 50,400 members from the acquisition of CarePlus Health Plans of Florida.
- Commercial medical membership declined by 134,300 members, or 4.1%, from December 31, 2004, including the loss of an 89,000 member unprofitable account that lapsed on January 1, 2005. Excluding the 89,000 member account, commercial medical membership declined 45,300 members, or 1.4%, since December 31, 2004, primarily due to continued competitive pricing pressures in the small to mid-market group account partially offset by an increase in ASO membership of 152,400 members.
- We reached an agreement with representatives of more than 700,000 physicians to settle a nationwide class action suit, subject to court approval. This agreement is more fully-described below and under “Legal Proceedings” in Note 14 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.
- Certain of our operations, primarily the Louisiana market, were negatively affected by the impact of Hurricane Katrina in August 2005 as more fully-described on the following page.
- The resolution of a contingent tax gain during the first quarter of 2005 contributed to the lower effective tax rate of 26.3% during 2005 compared to 32.4% during 2004 as more fully-described in Note 8 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.
- Cash flows from operations increased 77.3% or $266.0 million to $610.1 million in 2005 compared to $344.1 million in 2004.

We intend for the discussion of our financial condition and results of operations that follows to assist in the understanding of our financial statements and related changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain critical accounting principles and estimates impact our financial statements.

Settlement of Class Action Litigation

On October 17, 2005, we reached an agreement with representatives of more than 700,000 physicians to settle a nationwide class action suit, subject to court approval. In connection with the settlement and other related litigation costs, we recorded pretax administrative expenses of $71.9 million ($44.8 million after taxes, or $0.27 per diluted common share) in the third quarter of 2005. Of the $71.9 million, $33.4 million is included in the Government segment results and the remaining $38.5 million is included in the Commercial segment results. The settlement is more fully-described under "Legal Proceedings" in Note 14 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

Hurricane Katrina

Certain of our operations, primarily the Louisiana market, were negatively affected by the impact of Hurricane Katrina in August 2005. Expenses related to Hurricane Katrina primarily stem from our efforts, in cooperation with Departments of Insurance in the affected states, to help our members by offering participating-provider benefits at non-participating providers' rates, paying claims for members who were unable at the time to meet their premium obligations and similar measures. In connection with Hurricane Katrina, we recorded pretax medical and administrative expenses of $27.0 million ($16.9 million after taxes, or $0.10 per diluted common share) during the third and fourth quarters of 2005. Of the $27.0 million, $5.9 million is included in the Government segment results and the remaining $21.1 million is included in the Commercial segment results. We do not anticipate any significant additional costs for Hurricane Katrina related items in 2006.

Recent Acquisitions

In January 2006, our Commercial segment reached an agreement to acquire CHA Service Company, or CHA Health, for cash consideration of approximately $60.0 million plus any excess statutory surplus. The acquisition of CHA Health, a Kentucky health plan, is expected to add approximately 96,800 members to our Commercial segment medical membership. This transaction, which is subject to regulatory approval, is expected to close effective in the second quarter of 2006.

On December 20, 2005, our Commercial segment acquired Corphealth, Inc., a behavioral health care management company, for cash consideration of approximately $54.2 million, including transaction costs. This acquisition allows Humana to integrate coverage of medical and behavior health benefits.

On February 16, 2005, we acquired CarePlus Health Plans of Florida, or CarePlus, as well as its affiliated 10 medical centers and pharmacy company for approximately $444.9 million in cash, including transaction costs, adding approximately 50,400 Medicare Advantage members in Miami-Dade, Broward and Palm Beach counties. This acquisition enhances our Medicare market position in South Florida.

On April 1, 2004, we acquired Ochsner Health Plan, or Ochsner, from the Ochsner Clinic Foundation for $157.1 million in cash. Ochsner, a Louisiana health plan, added approximately 152,600 commercial medical members, primarily in fully insured large group accounts, and approximately 33,100 members in the Medicare Advantage program.

These transactions are more fully described in Note 3 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

Recently Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued SFAS 123R, which requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. This requirement represents a significant change because fixed-based stock option awards, historically a predominate form of stock compensation for us, were not recognized as compensation expense under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS 123R requires that the cost of the award, as determined on the date of grant at fair value, be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The grant-date fair value of the award is estimated using option-pricing models. SFAS 123R also requires that we estimate the expected forfeitures beginning January 1, 2006 under each stock compensation plan and only recognize compensation expense for those awards which are expected to vest. In addition, certain tax effects of stock-based compensation are reported as a financing activity rather than an operating activity in the statements of cash flows. We adopted SFAS 123R on January 1, 2006 under the modified retrospective transition method using the Black-Scholes pricing model. In accordance with the modified retrospective transition method, we have adjusted previously reported operating results to reflect the effect of expensing certain stock awards, primarily stock options, based on amounts previously included in the pro forma disclosures under the original provisions of SFAS 123 for all prior years for which the provisions of SFAS 123 were effective. Additional detail regarding our stock-based compensation plans and the effect of our retrospective application of SFAS 123R is included in Note 11 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

On February 23, 2006, the Board of Directors approved the issuance of 1,517,507 additional options and restricted stock awards. This grant was weighted more towards awards of restricted stock than stock options as compared to grants made in prior years. Consequently, compensation expense for 2006 is anticipated to be $0.08 per diluted common share related to stock options and $0.05 per diluted common share related to restricted stock. These amounts, which in total are in line with previous guidance, are dependent on certain assumptions, including additional grants during 2006. In 2005, the effect of expensing stock options was $0.08 per diluted common share and the effect of compensation expense related to restricted stock awards was $0.02 per diluted common share.

Comparison of Results of Operations for 2005 and 2004

Certain financial data for our two segments with retrospective application of SFAS 123R was as follows for the years ended December 31, 2005 and 2004:

			Change	
	2005	**2004**	**Dollars**	**Percentage**
	(dollars in thousands)			
Premium revenues:				
Medicare Advantage	$ 4,590,362	$ 3,086,598	$ 1,503,764	48.7%
TRICARE	2,407,653	2,127,595	280,058	13.2%
Medicaid	548,714	511,193	37,521	7.3%
Total Government	7,546,729	5,725,386	1,821,343	31.8%
Fully insured	6,068,115	6,614,482	(546,367)	(8.3)%
Specialty	386,747	349,564	37,183	10.6%
Total Commercial	6,454,862	6,964,046	(509,184)	(7.3)%
Total	$ 14,001,591	$ 12,689,432	$ 1,312,159	10.3%
Administrative services fees:				
Government	$ 50,059	$ 106,764	$ (56,705)	(53.1)%
Commercial	209,378	166,032	43,346	26.1%
Total	$ 259,437	$ 272,796	$ (13,359)	(4.9)%
Income before income taxes:				
Government	$ 316,676	$ 269,063	$ 47,613	17.7%
Commercial	86,204	130,315	(44,111)	(33.8)%
Total	$ 402,880	$ 399,378	$ 3,502	0.9%
Medical expense ratios (a):				
Government	83.1%	84.3%		(1.2)%
Commercial	83.3%	83.9%		(0.6)%
Total	83.2%	84.1%		(0.9)%
SG&A expense ratios (b):				
Government	12.7%	12.3%		0.4%
Commercial	18.5%	16.5%		2.0%
Total	15.4%	14.6%		0.8%

(a) Represents total medical expenses as a percentage of premium revenue. Also known as MER.

(b) Represents total selling, general, and administrative expenses as a percentage of premium revenues and administrative services fees. Also known as the SG&A expense ratio.

Medical membership was as follows at December 31, 2005 and 2004:

	2005	2004	Change Members	Change Percentage
Government segment medical members:				
Medicare Advantage	557,800	377,200	180,600	47.9%
Medicaid	457,900	478,600	(20,700)	(4.3)%
TRICARE	1,750,900	1,789,400	(38,500)	(2.2)%
TRICARE ASO	1,138,200	1,082,400	55,800	5.2%
Total Government	3,904,800	3,727,600	177,200	4.8%
Commercial segment medical members:				
Fully insured	1,999,800	2,286,500	(286,700)	(12.5)%
ASO	1,171,000	1,018,600	152,400	15.0%
Total Commercial	3,170,800	3,305,100	(134,300)	(4.1)%
Total medical membership	7,075,600	7,032,700	42,900	0.6%

This table of financial data should be reviewed in connection with the discussion on the following pages.

Summary

Net income was $296.7 million, or $1.79 per diluted common share, in 2005 compared to $269.9 million, or $1.66 per diluted common share, in 2004. The increase in net income primarily resulted from improved profits in our Government segment, driven by gains in membership and improved underwriting results in both our Medicare and TRICARE operations.

Net income for 2005 included expenses resulting from the class action litigation settlement ($44.8 million after taxes, or $0.27 per diluted common share) and costs associated with Hurricane Katrina ($16.9 million after taxes, or $0.10 per diluted common share). Net income for 2005 also included the favorable effect of an effective tax rate of approximately 26.3% compared to 32.4% in 2004, primarily due to the resolution of a contingent tax gain ($22.8 million, or $0.14 per diluted common share) during the first quarter of 2005 in connection with the expiration of the statute of limitations on an uncertain tax position related to the 2000 tax year.

Premium Revenues and Medical Membership

Premium revenues increased 10.3% to $14.0 billion for 2005, compared to $12.7 billion for 2004. Higher Government segment premium revenues were partially offset by a decrease in Commercial segment premium revenues. Premium revenues reflect changes in membership and increases in average per member premiums. Items impacting average per member premiums include changes in premium rates as well as changes in the geographic mix of membership, the mix of product offerings, and the mix of benefit plans selected by our membership.

Government segment premium revenues increased 31.8% to $7.5 billion for 2005, compared to $5.7 billion for 2004. This increase primarily was attributable to our Medicare Advantage operations and the effects of transitioning to the TRICARE South contract during 2004. Medicare Advantage membership was 557,800 at December 31, 2005, compared to 377,200 at December 31, 2004, an increase of 180,600 members, or 47.9%. This increase was due to expanded participation in various Medicare Advantage programs and geographic markets, as well as the CarePlus acquisition. The February 16, 2005 CarePlus acquisition added 50,400 members and $486.3 million in premium revenues in 2005. Average per member premiums for our Medicare Advantage business increased approximately 12% during 2005. This reflects a shift in our Medicare membership mix to higher reimbursement markets, due primarily to the South Florida CarePlus acquisition. Medicare geographic expansions during 2006 are anticipated to contribute to continued enrollment growth, with projected Medicare Advantage enrollment in the range of 900,000 to 1,100,000 at December 31, 2006 and PDP enrollment in the range of 1,900,000 to 2,200,000 at December 31, 2006. Total Medicare premium revenue for 2006 is projected to more than double from 2005. TRICARE premium revenues increased 13.2% in 2005, reflecting the transition to the new South Region contract during 2004 which included a temporary loss of approximately 1 million members for 4 months in 2004. Medicaid membership declined by 20,700 members from December 31, 2004 to December 31, 2005 primarily due to the fact that we did not renew our participation in the Medicaid program for the State of Illinois on July 31, 2005. The Illinois Medicaid business was not material to our results of operations, financial position, or cash flows.

Commercial segment premium revenues decreased 7.3% to $6.5 billion for 2005, compared to $7.0 billion for 2004. Lower premium revenues primarily resulted from a reduction of fully insured membership partially offset by increases in average per member premiums. Our fully insured membership decreased 12.5%, or 286,700 members, to 1,999,800 at December 31, 2005 compared to 2,286,500 at December 31, 2004. The decrease is primarily due to the relinquishment of an 89,000-member unprofitable account on January 1, 2005 and continued attrition due to the ongoing competitive environment within the fully insured group accounts, partially offset by membership gains in the individual and consumer-choice product lines. Average per member premiums for our fully insured group medical members increased approximately 7% to 9% in 2005 and are anticipated to further increase in the range of 7% to 9% in 2006.

Administrative Services Fees

Our administrative services fees for 2005 were $259.4 million, a decrease of $13.4 million, or 4.9%, from $272.8 million for 2004.

Administrative services fees for the Government segment decreased $56.7 million, or 53.1%, from $106.8 million for 2004 to $50.1 million for 2005. This decline resulted from the transition to the new South Region contract which carved out certain government programs including the administration of pharmacy and medical benefits to senior members over the age of 65. We transitioned services under these separate programs to other providers during 2004.

For the Commercial segment, administrative services fees increased $43.4 million, or 26.1%, from $166.0 million for 2004 to $209.4 million for 2005. This increase resulted from increased membership and higher average per member fees. ASO membership of 1,171,000 members at December 31, 2005 increased 15.0% compared to 1,018,600 at December 31, 2004. Average per member fees increased approximately 8% in 2005.

Investment and Other Income

Investment and other income totaled $157.1 million in 2005, an increase of $15.0 million from $142.1 million in 2004. This increase primarily was attributable to increased investment income from higher interest rates and average invested balances offset by lower capital gains. The average yield on investment securities was 4.0% in 2005 compared to 3.6% in 2004. The investment of cash flows from operations contributed to the increase in the average invested balance and added approximately $7.0 million to interest income. Net realized capital gains of $18.3 million in 2005 decreased $9.9 million from $28.2 million in 2004. As of December 31, 2005, we had an unrealized gain of $52.3 million related to a venture capital investment. We realized this gain in the first quarter of 2006 with the sale of this venture capital investment.

Medical Expense

Consolidated medical expenses increased $981.8 million or 9.2% during 2005. The increase was primarily driven by the increase in average per member claims costs primarily from the effects of health care inflation and incremental medical expenses related to the CarePlus acquisition.

The medical expense ratio, or MER, which is computed by taking total medical expenses as a percentage of premium revenues, represents a key industry statistic used to measure underwriting profitability.

The consolidated MER for 2005 was 83.2%, decreasing 90 basis points from 84.1% for 2004 due to improvements in both the Commercial and Government segments as further discussed below. The 2005 consolidated MER includes 20 basis points for expenses associated with Hurricane Katrina.

The Government segment's medical expenses increased $1.4 billion, or 30.0% during 2005 primarily due to the increase in average per member claims costs and the increase in the number of Medicare members, including those related to the CarePlus acquisition. The increase in average per member claims costs for Medicare approximated 8% to 10% during 2005.

The Government segment's MER for 2005 was 83.1%, a 120 basis point decrease from the 2004 rate of 84.3%. Excluding a 10 basis point increase in the 2005 MER from Hurricane Katrina, the decrease was primarily attributable to the increase in Medicare revenues as a percentage of total Government segment revenues and average per member Medicare premiums outpacing average per member Medicare claim costs.

The Commercial segment's medical expenses decreased $465.2 million, or 8.0%. This decrease primarily results from the decrease in fully insured group membership partially offset by the increase in average per member claims costs. The increase in average per member claims costs for fully insured group members was approximately 7% to 9% for 2005.

The MER for the Commercial segment of 83.3% in 2005 decreased 60 basis points from the 2004 MER of 83.9%. Higher medical expenses from Hurricane Katrina increased the 2005 MER 30 basis points. After considering the effect of Hurricane Katrina, the decrease in MER for the 2005 period primarily reflects the absence of the unprofitable 89,000-member large group account that lapsed on January 1, 2005.

SG&A Expense

Consolidated selling, general, and administrative (SG&A) expenses increased $301.3 million or 15.9% during 2005 primarily resulting from an increase in the number of employees due to the Medicare expansion, the class action litigation settlement, and increased advertising and marketing costs also due to the Medicare expansion. These increases were partially offset by a decrease in administrative expenses associated with transitioning to the TRICARE South contract in 2004. During 2005, the number of employees increased 5,000 to 18,700 at December 31, 2005, primarily in the sales and customer service functions associated with the growth in the Medicare business, as well as approximately 1,200 employees added with the CarePlus acquisition.

The SG&A expense ratio, which is computed by taking total selling, general, and administrative expenses as a percentage of premium revenues and administrative services fees, represents a key industry statistic used to measure administrative spending efficiency.

The consolidated SG&A expense ratio for 2005 was 15.4%, increasing 80 basis points from 14.6% for 2004. Expenses related to the class action litigation settlement increased the SG&A expense ratio 50 basis points for 2005. After considering the effect of the class action litigation expenses, the SG&A expense ratio increase primarily resulted from a commercial membership mix shift and increased spending associated with the Medicare expansion. The consolidated SG&A expense ratio is expected to be in the range of 12% to 13% for 2006 reflecting the continuing beneficial effect of growth in revenues and membership leveraging fixed costs.

Our Government and Commercial segments bear direct and indirect overhead SG&A expenses. We allocate indirect overhead expenses shared by the two segments primarily as a function of revenues. As a result, the profitability of each segment is interdependent.

SG&A expenses in the Government segment increased $248.1 million, or 34.7% during 2005 due to the CarePlus acquisition, increased spending associated with the Medicare expansion, and the class action litigation settlement. These increases were partially offset by a decrease in TRICARE expenses from the transition to the South contract in 2004. The Government segment SG&A expense ratio increased 40 basis points from 12.3% for 2004 to 12.7% for 2005. Expenses related to the class action litigation settlement increased the SG&A expense ratio 40 basis points for 2005.

The Commercial segment SG&A expenses increased $53.2 million, or 4.5% during 2005. The Commercial segment SG&A expense ratio increased 200 basis points from 16.5% for 2004 to 18.5% for 2005. Expenses related to the class action litigation settlement increased the SG&A expense ratio 60 basis points for 2005. After considering the effect of the class action litigation expenses, this increase resulted from the continued shift in the mix of membership towards ASO. ASO business bears a significantly higher SG&A ratio than fully insured business.

Depreciation and Amortization

Depreciation and amortization for 2005 totaled $128.9 million compared to $117.8 million for 2004, an increase of $11.1 million, or 9.4%. Amortization of other intangible assets increased $13.3 million during 2005 primarily as a result of intangible assets recorded in connection with the CarePlus acquisition.

Interest Expense

Interest expense was $39.3 million for 2005, compared to $23.2 million for 2004, an increase of $16.1 million. This increase primarily resulted from higher interest rates and higher average outstanding debt. The higher average outstanding debt balance increased interest expense $5.0 million during 2005. The average interest rate during 2005 of 5.3% increased 140 basis points compared to 3.9% during 2004.

Income Taxes

Our effective tax rate in 2005 of 26.3% decreased 6.1% compared to the 32.4% effective tax rate in 2004. The effective tax rate for 2005 reflects the favorable impact from the resolution of a contingent tax gain of $22.8 million during the first quarter of 2005 in connection with the expiration of the statute of limitations on an uncertain tax position related to the 2000 tax year. See Note 8 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K for a complete reconciliation of the federal statutory rate to the effective tax rate. We expect the 2006 effective tax rate to be in the range of 35% to 37%.

Comparison of Results of Operations for 2004 and 2003

Certain financial data for our two segments with retrospective application of SFAS 123R was as follows for the years ended December 31, 2004 and 2003:

			Change	
	2004	2003	Dollars	Percentage
		(dollars in thousands)		
Premium revenues:				
Medicare Advantage	$ 3,086,598	$ 2,527,446	$ 559,152	22.1%
TRICARE	2,127,595	2,249,725	(122,130)	(5.4)%
Medicaid	511,193	487,100	24,093	4.9%
Total Government	5,725,386	5,264,271	461,115	8.8%
Fully insured	6,614,482	6,240,806	373,676	6.0%
Specialty	349,564	320,206	29,358	9.2%
Total Commercial	6,964,046	6,561,012	403,034	6.1%
Total	$ 12,689,432	$ 11,825,283	$ 864,149	7.3%
Administrative services fees:				
Government	$ 106,764	$ 148,830	$ (42,066)	(28.3)%
Commercial	166,032	122,846	43,186	35.2%
Total	$ 272,796	$ 271,676	$ 1,120	0.4%
Income before income taxes:				
Government	$ 269,063	$ 221,240	$ 47,823	21.6%
Commercial	130,315	114,973	15,342	13.3%
Total	$ 399,378	$ 336,213	$ 63,165	18.8%
Medical expense ratios (a):				
Government	84.3%	84.3%		□%
Commercial	83.9%	82.9%		1.0%
Total	84.1%	83.5%		0.6%
SG&A expense ratios (b):				
Government	12.3%	13.5%		(1.2)%
Commercial	16.5%	17.0%		(0.5)%
Total	14.6%	15.4%		(0.8)%

(a) Represents total medical expenses as a percentage of premium revenue. Also known as MER.

(b) Represents total selling, general, and administrative expenses as a percentage of premium revenues and administrative services fees. Also known as the SG&A expense ratio.

Medical membership was as follows at December 31, 2004 and 2003:

	2004	2003	Change	
			Members	Percentage
Government segment medical members:				
Medicare Advantage	377,200	328,600	48,600	14.8%
Medicaid	478,600	468,900	9,700	2.1%
TRICARE	1,789,400	1,849,700	(60,300)	(3.3)%
TRICARE ASO	1,082,400	1,057,200	25,200	2.4%
Total Government	3,727,600	3,704,400	23,200	0.6%
Commercial segment medical members:				
Fully insured	2,286,500	2,352,800	(66,300)	(2.8)%
ASO	1,018,600	712,400	306,200	43.0%
Total Commercial	3,305,100	3,065,200	239,900	7.8%
Total medical membership	7,032,700	6,769,600	263,100	3.9%

This table of financial data should be reviewed in connection with the discussion on the following pages.

Summary

Net income was $269.9 million, or $1.66 per diluted common share, in 2004 compared to $223.7 million, or $1.38 per diluted common share, in 2003. The increase in net income consisted of improved profits in both of our business segments, driven by higher earnings from our Medicare and commercial products. The 2003 results included expenses for asset impairments as more fully described in Note 5 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

Premium Revenues and Medical Membership

Premium revenues increased 7.3% to $12.7 billion for 2004, compared to $11.8 billion for 2003. Higher premium revenues resulted primarily from the Ochsner acquisition, as more fully described in Note 3 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K, and an increase in Medicare Advantage and fully insured commercial average per member premiums. Items impacting average per member premiums include changes in premium rates as well as changes in the geographic mix of membership, the mix of product offerings, and the mix of benefit plans selected by our membership.

Government segment premium revenues increased 8.8% to $5.7 billion for 2004, compared to $5.3 billion for 2003. This increase primarily was attributable to our Medicare Advantage operations. Medicare Advantage membership was 377,200 at December 31, 2004, compared to 328,600 at December 31, 2003, an increase of 48,600 members, or 14.8%, including 33,100 members added through the acquisition of Ochsner. Average per member premiums for our Medicare Advantage business increased approximately 10% for 2004, reflecting higher reimbursement from CMS. TRICARE premium revenues decreased 5.4% in 2004 reflecting the transition to the new South Region contract which included a temporary loss of approximately 1 million members for 4 months in 2004.

Commercial segment premium revenues increased 6.1% to $7.0 billion for 2004, compared to $6.5 billion for 2003. This increase resulted from the Ochsner acquisition and increases in average per member premiums in the 6% to 8% range on our fully insured commercial business partially offset by membership attrition. Average per member premium increases of 6% to 8% include the impact of an increasing mix of individual products into our fully insured membership. A lower premium corresponding to lower benefits on products sold to individuals reduced our average per member premium trend by approximately 150 to 200 basis points. Our fully insured commercial medical membership decreased 2.8%, or 66,300 members, to 2,286,500 at December 31, 2004 after giving effect to the addition of 152,600 members from the acquisition of Ochsner. Without giving effect to the Ochsner acquisition, the decrease was primarily due to the lapse of certain under-performing large group accounts totaling approximately 94,000 members in 2004 and continued attrition due to the ongoing competitive environment within the small to mid-market group fully insured accounts, partially offset by membership gains in the Individual product lines.

Administrative Services Fees

Our administrative services fees for 2004 were $272.8 million, an increase of $1.1 million, or 0.4%, from $271.7 million for 2003. This increase resulted primarily from higher Commercial ASO membership partially offset by lower fees related to TRICARE's change in government-contracted services as described below.

Administrative services fees for the Government segment decreased $42.1 million, or 28.3%, from $148.8 million for 2003 to $106.8 million for 2004. This decline resulted from the transition to the new South Region contract which carved out certain government programs including the administration of pharmacy and medical benefits to senior members over the age of 65. We transitioned services under these separate programs to other providers during 2004.

For the Commercial segment, administrative services fees increased $43.2 million, or 35.2%, from $122.8 million for 2003 to $166.0 million for 2004. This increase resulted from a higher level of ASO membership at December 31, 2004, which was 1,018,600 members, compared to 712,400 members at December 31, 2003, an increase of 43%.

Investment and Other Income

Investment and other income totaled $142.1 million in 2004, an increase of $12.7 million from $129.4 million in 2003. This increase primarily resulted from an increase in the average invested balance partially offset by a decrease in net realized capital gains of approximately $8.4 million. The investment of cash flows from operations contributed to the increase in the average invested balance and added approximately $18.8 million to interest income. The average yield on investment securities was 3.6% in 2004 compared to 3.5% in 2003.

Medical Expense

Consolidated medical expenses increased $790.2 million, or 8.0%, to $10.7 billion in 2004 from $9.9 billion in 2003. The increase was primarily driven by the Ochsner acquisition and an increase in average per member claims costs primarily from the effects of health care inflation.

The consolidated MER for 2004 was 84.1%, increasing 60 basis points from 83.5% for 2003 primarily due to the increase in the MER for the Commercial segment.

The Government segment's medical expenses increased $386.1 million, or 8.7%, during 2004 primarily due to the increase in the number of Medicare members, including those related to the Ochsner acquisition, and the increase in average per member claims costs, partially offset by lower medical expenses associated with transitioning to the TRICARE South contract.

The Government segment's MER for 2004 was 84.3%, which was flat when compared to 2003. The Medicare Advantage premium increases were consistent with medical cost increases for 2004 reflecting our efforts of adjusting benefit levels commensurate with reimbursement rates.

The Commercial segment's medical expenses increased $404.2 million, or 7.4%, during 2004. The increase was primarily driven by an increase in average per member claims costs primarily from the effects of health care inflation. The increase in average per member claims costs for fully insured group members was approximately 8% to 10% for 2004.

The Commercial segment's MER for 2004 was 83.9%, increasing 100 basis points from 2003 of 82.9%. The 100 basis point increase was primarily due to underwriting losses associated with a large customer account serving approximately 89,000 members and a competitive pricing environment in the 2 to 300 life customer group. The 89,000-member large group account lapsed on January 1, 2005. Increasing per member premiums commensurate with claims trend becomes more difficult in a competitive pricing environment.

SG&A Expense

Consolidated SG&A expenses increased $27.8 million, or 1.5%, to $1.9 billion in 2004. Included in 2003 were costs of $17.2 million from the impairment of the Jacksonville, Florida service center building more fully described in Note 5 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K. Excluding the impairment, the increase resulted from higher Commercial segment SG&A expenses partially offset by lower Government segment SG&A expenses.

The consolidated SG&A expense ratio for 2004 was 14.6%, decreasing 80 basis points from 15.4% for 2003. This decrease, as well as the decrease in each of our segments' SG&A expense ratios, was the result of the revenue growth in excess of administrative cost inflation and operational efficiencies including gains from completing the consolidation of seven service centers into four during 2003. The Jacksonville, Florida building writedown increased the 2003 SG&A expense ratio 10 basis points.

SG&A expenses in the Government segment decreased $13.4 million, or 1.8% during 2004 primarily due to a decrease in TRICARE SG&A expenses from transitioning to the South contract partially offset by the Ochsner acquisition. The Government segment SG&A expense ratio decreased 120 basis points from 13.5% for 2003 to 12.3% for 2004. The Government segment SG&A expense ratio for 2003 included an approximate 20 basis point impact from the Jacksonville, Florida building writedown.

The Commercial segment SG&A expenses increased $41.2 million, or 3.6% during 2004 primarily due to the Ochsner acquisition. The Commercial segment SG&A expense ratio decreased 50 basis points from 17.0% for 2003 to 16.5% for 2004. The Commercial segment SG&A expense ratio for 2003 included an approximate 10 basis point impact from the Jacksonville, Florida building writedown.

Depreciation and Amortization

Depreciation and amortization for 2004 totaled $117.8 million compared to $126.8 million for 2003, a decrease of $9.0 million, or 7.1%. Accelerated depreciation from reducing the estimated useful life of software increased depreciation expense $9.3 million in 2004 and $13.5 million in 2003. Amortization of other intangible assets decreased when the other intangible assets allocated to an acquired TRICARE contract became fully amortized in the second quarter of 2003. This was partially offset by the increased amortization expense associated with other intangible assets recorded in connection with the April 1, 2004 Ochsner acquisition.

Interest Expense

Interest expense was $23.2 million for 2004, compared to $17.4 million for 2003, an increase of $5.8 million. This increase primarily resulted from higher average outstanding debt, due to the issuance of $300 million senior notes in August 2003.

Income Taxes

Our effective tax rate in 2004 of 32.4% decreased 1.1% compared to the 33.5% effective tax rate in 2003. Our effective tax rate is lower than the federal statutory rate due primarily to tax-exempt investment income. See Note 8 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K for a complete reconciliation of the federal statutory rate to the effective tax rate.

Liquidity

Our primary sources of cash include receipts of premiums, administrative services fees, investment income, as well as proceeds from the sale or maturity of our investment securities and from borrowings. Our primary uses of cash include disbursements for claims payments, SG&A expenses, interest expense, taxes, purchases of investment securities, capital expenditures, acquisitions, and payments on borrowings. Because premiums generally are collected in advance of claim payments by a period of up to several months in many instances, our business should normally produce positive cash flows during a period of increasing enrollment. Conversely, cash flows would be negatively impacted during a period of shrinking enrollment. We have recently been experiencing improving operating cash flows associated with growth in Medicare enrollment.

Cash and cash equivalents increased to $732.0 million at December 31, 2005 from $580.1 million at December 31, 2004. The change in cash and cash equivalents for the years ended December 31, 2005, 2004 and 2003 is summarized as follows:

	2005	2004 (in thousands)	2003
Net cash provided by operating activities	$610,082	$344,061	$397,921
Net cash used in investing activities	(767,276)	(624,081)	(382,837)
Net cash provided by (used in) financing activities	309,131	(71,305)	194,963
Increase (decrease) in cash and cash equivalents	$151,937	$(351,325)	$210,047

Cash Flow from Operating Activities

Our operating cash flows in 2004 were significantly impacted by the timing of the Medicare Advantage premium remittance which is payable to us on the first day of each month. When the first day of a month falls on a weekend or holiday, we have historically received this payment at the end of the previous month. As such, the Medicare Advantage receipts for January 2004 of $211.9 million and January 2003 of $205.8 million were received in December 2003 and December 2002, respectively, because January 1 is a holiday.

Beginning in 2005, the monthly premium payment schedule included a change in timing from previous practice. This new practice made an exception to the holiday rule for the January 1 payment. Although January 1 always represents a holiday, the new practice results in the January 1 payment being received on the first business day of January. As a result of this change, the January 2005 payment of $290.3 million originally scheduled to be received on Friday, December 31, 2004, was changed to Monday, January 3, 2005, or one business day later. Therefore, we received 12 monthly Medicare Advantage premium remittances in 2005, 11 in 2004, and 12 in 2003.

In addition to the impact from the timing of the Medicare Advantage premium receipts, higher earnings and Medicare enrollment growth contributed to increased operating cash flows in 2005, 2004 and 2003. Comparisons of our operating cash flows also are impacted by changes in our working capital. The most significant drivers of changes in our working capital are typically the timing of receipts for premiums and administrative services fees and payments of medical expenses. We illustrate these changes with the following summary of receivables and medical and other expenses payable.

The detail of total net receivables was as follows at December 31, 2005, 2004 and 2003:

				Change	
	2005	**2004**	**2003**	**2005**	**2004**
			(in thousands)		
TRICARE:					
Base receivable	$ 509,444	$ 396,355	$ 266,656	$ 113,089	$ 129,699
Bid price adjustments (BPAs)	—	25,601	92,875	(25,601)	(67,274)
Change orders	32,285	6,021	7,073	26,264	(1,052)
	541,729	427,977	366,604	113,752	61,373
Less: long-term portion of BPAs	—	—	(38,794)	—	38,794
TRICARE subtotal	541,729	427,977	327,810	113,752	100,167
Medicare	63,931	213	—	63,718	213
Commercial and other	165,549	185,931	178,577	(20,382)	7,354
Allowance for doubtful accounts	(32,557)	(34,506)	(40,400)	1,949	5,894
Total net receivables	$ 738,652	$ 579,615	$ 465,987	159,037	113,628
Reconciliation to cash flow statement:					
Change in long-term receivables				—	(52,583)
Provision for doubtful accounts				4,566	6,433
Receivables from acquisition				(2,289)	(16,420)
Change in receivables in cash flow statement				$ 161,314	$ 51,058

TRICARE base receivables began increasing in 2004 due to the transition to the reimbursement model under the South Region contract beginning on August 1, 2004. Under our former TRICARE contracts with a fixed price, we bore the cost of changes in the underlying pattern of health care for which the government was at risk until subsequently reimbursed in a later period through a bid price adjustment, or BPA process. The fixed price and BPA process added variability to our revenues, related receivables and operating cash flows because the timing of the settlement was uncertain. Under the new TRICARE South region contract, the fixed price and BPA process was eliminated and replaced with a new reimbursement model. We are reimbursed by the federal government generally within 15 calendar days of when we pay the claim under the new reimbursement model.

The delivery of health care services under the TRICARE South region contract results in (1) a lag between the time the service is provided and when the claim is paid by us, generally three months, and (2) a lag between the time the claim is paid by us and ultimately reimbursed by the federal government, generally 15 calendar days. Thus, the claims reimbursement component of TRICARE base receivables is generally collected over a three to four month period. The transition to the South region contract had the effect of increasing the TRICARE base receivable and, by a like amount, increasing TRICARE claims payable.

In addition to the effect of transitioning to the new South region contract reimbursement model, TRICARE base receivables (and related claims payable) increased in 2005 from higher claims inventories at our third party claims processing vendor. The $26.3 million increase in TRICARE change order receivables resulted from negotiating an equitable adjustment to the contract price in late 2005 for services not originally specified in the contract. We expect to collect the majority of these receivables during the first half of 2006.

The $63.7 million increase in Medicare Advantage receivables as of December 31, 2005 as compared to December 31, 2004 primarily resulted from recording revenues associated with CMS's risk adjustment model. CMS has implemented a risk adjustment model which apportions premiums paid to all health plans, including Humana, according to health severity. This model pays more for enrollees with predictably higher costs. Under this risk adjustment methodology, diagnosis data from inpatient and ambulatory treatment settings are used to calculate the risk adjusted premium payment to us. We collect, capture and submit the necessary diagnosis data to CMS weekly. We estimate risk adjustment revenues based upon the diagnosis data we submitted to CMS. This also resulted in a corresponding increase in the capitation payable to physicians under risk sharing arrangements discussed below.

The detail of medical and other expenses payable was as follows at December 31, 2005, 2004 and 2003:

				Change	
	2005	2004	2003	2005	2004
			(in thousands)		
IBNR (1)	$ 1,483,902	$ 1,164,518	$ 1,043,360	$ 319,384	$ 121,158
Reported claims in process (2)	83,635	97,801	74,262	(14,166)	23,539
Other medical expenses payable (3)	342,145	159,691	154,534	182,454	5,157
Total medical and other expenses payable	$ 1,909,682	$ 1,422,010	$ 1,272,156	487,672	149,854
Reconciliation to cash flow statement:					
Medical and other expenses payable from acquisition				(37,375)	(71,063)
Change in medical and other expenses payable in cash flow statement				$ 450,297	$ 78,791

(1) IBNR represents an estimate of medical expenses payable for claims incurred but not reported (IBNR) at the balance sheet date. The level of IBNR is primarily impacted by membership levels, medical claim trends and the receipt cycle time, which represents the length of time between when a claim is initially incurred and when the claim form is received (i.e. a shorter time span results in a lower IBNR).

(2) Reported claims in process represents the estimated valuation of processed claims that are in the post claim adjudication process, which consists of administrative functions such as audit and check batching and handling.

(3) Other medical expenses payable includes capitation and pharmacy payables. The balance due to our pharmacy benefit administrator fluctuates due to bi-weekly payments and the month-end cutoff.

Medical and other expenses payable primarily increased during 2005 due to (1) growth in Medicare membership, (2) medical claims inflation, (3) the transition to the new South region contract, (4) an increase in the TRICARE payable resulting from an increase in claims inventory at our third party claims processing vendor as discussed under the total net receivables table on the previous page, and (5) an increase in the capitation payable to physicians under risk sharing arrangements.

Medical and other expenses payable increased during 2004 due primarily to medical claims inflation.

Cash Flow from Investing Activities

During 2005, we paid $352.8 million to acquire CarePlus, net of $92.1 million of cash acquired, and we paid $50.0 million to acquire Corphealth, net of $4.0 million of cash acquired. During 2004, we paid $141.8 million to acquire Ochsner, net of $15.3 million of cash acquired.

We reinvested a portion of our operating cash flows over the last several years in investment securities, primarily short-duration fixed income securities, totaling $233.3 million in 2005, $407.3 million in 2004, and $283.1 million in 2003. Our ongoing capital expenditures primarily relate to our technology initiatives and administrative facilities necessary for activities such as claims processing, billing and collections, medical utilization review, and customer service. Total capital expenditures, excluding acquisitions, were $165.8 million in 2005, $114.1 million in 2004, and $101.3 million in 2003. The increased spending in 2005 primarily resulted from our Medicare expansion initiatives. Excluding acquisitions, we expect our total capital expenditures in 2006 to range between $125 million and $135 million.

During 2004 and 2003, proceeds from the sale of property and equipment relate primarily to consolidating our service centers in Jacksonville and San Antonio, including the sale of the Jacksonville office tower in 2004 for $14.8 million and a San Antonio office building for $5.9 million in 2003.

Cash Flow from Financing Activities

During 2005, we borrowed $494 million under our credit agreement. This amount included $294 million which we borrowed temporarily to finance the CarePlus acquisition. Additional borrowings related primarily to the anticipation of funding additional capital into certain subsidiaries during 2006 in conjunction with anticipated growth in revenues.

During 2003, we issued $300 million in 6.3% senior notes due August 1, 2018 in order to repay our short-term debt and take advantage of historically low interest rates. In addition, during 2003 we received proceeds of $31.6 million in exchange for new swap agreements. See Note 9 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K for more detailed information regarding our borrowings and swap agreements.

The remainder of the cash provided by financing activities in 2005, 2004 and 2003 resulted primarily from the change in the book overdraft, proceeds from stock option exercises, tax benefits of stock-based compensation, and the change in the securities lending payable. During 2005, we acquired approximately 68,300 of our common shares in connection with employee stock plans at an aggregate cost of $2.4 million, or an average of $34.62 per share. In 2004, we repurchased 3.6 million common shares in open market transactions and 0.2 million common shares in connection with employee stock plans for $67.0 million at an average price of $17.83 per share. In 2003, we repurchased 2.3 million common shares in open market transactions and 1.4 million common shares in connection with employee stock plans for $44.1 million at an average price of $12.03 per share. The Board of Directors' authorization for open market transactions expired in January 2005.

Senior Notes

We issued in the public debt capital markets, $300 million aggregate principal amount of 7.25% senior unsecured notes that mature on August 1, 2006 and $300 million aggregate principal amount of 6.30% senior unsecured notes that mature on August 1, 2018. We have entered into interest rate swap agreements to exchange the fixed interest rate under these senior notes for a variable interest rate based on LIBOR, as more fully discussed in Note 9 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

Credit Agreement

Our 5-year $600 million unsecured revolving credit agreement expires in September 2009. Under the agreement, at our option, we can borrow on either a competitive advance basis or a revolving credit basis. The revolving credit portion of the agreement bears interest at either a fixed rate or floating rate based on LIBOR plus a spread. The spread, which varies depending on our credit ratings, ranges from 50 to 112.5 basis points. We also pay an annual facility fee regardless of utilization. This facility fee, currently 15 basis points, may fluctuate between 12.5 and 37.5 basis points, depending upon our credit ratings. In addition, a utilization fee of 12.5 basis points is payable for any day in which borrowings under the facility exceed 50% of the total $600 million commitment. The competitive advance portion of any borrowings will bear interest at market rates prevailing at the time of borrowing on either a fixed rate or a floating rate basis, at our option.

The 5-year $600 million credit agreement contains customary restrictive and financial covenants as well as customary events of default, including financial covenants regarding the maintenance of net worth, minimum interest coverage, and maximum leverage ratios. At December 31, 2005, we were in compliance with all applicable financial covenant requirements. The terms of this credit agreement also include standard provisions related to conditions of borrowing, including a customary material adverse effect clause which could limit our ability to borrow. We have not experienced a material adverse effect, and we know of no circumstances or events which would be reasonably likely to result in a material adverse effect. At this time, we do not believe the material adverse effect clause poses a material funding risk to us. We have other relationships, including financial advisory and banking, with some of the parties to the credit agreement.

At December 31, 2005, we had $200 million of borrowings under the credit agreement outstanding at an interest rate of 5.04%. In addition, we have outstanding letters of credit of $35.1 million secured under the credit agreement. No amounts have ever been drawn on these letters of credit. As of December 31, 2005, we had $364.9 million of remaining borrowing capacity under the credit agreement.

Commercial Paper Program

We maintain and may issue short-term debt securities under a commercial paper program when market conditions allow. The program is backed by our credit agreement described above. Aggregate borrowings under both the credit agreement and commercial paper program generally may not exceed $600 million.

At December 31, 2005 and 2004, we had no commercial paper borrowings outstanding.

Other Borrowings

Other borrowings of $3.6 million at December 31, 2005 represent financing for the renovation of a building, bear interest at 2% per annum, are collateralized by the building, and are payable in various installments through 2014.

Shelf Registration

Our universal shelf registration with the Securities and Exchange Commission allows us to register the sale of debt or equity securities, from time to time, with the amount, price and terms to be determined at the time of the sale. We have up to $300 million remaining from a total of $600 million under the universal shelf registration. The net proceeds from any future sales of our debt securities under the universal shelf registration may be used for our operations and for other general corporate purposes, including repayment or refinancing of borrowings, working capital, capital expenditures, investments, acquisitions, or the repurchase of our outstanding securities. Given revised rules relating to universal shelf registration statements, we are exploring our options to file a new shelf registration statement.

Liquidity Requirements

We believe our cash balances, investment securities, operating cash flows, access to debt and equity markets and borrowing capacity, taken together, provide adequate resources to fund ongoing operating and regulatory requirements and fund future expansion opportunities and capital expenditures in the foreseeable future.

Adverse changes in our credit rating may increase the rate of interest we pay and may impact the amount of credit available to us in the future. Our investment-grade credit rating at December 31, 2005 was Baa3 according to Moody's Investors Services, Inc., or Moody's, and BBB, according to Standard & Poor's Ratings Services, or S&P. A downgrade to Ba2 or lower by Moody's and BB or lower by S&P would give the counterparties of three of our interest rate swap agreements with a $300 million notional amount, the right, but not the obligation, to cancel the interest rate swap agreement. If cancelled, we would pay or receive an amount based on the fair market value of the swap agreement. Assuming these swap agreements had been cancelled on December 31, 2005, we would have received $5.8 million, net, and future net interest payments would increase assuming LIBOR does not change. Other than the swap agreements, adverse changes in our credit ratings may not create, increase, or accelerate any liabilities.

In addition, we operate as a holding company in a highly regulated industry. Our parent company is dependent upon dividends and administrative expense reimbursements from our subsidiaries, most of which are subject to regulatory restrictions. Cash, cash equivalents and short-term investments at the parent company decreased $19.7 million to $419.6 million at December 31, 2005 compared to $439.3 million at December 31, 2004 reflecting the use of parent company cash for acquisition activity during 2005. See Exhibit 99.4 to this Current Report on Form 8-K for our parent company only financial information.

Regulatory Requirements

Certain of our subsidiaries operate in states that regulate the payment of dividends, loans, or other cash transfers to Humana Inc., our parent company, and require minimum levels of equity as well as limit investments to approved securities. The amount of dividends that may be paid to Humana Inc. by these subsidiaries, without prior approval by state regulatory authorities, is limited based on the entity's level of statutory income and statutory capital and surplus. In most states, prior notification is provided before paying a dividend even if approval is not required.

As of December 31, 2005, we maintained aggregate statutory capital and surplus of $1,203.2 million in our state regulated subsidiaries. Each of these subsidiaries was in compliance with applicable statutory requirements which aggregated $722.2 million. Although the minimum required levels of equity are largely based on premium volume, product mix, and the quality of assets held, minimum requirements can vary significantly at the state level. Given our anticipated premium growth in 2006 resulting from the expansion of our Medicare products, capital requirements will increase. We expect to fund these increased requirements with capital contributions from Humana Inc., our parent company, in the range of $450 million to $650 million in 2006.

Most states rely on risk-based capital requirements, or RBC, to define the required levels of equity. RBC is a model developed by the National Association of Insurance Commissioners to monitor an entity's solvency. This calculation indicates recommended minimum levels of required capital and surplus and signals regulatory measures should actual surplus fall below these recommended levels. If RBC were adopted by all states and Puerto Rico at December 31, 2005, we would be required to fund $14.7 million in one of our Puerto Rico subsidiaries to meet all requirements. After this funding, we would have $378.2 million of aggregate capital and surplus above any of the levels that require corrective action under RBC.

Contractual Obligations

We are contractually obligated to make payments for years subsequent to December 31, 2005 as follows:

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(in thousands)		
Debt	$ 803,640	$ 300,574	$ 1,080	$ 201,080	$ 300,906
Interest (1)	285,720	50,333	66,900	45,396	123,091
Operating leases (2)	297,113	84,993	121,622	62,325	28,173
Purchase and other obligations (3)	46,433	24,044	18,346	4,043	—
Total	$ 1,432,906	$ 459,944	$ 207,948	$ 312,844	$ 452,170

(1) Interest includes the estimated contractual interest payments under our debt agreements net of the effect of the associated swap agreements assuming no change in the LIBOR rate as of December 31, 2005.

(2) We lease facilities, computer hardware, and other equipment under long-term operating leases that are noncancelable and expire on various dates through 2023. We sublease facilities or partial facilities to third party tenants for space not used in our operations which partially mitigates our operating lease commitments. An operating lease, accounted for under the provisions of SFAS No. 13, *Accounting for Leases*, is a type of off-balance sheet arrangement. Assuming we acquired the asset, rather than leased such asset, we would have recognized a liability for the financing of these assets. See also Note 14 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

(3) Purchase and other obligations include agreements to purchase services, primarily information technology related services, or to make improvements to real estate, in each case that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum levels of service to be purchased; fixed, minimum or variable price provisions; and the appropriate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate or knowingly seek to participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2005, we are not involved in any SPE transactions.

Guarantees and Indemnifications

Our operating lease of an airplane, which expires January 1, 2010, provides for a residual value payment of no more than $4.8 million at the end of the lease term. At the end of the term, we have the right to exercise a purchase option for $8.9 million or the airplane can be sold to a third party. If we decide not to exercise our purchase option, we must pay the lessor a maximum amount of $4.8 million. This amount will be reduced by the net sales proceeds in excess of $4.2 million from the sale of the airplane to a third party.

Through indemnity agreements approved by the state regulatory authorities, certain of our regulated subsidiaries generally are guaranteed by Humana Inc., our parent company, in the event of insolvency for (1) member coverage for which premium payment has been made prior to insolvency; (2) benefits for members then hospitalized until discharged; and (3) payment to providers for services rendered prior to insolvency. Our parent also has guaranteed the obligations of our TRICARE subsidiaries.

In the ordinary course of business, we enter into contractual arrangements under which we may agree to indemnify a third party to such arrangement from any losses incurred relating to the services they perform on behalf of us, or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.

Related Parties

No related party transactions had a material effect on our financial position, results of operations, or cash flows. Certain related party transactions not having a material effect are discussed in our Proxy Statement for the meeting to be held April 27, 2006 — see "Certain Transactions with Management and Others."

Government Contracts

Our Medicare business, which accounted for approximately 32% of our total premiums and ASO fees for the year ended December 31, 2005, primarily consisted of HMO, PPO and PFFS products covered under the Medicare Advantage contracts with the federal government. The contracts are renewed generally for a one-year term each December 31 unless CMS notifies Humana of its decision not to renew by May 1 of the contract year, or Humana notifies CMS of its decision not to renew by the first Monday in June of the contract year.

Our TRICARE business, which accounted for approximately 17% of our total premiums and ASO fees for the year ended December 31, 2005, primarily consisted of the South Region contract. The 5-year South Region contract is subject to annual renewals at the Government's option and expires March 31, 2009. This contract contains provisions to negotiate a target health care cost amount annually with the federal government. Any variance from the target health care cost is shared with the federal government. As such, events and circumstances not contemplated in the negotiated target health care cost amount could have a material adverse effect on our business. These changes may include, for example, an increase or reduction in the number of persons enrolled or eligible to enroll due to the federal government's decision to increase or decrease U.S. military presence around the world. In the event government reimbursements were to decline from projected amounts, our failure to reduce the health care costs associated with these programs could have a material adverse effect on our business.

Our Medicaid business, which accounted for approximately 4% of our total premiums and ASO fees for the year ended December 31, 2005, consisted of contracts in Puerto Rico, Florida and Illinois. Our 3-year contracts with the Puerto Rico Health Insurance Administration, which accounted for approximately 3% of our total premium and ASO fees for the year ended December 31, 2005, were extended a fourth year and these contracts expire on June 30, 2006. We are preparing to bid on the new contracts that will be effective July 2006 although a request for such proposal has not yet been issued by the Puerto Rico Health Insurance Administration. At this time we are unable to predict the ultimate impact that any government policy decisions might have on our Medicaid contracts in Puerto Rico.

Our other current Medicaid contract, which is in Florida, is scheduled to expire on June 30, 2006. Due to Medicaid reform in Florida, we are currently negotiating the terms and rates for the renewal contract. We expect the current contract to be extended until August 31, 2006, and the subsequent renewal contract to be effective for a two-year term beginning September 1, 2006. Due to continual decreases in the reimbursement from the state of Illinois, we exited the Illinois Medicaid market effective July 31, 2005. The Illinois and Florida Medicaid contracts accounted for approximately 1% of our total premiums and ASO fees for the year ended December 31, 2005.

Other than as described herein, the loss of any of the contracts above or significant changes in these programs as a result of legislative action, including reductions in premium payments to us, or increases in member benefits without corresponding increases in premium payments to us, may have a material adverse effect on our financial position, results of operations, and cash flows.

Legal Proceedings

We are party to a variety of legal actions in the ordinary course of business, including employment matters, breach of contract actions, tort claims, and shareholder suits involving alleged securities fraud. A description of material legal actions in which we are currently involved is included under "Legal Proceedings" of Item 3 in Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Form 10-K"). We cannot predict the outcome of these suits with certainty, and we are incurring expenses in defense of these matters. In addition, recent court decisions and legislative activity may increase our exposure for any of these types of claims. Therefore, these legal actions could have a material adverse effect on our financial position, results of operations and cash flows.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements and accompanying notes, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements and accompanying notes requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We continuously evaluate our estimates and those critical accounting policies related primarily to medical cost and revenue recognition as well as accounting for impairments related to our investment securities, goodwill, and long-lived assets. These estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results ultimately may differ from those estimates. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Medical Expense Recognition

Medical expenses are recognized in the period in which services are provided and include an estimate of the cost of services which have been incurred but not yet reported, or IBNR. IBNR represents a substantial portion of our medical and other expenses payable as follows:

	December 31, 2005	Percentage of Total	December 31, 2004	Percentage of Total
	(dollars in thousands)			
IBNR	$ 1,483,902	77.7%	$ 1,164,518	81.9%
Reported claims in process	83,635	4.4	97,801	6.9
Other medical expenses payable	342,145	17.9	159,691	11.2
Total medical and other expenses payable	$ 1,909,682	100.0%	$ 1,422,010	100.0%

Estimating IBNR is complex and involves a significant amount of judgment. Accordingly, it represents a critical accounting estimate. Changes in this estimate can materially affect, either favorably or unfavorably, our results from operations and overall financial position. For example, a 100 basis point, or 1 percent, change in the estimate of our medical and other expenses payable at December 31, 2005, which represents approximately 44% of total liabilities, would require an adjustment of approximately $19 million in a future period in which a revision in the estimate became known.

We develop our estimate for IBNR using actuarial methodologies and assumptions, primarily based upon historical claim payment and claim receipt patterns, as well as historical medical cost trends. Depending on the period for which incurred claims are estimated, we apply a different method in determining our estimate. For periods prior to the most recent three months, the key assumption used in estimating our IBNR is that the completion factor pattern remains consistent over a rolling 12-month period after adjusting for known changes in claim inventory levels and known changes in claim payment processes. Completion factors result from the calculation of the percentage of claims incurred during a given period that have historically been adjudicated as of the reporting period. For the most recent three months, the incurred claims are estimated primarily from a trend analysis based upon per member per month claims trends developed from our historical experience in the preceding months, adjusted for known changes in estimates of recent hospital and drug utilization data, provider contracting changes, changes in benefit levels, product mix, and weekday seasonality.

The completion factor method is used for the months of incurred claims prior to the most recent three months because the historical percentage of claims processed for those months is at a level sufficient to produce a consistently reliable result. Conversely, for the most recent three months of incurred claims, the volume of claims processed historically is not at a level sufficient to produce a reliable result, which therefore requires us to examine historical trend patterns as the primary method of evaluation.

Medical cost trends potentially are more volatile than other segments of the economy. The drivers of medical cost trends include increases in the utilization of hospital facilities, physician services, prescription drugs, and new medical technologies, as well as the inflationary effect on the cost per unit of each of these expense components. Other external factors such as government-mandated benefits or other regulatory changes, increases in medical services capacity, direct to consumer advertising for prescription drugs and medical services, an aging population, catastrophes, and epidemics also may impact medical cost trends. Internal factors such as system conversions, claims processing cycle times, changes in medical management practices and changes in provider contracts also may impact our ability to accurately predict estimates of historical completion factors or medical cost trends. All of these factors are considered in estimating IBNR and in estimating the per member per month claims trend for purposes of determining the reserve for the most recent three months. Additionally, we continually prepare and review follow-up studies to assess the reasonableness of the estimates generated by our process and methods over time. The results of these studies are also considered in determining the reserve for the most recent three months. Each of these factors requires significant judgment by management.

The completion and claims per member per month trend factors are the most significant factors impacting the IBNR estimate. The following table illustrates the sensitivity of these factors and the estimated potential impact on our operating results caused by changes in these factors based on December 31, 2005 data:

Completion Factor (a):		Claims Trend Factor (b):	
(Decrease) Increase in Factor	Increase (Decrease) in Medical and Other Expenses Payable	(Decrease) Increase in Factor	(Decrease) Increase in Medical and Other Expenses Payable
		(dollars in thousands)	
(3%)	$ 183,000	(3%)	$ (68,000)
(2%)	$ 117,000	(2%)	$ (44,000)
(1%)	$ 56,000	(1%)	$ (21,000)
1%	$ (53,000)	1%	$ 26,000
2%	$ (102,000)	2%	$ 49,000
3%	$ (150,000)	3%	$ 73,000

(a) Reflects estimated potential changes in medical and other expenses payable caused by changes in completion factors for incurred months prior to the most recent three months.

(b) Reflects estimated potential changes in medical and other expenses payable caused by changes in annualized claims trend used for the estimation of per member per month incurred claims for the most recent three months.

Most medical claims are paid within a few months of the member receiving service from a physician or other health care provider. As a result, these liabilities generally are described as having a "short-tail", which causes less than 2% of our medical and other expenses payable as of the end of any given period to be outstanding for more than 12 months. As such, we expect that substantially all of the December 31, 2005 estimate of medical and other expenses payable will be known and paid during 2006.

Our reserving practice is to consistently recognize the actuarial best point estimate within a level of confidence required by actuarial standards. Actuarial standards of practice generally require a level of confidence such that the liabilities established for IBNR have a greater probability of being adequate versus being insufficient, or such that the liabilities established for IBNR are sufficient to cover obligations under an assumption of moderately adverse conditions. Adverse conditions are situations in which the actual claims are expected to be higher than the otherwise estimated value of such claims at the time of the estimate. Therefore, in many situations, the claim amounts ultimately settled will be less than the estimate that satisfies the actuarial standards of practice.

IBNR established in connection with our TRICARE contracts is typically more difficult to estimate than for our other operations, because there are more variables that impact the estimate. These additional variables include continual changes in the number of eligible beneficiaries, changes in the utilization of military treatment facilities and changes in levels of benefits versus the original contract provisions. Many of these variables are impacted by an increase or decrease in military activity involving the United States armed forces. We have considered all of these factors in establishing our IBNR estimate. Each of these factors requires significant judgment by management.

Our TRICARE contract contains risk-sharing provisions with the Department of Defense and with subcontractors, which effectively limit profits and losses when actual claim experience varies from the targeted medical claim amount negotiated in our annual bid. As a result of these contract provisions, the impact of changes in estimates for prior year TRICARE medical claims payable on our results of operations is reduced substantially, whether positive or negative.

We have a significant percentage of our Medicare and Medicaid membership under risk-sharing arrangements with providers. Accordingly, the impact of changes in estimates for prior year medical claims payable on our results from operations that are attributable to our Medicare and Medicaid lines of business may also be significantly reduced, whether positive or negative.

The following table provides a reconciliation of changes in medical and other expenses payable for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
		(in thousands)	
Balances at January 1	$ 1,422,010	$ 1,272,156	$ 1,142,131
Acquisitions	37,375	71,063	—
Incurred related to:			
Current year	11,765,662	10,763,105	9,955,491
Prior years	(114,192)	(93,458)	(76,070)
Total incurred	11,651,470	10,669,647	9,879,421
Paid related to:			
Current year	(9,979,449)	(9,504,331)	(8,710,393)
Prior years	(1,221,724)	(1,086,525)	(1,039,003)
Total paid	(11,201,173)	(10,590,856)	(9,749,396)
Balances at December 31	$ 1,909,682	$ 1,422,010	$ 1,272,156

Amounts incurred related to prior years vary from previously estimated liabilities as the claims ultimately are settled. Negative amounts reported for incurred related to prior years result from claims being ultimately settled for amounts less than originally estimated (favorable development).

As summarized in the previous table, claim reserve balances at December 31, 2004 ultimately settled during 2005 for $114.2 million less than the amounts originally estimated, representing 1.1% of medical claim expenses recorded in 2004. During 2004, claim reserve balances at December 31, 2003 ultimately settled for $93.5 million less than the amounts originally estimated, representing 0.9% of medical claim expenses recorded in 2003. This $20.7 million change in the amounts incurred related to prior years for 2005 as compared to 2004 resulted primarily from favorable development in our TRICARE line of business as a result of less than expected utilization in the latter half of 2004.

During 2003, claim reserve balances at December 31, 2002 ultimately settled during 2003 for $76.1 million less than the amounts originally estimated, representing 0.8% of medical claim expenses recorded in 2002. The $17.4 million change in the amounts incurred related to prior years for 2004 as compared to 2003 resulted primarily from favorable development in our Medicare line of business as a result of less than expected utilization in the latter half of 2003.

Revenue Recognition

We generally establish one-year contracts with commercial employer groups, subject to cancellation by the employer group on 30-day written notice. Our commercial contracts establish rates on a per member basis for each month of coverage.

Our contracts with federal or state governments are generally multi-year contracts subject to annual renewal provisions with the exception of our Medicare Advantage and PDP contracts with the federal government which renew annually. Except for TRICARE contracts discussed in the following section, our government contracts also establish monthly rates per member but may have additional amounts due to us based on items such as age, working status, or specific health issues of the member. For example, CMS has implemented a risk adjustment model which apportions premiums paid to all health plans according to health severity.

The CMS risk adjustment model pays more for members with predictably higher costs, as more fully described in Item 1 of the 2005 Form 10-K (on page 5). Under this risk adjustment methodology, diagnosis data from inpatient and ambulatory treatment settings are used to calculate the risk adjusted premium payment to us. We collect, capture, and submit the necessary diagnosis data to CMS within prescribed deadlines. We estimate risk adjustment revenues based upon the diagnosis data submitted to CMS and ultimately accepted by CMS.

CMS is transitioning to the risk adjustment model while the old demographic model is phased out. The demographic model based the monthly premiums paid to health plans on factors such as age, sex and disability status. The monthly premium amount for each member is separately determined under both the risk adjustment and demographic model. These separate payment amounts are then blended according to the transition schedule. CMS is transitioning to the risk adjustment model for Medicare Advantage plans as follows: 50% in 2005, 75% in 2006 and 100% in 2007. The PDP payment methodology is based 100% on the risk adjustment model beginning in 2006. As a result of this process and the phasing in of the risk adjustment model, as well as budget neutrality as described in Item 1 of the 2005 Form 10-K (on page 5), our CMS monthly premium payments per member may change materially, either favorably or unfavorably.

Premium revenues and ASO fees are estimated by multiplying the membership covered under the various contracts by the contractual rates. In addition, we adjust revenues for estimated changes in an employer's enrollment and customers that ultimately may fail to pay. Enrollment changes not yet reported by an employer group, an individual, or the government, also known as retroactive membership adjustments, are estimated based on historical trends. We monitor the collectibility of specific accounts, the aging of receivables, as well as prevailing and anticipated economic conditions, and reflect any required adjustments in the current period's revenue.

We bill and collect premium and ASO fee remittances from employer groups, the federal and state governments, and individual Medicare Advantage members monthly. Premium and ASO fee receivables are presented net of allowances for estimated uncollectible accounts and retroactive membership adjustments. Premiums and ASO fees received prior to the period members are entitled to receive services are recorded as unearned revenues.

TRICARE Contract

In 2005, TRICARE revenues represented 17% of total premiums and administrative services fees. The single TRICARE contract for the South Region includes multiple revenue generating activities and as such was evaluated under Emerging Issues Task Force (EITF) Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. We allocate the consideration to the various components based on the relative fair values of the components. TRICARE revenues consist generally of (1) an insurance premium for assuming underwriting risk for the cost of civilian health care services delivered to eligible beneficiaries; (2) health care services provided to beneficiaries which are in turn reimbursed by the federal government; and (3) administrative service fees related to claim processing, customer service, enrollment, disease management and other services. We recognize the insurance premium as revenue ratably over the period coverage is provided. Health care services reimbursements are recognized as revenue in the period health care services are provided. Administrative service fees are recognized as revenue in the period services are performed.

The TRICARE contract contains provisions whereby the federal government bears a substantial portion of the risk associated with financing the cost of health benefits. Annually, we negotiate a target health care cost amount, or target cost, with the federal government and determine an underwriting fee. Any variance from the target cost is shared. We earn more revenue or incur additional costs based on the variance in actual health care costs versus the negotiated target cost. We receive 20% for any cost underrun, subject to a ceiling that limits the underwriting profit to 10% of the target cost. We pay 20% for any cost overrun, subject to a floor that limits the underwriting loss to negative 4% of the target cost. A final settlement occurs 12 to 18 months after the end of each contract year to which it applies. We defer the recognition of any revenues for favorable contingent underwriting fee adjustments related to cost underruns until the amount is determinable and the collectibility is reasonably assured. We estimate and recognize unfavorable contingent underwriting fee adjustments related to cost overruns currently in operations as an increase in medical expenses. We continually review these medical expense estimates of future payments to the government for cost overruns and make necessary adjustments to our reserves.

The TRICARE contract contains provisions to negotiate change orders. Change orders occur when we perform services or incur costs under the directive of the federal government that were not originally specified in our contract. Under federal regulations we may be entitled to an equitable adjustment to the contract price in these situations. Change orders may be negotiated and settled at any time throughout the year. We record revenue applicable to change orders when services are performed and these amounts are determinable and collectibility is reasonably assured.

Our former TRICARE contracts for Regions 3 and 4 and Regions 2 and 5, which expired during 2004, contained provisions not only for change orders but for bid price adjustments, or BPAs, as well. There are no provisions for BPAs in our current TRICARE contract. BPAs were utilized to retroactively adjust revenues for the impact of the items for which the federal government retains risk, including the risks associated with changes in usage levels at military treatment facilities, or MTFs, change in the number of persons eligible for TRICARE benefits, and medical unit cost inflation. We worked closely with the federal government to obtain and review eligibility and MTF workload data, and to quantify and negotiate amounts recoverable or payable under our contractual BPA requirements. Final settlement of BPAs occurred only at specified intervals, typically in excess of 6 months after the end of a contract year. We recorded revenues applicable to BPAs when these amounts were determinable and collectibility was reasonably assured.

Investment Securities

Investment securities totaled $2,745.9 million, or 40% of total assets at December 31, 2005. Debt securities totaled $2,720.8 million, or 99% of this investment portfolio. More than 97% of our debt securities were of investment-grade quality, with an average credit rating of AA+ by S&P at December 31, 2005. Most of the debt securities that are below investment grade are rated at the higher end (BB or better) of the non-investment grade spectrum. Our investment policy limits investments in a single issuer and requires diversification among various asset types.

Duration is indicative of the relationship between changes in market value and changes in interest rates, providing a general indication of the sensitivity of the fair values of our debt securities to changes in interest rates. However, actual market values may differ significantly from estimates based on duration. The average duration of our debt securities was approximately 3.4 years at December 31, 2005. Based on this duration, a 1% increase in interest rates would generally decrease the fair value of our debt securities by approximately $90 million.

Our investment securities are categorized as available for sale and, as a result, are stated at fair value. Fair value of publicly traded debt and equity securities are based on quoted market prices. Non-traded debt securities are priced independently by a third party vendor. Fair value of venture capital debt securities that are privately held are estimated using a variety of valuation methodologies where an observable quoted market price does not exist. Such methodologies include reviewing the value ascribed to the most recent financing, comparing the security with securities of publicly traded companies in a similar line of business, and reviewing the underlying financial performance including estimating discounted cash flows. Unrealized holding gains and losses, net of applicable deferred taxes, are included as a component of stockholders' equity and comprehensive income until realized from a sale or impairment.

Gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2005, included the following:

	Less than 12 months		12 months or more		Total	
2005	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(in thousands)			
U.S. Government obligations	$ 611,683	$ (3,790)	$ 272,176	$ (8,481)	$ 883,859	$ (12,271)
Tax exempt municipal securities	470,477	(4,846)	258,825	(7,914)	729,302	(12,760)
Corporate and other securities	248,016	(4,932)	131,166	(4,867)	379,182	(9,799)
Mortgage-backed securities	51,921	(742)	36,987	(2,225)	88,908	(2,967)
Redeemable preferred stocks	—	—	6,862	(338)	6,862	(338)
Debt securities	1,382,097	(14,310)	706,016	(23,825)	2,088,113	(38,135)
Non-redeemable preferred stocks	4,409	(37)	5,477	(206)	9,886	(243)
Total investment securities	$ 1,386,506	$ (14,347)	$ 711,493	$ (24,031)	$ 2,097,999	$ (38,378)

We regularly evaluate our investment securities for impairment. We consider factors affecting the issuer, factors affecting the industry the issuer operates within, and general debt and equity market trends. We consider the length of time an investment's fair value has been below carrying value, the severity of the decline, the near term prospects for recovery to carrying value and our intent and ability to hold the investment until maturity or market recovery is realized. If and when a determination is made that a decline in fair value below the cost basis is other than temporary, the related investment is written down to its estimated fair value through a charge to earnings. The risks inherent in assessing the impairment of an investment include the risk that market factors may differ from our expectations; facts and circumstances factored into our assessment may change with the passage of time; or we may decide to subsequently sell the investment. The determination of whether a decline in the value of an investment is other than temporary requires us to exercise significant diligence and judgment. The discovery of new information and the passage of time can significantly change these judgments. The status of the general economic environment and significant changes in the national securities markets influence the determination of fair value and the assessment of investment impairment.

Unrealized losses at December 31, 2005 resulted from 447 positions out of a total of 731 positions held. Approximately 26% of the carrying value of our consolidated investment securities have been in an unrealized loss position greater than one year. The unrealized losses at December 31, 2005 primarily were caused by increases in interest rates. All issuers of securities trading at an unrealized loss remain current on all contractual payments and we believe it is probable that we will be able to collect all amounts due according to the contractual terms of the debt securities. After taking into account these and other factors, including the severity of the decline and our ability and intent to hold these securities until recovery or maturity, we determined the unrealized losses on these investment securities were temporary and, as such, no impairment was required.

There were no impairment losses recorded in 2005 or 2004. We recorded $3.2 million in 2003 after an evaluation indicated that a decline in fair value below the cost basis was other than temporary.

Goodwill and Long-lived Assets

At December 31, 2005, goodwill and other long-lived assets represented 27% of total assets and 74% of total stockholders' equity.

SFAS No. 142, *Goodwill and Other Intangible Assets*, requires that we not amortize goodwill to earnings, but instead that we test goodwill at least annually for impairment at a level of reporting referred to as the reporting unit and more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. A reporting unit is one level below our Commercial and Government segments. The Commercial segment's two reporting units consist of fully and self-insured medical and specialty. The Government segment's three reporting units consist of Medicare Advantage, TRICARE and Medicaid. Goodwill is assigned to the reporting unit that is expected to benefit from a specific acquisition.

Our strategy, long-range business plan, and annual planning process support our goodwill impairment tests. These tests are based primarily on an evaluation of future discounted cash flows under several scenarios. We used a range of discount rates that correspond to our weighted-average cost of capital. Key assumptions including changes in membership, premium yields, medical cost trends and certain government contract extensions are consistent with those utilized in our long-range business plan and annual planning process. If these assumptions differ from actual, the estimates underlying our goodwill impairment tests could be adversely affected. Goodwill impairment tests completed in each of the last three years did not result in an impairment loss.

Long-lived assets consist of property and equipment and other finite-lived intangible assets. These assets are depreciated or amortized over their estimated useful life, and are subject to impairment reviews. We periodically review long-lived assets whenever adverse events or changes in circumstances indicate the carrying value of the asset may not be recoverable. In assessing recoverability, we must make assumptions regarding estimated future cash flows and other factors to determine if an impairment loss may exist, and, if so, estimate fair value. We also must estimate and make assumptions regarding the useful life we assign to our long-lived assets. If these estimates or their related assumptions change in the future, we may be required to record impairment losses or change the useful life, including accelerating depreciation for these assets. There were no impairment losses in 2005. We recognized losses due to impairment and accelerated depreciation from changes in estimated useful life of $9.3 million in 2004 and $30.8 million in 2003. See Note 5 to the consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K.

Exhibit 99.3

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA WITH RETROSPECTIVE APPLICATION OF SFAS 123R

Financial statements and supplementary data set forth in this Exhibit 99.3 have been revised from the financial statements and supplementary data included in Item 8 to Humana's Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Form 10-K") to reflect the retrospective application of Humana's adoption of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R. Financial statements and supplementary data set forth below have not been revised to reflect events or developments subsequent to March 3, 2006, the date that Humana filed the 2005 Form 10-K. Revisions are highlighted in blue. For a discussion of events and developments subsequent to the filing date of the 2005 Form 10-K, please refer to the reports and other information Humana has filed with the Securities and Exchange Commission since that date, including Humana's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006.

Humana Inc.
CONSOLIDATED BALANCE SHEETS

	December 31, 2005	December 31, 2004
	(in thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 732,016	$ 580,079
Investment securities	2,354,904	2,145,645
Receivables, less allowance for doubtful accounts of $32,557 in 2005 and $34,506 in 2004:		
Premiums	723,190	554,661
Administrative services fees	15,462	24,954
Securities lending collateral	47,610	77,840
Other	333,004	212,958
Total current assets	4,206,186	3,596,137
Property and equipment, net	484,412	399,506
Other assets:		
Long-term investment securities	391,035	348,465
Goodwill	1,264,575	885,572
Other	523,406	427,937
Total other assets	2,179,016	1,661,974
Total assets	$ 6,869,614	$ 5,657,617
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Medical and other expenses payable	$ 1,909,682	$ 1,422,010
Trade accounts payable and accrued expenses	560,550	488,332
Book overdraft	280,005	192,060
Securities lending payable	47,610	77,840
Unearned revenues	120,489	146,326
Current portion of long-term debt	301,254	—
Total current liabilities	3,219,590	2,326,568
Long-term debt	513,790	636,696
Other long-term liabilities	627,360	570,105
Total liabilities	4,360,740	3,533,369
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $1 par; 10,000,000 shares authorized; none issued	—	—
Common stock, $0.16 2/3 par; 300,000,000 shares authorized; 179,062,807 shares issued in 2005 and 176,044,649 shares issued in 2004	29,843	29,340
Capital in excess of par value	1,235,888	1,154,437
Retained earnings	1,421,675	1,124,945
Accumulated other comprehensive income	24,832	16,526
Treasury stock, at cost, 15,846,384 shares in 2005 and 15,778,088 shares in 2004	(203,364)	(201,000)
Total stockholders' equity	2,508,874	2,124,248
Total liabilities and stockholders' equity	$ 6,869,614	$ 5,657,617

The accompanying notes are an integral part of the consolidated financial statements.

Humana Inc.
CONSOLIDATED STATEMENTS OF INCOME

	For the year ended December 31,		
	2005	2004	2003
	(in thousands, except per share results)		
Revenues:			
Premiums	$ 14,001,591	$ 12,689,432	$ 11,825,283
Administrative services fees	259,437	272,796	271,676
Investment and other income	157,099	142,097	129,352
Total revenues	14,418,127	13,104,325	12,226,311
Operating expenses:			
Medical	11,651,470	10,669,647	9,879,421
Selling, general and administrative	2,195,604	1,894,336	1,866,531
Depreciation and amortization	128,858	117,792	126,779
Total operating expenses	13,975,932	12,681,775	11,872,731
Income from operations	442,195	422,550	353,580
Interest expense	39,315	23,172	17,367
Income before income taxes	402,880	399,378	336,213
Provision for income taxes	106,150	129,431	112,474
Net income	$ 296,730	$ 269,947	$ 223,739
Basic earnings per common share	$ 1.83	$ 1.68	$ 1.41
Diluted earnings per common share	$ 1.79	$ 1.66	$ 1.38

The accompanying notes are an integral part of the consolidated financial statements.

Humana Inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
	Issued Shares	Amount					
				(in thousands)			
Balances, January 1, 2003	171,335	$ 28,556	$ 1,048,832	$ 631,259	$ 22,455	$ (89,987)	$ 1,641,115
Comprehensive income:							
Net income	—	—	—	223,739	—	—	223,739
Other comprehensive loss:							
Net unrealized investment losses, net of $(3,531) tax	—	—	—	—	(5,546)	—	(5,546)
Comprehensive income							218,193
Common stock repurchases	—	—	—	—	—	(44,147)	(44,147)
Restricted stock forfeitures	(72)	(13)	13	—	—	—	—
Stock option exercises	2,646	441	27,598	—	—	—	28,039
Stock option and restricted stock tax benefit	—	—	10,932	—	—	—	10,932
Other stock compensation	—	—	14,682	—	—	158	14,840
Balances, December 31, 2003	173,909	28,984	1,102,057	854,998	16,909	(133,976)	1,868,972
Comprehensive income:							
Net income	—	—	—	269,947	—	—	269,947
Other comprehensive loss:							
Net unrealized investment losses, net of $(243) tax	—	—	—	—	(383)	—	(383)
Comprehensive income							269,564
Common stock repurchases	—	—	—	—	—	(67,024)	(67,024)
Restricted stock grants	37	6	—	—	—	—	6
Stock option exercises	2,099	350	29,613	—	—	—	29,963
Stock option and restricted stock tax benefit	—	—	2,275	—	—	—	2,275
Other stock compensation	—	—	20,492	—	—	—	20,492
Balances, December 31, 2004	176,045	29,340	1,154,437	1,124,945	16,526	(201,000)	2,124,248
Comprehensive income:							
Net income	—	—	—	296,730	—	—	296,730
Other comprehensive income:							
Net unrealized investment gains, net of $4,441 tax	—	—	—	—	8,306	—	8,306
Comprehensive income							305,036
Common stock repurchases	—	—	—	—	—	(2,364)	(2,364)
Restricted stock grants	525	88	(83)	—	—	—	5
Restricted stock forfeitures	(16)	(3)	3	—	—	—	—
Stock option exercises	2,509	418	35,960	—	—	—	36,378
Stock option and restricted stock tax benefit	—	—	15,418	—	—	—	15,418
Other stock compensation	—	—	30,153	—	—	—	30,153
Balances, December 31, 2005	179,063	$ 29,843	$ 1,235,888	$ 1,421,675	$ 24,832	$ (203,364)	$ 2,508,874

The accompanying notes are an integral part of the consolidated financial statements.

Humana Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended December 31,		
	2005	2004	2003
	(in thousands)		
Cash flows from operating activities			
Net income	$ 296,730	$ 269,947	$ 223,739
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	128,858	117,792	126,779
Stock-based compensation	30,153	20,492	14,840
Loss (gain) on sale of property and equipment, net	152	(935)	298
Gain on sale of investment securities, net	(18,323)	(28,206)	(36,651)
(Benefit) provision for deferred income taxes	(39,007)	52,507	33,869
Provision for doubtful accounts	4,566	6,433	7,416
Writedown of property and equipment	—	—	17,233
Changes in operating assets and liabilities excluding the effects of acquisitions:			
Receivables	(161,314)	(51,058)	(22,636)
Other assets	(63,962)	3,991	25,110
Medical and other expenses payable	450,297	78,791	130,025
Other liabilities	25,617	56,678	(127,577)
Unearned revenues	(45,610)	(190,759)	(2,686)
Other	1,925	8,388	8,162
Net cash provided by operating activities	610,082	344,061	397,921
Cash flows from investing activities			
Acquisitions, net of cash acquired	(402,844)	(141,810)	—
Purchases of property and equipment	(165,846)	(114,096)	(101,268)
Proceeds from sales of property and equipment	4,497	30,491	11,182
Purchases of investment securities	(3,717,916)	(4,106,210)	(4,572,577)
Maturities of investment securities	1,761,588	1,015,144	769,436
Proceeds from sales of investment securities	1,723,015	2,683,749	3,520,064
Change in securities lending collateral	30,230	8,651	(9,674)
Net cash used in investing activities	(767,276)	(624,081)	(382,837)
Cash flows from financing activities			
Borrowings under credit agreement	494,000	—	—
Repayments under credit agreement	(294,000)	—	—
Net conduit commercial paper (repayments) borrowings	—	—	(265,000)
Proceeds from issuance of senior notes	—	—	299,139
Proceeds from swap exchange	—	—	31,556
Debt issue costs	—	(1,954)	(3,331)
Change in book overdraft	87,945	(26,994)	124,172
Change in securities lending payable	(30,230)	(8,651)	9,674
Common stock repurchases	(2,364)	(67,024)	(44,147)
Tax benefit from stock-based compensation	15,545	3,748	15,219
Proceeds from stock option exercises and other	38,235	29,570	27,681
Net cash provided by (used in) financing activities	309,131	(71,305)	194,963
Increase (decrease) in cash and cash equivalents	151,937	(351,325)	210,047
Cash and cash equivalents at beginning of year	580,079	931,404	721,357
Cash and cash equivalents at end of year	$ 732,016	$ 580,079	$ 931,404
Supplemental cash flow disclosures:			
Interest payments	$ 45,258	$ 30,779	$ 18,096
Income tax payments, net	$ 179,300	$ 51,086	$ 59,622
Details of businesses acquired in purchase transactions:			
Fair value of assets acquired, net of cash acquired	$ 508,443	$ 243,422	
Less: Fair value of liabilities assumed	(105,599)	(101,612)	
Cash paid for acquired businesses, net of cash acquired	$ 402,844	$ 141,810	

The accompanying notes are an integral part of the consolidated financial statements.

Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. REPORTING ENTITY

Nature of Operations

Headquartered in Louisville, Kentucky, Humana Inc. is one of the nation's largest publicly traded health benefits companies, based on our 2005 revenues of $14.4 billion. References throughout this document to "we," "us," "our," "Company," and "Humana," mean Humana Inc. and its subsidiaries. We offer coordinated health insurance coverage and related services through a variety of traditional and Internet-based plans for employer groups, government-sponsored programs, and individuals. We derived approximately 51% of our premiums and administrative services fees from contracts with the federal government in 2005. Under a federal government contract with the Department of Defense, we provide health insurance coverage to TRICARE members, accounting for approximately 17% of our total premiums and administrative services fees in 2005. Under our federal government contracts with the Centers for Medicare and Medicaid Services, or CMS, we provide health insurance coverage for Medicare Advantage members in Florida, accounting for approximately 20% of our total premiums and administrative services fees in 2005.

We manage our business with two segments: Government and Commercial. The Government segment consists of members enrolled in government-sponsored programs, and includes three lines of business: Medicare Advantage, TRICARE, and Medicaid. The Commercial segment consists of members enrolled in products marketed to employer groups and individuals, and includes three lines of business: fully insured medical, administrative services only, or ASO, and specialty. We identified our segments in accordance with the aggregation provisions of SFAS 131, which is consistent with information used by our Chief Executive Officer in managing our business. The segment information aggregates products with similar economic characteristics. These characteristics include the nature of customer groups and pricing, benefits and underwriting requirements.

The accounting policies of each segment are the same and are described in Note 2. The results of each segment are measured by income before income taxes. We allocate all selling, general and administrative expenses, investment and other income, interest expense, and goodwill, but no other assets or liabilities, to our segments. Members served by our two segments often utilize the same medical provider networks, enabling us to obtain more favorable contract terms with providers. Our segments also share overhead costs and assets. As a result, the profitability of each segment is interdependent.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Our financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Our consolidated financial statements include the accounts of Humana Inc., and subsidiaries that the Company controls. All significant intercompany balances and transactions have been eliminated.

The preparation of financial statements in accordance with generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The areas involving the most significant use of estimates are the estimation of medical expenses payable, the impact of risk sharing provisions related to our TRICARE and Medicare contracts, the valuation and related impairment recognition of investment securities, and the valuation and related impairment recognition of long-lived assets, including goodwill. These estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash, time deposits, money market funds, commercial paper, other money market instruments, and certain U.S. Government securities with an original maturity of three months or less. Carrying value approximates fair value due to the short-term maturity of the investments.

Investment Securities

Investment securities, which consist primarily of debt securities, have been categorized as available for sale and, as a result, are stated at fair value. Fair value of publicly traded debt and equity securities are based on quoted market prices. Non-traded debt securities are priced independently by a third party. Fair value of venture capital debt securities that are privately held are estimated using a variety of valuation methodologies where an observable quoted market price does not exist. Such methodologies include reviewing the value ascribed to the most recent financing, comparing the security with securities of publicly traded companies in a similar line of business, and reviewing the underlying financial performance including estimating discounted cash flows. Investment securities available for current operations are classified as current assets. Investment securities available for our professional liability and long-term insurance product funding requirements, as well as restricted statutory deposits and venture capital investments, are classified as long-term assets. Unrealized holding gains and losses, net of applicable deferred taxes, are included as a component of stockholders' equity and comprehensive income until realized from a sale or impairment.

For the purpose of determining gross realized gains and losses, which are included as a component of investment and other income in the consolidated statements of income, the cost of investment securities sold is based upon specific identification. We regularly evaluate our investment securities for impairment. We consider factors affecting the issuer, factors affecting the industry the issuer operates within, and general debt and equity market trends. We consider the length of time an investment's fair value has been below carrying value, the severity of the decline, the near term prospects for recovery to carrying value, and our intent and ability to hold the investment until maturity or market recovery is realized. If and when a determination is made that a decline in fair value below the cost basis is other than temporary, the related investment is written down to its estimated fair value through a charge to earnings.

We participate in a securities lending program to maximize investment income. We loan certain investment securities for short periods of time in exchange for collateral initially equal to at least 102% of the fair value of the investment securities on loan. The fair value of the loaned investment securities is monitored on a daily basis, with additional collateral obtained or refunded as the fair value of the loaned investment securities fluctuates. The collateral, which may be in the form of cash or U.S. Government securities, is deposited by the borrower with an independent lending agent. Any cash collateral is invested by the lending agent according to our investment guidelines, primarily in cash equivalents or other liquid investments. Cash collateral is recorded on our consolidated balance sheet, along with a liability to reflect our obligation to return the collateral. Collateral received in the form of securities is not recorded in our consolidated balance sheet because we do not have the right to sell, pledge or otherwise reinvest securities collateral. Loaned securities continue to be carried as investment securities on the consolidated balance sheets. Revenue, net of related expense, is recorded as investment income.

Receivables and Revenue Recognition

We generally establish one-year commercial membership contracts with employer groups, subject to cancellation by the employer group on 30-day written notice. Our TRICARE contract with the federal government and our contracts with various state Medicaid programs generally are multi-year contracts subject to annual renewal provisions. Our Medicare Advantage contracts with the federal government renew annually.

We bill and collect premium and administrative fee remittances from employer groups and some individual Medicare Advantage members monthly. We receive monthly premiums and administrative fees from the federal government and various states according to government specified reimbursement rates and various contractual terms. Changes in revenues from CMS for our Medicare products resulting from the periodic changes in risk adjustment scores for our membership are recognized when the amounts become determinable and the collectibility is reasonably assured.

Premium revenues are recognized as income in the period members are entitled to receive services, and are net of estimated uncollectible amounts and retroactive membership adjustments. Retroactive membership adjustments result from enrollment changes not yet processed, or not yet reported by an employer group or the government. We routinely monitor the collectibility of specific accounts, the aging of receivables, historical retroactivity trends, as well as prevailing and anticipated economic conditions, and reflect any required adjustments in current operations.

We account for the TRICARE South Region contract under EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables,* and as such allocate the consideration to the various components of the contract based on the relative fair value of the components. TRICARE revenues consist generally of (1) an insurance premium for assuming underwriting risk for the cost of civilian health care services delivered to eligible beneficiaries; (2) health care services provided to beneficiaries which are in turn reimbursed by the federal government; and (3) administrative service fees related to claim processing, customer service, enrollment, disease management and other services. We recognize the insurance premium as revenue ratably over the period coverage is provided. Health care services reimbursements are recognized as revenue in the period health services are provided. Administrative services fees are recognized as revenue in the period services are performed. Our TRICARE South contract contains provisions to share the risk associated with financing the cost of health benefits with the federal government. We earn more revenue or incur additional costs based on the variance of actual health care costs versus a negotiated target cost. We defer the recognition of any contingent revenues for favorable variances until the amount is determinable and the collectibility is reasonably assured. We estimate and recognize contingent medical expense for unfavorable variances currently in our results of operations. We continually review the contingent medical expense estimates of future payments to the government for cost overruns and make necessary adjustments to our reserves.

Revenues also may include change orders and bid price adjustments attributable to our TRICARE contracts. Change orders represent equitable adjustments for services not originally specified in the contracts. Bid price adjustments, or BPAs, represent adjustments defined in our former contracts subject to negotiations with the federal government. Revenues for these adjustments are recognized when a settlement amount becomes determinable and the collectibility is reasonably assured.

ASO fees are recognized as income in the period services are performed. Administrative services fees cover the processing of claims, offering access to our provider networks and clinical programs, and responding to customer service inquiries from members of self-funded groups. Under ASO contracts, self-funded employers retain the risk of financing substantially all of the cost of health benefits. However, most ASO customers purchase stop loss insurance coverage from us to cover catastrophic claims or to limit aggregate annual costs. Accordingly, we have recorded premiums and medical expenses related to these stop loss arrangements.

Premium and ASO fee receivables are shown net of allowances for estimated uncollectible accounts and retroactive membership adjustments. Premiums and ASO fees received prior to the service period are recorded as unearned revenues.

Policy Acquisition Costs

Policy acquisition costs are those costs that vary with and primarily are related to the acquisition of new and renewal business. Such costs include broker commissions, costs of policy issuance and underwriting, and other costs we incur to acquire new business or renew existing business. We expense policy acquisition costs related to our employer-group prepaid health services policies as incurred in accordance with the *Health Care Organization Audit and Accounting Guide*. These short-duration employer-group prepaid health services policies typically have a one-year term and may be cancelled upon 30 days notice by the employer group.

Our health and life policies sold to individuals, when aggregated as a block of policies, are expected to remain in force for an extended period beyond one year because, by law, these contracts are guaranteed renewable. Accordingly, we account for these policies as long-duration insurance products under the provisions of SFAS No. 60, *Accounting and Reporting by Insurance Enterprises,* or SFAS 60. As a result, we defer policy acquisition costs and amortize them over the estimated life of the policies in proportion to premiums earned. Deferred acquisition costs are regularly reviewed to determine if they are recoverable from future income.

Long-Lived Assets

Property and equipment is recorded at cost. Gains and losses on sales or disposals of property and equipment are included in administrative expense. Certain costs related to the development or purchase of internal-use software are capitalized in accordance with AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Depreciation is computed using the straight-line method over estimated useful lives ranging from 3 to 10 years for equipment, 3 to 7 years for computer software, and 20 to 40 years for buildings. Improvements to leased facilities are depreciated over the shorter of the remaining lease term or the anticipated life of the improvement.

We periodically review long-lived assets, including property and equipment and other intangible assets, for impairment whenever adverse events or changes in circumstances indicate the carrying value of the asset may not be recoverable. Losses are recognized for a long-lived asset to be held and used in our operations when the undiscounted future cash flows expected to result from the use of the asset are less than its carrying value. We recognize an impairment loss based on the excess of the carrying value over the fair value of the asset. A long-lived asset held for sale is reported at the lower of the carrying amount or fair value less costs to sell. Depreciation expense is not recognized on assets held for sale. Losses are recognized for a long-lived asset to be abandoned when the asset ceases to be used. In addition, we periodically review the estimated lives of all long-lived assets for reasonableness.

Goodwill and Other Intangible Assets

Goodwill represents the unamortized excess of cost over the fair value of the net tangible and other intangible assets acquired. SFAS No. 142, *Goodwill and Other Intangible Assets*, or SFAS 142, requires that we not amortize goodwill to earnings, but instead requires that we test at least annually for impairment at a level of reporting referred to as the reporting unit and more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. A reporting unit is one level below our Commercial and Government segments. The Commercial segment's two reporting units consist of health insurance (fully insured and ASO) and specialty products. The Government segment's three reporting units consist of Medicare Advantage, TRICARE and Medicaid. Goodwill is assigned to the reporting unit that is expected to benefit from a specific acquisition.

SFAS 142 requires a two-step process to review goodwill for impairment. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. Impairment tests are performed, at a minimum, in the fourth quarter of each year supported by our long-range business plan and annual planning process. Impairment tests completed for 2005, 2004 and 2003 did not result in an impairment loss.

Other intangible assets primarily relate to acquired subscriber and provider contracts and are included with other long-term assets in the consolidated balance sheets. Other intangible assets are amortized over the useful life, based upon the pattern of future cash flows attributable to the asset. This sometimes results in an accelerated method of amortization for subscriber contracts because the asset tends to dissipate at a more rapid rate in earlier periods. Other than subscriber contracts, other intangible assets generally are amortized using the straight-line method. We review other finite-lived intangible assets for impairment under our long-lived asset policy.

Medical and Other Expenses Payable and Medical Cost Recognition

Medical costs include claim payments, capitation payments, pharmacy costs net of rebates, allocations of certain centralized expenses and various other costs incurred to provide health insurance coverage to members, as well as estimates of future payments to hospitals and others for medical care provided prior to the balance sheet date. Capitation payments represent monthly contractual fees disbursed to primary care physicians and other providers who are responsible for providing medical care to members. Pharmacy costs represent payments for members' prescription drug benefits, net of rebates from drug manufacturers. Receivables for such pharmacy rebates are included in other current assets in the consolidated balance sheet.

We estimate the costs of our medical claims and other medical expense payments using actuarial methods and assumptions based upon claim payment patterns, medical cost inflation, historical developments such as claim inventory levels and claim receipt patterns, and other relevant factors, and record medical claims reserves for future payments. We continually review estimates of future payments relating to medical claims costs for services incurred in the current and prior periods and make necessary adjustments to our reserves.

We reassess the profitability of our contracts for providing health insurance coverage to our members when current operating results or forecasts indicate probable future losses. We establish a premium deficiency liability in current operations to the extent that the sum of expected future medical costs, claim adjustment expenses, and maintenance costs exceeds related future premiums under contract without consideration of investment income. For purposes of premium deficiencies, contracts are grouped in a manner consistent with our method of acquiring, servicing, and measuring the profitability of such contracts. Losses recognized as a premium deficiency result in a beneficial effect in subsequent periods as operating losses under these contracts are charged to the liability previously established. There were no premium deficiency liabilities recorded at December 31, 2005 and 2004. Because the majority of our member contracts renew annually, we do not anticipate recording a premium deficiency liability, except when unanticipated adverse events or changes in circumstances indicate otherwise.

For our health and life policies sold to individuals and accounted for as long-duration insurance products under the provisions of SFAS 60, medical and other expenses payable include liabilities for future policy benefits for which some of the premium received in the earlier years is intended to pay anticipated benefits to be incurred in future years.

We believe our medical and other expenses payable are adequate to cover future claims payments required. However, such estimates are based on knowledge of current events and anticipated future events. Therefore, the actual liability could differ materially from the amounts provided.

Book Overdraft

Under our cash management system, checks issued but not yet presented to banks frequently result in overdraft balances for accounting purposes and are classified as a current liability in the consolidated balance sheets. Changes in book overdrafts from period to period are reported in the consolidated statement of cash flows as a financing activity.

Income Taxes

We recognize an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. We also recognize the future tax benefits such as net operating and capital loss carryforwards as deferred tax assets. A valuation allowance is provided against these deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized. Future years' tax expense may be increased or decreased by adjustments to the valuation allowance or to the estimated accrual for income taxes.

We record reserves for contingent tax benefits when it is not probable that the tax return position taken with respect to a particular transaction will be sustained. The contingency is not considered resolved until (1) the tax audit statute of limitations has expired, (2) a settlement is reached with the appropriate level of taxing authorities, or (3) the law changes such that there is objective evidence that it is probable that the uncertain tax position will be sustained.

Professional Liability Risk

We bear general business risks associated with operating our Company such as professional and general liability, employee workers' compensation, and officer and director errors and omissions risks. Professional and general liability risks may include, for example, medical malpractice claims and disputes with members regarding benefit coverage. We retain these risks through our wholly-owned, consolidated insurance subsidiary. We reduce exposure to our own general business risks by insuring levels of coverage for losses in excess of our retained limits with a number of third party insurance companies. We remain liable in the event these insurance companies are unable to pay their portion of the losses. In an effort to minimize credit risk, we insure our risks with a number of insurance companies having a long history of strong financial ratings.

We accrue for professional liability claims reported and outstanding and an estimate of claims incurred but not reported (based on actuarial determinations using past experience, modified for current trends) and corresponding loss adjustment expenses incurred to adjudicate such claims. We continually review these estimated liabilities, and make necessary adjustments. We believe our professional liabilities are adequate to cover future payments required. However, given the nature and degree of uncertainty involved in projecting professional liability losses and the potential size of a claim, the actual liability could differ significantly from the amounts provided. We record the provision for professional liability losses, including any necessary adjustments to the estimated liability as well as the cost of third party insurance coverage and related legal expenses, as an administrative expense. We record estimated recoveries from third party insurers as a reduction of administrative expense. The recoverable from third party insurers is included as an asset in the accompanying consolidated balance sheet, as discussed in Note 10.

Derivative Financial Instruments

We use interest rate swap agreements to manage our exposure to interest rate risk. The differential between fixed and variable rates to be paid or received is accrued and recognized over the life of the agreements as adjustments to interest expense in the consolidated statements of income. Our interest rate swap agreements convert the fixed interest rates on our senior notes to a variable rate and are accounted for as fair value hedges. Our interest rate swap agreements are more fully described in Note 9.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R, which requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. This requirement represents a significant change because fixed-based stock option awards, historically a predominate form of stock compensation for us, were not recognized as compensation expense under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS 123R requires that the cost of the award, as determined on the date of grant at fair value, be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The grant-date fair value of the award is estimated using option-pricing models. SFAS 123R also requires that we estimate the expected forfeitures beginning January 1, 2006 under each stock compensation plan and only recognize compensation expense for those awards which are expected to vest. In addition, certain tax effects of stock-based compensation are reported as a financing activity rather than an operating activity in the statements of cash flows. We adopted SFAS 123R on January 1, 2006 under the modified retrospective transition method using the Black-Scholes pricing model. In accordance with the modified retrospective transition method, we have adjusted previously reported operating results to reflect the effect of expensing of certain stock awards, primarily stock options, based on amounts previously included in the pro forma disclosures under the original provisions of SFAS 123 for all prior years for which the provisions of SFAS 123 were effective. Additional detail regarding our stock-based compensation plans and the effect of our retrospective application of SFAS 123R is included in Note 11.

Earnings Per Common Share

We compute basic earnings per common share on the basis of the weighted average number of unrestricted common shares outstanding. Diluted earnings per common share is computed on the basis of the weighted average number of unrestricted common shares outstanding plus the dilutive effect of outstanding employee stock options and restricted shares using the treasury stock method.

3. ACQUISITIONS

In January 2006, our Commercial segment reached an agreement to acquire CHA Service Company, or CHA Health, a health plan serving employer groups in Kentucky, for cash consideration of approximately $60.0 million plus any excess statutory surplus. This transaction, which is subject to regulatory approval, is expected to close effective in the second quarter of 2006.

On December 20, 2005, our Commercial segment acquired Corphealth, Inc., or Corphealth, a behavioral health care management company, for cash consideration of approximately $54.2 million, including transaction costs. This acquisition allows Humana to integrate coverage of medical and behavior health benefits. Net tangible assets acquired of $6.0 million primarily consisted of cash and cash equivalents. The purchase price exceeded the estimated fair value of the net tangible assets acquired by approximately $48.2 million. We preliminarily allocated this excess purchase price to other intangible assets of $8.6 million and associated deferred tax liabilities of $3.2 million, and non-deductible goodwill of $42.8 million. The other intangible assets, which consist primarily of customer contracts, have a weighted average useful life of 14.7 years. The allocation is subject to change pending completion of the valuation by a third party valuation specialist firm assisting us in evaluating the fair value of the assets acquired.

On February 16, 2005, our Government segment acquired CarePlus Health Plans of Florida, or CarePlus, as well as its affiliated 10 medical centers and pharmacy company. CarePlus provides Medicare Advantage HMO plans and benefits to Medicare Advantage members in Miami-Dade, Broward and Palm Beach counties. This acquisition enhances our Medicare market position in South Florida. We paid approximately $444.9 million in cash, including transaction costs. We financed the transaction with $294.0 million of borrowings under our credit agreement and $150.9 million of cash on hand. The purchase price is subject to a balance sheet settlement process with a nine month claims run-out period. This settlement, which will be reflected as an adjustment to goodwill, is not expected to be material. The fair value of the acquired tangible assets (assumed liabilities) consisted of the following:

	(in thousands)
Cash and cash equivalents	$ 92,116
Premiums receivable and other current assets	6,510
Property and equipment and other assets	21,315
Medical and other expenses payable	(37,375)
Other current liabilities	(23,359)
Other liabilities	(5,915)
Net tangible assets acquired	$ 53,292

The purchase price exceeded the estimated fair value of the net tangible assets acquired by approximately $391.6 million. We allocated the excess purchase price over the fair value of the net tangible assets acquired to other intangible assets of $88.9 million and associated deferred tax liabilities of $33.5 million, and goodwill of $336.2 million. The other intangible assets, which consist primarily of subscriber contracts, have a weighted-average useful life of approximately 10 years. Approximately $47.4 million of the acquired goodwill is deductible for income tax purposes. We used an independent third party valuation specialist firm to assist us in evaluating the fair value of assets acquired.

On April 1, 2004, we acquired Ochsner Health Plan, or Ochsner, from the Ochsner Clinic Foundation for $157.1 million in cash.

The results of operations and financial condition of Corphealth, CarePlus and Ochsner have been included in our consolidated statements of income and consolidated balance sheets from the respective acquisition dates. The pro forma financial information presented below assumes that the acquisitions of Corphealth, CarePlus and Ochsner had occurred as of the beginning of each respective period. The pro forma adjustments include the pro forma effect of amortization of other intangible assets arising from the purchase price allocation and interest expense related to the assumed financing of the cash purchase price and the associated income tax effects of the pro forma adjustments. The pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations that would have occurred had the Corphealth, CarePlus and Ochsner acquisitions been consummated at the beginning of the respective periods.

	For the year ended December 31, 2005 (1)	For the year ended December 31, 2004 (2)
	(in thousands, except per share results)	
Revenues	$ 14,500,064	$ 13,786,237
Net income	$ 301,198	$ 293,362
Earnings per common share:		
Basic	$ 1.86	$ 1.83
Diluted	$ 1.82	$ 1.80

(1) This period includes the pro forma impact of Corphealth for approximately 11.5 months and CarePlus for approximately 1.5 months.

(2) This period includes the pro forma impact of Corphealth and CarePlus for 12 months and Ochsner for 3 months.

4. INVESTMENT SECURITIES

Investment securities classified as current assets were as follows at December 31, 2005 and 2004:

	2005				2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)							
U.S. Government obligations	$ 791,322	$ 84	$ (9,729)	$ 781,677	$ 650,200	$ 3,437	$ (2,952)	$ 650,685
Tax exempt municipal securities	971,330	1,112	(11,637)	960,805	888,592	11,379	(3,722)	896,249
Corporate and other securities	422,127	566	(9,182)	413,511	469,375	8,593	(3,121)	474,847
Mortgage-backed securities	105,859	142	(2,761)	103,240	78,722	839	(1,146)	78,415
Redeemable preferred stocks	19,668	52,285	(289)	71,664	7,310	—	(134)	7,176
Debt securities	2,310,306	54,189	(33,598)	2,330,897	2,094,199	24,248	(11,075)	2,107,372
Non-redeemable preferred stocks	24,237	13	(243)	24,007	38,221	621	(569)	38,273
Investment securities	$ 2,334,543	$ 54,202	$ (33,841)	$ 2,354,904	$ 2,132,420	$ 24,869	$ (11,644)	$ 2,145,645

During the first quarter of 2006, we sold CorSolutions Medical, Inc., a disease management venture capital investment classified as a redeemable preferred stock in the above table, for cash proceeds of $65.9 million, resulting in a realized gain of $52.3 million ($32.6 million after tax).

Investment securities classified as long-term assets were as follows at December 31, 2005 and 2004:

	2005				2004			
	Amortized Cost	Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)							
U.S. Government obligations	$ 174,397	$ 36	$ (2,542)	$ 171,891	$ 146,221	$ 514	$ (901)	$ 145,834
Tax exempt municipal securities	96,875	119	(1,123)	95,871	69,529	686	(271)	69,944
Corporate and other securities	73,562	88	(617)	73,033	69,514	1,077	(143)	70,448
Mortgage-backed securities	11,104	—	(206)	10,898	14,258	143	(37)	14,364
Redeemable preferred stocks	14,552	23,728	(49)	38,231	31,348	12,767	(36)	44,079
Debt securities	370,490	23,971	(4,537)	389,924	330,870	15,187	(1,388)	344,669
Non-redeemable preferred stocks	—	—	—	—	2,491	24	—	2,515
Common stocks	1,111	—	—	1,111	1,281	—	—	1,281
Equity securities	1,111	—	—	1,111	3,772	24	—	3,796
Long-term investment securities	$ 371,601	$ 23,971	$ (4,537)	$ 391,035	$ 334,642	$ 15,211	$ (1,388)	$ 348,465

Long-term investment securities with a fair value of $93.5 million at December 31, 2005 and $95.4 million at December 31, 2004 were on deposit at financial institutions in certain states pursuant to the respective states' insurance regulations.

Gross unrealized losses and fair value aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows at December 31, 2005 and 2004:

	Less than 12 months		12 months or more		Total	
2005	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
U.S. Government obligations	$ 611,683	$ (3,790)	$ 272,176	$ (8,481)	$ 883,859	$ (12,271)
Tax exempt municipal securities	470,477	(4,846)	258,825	(7,914)	729,302	(12,760)
Corporate and other securities	248,016	(4,932)	131,166	(4,867)	379,182	(9,799)
Mortgage-backed securities	51,921	(742)	36,987	(2,225)	88,908	(2,967)
Redeemable preferred stocks	—	—	6,862	(338)	6,862	(338)
Debt securities	1,382,097	(14,310)	706,016	(23,825)	2,088,113	(38,135)
Non-redeemable preferred stocks	4,409	(37)	5,477	(206)	9,886	(243)
Total investment securities	$ 1,386,506	$ (14,347)	$ 711,493	$ (24,031)	$ 2,097,999	$ (38,378)

	Less than 12 months		12 months or more		Total	
2004	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
U.S. Government obligations	$ 486,209	$ (3,717)	$ 4,351	$ (136)	$ 490,560	$ (3,853)
Tax exempt municipal securities	316,913	(3,346)	26,869	(647)	343,782	(3,993)
Corporate and other securities	171,048	(1,846)	32,719	(1,418)	203,767	(3,264)
Mortgage-backed securities	28,865	(430)	16,581	(753)	45,446	(1,183)
Redeemable preferred stocks	6,266	(158)	1,238	(12)	7,504	(170)
Debt securities	1,009,301	(9,497)	81,758	(2,966)	1,091,059	(12,463)
Non-redeemable preferred stocks	8,455	(240)	10,789	(329)	19,244	(569)
Total investment securities	$ 1,017,756	$ (9,737)	$ 92,547	$ (3,295)	$ 1,110,303	$ (13,032)

Unrealized losses at December 31, 2005 resulted from 447 positions out of a total of 731 positions held. Approximately 26% of the carrying value of our consolidated investment securities have been in an unrealized loss position greater than one year. The unrealized losses at December 31, 2005 primarily were caused by increases in interest rates. All issuers of securities trading at an unrealized loss remain current on all contractual payments and we believe it is probable that we will be able to collect all amounts due according to the contractual terms of the debt securities. After taking into account these and other factors, including the severity of the decline and our ability and intent to hold these securities until recovery or maturity, we determined the unrealized losses on these investment securities were temporary and, as such, no impairment was required.

The contractual maturities of debt securities available for sale at December 31, 2005, regardless of their balance sheet classification, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$ 262,934	$ 313,692
Due after one year through five years	819,201	806,441
Due after five years through ten years	581,570	572,478
Due after ten years	1,017,091	1,028,210
Total debt securities	$2,680,796	$2,720,821

Gross realized investment gains were $21.8 million in 2005, $36.6 million in 2004, and $52.8 million in 2003. Gross realized gains included gains from the sale of venture capital investments of $5.7 million in 2005, $16.0 million in 2004, and $15.2 million in 2003.

Gross realized investment losses were $3.5 million in 2005, $8.4 million in 2004, and $16.2 million in 2003. There were no impairment losses in 2005 or 2004. Gross realized losses included impairment losses of $3.2 million in 2003 after an evaluation indicated that a decline in fair value below the cost basis was other than temporary.

We participate in a securities lending program where we loan certain investment securities for short periods of time in exchange for collateral, consisting of cash or U.S. Government securities, initially equal to at least 102% of the fair value of the investment securities on loan. As of December 31, 2005, investment securities with a fair value of $134.2 million were on loan. Net investment income earned on securities lending transactions was $0.2 million in 2005, 2004 and 2003.

5. PROPERTY AND EQUIPMENT, NET

Property and equipment was comprised of the following at December 31, 2005 and 2004:

	2005	2004
	(in thousands)	
Land	$ 16,699	$ 19,329
Buildings	278,405	256,997
Equipment and computer software	936,463	786,713
Assets held for sale	9,786	6,172
	1,241,353	1,069,211
Accumulated depreciation	(756,941)	(669,705)
Property and equipment, net	$ 484,412	$ 399,506

Depreciation expense was $105.1 million in 2005, $107.3 million in 2004, and $115.2 million in 2003. Depreciation expense in 2004 and 2003 included the impact of accelerating depreciation related to abandoned software more fully described below.

Accelerated Depreciation in 2004 and 2003

After finalizing plans during the third quarter of 2004 to abandon some enrollment software by December 31, 2004, we reduced the estimated useful life of the software effective July 1, 2004. Accordingly, we accelerated the depreciation of the remaining software balance. The change in the useful life increased depreciation expense during 2004 by approximately $9.3 million ($5.7 million after tax).

After finalizing plans during the first quarter of 2003 to abandon software used in our operations by March 2003, we reduced the estimated useful life of the software effective January 1, 2003. Accordingly, we accelerated the depreciation of the remaining software balance of approximately $13.5 million ($8.3 million after tax) during the first quarter of 2003.

2003 Impairment

A decision to close the Jacksonville, Florida customer service center prompted a review for the possible impairment of long-lived assets associated with this center. Under a transition plan, we continued to use the long-lived assets of the Jacksonville customer service center until mid-2003, the completion date for consolidating this customer service center. The long-lived assets of this customer service center were supported by the future cash flows expected to result from members serviced by that center. Cash flows from members serviced by the center represented the lowest level of independently identifiable cash flows. For example, cash flows from members located primarily in the state of Florida and serviced by the Jacksonville service center supported the Jacksonville center's long-lived assets until those members' service was transitioned elsewhere.

Our impairment review during the first quarter of 2003 indicated that estimated undiscounted cash flows expected to result from the remaining use of the Jacksonville, Florida customer service center long-lived assets, primarily a building, were insufficient to recover their carrying value. Accordingly, we reduced the carrying value of these long-lived assets to their estimated fair value resulting in non-cash impairment expenses of $17.2 million ($10.5 million after tax) during the first quarter of 2003.

We used an independent third party appraisal to assist us in evaluating the fair value of the building. The non-cash impairment expenses are included with selling, general and administrative expenses in the accompanying consolidated statements of income.

Based upon our decision to sell the building previously used in our Jacksonville customer service operations, we classified it as held for sale and ceased depreciating the building effective July 1, 2003. The impact of ceasing depreciation of the building was not material to our results of operations. During the first quarter of 2004, we completed the sale of the Jacksonville building, recording proceeds of $14.8 million and a pretax loss of $0.2 million.

The allocation of the non-cash pretax expenses related to the accelerated depreciation and writedown of certain long-lived assets to our Commercial and Government segments was as follows for the years ended December 31, 2004 and 2003:

	2004		
	Commercial	Government (in thousands)	Total
Line item affected:			
Depreciation and amortization	$ 9,349	$ —	$ 9,349
Total pretax impact	$ 9,349	$ —	$ 9,349

	2003		
	Commercial	Government (in thousands)	Total
Line item affected:			
Selling, general and administrative	$ 4,325	$ 12,908	$ 17,233
Depreciation and amortization	13,527	—	13,527
Total pretax impact	$ 17,852	$ 12,908	$ 30,760

6. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of goodwill, by operating segment, for the year ended December 31, 2005 were as follows:

	Commercial	Government	Total
		(in thousands)	
Balance at December 31, 2004	$ 698,430	$ 187,142	$ 885,572
CarePlus acquisition	—	336,173	336,173
Corphealth acquisition	42,830	—	42,830
Balance at December 31, 2005	$ 741,260	$ 523,315	$ 1,264,575

Other intangible assets primarily relate to acquired subscriber contracts and are included with other long-term assets in the consolidated balance sheets. Amortization expense for other intangible assets was approximately $23.8 million in 2005, $10.5 million in 2004 and $11.6 million in 2003. The following table presents our estimate of amortization expense for each of the five next succeeding fiscal years:

	(in thousands)
For the years ending December 31,:	
2006	$ 17,782
2007	$ 14,550
2008	$ 11,951
2009	$ 8,126
2010	$ 7,582

The following table presents details of our other intangible assets included in other non-current assets in the accompanying consolidated balance sheets at December 31, 2005 and 2004:

	Weighted Average Life	2005 Cost	2005 Accumulated Amortization	2005 Net	2004 Cost	2004 Accumulated Amortization	2004 Net
				(in thousands)			
Other intangible assets:							
Subscriber contracts	10.5 yrs	$ 103,251	$ 18,483	$ 84,768	$ 97,256	$ 82,343	$ 14,913
Provider contracts	15.0 yrs	10,300	1,202	9,098	22,428	11,022	11,406
Licenses and other	17.8 yrs	12,890	2,741	10,149	5,790	1,787	4,003
Total other intangible assets	11.5 yrs	$ 126,441	$ 22,426	$ 104,015	$ 125,474	$ 95,152	$ 30,322

7. MEDICAL AND OTHER EXPENSES PAYABLE

Activity in medical and other expenses payable was as follows for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
		(in thousands)	
Balances at January 1	$ 1,422,010	$ 1,272,156	$ 1,142,131
Acquisitions	37,375	71,063	
Incurred related to:			
Current year	11,765,662	10,763,105	9,955,491
Prior years	(114,192)	(93,458)	(76,070)
Total incurred	11,651,470	10,669,647	9,879,421
Paid related to:			
Current year	(9,979,449)	(9,504,331)	(8,710,393)
Prior years	(1,221,724)	(1,086,525)	(1,039,003)
Total paid	(11,201,173)	(10,590,856)	(9,749,396)
Balances at December 31	$ 1,909,682	$ 1,422,010	$ 1,272,156

Amounts incurred related to prior years vary from previously estimated liabilities as the claims ultimately are settled. Negative amounts reported for incurred related to prior years result from claims being ultimately settled for amounts less than originally estimated (favorable development).

As summarized in the previous table, claim reserve balances at December 31, 2004 ultimately settled during 2005 for $114.2 million less than the amounts originally estimated, representing 1.1% of medical claim expenses recorded in 2004. During 2004, claim reserve balances at December 31, 2003 ultimately settled for $93.5 million less than the amounts originally estimated, representing 0.9% of medical claim expenses recorded in 2003. This $20.7 million change in the amounts incurred related to prior years for 2005 as compared to 2004 resulted primarily from favorable development in our TRICARE line of business as a result of less than expected utilization in the latter half of 2004.

During 2003, claim reserve balances at December 31, 2002 ultimately settled during 2003 for $76.1 million less than the amounts originally estimated, representing 0.8% of medical claim expenses recorded in 2002. The $17.4 million change in the amounts incurred related to prior years for 2004 as compared to 2003 resulted primarily from favorable development in our Medicare line of business as a result of less than expected utilization in the latter half of 2003.

Our TRICARE contract contains risk-sharing provisions with the Department of Defense and with subcontractors, which effectively limit profits and losses when actual claim experience varies from the targeted medical claim amount negotiated annually. As a result of these contract provisions, the impact of changes in estimates for prior year TRICARE medical claims payable on our results of operations is reduced substantially, whether positive or negative.

We have 52% of our Medicare membership and 97% of our Medicaid membership under risk-sharing arrangements with providers. Accordingly, the impact of changes in estimates for prior year medical claims payable on our results from operations that are attributable to our Medicare and Medicaid lines of business may also be significantly reduced, whether positive or negative.

8. INCOME TAXES

The provision for income taxes consisted of the following for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
		(in thousands)	
Current provision:			
Federal	$ 127,653	$ 73,280	$ 65,477
States and Puerto Rico	17,504	3,644	13,128
Total current provision	145,157	76,924	78,605
Deferred (benefit) provision	(39,007)	52,507	33,869
Provision for income taxes	$ 106,150	$ 129,431	$ 112,474

The provision for income taxes was different from the amount computed using the federal statutory rate for the years ended December 31, 2005, 2004 and 2003 due to the following:

	2005	2004	2003
		(in thousands)	
Income tax provision at federal statutory rate	$ 141,008	$ 139,782	$ 117,674
States, net of federal benefit and Puerto Rico	13,169	13,361	13,033
Tax exempt investment income	(11,917)	(12,700)	(10,546)
Capital loss valuation allowance	(5,198)	(6,855)	(9,492)
Contingent tax benefits	(27,365)	(6,409)	—
Examination settlements	(3,518)	—	—
Other, net	(29)	2,252	1,805
Provision for income taxes	$ 106,150	$ 129,431	$ 112,474

The $27.4 million reduction in 2005 tax expense primarily related to the recognition of a $22.8 million contingent tax benefit and associated $3.1 million reversal of accrued interest resulting from the resolution of an uncertain tax position associated with the 2000 tax year during the first quarter of 2005 in connection with the expiration of the statute of limitations. In addition, during 2005 the Internal Revenue Service completed their audit of all open years prior to 2003 which also resulted in a $3.5 million reduction in 2005 tax expense associated with revisions to prior year's estimated taxes. Changes in the capital loss valuation allowance resulted from our regular evaluation of probable capital gain realization in the allowable carryforward period given our recent and historical capital gain experience and the consideration of alternative tax planning strategies. The capital loss carryforward expired on December 31, 2005. As such, the remaining unused deferred tax asset and associated allowance were written off.

Deferred income tax balances reflect the impact of temporary differences between the tax bases of assets or liabilities and their reported amounts in our consolidated financial statements, and are stated at enacted tax rates expected to be in effect when the reported amounts are actually recovered or settled. Principal components of our net deferred tax balances at December 31, 2005 and 2004 were as follows:

	Assets (Liabilities)	
	2005	2004
	(in thousands)	
Investment securities	$ (14,963)	$ (10,522)
Depreciable property and intangible assets	(133,672)	(110,369)
Medical and other expenses payable	(4,119)	(2,538)
Unearned revenues	5,718	8,858
Professional liability risks	13,650	13,193
Compensation and other accruals	74,210	43,873
Stock-based awards	39,452	35,298
Net operating loss carryforwards	11,987	13,970
Capital loss carryforward	—	22,078
Valuation allowance — capital loss carryforward	—	(20,123)
Total net deferred income tax liabilities	$ (7,737)	$ (6,282)
Amounts recognized in the consolidated balance sheets:		
Other current assets	$ 68,510	$ 19,428
Other long-term liabilities	(76,247)	(25,710)
Total net deferred income tax liabilities	$ (7,737)	$ (6,282)

At December 31, 2005, we had approximately $31.9 million of net operating losses to carryforward related to prior acquisitions. These net operating loss carryforwards, if not used to offset future taxable income, will expire from 2006 through 2020. Based on our historical record of producing taxable income and profitability, we have concluded that future operating income will be sufficient to give rise to tax expense to recover all deferred tax assets.

9. DEBT

Long-term debt outstanding was as follows at December 31, 2005 and 2004:

	2005	2004
	(in thousands)	
Long-term debt:		
6.30% senior, unsecured notes due 2018, net of unamortized discount of $724 at December 31, 2005 and $780 at December 31, 2004	$ 299,276	$ 299,220
7.25% senior, unsecured notes due 2006, net of unamortized discount of $86 at December 31, 2005 and $231 at December 31, 2004	299,914	299,769
Fair value of interest rate swap agreements	6,084	17,082
Deferred gain from interest rate swap exchange	6,131	16,338
Total senior notes	611,405	632,409
Credit agreement	200,000	—
Other long-term borrowings	3,639	4,287
Total debt	815,044	636,696
Less: Current portion of long-term debt	301,254	—
Total long-term debt	$513,790	$636,696

Swap Agreements

In order to hedge the risk of changes in the fair value of our $300 million 6.30% senior notes and our $300 million 7.25% senior notes attributable to fluctuations in interest rates, we entered into interest rate swap agreements. Interest rate swap agreements, which are considered derivatives, are contracts that exchange interest payments on a specified principal amount, or notional amount, for a specified period. The interest rate swap agreements, which have the same critical terms as our 6.30% senior notes and our 7.25% senior notes, are designated fair value hedges. Changes in the fair value of the 6.30% or 7.25% senior notes and the swap agreements due to changing interest rates are assumed to offset each other completely, resulting in no impact to earnings from hedge ineffectiveness. Our swap agreements are recognized in our consolidated balance sheet at fair value with an equal and offsetting adjustment to the carrying value of our senior notes. The fair value of our interest rate swap agreements are estimated based on quoted market prices of comparable agreements, and reflect the amounts we would receive (or pay) to terminate the agreements at the reporting date.

Our interest rate swap agreements exchange the fixed interest rate under our 6.30% and 7.25% senior notes for a variable interest rate based on LIBOR. At December 31, 2005, the effective interest rate was 5.41% for the 6.30% senior notes and 6.22% for the 7.25% senior notes, including the amortization of the deferred swap gain. The $300 million swap agreements for the 6.30% senior notes mature on August 1, 2018, and the $300 million swap agreements for the 7.25% senior notes mature on August 1, 2006, and each has the same critical terms as the related senior notes.

At December 31, 2005, the fair value of our swap agreements related to the 6.30% senior notes was in our favor by $10.9 million and is included in other long-term assets and the fair value of our swap agreements related to the 7.25% senior notes was out of our favor by $4.8 million and is included in trade accounts payable and accrued expenses. Likewise, the carrying value of our senior notes has been increased $6.1 million to reflect their fair value. The counterparties to our swap agreements are major financial institutions with which we also have other financial relationships.

In June 2003, we recorded a deferred gain and received proceeds of $31.6 million in exchange for new swap agreements discussed above related to our 7.25% senior notes. The corresponding deferred swap gain of $31.6 million is being amortized to reduce interest expense over the remaining term of the 7.25% senior notes. Amortization of the deferred swap gain reduced interest expense $10.2 million in 2005, $9.8 million in 2004 and $5.5 million in 2003.

Credit Agreement

Our 5-year $600 million unsecured revolving credit agreement expires in September 2009. Under the agreement, at our option, we can borrow on either a competitive advance basis or a revolving credit basis. The revolving credit portion of the agreement bears interest at either a fixed rate or floating rate based on LIBOR plus a spread. The spread, which varies depending on our credit ratings, ranges from 50 to 112.5 basis points. We also pay an annual facility fee regardless of utilization. This facility fee, currently 15 basis points, may fluctuate between 12.5 and 37.5 basis points, depending upon our credit ratings. In addition, a utilization fee of 12.5 basis points is payable for any day in which borrowings under the facility exceed 50% of the total $600 million commitment. The competitive advance portion of any borrowings will bear interest at market rates prevailing at the time of borrowing on either a fixed rate or a floating rate basis, at our option.

The 5-year $600 million credit agreement contains customary restrictive and financial covenants as well as customary events of default, including financial covenants regarding the maintenance of net worth, minimum interest coverage, and maximum leverage ratios. At December 31, 2005, we were in compliance with all applicable financial covenant requirements. The terms of this credit agreement also include standard provisions related to conditions of borrowing, including a customary material adverse effect clause which could limit our ability to borrow. We have not experienced a material adverse effect, and we know of no circumstances or events which would be reasonably likely to result in a material adverse effect. At this time, we do not believe the material adverse effect clause poses a material funding risk to us. We have other relationships, including financial advisory and banking, with some of the parties to the credit agreement.

At December 31, 2005, we had $200 million of borrowings under the credit agreement outstanding at an interest rate of 5.04%. In addition, we have outstanding letters of credit of $35.1 million secured under the credit agreement. No amounts have ever been drawn on these letters of credit. As of December 31, 2005, we had $364.9 million of remaining borrowing capacity under the credit agreement.

Commercial Paper Program

We maintain and may issue short-term debt securities under a commercial paper program when market conditions allow. The program is backed by our credit agreement described above. Aggregate borrowings under both the credit agreement and commercial paper program generally may not exceed $600 million.

At December 31, 2005 and 2004, we had no commercial paper borrowings outstanding.

Other Borrowings

Other borrowings of $3.6 million at December 31, 2005 represent financing for the renovation of a building, bear interest at 2% per annum, are collateralized by the building, and are payable in various installments through 2014.

Shelf Registration

Our universal shelf registration with the Securities and Exchange Commission allows us to register debt or equity securities, from time to time, with the amount, price and terms to be determined at the time of the sale. We have up to $300 million remaining from a total of $600 million under the universal shelf registration. The net proceeds from any future sales of our debt securities under the universal shelf registration may be used for our operations and for other general corporate purposes, including repayment or refinancing of borrowings, working capital, capital expenditures, investments, acquisitions, or the repurchase of our outstanding securities.

10. PROFESSIONAL LIABILITY RISKS

Activity in the reserve for our professional liability risks was as follows for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
		(in thousands)	
Gross reserve at January 1	$ 231,494	$ 242,516	$ 262,763
Less recoverables from insurance	(52,423)	(95,008)	(142,595)
Net reserve at January 1	179,071	147,508	120,168
Acquisition	8,276	—	—
Incurred related to:			
Current year	53,184	53,525	48,778
Prior years	(9,196)	(688)	—
Total incurred	43,988	52,837	48,778
Paid related to:			
Current year	(251)	(659)	(1,356)
Prior years	(11,771)	(20,615)	(20,082)
Total paid	(12,022)	(21,274)	(21,438)
Net reserve at December 31	219,313	179,071	147,508
Plus recoverables from insurance	65,790	52,423	95,008
Gross reserve at December 31	$ 285,103	$ 231,494	$ 242,516

As a result of changes in estimates of insured exposures in prior years, the total incurred losses decreased by $9.2 million in 2005 and $0.7 million in 2004 reflecting favorable loss development related to professional and general liability exposures. In 2004, this was partially offset by required strengthening related to our director and officer errors and omissions exposures.

For the past several years, we have reduced the amount of coverage purchased from third party insurance companies. This increased level of retention resulted in an increasing net reserve balance.

The total cost associated with our professional liabilities, including the cost of purchasing insurance coverage from a number of third party insurance companies not included in the previous table, totaled $48.2 million in 2005, $58.4 million in 2004 and $52.5 million in 2003.

Amounts classified as current and non-current and their respective location in the consolidated balance sheets were as follows at December 31, 2005 and 2004:

	2005	2004
	(in thousands)	
Gross reserve included in:		
Trade accounts payable and accrued expenses (current)	$ 39,471	$ 37,619
Other long-term liabilities (non-current)	245,632	193,875
Total gross reserve	285,103	231,494
Recoverables from insurance included in:		
Other current assets (current)	7,886	8,441
Other assets (non-current)	57,904	43,982
Total recoverables from insurance	65,790	52,423
Total net reserve	$ 219,313	$ 179,071

11. EMPLOYEE BENEFIT PLANS

Employee Savings Plan

We have defined contribution retirement and savings plans covering eligible employees. Our contribution to these plans is based on various percentages of compensation, and in some instances, on the amount of our employees' contributions to the plans. The cost of these plans amounted to approximately $42.9 million in 2005, $37.6 million in 2004, and $37.9 million in 2003, all of which was funded currently to the extent it was deductible for federal income tax purposes. Based on the year end closing stock price of $54.33, approximately 31% of the retirement and savings plan's assets were invested in our common stock representing less than 4% of the shares outstanding as of December 31, 2005. The Company match is invested in the Humana common stock fund. However, a participant may reinvest any funds, including the Company match in the Humana common stock fund, in any other plan investment option at any time.

Severance Benefits

We provide severance and related employee benefits based upon our existing employee benefit plans and policies. Severance benefits are generally determined based on years of service and salary. We accrue severance benefits when payment is probable and reasonably estimable in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits.* The cost of this benefit amounted to approximately $0.7 million in 2005, $15.5 million in 2004 and $11.2 million in 2003. Severance is paid bi-weekly resulting in payments in periods subsequent to termination. We continually review estimates of future payments for probable severance benefits and make necessary adjustments to our liability for severance benefits.

Stock Based Compensation

We have plans under which options to purchase our common stock and restricted stock awards have been granted to officers, directors, key employees and consultants. The terms and vesting schedules for stock-based awards vary by type of grant. Generally, the awards vest upon time-based conditions. Upon exercise, stock-based compensation awards are generally settled with authorized but unissued company stock. The compensation cost that has been charged against income for these plans was as follows for the years ended December 31, 2005, 2004, and 2003:

	2005	2004	2003
		(in thousands)	
Stock-based compensation expense by type:			
Stock options	$ 24,304	$ 19,648	$ 8,881
Restricted stock awards	5,849	844	5,959
Total stock-based compensation expense	30,153	20,492	14,840
Tax benefit recognized	(11,337)	(7,971)	(5,773)
Stock-based compensation expense, net of tax	$ 18,816	$ 12,521	$ 9,067

A greater proportion of the awards granted to employees, excluding executive officers, during 2005 were restricted stock awards as opposed to stock options when compared to grants made in prior years.

The tax benefit recognized in our consolidated financial statements is based on the amount of compensation expense recorded for book purposes. The actual tax benefit realized in our tax return is based on the intrinsic value, or the excess of the market value over the exercise or purchase price, of stock options exercised and restricted stock awards vested during the period. The actual tax benefit realized for the deductions taken on our tax returns from option exercises and restricted stock vesting totaled $22.3 million in 2005, $9.0 million in 2004, and $28.5 million in 2003. There was no capitalized stock-based compensation cost.

At December 31, 2005, there were 12,513,939 shares reserved for employee and director stock award plans, including 2,852,181 shares of common stock available for future grants. On February 23, 2006, the Board of Directors approved the issuance of 1,517,507 additional options and restricted stock awards.

Stock Options

Stock options are granted with an exercise price equal to the average market value of the underlying common stock on the date of grant. Exercise provisions vary, but most options vest in whole or in part 1 to 3 years after grant and expire 7 to 10 years after grant. Upon grant, stock options are assigned a fair value based on the Black-Scholes valuation model. Compensation expense is recognized on a straight-line basis over the total requisite service period, generally the total vesting period, for the entire award.

The weighted average fair value of each option granted during 2005, 2004, and 2003 is provided below. The fair value was estimated on the date of grant using the Black-Scholes pricing model with the weighted average assumptions indicated below:

	2005	2004	2003
Weighted average fair value at grant date	$ 12.93	$ 9.95	$ 5.33
Expected option life (years)	5.0	6.0	6.5
Expected volatility	37.2%	44.6%	44.5%
Risk-free interest rate	3.9%	3.4%	3.4%
Dividend yield	None	None	None

When valuing employee stock options, we stratify the employee population into homogenous groups that historically have exhibited similar exercise behaviors. These groups include directors, executives, and all other employees. We value the stock options based on the unique assumptions for each of these employee groups.

We calculate the expected term for our employee stock options based on historical employee exercise behavior. The increase in our stock price in recent years has led to a pattern of earlier exercise by employees, therefore contributing to the gradual decline in the average expected term from 6.5 years in 2003, to 6.0 years in 2004, to 5.0 years in 2005. Also contributing to the decline in the expected term is the change in the contractual term of stock options granted in 2005. Prior to 2005, the contractual term of employee stock options was 10 years. For stock options granted in 2005 and 2006 the contractual term was reduced to 7 years.

The volatility used to value employee stock options is based on historical volatility. We calculate historical volatility using a simple average calculation methodology based on daily price intervals as measured over the expected term of the option. We have consistently applied this methodology since our adoption of the disclosure provisions of SFAS 123. The decrease in the historical volatility used to value our employee stock options is due to changes in the stock price pattern over the past several years. Our stock price was more volatile in 1998 and 1999 than in recent years. As noted above, we measure volatility over a period equal to the expected term. The average expected term was 6.0 years in 2004, and therefore the period over which volatility was measured when valuing the 2004 stock options included more volatile years than 2005. The combination of the passage of time and the reduction of the expected term to 5.0 years reduced the volatility used to value stock options granted in 2005.

We base the risk-free interest rate on a traded zero-coupon U.S. Treasury bond with a term substantially equal to the option's expected term.

Activity for our option plans was as follows for the years ended December 31, 2005, 2004 and 2003:

	Shares Under Option	Weighted Average Exercise Price
Options outstanding at December 31, 2002	10,526,871	$ 13.11
Granted	2,500,000	11.51
Exercised	(2,646,578)	10.59
Forfeited	(235,110)	12.39
Expired	(451,206)	17.08
Options outstanding at December 31, 2003	9,693,977	$ 13.22
Granted	2,784,000	21.03
Exercised	(2,098,679)	14.28
Forfeited	(210,987)	16.85
Expired	(75,625)	11.75
Options outstanding at December 31, 2004	10,092,686	$ 15.09
Granted	2,314,900	33.51
Exercised	(2,508,871)	14.50
Forfeited	(235,290)	21.39
Expired	(1,667)	20.66
Options outstanding at December 31, 2005	9,661,758	$ 19.50

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value Per Share(1)	Aggregate Intrinsic Value ($000)(1)
Options exercisable at December 31, 2005	4,830,165	$ 13.70	4.9 Years	$ 40.78	$ 196,982
Options vested and expected to vest at December 31, 2005(2)	9,661,758	$ 19.50	6.0 Years	$ 34.99	$ 338,041

(1) Computed based upon the amount by which the fair market value of our common stock at December 31, 2005 of $54.49 per share exceeded the weighted average exercise price.

(2) We began estimating forfeitures under SFAS 123R upon adoption on January 1, 2006.

The total intrinsic value of stock options exercised during 2005 was $57.8 million, compared with $18.9 million during 2004 and $14.0 million during 2003. Cash received from stock option exercises for the years ended December 31, 2005, 2004, and 2003 totaled $36.4 million, $30.0 million, and $28.0 million, respectively.

Total compensation cost related to nonvested options not yet recognized was $21.1 million at December 31, 2005. We expect to recognize this compensation cost over a weighted average period of approximately 1.0 year.

Restricted Stock Awards

Restricted stock awards are granted with a fair value equal to the average market price of our common stock on the date of grant. Compensation expense is recorded straight-line over the vesting period, generally three years from the date of grant.

The weighted average grant date fair value of our restricted stock awards was $32.81, $24.77, and $10.19 for the years ended December 31, 2005, 2004, and 2003, respectively. Activity for our restricted stock awards was as follows for the year ended December 31, 2005:

	Shares	Weighted Average Grant-Date Fair Value
Nonvested restricted stock at December 31, 2004	12,453	$ 25.73
Granted	524,787	32.81
Vested	(20,400)	29.25
Forfeited	(15,500)	32.53
Nonvested restricted stock at December 31, 2005	501,340	$ 32.79

The fair value of shares vested during the years ended December 31, 2005, 2004, and 2003 was $0.6 million, $0.6 million, and $0.1 million, respectively. Total compensation cost related to nonvested restricted stock awards not yet recognized was $11.7 million at December 31, 2005. We expect to recognize this compensation cost over a weighted average period of approximately 2.1 years. There are no other contractual terms covering restricted stock awards once vested.

Restrospective Application

We adopted SFAS 123R effective January 1, 2006. In accordance with the modified retrospective transition method, we have adjusted previously reported results to reflect the effect of expensing stock awards. The following table illustrates the effect of the retrospective application on the beginning balances of the specified balance sheet accounts as if the fair value method described in SFAS 123R had been applied to all prior years for which the original provisions of SFAS 123 were effective.

	As of December 31,	
	2005	2004
	(in thousands)	
Other long-term liabilities (net deferred tax liability), before adoption	$ 662,129	$ 604,229
Adjustment for SFAS 123	(34,769)	(34,124)
Other long-term liabilities (net deferred tax liability), after adoption	$627,360	$570,105
Capital in excess of par value, before adoption	$ 1,098,117	$ 1,017,156
Adjustment for SFAS 123	137,771	137,281
Capital in excess of par value, after adoption	$1,235,888	$1,154,437
Retained earnings, before adoption	$ 1,538,306	$ 1,229,823
Adjustment for SFAS 123	(116,631)	(104,878)
Retained earnings, after adoption	$1,421,675	$1,124,945

The effect of the retrospective adoption of SFAS 123R on the consolidated statements of income and cash flows for the years presented is as follows:

	For the years ended December 31,		
	2005	2004	2003
	(in thousands, except per share results)		
Income from operations, before adoption	$ 461,029	$ 439,022	$ 362,083
Adjustment for SFAS 123	(18,834)	(16,472)	(8,503)
Income from operations, after adoption	$ 442,195	$ 422,550	$ 353,580
Income before income taxes, before adoption	$ 421,714	$ 415,850	$ 344,716
Adjustment for SFAS 123	(18,834)	(16,472)	(8,503)
Income before income taxes, after adoption	$ 402,880	$ 399,378	$ 336,213
Net income, before adoption	$ 308,483	$ 280,012	$ 228,934
Adjustment for SFAS 123	(11,753)	(10,065)	(5,195)
Net income, after adoption	$ 296,730	$ 269,947	$ 223,739
Basic earnings per common share, before adoption	$ 1.91	$ 1.75	$ 1.44
Adjustment for SFAS 123	(0.08)	(0.07)	(0.03)
Basic earnings per common share, after adoption	$ 1.83	$ 1.68	$ 1.41
Diluted earnings per common share, before adoption	$ 1.87	$ 1.72	$ 1.41
Adjustment for SFAS 123	(0.08)	(0.06)	(0.03)
Diluted earnings per common share, after adoption	$ 1.79	$ 1.66	$ 1.38
Net cash provided by operating activities, before adoption	$ 625,627	$ 347,809	$ 413,140
Adjustment for SFAS 123	(15,545)	(3,748)	(15,219)
Net cash provided by operating activities, after adoption	$ 610,082	$ 344,061	$ 397,921
Net cash provided by (used in) financing activities, before adoption	$ 293,586	$ (75,053)	$ 179,744
Adjustment for SFAS 123	15,545	3,748	15,219
Net cash provided by (used in) financing activities, after adoption	$ 309,131	$ (71,305)	$ 194,963

12. EARNINGS PER COMMON SHARE COMPUTATION

Detail supporting the computation of basic and diluted earnings per common share was as follows for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
	(in thousands, except per share results)		
Net income available for common stockholders	$ 296,730	$ 269,947	$ 223,739
Weighted average outstanding shares of common stock used to compute basic earnings per common share	161,714	160,421	158,968
Dilutive effect of:			
Employee stock options	3,751	2,448	1,686
Restricted stock awards	95	36	1,752
Shares used to compute diluted earnings per common share	165,560	162,905	162,406
Basic earnings per common share	$ 1.83	$ 1.68	$ 1.41
Diluted earnings per common share	$ 1.79	$ 1.66	$ 1.38

Stock options to purchase 9,934 shares in 2005, 2,134,184 shares in 2004, and 4,209,266 shares in 2003 were anti-dilutive and, therefore, were not included in the computations of diluted earnings per common share.

13. STOCKHOLDERS' EQUITY

Stock Repurchases

During 2005, we acquired 68,296 of our common shares in connection with employee stock plans at an aggregate cost of $2.4 million, or an average of $34.62 per share.

Stockholders' Rights Plan

Our stockholders' rights plan expired in accordance with its terms in February 2006.

Regulatory Requirements

Certain of our subsidiaries operate in states that regulate the payment of dividends, loans, or other cash transfers to Humana Inc., our parent company, and require minimum levels of equity as well as limit investments to approved securities. The amount of dividends that may be paid to Humana Inc. by these subsidiaries, without prior approval by state regulatory authorities, is limited based on the entity's level of statutory income and statutory capital and surplus. In most states, prior notification is provided before paying a dividend even if approval is not required.

As of December 31, 2005, we maintained aggregate statutory capital and surplus of $1,203.2 million in our state regulated subsidiaries. Each of these subsidiaries was in compliance with applicable statutory requirements which aggregated $722.2 million. Although the minimum required levels of equity are largely based on premium volume, product mix, and the quality of assets held, minimum requirements can vary significantly at the state level.

Most states rely on risk-based capital requirements, or RBC, to define the required levels of equity. RBC is a model developed by the National Association of Insurance Commissioners to monitor an entity's solvency. This calculation indicates recommended minimum levels of required capital and surplus and signals regulatory measures should actual surplus fall below these recommended levels. If RBC were adopted by all states and Puerto Rico at December 31, 2005, we would be required to fund $14.7 million in one of our Puerto Rico subsidiaries to meet all requirements. After this funding, we would have $378.2 million of aggregate capital and surplus above any of the levels that require corrective action under RBC.

14. COMMITMENTS, GUARANTEES AND CONTINGENCIES

Leases

We lease facilities, computer hardware, and other equipment under long-term operating leases that are noncancelable and expire on various dates through 2023. We sublease facilities or partial facilities to third party tenants for space not used in our operations. Rent with scheduled escalation terms are accounted for on a straight-line basis over the lease term. Rent expense and sublease rental income, which are recorded net as an administrative expense, for all operating leases was as follows for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
		(in thousands)	
Rent expense	$81,357	$78,222	$70,815
Sublease rental income	(11,192)	(11,291)	(12,007)
Net rent expense	$70,165	$66,931	$58,808

Future annual minimum payments due subsequent to December 31, 2005 under all of our noncancelable operating leases with initial terms in excess of one year are as follows:

	Minimum Lease Payments	Sublease Rental Receipts	Net Lease Commitments
For the years ending December 31:		(in thousands)	
2006	$ 84,993	$ (4,163)	$ 80,830
2007	71,969	(3,562)	68,407
2008	49,653	(1,863)	47,790
2009	31,882	(889)	30,993
2010	30,443	(515)	29,928
Thereafter	28,173	(1,325)	26,848
Total	$ 297,113	$ (12,317)	$ 284,796

Purchase Obligations

We have agreements to purchase services, primarily information technology related services, or to make improvements to real estate, in each case that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum levels of service to be purchased; fixed, minimum or variable price provisions; and the appropriate timing of the transaction. We have purchase obligation commitments of $24.0 million in 2006, $11.6 million in 2007, $6.7 million in 2008, $2.4 million in 2009 and $1.7 million thereafter. Purchase obligations exclude agreements that are cancelable without penalty.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate or knowingly seek to participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2005, we are not involved in any SPE transactions.

Guarantees and Indemnifications

Our operating lease of an airplane, which expires January 1, 2010, provides for a residual value payment of no more than $4.8 million at the end of the lease term. At the end of the term, we have the right to exercise a purchase option for $8.9 million or the airplane can be sold to a third party. If we decide not to exercise our purchase option, we must pay the lessor a maximum amount of $4.8 million. This amount will be reduced by the net sales proceeds in excess of $4.2 million from the sale of the airplane to a third party.

Through indemnity agreements approved by the state regulatory authorities, certain of our regulated subsidiaries generally are guaranteed by Humana Inc., our parent company, in the event of insolvency for (1) member coverage for which premium payment has been made prior to insolvency; (2) benefits for members then hospitalized until discharged; and (3) payment to providers for services rendered prior to insolvency. Our parent also has guaranteed the obligations of our TRICARE subsidiaries.

In the ordinary course of business, we enter into contractual arrangements under which we may agree to indemnify a third party to such arrangement from any losses incurred relating to the services they perform on behalf of us, or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.

Government Contracts

Our Medicare business, which accounted for approximately 32% of our total premiums and ASO fees for the year ended December 31, 2005, primarily consisted of HMO, PPO and Fee-For-Service products covered under the Medicare Advantage contracts with the federal government. The contracts are renewed generally for a one-year term each December 31 unless CMS notifies Humana of its decision not to renew by May 1 of the contract year, or Humana notifies CMS of its decision not to renew by the first Monday in June of the contract year.

Our TRICARE business, which accounted for approximately 17% of our total premiums and ASO fees for the year ended December 31, 2005, primarily consisted of the South Region contract. The 5-year South Region contract is subject to annual renewals at the Government's option and expires March 31, 2009. This contract contains provisions to negotiate a target health care cost amount annually with the federal government. Any variance from the target health care cost is shared with the federal government. As such, events and circumstances not contemplated in the negotiated target health care cost amount could have a material adverse effect on our business. These changes may include, for example, an increase or reduction in the number of persons enrolled or eligible to enroll due to the federal government's decision to increase or decrease U.S. military presence around the world. In the event government reimbursements were to decline from projected amounts, our failure to reduce the health care costs associated with these programs could have a material adverse effect on our business.

Our Medicaid business, which accounted for approximately 4% of our total premiums and ASO fees for the year ended December 31, 2005, consisted of contracts in Puerto Rico, Florida and Illinois. Our 3-year contracts with the Puerto Rico Health Insurance Administration, which accounted for approximately 3% of our total premium and ASO fees for the year ended December 31, 2005, were extended a fourth year and these contracts expire on June 30, 2006. We are preparing to bid on the new contracts that will be effective July 2006 although a request for such proposal has not yet been issued by the Puerto Rico Health Insurance Administration. At this time we are unable to predict the ultimate impact that any government policy decisions might have on our Medicaid contracts in Puerto Rico.

Our other current Medicaid contract, which is in Florida, is scheduled to expire on June 30, 2006. Due to Medicaid reform in Florida, we are currently negotiating the terms and rates for the renewal contract. We expect the current contract to be extended until August 31, 2006, and the subsequent renewal contract to be effective for a two-year term beginning September 1, 2006. Due to continual decreases in the reimbursement from the state of Illinois, we exited the Illinois Medicaid market effective July 31, 2005. The Illinois and Florida Medicaid contracts accounted for approximately 1% of our total premiums and ASO fees for the year ended December 31, 2005.

Other than as described herein, the loss of any of the contracts above or significant changes in these programs as a result of legislative action, including reductions in premium payments to us, or increases in member benefits without corresponding increases in premium payments to us, may have a material adverse effect on our financial position, results of operations, and cash flows.

Legal Proceedings

Managed Care Industry Purported Class Action Litigation

Since 1999, we have been involved in several purported class action lawsuits that were part of a wave of generally similar actions targeting the health care payer industry and particularly managed care companies. These included a lawsuit against us and originally nine of our competitors that purported to be brought on behalf of physicians who treated our members since January 1, 1990. The plaintiffs asserted that we and other defendants paid providers' claims incorrectly by paying lesser amounts than they submitted. These cases were consolidated in the United States District Court for the Southern District of Florida ("the Court"), and styled *In re Managed Care Litigation*.

On October 17, 2005, we and representatives of over 700,000 physicians and several state medical societies reached an agreement ("Settlement Agreement") to settle the lawsuit by payment of $40 million for the physicians and an amount up to $18 million for the plaintiffs' attorneys, subject to approval by the Court. The Settlement Agreement recognizes that we have undertaken certain initiatives to facilitate relationships with, and payments to, physicians and provides for additional initiatives over its four-year term. The Court preliminarily approved the Settlement Agreement on October 19, 2005, and set a Settlement Hearing for March 6, 2006.

Three other defendants, Aetna Inc., Cigna Corporation, and The Prudential Insurance Company of America previously entered into settlement agreements that have been approved by the Court. Health Net, Inc. announced a settlement agreement on May 2, 2005, and Wellpoint, Inc. (formerly WellPoint Health Networks, Inc. and Anthem, Inc.) announced a settlement agreement on July 11, 2005.

In connection with the settlement and other related litigation costs, we recorded pretax administrative expense of $71.9 million ($44.8 million after taxes, or $0.27 per diluted common share) in the third quarter of 2005.

Other Litigation and Proceedings

In July 2000, the Office of the Florida Attorney General initiated an investigation, apparently relating to some of the same matters that are involved in the managed care industry purported class action litigation described above. On September 21, 2001, the Texas Attorney General initiated a similar investigation. No actions have been filed against us by either state.

In addition, our business practices are subject to review by various state insurance and health care regulatory authorities and federal regulatory authorities. There has been increased scrutiny by these regulators of the business practices of managed care companies, including allegations of anticompetitive and unfair business activities, claims payment practices, commission payment practices, and utilization management practices. Some of these reviews have resulted in fines imposed on us and required changes in some of our practices. We continue to be subject to these reviews, which could result in additional fines or other sanctions being imposed on us or additional changes in some of our practices.

We also are involved in other lawsuits that arise in the ordinary course of our business operations, including claims of medical malpractice, bad faith, nonacceptance or termination of providers, improper rate setting, failure to disclose network discounts and various other provider arrangements, as well as challenges to subrogation practices. We also are subject to claims relating to performance of contractual obligations to providers, members, and others, including failure to properly pay claims and challenges to the use of certain software products in processing claims. Pending state and federal legislative activity may increase our exposure for any of these types of claims.

In addition, some courts have issued rulings which make it easier to hold plans liable for medical negligence on the part of network providers on the theory that providers are agents of the plans and that the plans are therefore vicariously liable for the injuries to members by providers.

Personal injury claims and claims for extracontractual damages arising from medical benefit denials are covered by insurance from our wholly owned captive insurance subsidiary and excess carriers, except to the extent that claimants seek punitive damages, which may not be covered by insurance in certain states in which insurance coverage for punitive damages is not permitted. In addition, insurance coverage for all or certain forms of liability has become increasingly costly and may become unavailable or prohibitively expensive in the future.

The outcome of current suits or likelihood or outcome of future suits or governmental investigations cannot be accurately predicted with certainty. In addition, the potential for increased liability for medical negligence arising from claims adjudication, along with the increased litigation that has accompanied the negative publicity and public perception of our industry, adds to this uncertainty. Therefore, such legal actions and government audits and investigations could have a material adverse effect on our financial position, results of operations, and cash flows.

15. SEGMENT INFORMATION

We manage our business with two segments: Government and Commercial. The Government segment consists of members enrolled in government-sponsored programs, and includes three lines of business: Medicare Advantage, TRICARE, and Medicaid. The Commercial segment consists of members enrolled in products marketed to employer groups and individuals, and includes three lines of business: fully insured medical, ASO, and specialty. We identified our segments in accordance with the aggregation provisions of SFAS 131, which is consistent with information used by our Chief Executive Officer in managing our business. The segment information aggregates products with similar economic characteristics. These characteristics include the nature of customer groups and pricing, benefits and underwriting requirements.

The accounting policies of each segment are the same and are described in Note 2. The results of each segment are measured by income before income taxes. We allocate all selling, general and administrative expenses, investment and other income, interest expense, and goodwill, but no other assets or liabilities, to our segments. Members served by our two segments often utilize the same medical provider networks, enabling us to obtain more favorable contract terms with providers. Our segments also share overhead costs and assets. As a result, the profitability of each segment is interdependent.

Our segment results were as follows for the years ended December 31, 2005, 2004, and 2003:

	Government Segment		
	2005	2004	2003
	(in thousands)		
Revenues:			
Premiums:			
Medicare Advantage	$ 4,590,362	$ 3,086,598	$ 2,527,446
TRICARE	2,407,653	2,127,595	2,249,725
Medicaid	548,714	511,193	487,100
Total premiums	7,546,729	5,725,386	5,264,271
Administrative services fees	50,059	106,764	148,830
Investment and other income	21,123	26,261	22,839
Total revenues	7,617,911	5,858,411	5,435,940
Operating expenses:			
Medical	6,272,045	4,825,064	4,439,007
Selling, general and administrative	963,354	715,299	728,651
Depreciation and amortization	56,310	44,488	43,831
Total operating expenses	7,291,709	5,584,851	5,211,489
Income from operations	326,202	273,560	224,451
Interest expense	9,526	4,497	3,211
Income before income taxes	$ 316,676	$ 269,063	$ 221,240

Premium and administrative services revenues derived from our contracts with the federal government, as a percentage of our total premium and ASO revenues, were approximately 51% for 2005, 43% for 2004 and 42% for 2003.

	Commercial Segment		
	2005	2004	2003
	(in thousands)		
Revenues:			
Premiums:			
Fully insured:			
PPO	$ 3,635,347	$ 3,786,501	$ 3,369,109
HMO	2,432,768	2,827,981	2,871,697
Total fully insured	6,068,115	6,614,482	6,240,806
Specialty	386,747	349,564	320,206
Total premiums	6,454,862	6,964,046	6,561,012
Administrative services fees	209,378	166,032	122,846
Investment and other income	135,976	115,836	106,513
Total revenues	6,800,216	7,245,914	6,790,371
Operating expenses:			
Medical	5,379,425	5,844,583	5,440,414
Selling, general and administrative	1,232,250	1,179,037	1,137,880
Depreciation and amortization	72,548	73,304	82,948
Total operating expenses	6,684,223	7,096,924	6,661,242
Income from operations	115,993	148,990	129,129
Interest expense	29,789	18,675	14,156
Income before income taxes	$ 86,204	$ 130,315	$ 114,973

16. REINSURANCE

Certain old blocks of run-off insurance assumed in acquisitions, primarily life insurance and annuities, are subject to 100% coinsurance agreements where the underwriting risk and all administrative functions, including premium collections and claim payments, related to these policies has been ceded to a third-party. Coinsurance is a form of reinsurance. We acquired these policies and the related reinsurance agreements with the purchase of the stock of the companies in which the policies were originally written. We acquired these companies for business reasons unrelated to these policies, including the companies' licenses necessary to fulfill strategic plans.

A reinsurance agreement between two entities transfers the underwriting risk of policyholder liabilities to a reinsurer; while the primary insurer retains the contractual relationship with the ultimate insured. As such, these reinsurance agreements do not completely relieve us of our potential liability to the ultimate insured. However, given the transfer of underwriting risk, our potential liability is limited to the credit exposure which exists should the reinsurer be unable to meet their obligations assumed under these reinsurance agreements.

Given that all policies are 100% reinsured by third parties, the following amounts pertaining to the reinsurance agreements had no effect on our results of operations. Premiums ceded were $21.7 million in 2005, $30.0 million in 2004, and $45.3 million in 2003. Liabilities, included in other long-term liabilities, and related reinsurance recoverables, included in other long-term assets, in the accompanying consolidated balance sheets under these coinsurance agreements were $253.4 million at December 31, 2005 and $260.6 million at December 31, 2004.

We evaluate the financial condition of these reinsurers on a regular basis. These reinsurers are well-known and well-established, as evidenced by the strong financial ratings at December 31, 2005 presented below:

Reinsurer	Total Recoverable	Rating (a)
	(in thousands)	
Protective Life Insurance Company	$ 229,019	A+ (superior)
All others	24,400	A to A-(excellent)
	$ 253,419	

(a) Ratings are published by A.M. Best Company Inc.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
of Humana Inc.:

We have completed integrated audits of Humana Inc.'s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedules

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Humana Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules included as Exhibit 99.4 present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, in accordance with the modified retrospective transition method effective January 1, 2006.

Internal control over financial reporting

Also, in our opinion, management's assessment (not separately presented herein), included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A of the Company's Annual Report on Form 10-K for the year ended December 31, 2005, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control— Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Louisville, Kentucky
March 3, 2006, except for Notes 2, 8, and 11
for which the date is May 24, 2006

The quarterly unaudited results of operations set forth below have been revised from the quarterly unaudited results included in Humana's Annual Report on Form 10-K for the year ended December 31, 2005 to reflect the retrospective application of Humana's adoption of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R. Revisions are highlighted in blue.

Humana Inc.
QUARTERLY FINANCIAL INFORMATION
(Unaudited)

A summary of our quarterly unaudited results of operations for the years ended December 31, 2005 and 2004 follows:

	2005			
	First (a)	Second	Third	Fourth (b)
	(in thousands, except per share results)			
Total revenues	$ 3,387,225	$ 3,546,361	$ 3,821,461	$ 3,663,080
Income before income taxes	116,680	124,848	66,678	94,674
Net income	106,735	81,412	46,807	61,776
Basic earnings per common share	0.66	0.50	0.29	0.38
Diluted earnings per common share	0.65	0.49	0.28	0.37

	2004			
	First	Second (c)	Third	Fourth
	(in thousands, except per share results)			
Total revenues	$ 3,286,949	$ 3,431,478	$ 3,176,273	$ 3,209,625
Income before income taxes	99,417	117,123	123,177	59,661
Net income	65,780	77,558	81,678	44,931
Basic earnings per common share	0.41	0.48	0.51	0.28
Diluted earnings per common share	0.40	0.48	0.51	0.27

(a) Includes the operations of CarePlus since February 16, 2005, the date of its acquisition.

(b) Includes the operations of Corphealth since December 20, 2005, the date of its acquisition.

(c) Includes the operations of Ochsner since April 1, 2004, the date of its acquisition.

Exhibit 99.4

FINANCIAL STATEMENT SCHEDULES WITH RETROSPECTIVE APPLICATION OF SFAS 123R

The financial statement schedules set forth in this Exhibit 99.4 have been revised from the financial statement schedules included in Humana's Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Form 10-K") to reflect the retrospective application of Humana's adoption of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, or SFAS 123R. The financial statement schedules set forth below have not been revised to reflect events or developments subsequent to March 3, 2006, the date that Humana filed the 2005 Form 10-K. Revisions are highlighted in blue. For a discussion of events and developments subsequent to the filing date of the 2005 Form 10-K, please refer to the reports and other information Humana has filed with the Securities and Exchange Commission since that date, including Humana's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006.

Humana Inc.
SCHEDULE I — PARENT COMPANY FINANCIAL INFORMATION
CONDENSED BALANCE SHEETS

	December 31,	
	2005	2004
	(in thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 169,206	$ 242,868
Investment securities	250,399	196,420
Receivable from operating subsidiaries	197,172	115,813
Securities lending collateral	1,983	7,991
Other current assets	87,833	67,696
Total current assets	706,593	630,788
Property and equipment, net	352,013	292,523
Investments in subsidiaries	3,159,349	2,530,458
Notes receivable from operating subsidiaries	7,000	17,000
Other	58,320	75,087
Total assets	$ 4,283,275	$ 3,545,856
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Payable to operating subsidiaries	$568,313	$400,960
Current portion of notes payable to operating subsidiaries	27,600	27,600
Book overdraft	46,847	53,526
Other current liabilities	230,947	211,595
Securities lending payable	1,983	7,991
Current portion of long-term debt	301,254	—
Total current liabilities	1,176,944	701,672
Long-term debt	513,790	636,696
Notes payable to operating subsidiaries	18,000	18,000
Other	65,667	65,240
Total liabilities	1,774,401	1,421,608
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $1 par; 10,000,000 shares authorized; none issued	—	—
Common stock, $0.16 2/3 par; 300,000,000 shares authorized; 179,062,807 shares issued in 2005, and 176,044,649 shares issued in 2004	29,843	29,340
Treasury stock, at cost, 15,846,384 shares in 2005, and 15,778,088 shares in 2004	(203,364)	(201,000)
Other stockholders' equity	2,682,395	2,295,908
Total stockholders' equity	2,508,874	2,124,248
Total liabilities and stockholders' equity	$ 4,283,275	$ 3,545,856

See accompanying notes to the parent company financial statements.

Humana Inc.
SCHEDULE I – PARENT COMPANY FINANCIAL INFORMATION
CONDENSED STATEMENTS OF OPERATIONS

	For the year ended December 31, 2005	2004	2003
		(in thousands)	
Revenues:			
Management fees charged to operating subsidiaries	$ 581,362	$ 502,833	$ 458,373
Investment income and other income, net	23,657	18,312	19,883
	605,019	521,145	478,256
Expenses:			
Selling, general and administrative	499,787	423,614	363,501
Depreciation	81,634	87,597	82,478
Interest	40,935	24,857	21,229
	622,356	536,068	467,208
(Loss) income before income taxes and equity in net earnings of subsidiaries	(17,337)	(14,923)	11,048
(Benefit) provision for income taxes	(44,174)	(20,482)	7,636
Income before equity in net earnings of subsidiaries	26,837	5,559	3,412
Equity in net earnings of subsidiaries	269,893	264,388	220,327
Net income	$ 296,730	$ 269,947	$ 223,739

See accompanying notes to the parent company financial statements.

Humana Inc.
SCHEDULE I — PARENT COMPANY FINANCIAL INFORMATION
CONDENSED STATEMENTS OF CASH FLOWS

	For the year ended December 31, 2005	2004	2003
		(in thousands)	
Net cash provided by operating activities	$ 414,790	$ 263,027	$ 184,792
Cash flows from investing activities:			
Acquisitions	(498,948)	—	—
Purchases of investment securities	(200,048)	(989,757)	(388,138)
Proceeds from sale of investment securities	193,391	812,796	244,442
Maturities of investment securities	22,041	56,740	65,393
Purchases of property and equipment, net	(141,124)	(98,953)	(90,765)
Capital contributions to operating subsidiaries	(116,000)	(5,201)	(17,000)
Surplus note redemption from operating subsidiaries	10,000	—	35,000
Change in securities lending collateral	6,008	(7,991)	—
Other	—	(4,726)	70
Net cash used in investing activities	(724,680)	(237,092)	(150,998)
Cash flows from financing activities:			
Borrowings under credit agreement	494,000	—	—
Repayments under credit agreement	(294,000)	—	—
Net conduit commercial paper borrowings	—	—	(265,000)
Proceeds from issuance of senior notes	—	—	299,139
Proceeds from swap exchange	—	—	31,556
Debt issue costs	—	(1,954)	(3,331)
Change in book overdraft	(6,679)	(77,422)	73,463
Change in securities lending payable	(6,008)	7,991	—
Repayment of notes issued to operating subsidiaries	—	—	(31,500)
Common stock repurchases	(2,364)	(67,024)	(44,147)
Tax benefit from stock-based compensation	15,545	3,748	15,219
Proceeds from stock option exercises and other	35,734	29,918	25,475
Net cash provided by (used in) financing activities	236,228	(104,743)	100,874
(Decrease) increase in cash and cash equivalents	(73,662)	(78,808)	134,668
Cash and cash equivalents at beginning of year	242,868	321,676	187,008
Cash and cash equivalents at end of year	$ 169,206	$ 242,868	$ 321,676

See accompanying notes to the parent company financial statements.

Humana Inc.
SCHEDULE I — PARENT COMPANY FINANCIAL INFORMATION
NOTES TO CONDENSED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Parent company financial information has been derived from our consolidated financial statements and excludes the accounts of all operating subsidiaries. This information should be read in conjunction with our consolidated financial statements.

2. TRANSACTIONS WITH SUBSIDIARIES

Management Fee

Through intercompany service agreements approved, if required, by state regulatory authorities, Humana Inc., our parent company, charges a management fee for reimbursement of certain centralized services provided to its subsidiaries including information systems, disbursement, investment and cash administration, marketing, legal, finance, and medical and executive management oversight.

Dividends

Cash dividends received from subsidiaries and included as a component of net cash provided by operating activities were $236.0 million in 2005, $126.0 million in 2004 and $131.0 million in 2003.

Guarantee

Through indemnity agreements approved by state regulatory authorities, certain of our regulated subsidiaries generally are guaranteed by our parent company in the event of insolvency for; (1) member coverage for which premium payment has been made prior to insolvency; (2) benefits for members then hospitalized until discharged; and (3) payment to providers for services rendered prior to insolvency. Our parent has also guaranteed the obligations of our TRICARE subsidiaries.

Notes Receivables from Operating Subsidiaries

We funded certain subsidiaries with surplus note agreements. These notes are generally non-interest bearing and may not be entered into or repaid without the prior approval of the applicable Departments of Insurance.

Notes Payable to Operating Subsidiaries

We borrowed funds from certain subsidiaries with notes generally collateralized by real estate. These notes, which have various payment and maturity terms, bear interest ranging from 5.07% to 6.65% and are payable between 2006 and 2009. We recorded interest expense of $2.2 million, $1.7 million and $3.9 million related to these notes for the years ended December 31, 2005, 2004 and 2003, respectively.

3. REGULATORY REQUIREMENTS

Certain of our subsidiaries operate in states that regulate the payment of dividends, loans, or other cash transfers to Humana Inc., our parent company, and require minimum levels of equity as well as limit investments to approved securities. The amount of dividends that may be paid to Humana Inc. by these subsidiaries, without prior approval by state regulatory authorities, is limited based on the entity's level of statutory income and statutory capital and surplus. In most states, prior notification is provided before paying a dividend even if approval is not required.

As of December 31, 2005, we maintained aggregate statutory capital and surplus of $1,203.2 million in our state regulated subsidiaries. Each of these subsidiaries was in compliance with applicable statutory requirements which aggregated $722.2 million. Although the minimum required levels of equity are largely based on premium volume, product mix, and the quality of assets held, minimum requirements can vary significantly at the state level.

Most states rely on risk-based capital requirements, or RBC, to define the required levels of equity. RBC is a model developed by the National Association of Insurance Commissioners to monitor an entity's solvency. This calculation indicates recommended minimum levels of required capital and surplus and signals regulatory measures should actual surplus fall below these recommended levels. If RBC were adopted by all states and Puerto Rico at December 31, 2005, we would be required to fund $14.7 million in one of our Puerto Rico subsidiaries to meet all requirements. After this funding, we would have $378.2 million of aggregate capital and surplus above any of the levels that require corrective action under RBC.

4. ACQUISITIONS

Refer to Note 3 of the notes to consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K for a description of acquisitions.

5. INCOME TAXES

The decrease in 2005 tax expense primarily related to the recognition of a $22.8 million contingent tax benefit and associated $3.1 million reversal of accrued interest resulting from the resolution of an uncertain tax position associated with the 2000 tax year during the first quarter of 2005 in connection with the expiration of the statute of limitations. Refer to Note 8 of the notes to consolidated financial statements included in Exhibit 99.3 to this Current Report on Form 8-K for a description of income taxes.

Humana Inc.

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31, 2005, 2004, and 2003
(in thousands)

			Additions			
	Balance at Beginning of Period	Acquired Balances	Charged (Credited) to Costs and Expenses	Charged to Other Accounts (1)	Deductions or Write-offs	Balance at End of Period
Allowance for loss on receivables:						
2005	$ 34,506	—	$ 4,566	$ (1,027)	$ (5,488)	$ 32,557
2004	40,400	355	6,433	(1,338)	(11,344)	34,506
2003	30,178	—	7,416	6,584	(3,778)	40,400
Deferred tax asset valuation allowance:						
2005	20,123	—	(5,198)	—	(14,925)	—
2004	26,978	—	(6,855)	—	—	20,123
2003	36,470	—	(9,492)	—	—	26,978

(1) Represents changes in retroactive membership adjustments to premium revenues as more fully described in Note 2 to the consolidated financial statements.