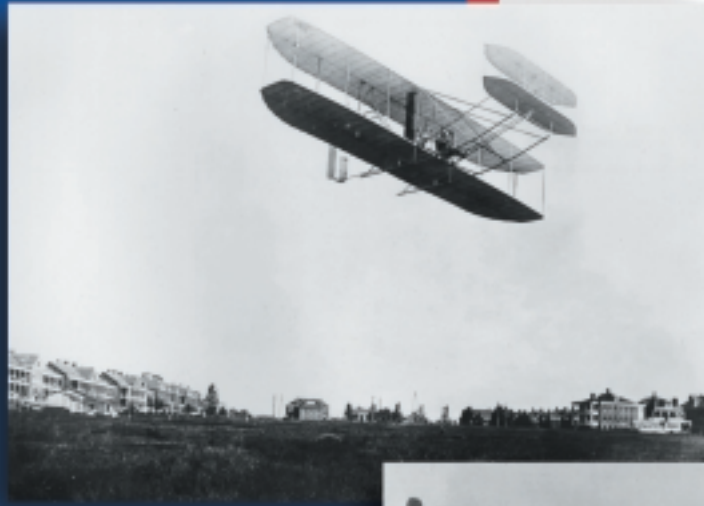




AAFMAA

2002

124th Annual Report



Celebrating
100 Years
of Flight



AAFMAA Board of Directors

(As of 31 December 2002)

Executive Committee



Robert W. Sennewald
GEN, USA, Retired
Chairman of the Board



Donald M. Babers
LTG, USA, Retired
Vice Chairman of the Board
Chairman, Finance Committee



Jack N. Merritt
GEN, USA, Retired
Chairman, Membership
Committee



Walter R. Lincoln, CFP
MAJ, USA, Retired
President and Treasurer

Membership Committee



Joe R. Reeder
MAJ, USAR



John A. Dubia
LTG, USA, Retired



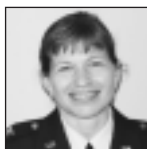
Richard S. Hassan
BGen, USAF



Mike O'Connell
BG, USA, Retired



Donald W. Shepperd
MGen, USAF, Retired



Elisabeth J. Strines
Col, USAF



John A. Shaud
Gen, USAF, Retired

Finance Committee



Wayne T. Fujito
COL, USA, Retired



Sam E. Parish
CMSAF, USAF, Retired



L. Donne Olvey
BG, USA, Retired



George T. Greiling
LTC, USA, Retired



Robert L. Smolen
BGen, USAF

Chairmen Emeriti

GEN Walter T. Kerwin, USA, Retired
GEN Michael S. Davison, USA, Retired

Directors Emeriti

GEN John R. Guthrie, USA, Retired
BG Elizabeth P. Hoisington, USA, Retired

Association Officers

MAJ Walter R. Lincoln, USA, Retired
President and Treasurer
LTC Tom E. Hargis, USA, Retired
Secretary
CMSgt Brady M. Gruler, USAF, Retired
Vice President for Insurance

Cover Photos. Top: Trials at Ft Myer, September 1908 - AAFMAA member LT Frank P. Lahm becomes the first military passenger to fly. Orville Wright brought the 1908 Flyer to Ft Myer, VA on 20 August 1908. Beginning on 3 September, he made public flights almost daily and as the word spread, people flocked to Ft Myer in droves. On 9 September, he stayed aloft over an hour, establishing a record, and later the same day he took LT Lahm aloft. **Center:** Continuation of trials at Ft Myer 1909 - LT Lahm stands with Orville Wright on 27 July before the start of the official tests. After a month of practice flights, Orville, with LT Lahm as a passenger, flew for 1 hour, 12 minutes, 40 seconds, fulfilling the requirement of remaining in the air for one hour carrying two persons. **Bottom:** Ft Myer, 1908 - LT Lahm stands with Glen Curtis. Curtis, LT Thomas E. Selfridge and Alexander Graham Bell, along with several others, founded the Aerial Experiment Association. It was their desire to develop alternative aeronautical concepts to the Wright Brothers' design. LT Selfridge was killed when Orville's plane crashed at Ft Myer in 1908 during the first pretrial tests, one week after LT Lahm had flown. He became the first person to die in an airplane crash. A pedestrian gate to Arlington National Cemetery and Selfridge ANGB outside Detroit, MI are named in his honor.

From the Chairman

These are uncertain times. Technological change and political instability accentuate the uncertainty. Our soldiers and airmen face increasing OPTEMPO rates with ever greater uncertainty in their personal lives. Uncertainty is not new to the Army or the Air Force. When Orville Wright and LT Frank P. Lahm lifted off from the parade ground at Ft Myer in 1908, no one knew the outcome. Later, when Orville Wright carried LT Thomas E. Selfridge aloft, no one knew the outcome. One lived, one died. As aviation expanded as part of our military arsenal, uncertainty surrounded every new plane, every new air tactic and every AAFMAA member who flew. Throughout this Century of Flight, from the very first military passenger, LT Frank P. Lahm, AAFMAA has been there to provide certainty. Every member can be absolutely certain that they are receiving insurance at the lowest possible cost and services unmatched by any other insurance company.



Why has AAFMAA grown and prospered even in these uncertain times? We believe it's all about TRUST. In uncertain times, individuals pay more attention to the institutions with which they entrust their assets and the future care of their survivors. Safety. Security. Dependability. Price. Services. For over 124 years AAFMAA has provided certainty and VALUE.

That's the past and the present. Where are we going in the future? Our vision is to continue to build AAFMAA into a full service insurance company. We will continue to expand products to meet the needs of our members during their entire military career. We now offer our Career Assistance Program for NCOs and junior officers; a lower cost, better product than SGLI for those just starting a career; coverage up to \$600,000 for a spouse and children; a lower cost, better product than VGLI for those retiring; a Long Term Care Settlement Option for our traditional Value-Added Whole Life product to help take care of elderly members who need assistance for nursing care. We are preparing to implement tax-deferred annuities and offer improved settlement options for survivors.

These are, indeed, uncertain times...but it's always been uncertain for those who don the uniform of our country. They risk their lives so others may live free. Whether in the air or on the ground, AAFMAA has no aviator clause, no war clause, no terrorism clause. We stand now and forever with those who stand for us.

Yours very truly,

A handwritten signature in cursive script that reads "Robert W. Sennewald".

Robert W. Sennewald
General, USA, Retired



The Wright Flyer arrives at Ft Myer in 1908. The contract required that the airplane be quickly and easily assembled and taken apart and packed for transportation in Army wagons, taking no more than about one hour.

Message to the Army and Air Force Mutual Aid Association

March 31, 2003

Congratulations to the Army and Air Force Mutual Aid Association for its 124th year of dedicated service to our Nation's Soldiers and Airmen. The Association's legacy of support to families recognizes the dedication and importance we place on honored service in uniform.

We have the best Army and most powerful Air Force in the world—the best led, best trained, and best equipped. But it is about more than just equipment. It's about our Soldiers and Airmen—who have always kept us the world's best. Their determination and commitment are firm; they can take any objective, perform any task, and accomplish any mission assigned. Our Soldiers and Airmen jointly respond to the President's call with the professionalism, determination, and courage that have always defined our service to this great Nation.

Soldiers remain the centerpiece of The Army's formations. We assure the Nation's security by equipping and training them for victory, and caring for them in times of need. Organizations like the Army and Air Force Mutual Aid Association supplement that effort, offering life insurance and survivor services that augment our own, giving our military families accessible choices in their own Well-Being.

We could not be more proud of each of our Soldiers and Airmen and all that they accomplish every day. There will be challenges ahead, but teamwork will overcome them all. For the past 227 years, Soldiers have delivered victories whenever and wherever we have been called into action—and they continue to preserve that legacy today. Thank you for your important role and the services that you have made available over these many years. Best wishes for continued success. God bless you and your families, God bless our Army and Air Force, and God bless America.

Sincerely,



Eric K. Shinseki

General, United States Army

Wright Flyer being removed from its hangar at Ft Myer.



Message to the Army and Air Force Mutual Aid Association

24 March 2003

Since 1879 the Army and Air Force Mutual Aid Association has stood with our airmen in times of personal need. Congratulations on 124 years of excellence.

In the uncertain world in which we live, the financial and emotional welfare of our military members and their families remains a central concern of the Air Force leadership. Through your commitment, your deeds and your service, the Army and Air Force Mutual Aid Association has brought peace of mind and security during these difficult and uncertain times to the members of our Armed Forces and their families.

Your Association has earned our deepest respect and gratitude for its important work and for its countless efforts on behalf of our men and women in uniform. Thank you for what you have done and for what you continue to do. Best wishes for continued success.



JOHN P. JUMPER
General, USAF



Launching the Wright Flyer was accomplished with a catapult (derrick shown in background). The plane was mounted on a 50 foot track with ropes attached to 1500 lbs of weights. The trigger for releasing the weight was pulled by the pilot. The Ft Myer Post Headquarters building can be seen in the background.

Report of the President and Treasurer



As General Sennewald illustrated, in these uncertain times, we remain focused on doing our very best for AAFMAA members. The year 2002 has been challenging but we set records in virtually every area. My report covers insurance in force, insurance policies, lives insured, membership, investments, financial results, and the crediting rate.

Insurance in Force. Our insurance in force grew from \$3.6B in 2001 to \$5.2B in 2002. This net increase of \$1.6B, a growth of 28%, is the best result in Association history, and almost as much as all the cumulative insurance in force for the past 120 years of the Association's history. Competitive premium pricing, policy coverages up to \$600,000 and more aggressive marketing efforts contributed to this record growth.

Insurance Policies. Insurance policies, on a net basis, grew from 89,589 to 92,272, or 2.9%. More members are using AAFMAA to insure their entire family. The opportunity to insure spouses, children and grandchildren has contributed to the growth in the number of policies.

Lives Insured. While the membership grew by 1,395, spouses, children and grandchildren grew by 660. The growth in members and family members resulted in a total of 67,505 lives insured. This healthy expansion of 3.1% indicates that our competitive products address the needs of a broader market.

Membership. The number of Association members grew by 2.1%, to an all-time high of 65,315. This indicates that our Association continues to evolve and become increasingly important to the soldiers and airmen of the Army and Air Force.

Investments. The \$5.2B insurance in force constitutes our liabilities. Our investments are the assets which enable us to meet those liabilities. On an Amortized Value basis, investments grew from \$677M in 2001 to \$678M in 2002. This \$1M growth was achieved in a year when the stock markets were turbulent and declining. However, let me point out that on a Market Value basis assets grew from \$711M to \$748M. These assets, plus our future premium income and future investment earnings, will meet our \$5.2B of future liabilities. The \$678M of investments is allocated as reflected in the Summary of Assets.

Financial Results. As mentioned above, year 2002 included substantial market turbulence. In spite of that, our results for 2002 were very positive. Net Income totaled \$1M. Recall that Net Income is the amount left after expenses, death and other benefits paid, additions to members' policies, and term insurance premium refunds. In 2002 we paid \$23.3M in death benefits, added \$21M to member policies and insurance reserves and refunded \$520,299 to term policyholders. While setting records for insurance in force, policies, lives, and members, General Administrative and Operating Expenses *declined* as a percentage of revenue from 7.6% to 7.1%. This illustrates the care with which we treat *your* money. Continuing to control costs is imperative in achieving our goal of being the absolutely lowest cost provider of insurance.

Our Net Yield on Assets for 2002 was 6.5%. Considering the lower interest rates and the decline in equity markets during 2002, these returns validate our disciplined, consistent investment policies.

Consolidated Realty LLC, the Association's real estate equity investment arm, contributed to this outstanding financial result. The Net Rental Income for 2002 totaled \$4.1M, an increase of 53% over 2001. Note that this result is *after depreciation*. The properties within Consolidated Realty, totaling 434,000 square feet of Class A office space, had a 100% occupancy rate. Additional information on Consolidated Realty LLC is included later in this report.

Crediting Rate. Recall that the crediting rate is significantly influenced by the previous year's financial results and estimates of projected results. When setting the 2002 crediting rate (at the end of 2001) financial returns supported the crediting rate of 7.7% on Value-Added Whole Life policies for the year 2002. The crediting rate determines the amount of interest that is added to policy cash values each month. As cash values grow to sufficient levels, members' insurance coverages grow. Recognizing that interest rates have declined, coupled with the stock market turbulence, (at the end of 2002) we determined that a crediting rate of 7.0% for 2003 would be a supportable and prudent crediting rate. Both the 7.7% crediting rate during 2002 and the 7.0% crediting rate for 2003 remain very competitive. As we repeatedly reinforce, crediting rates can vary from year to year, depending upon investment returns.

In summary, our Association had a record year. AAFMAA is larger, growing faster, and more financially sound than ever before. The officers of the Association and the management team have led the operations with efficiency, focus, and success. Most importantly, the staff of your Association has provided every member with great service and great results. As President and Treasurer, I am honored to report to the membership on their successful efforts.

A handwritten signature in cursive script that reads "Walter R. Lincoln".

Walter R. Lincoln, CFP
President and Treasurer

With the Ft Myer Post Headquarters in the background, the Wright Flyer takes off. It would take several revolutions around the parade field next to Arlington Cemetery for the plane to gain altitude.

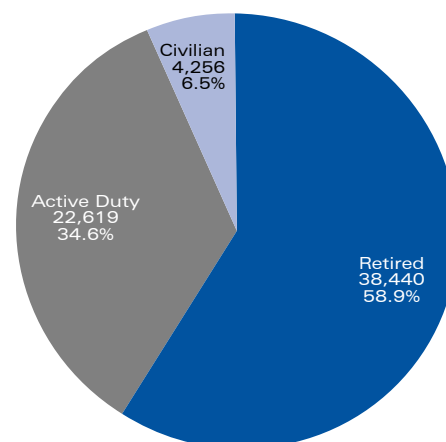


AAFMAA Overview 2002

Comparative Highlights

	Year ended 31 December	
	2002	2001
Insurance in Force (\$ millions)	\$5,242.9	\$3,617.0
Total Reserves (\$ millions)	\$672.4	\$673.3
Number of members	65,315	63,920
Number of member deaths	856	826
Death benefits (\$ millions)	\$23.4	\$20.6
Net Yield on Assets	6.5%	6.1%
Total Portfolio Return	7.5%	6.1%
Expenses (% of gross revenue)	7.1%	7.6%

Member Profile



Surviving Spouses: 10,713

Statement of the Association Actuary A.C. Eddy, Inc., Norcross, GA

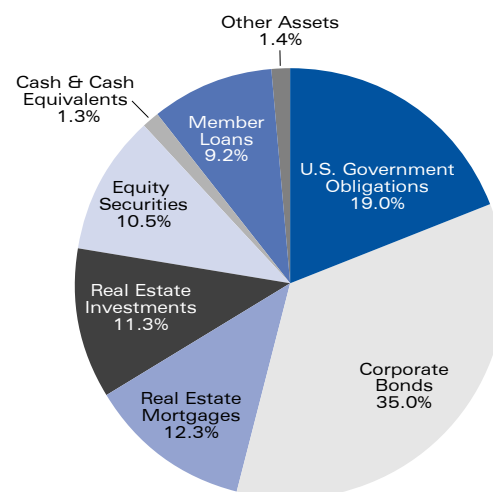
In my opinion the reserves of the Association are necessary and sufficient to provide for liabilities to its membership and will achieve the objective of distributing the Association's assets to members and/or their beneficiaries in an equitable manner.

*Arthur Crooks Eddy, FSA
President*

2002 Assets

Summary of Assets

Securities	Year ended 31 December	
	Amortized Value	Market Value
U.S. Government Obligations	\$129,028,420	\$159,212,944
Corporate Bonds	237,197,165	259,431,276
Real Estate Mortgages	83,594,623	83,594,623
Real Estate Investments	77,068,895	94,598,920
Equity Securities	71,267,305*	71,267,305
Cash and Cash Equivalents	8,618,628	8,618,628
Accrued Investment Income	7,775,264	7,775,264
Total Securities	614,550,300	684,498,960
Member Loans	62,157,314	62,157,314
Property & Equipment		
Net of Accumulated Depreciation	820,206	820,206
Other Assets	704,304	704,304
Total Assets	\$ 678,232,124	\$ 748,180,784



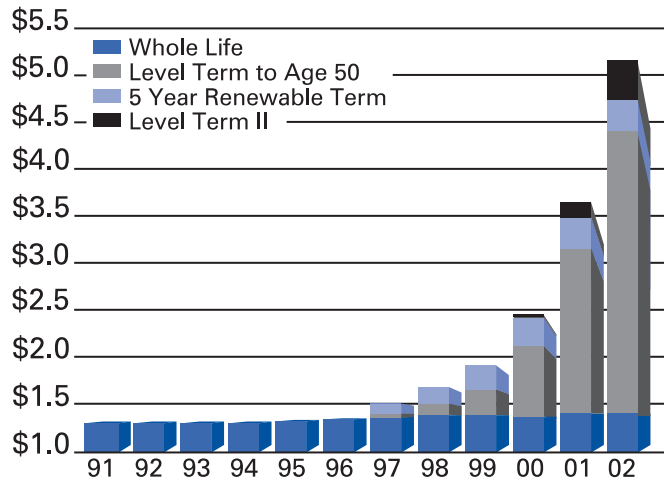
Total Assets: \$678 Million

*Equity Securities are valued at market.

Insurance in Force Statement

(includes family coverages)

Insurance in force, beginning of year	\$3,617,033,332
Insurance sold in 2002	\$1,934,729,341
Death benefit growth	16,876,642
Death benefits incurred	(23,351,697)
Other terminations	(302,363,612)
Insurance in force, end of year	\$5,242,924,006

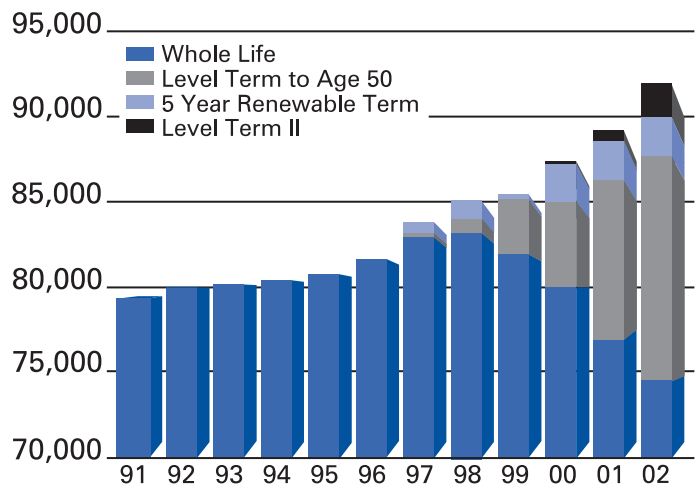


Insurance Policy Statement

(includes family coverages)

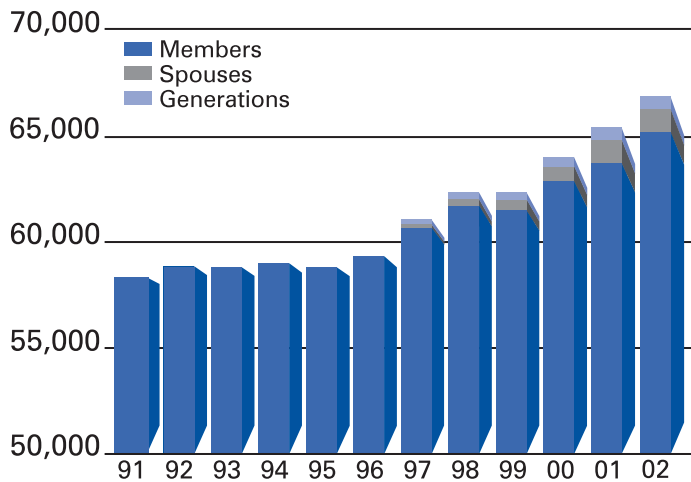
Insurance policies in force, beginning of year	89,589
New policies issued	7,212
Policies matured by death	(1,186)
Other policy net terminations	(3,343)
Insurance policies in force, end of year	92,272

Note: Beginning balance includes 288 Service Only (SO) policies and ending balance includes 267 SO policies.



Members and Lives Statement

(includes family coverages)



Members, beginning of year	63,920
Gains	4,614
Losses	(3,219)
Members, end of year	65,315
Spouses and Generations, beginning of year	1,529
Gains	711
Losses	(50)
Spouses and Generations, end of year	2,190
Total Lives	67,505



REMINDER: In order to maintain status and services as a grandfathered member, grandfathered members must continuously satisfy two requirements: (1) continue in good standing as an AAFMAA member from and after 30 June 2000; and (2) continue in good standing at least one life insurance policy which was issued on or before 30 June 2000, which includes a charge for services, either embedded or additional. Free Service Only and Insurance Only members were excluded from being grandfathered. Any grandfathered member who terminates all life insurance policies issued prior to 1 July 2000 forfeits his or her grandfathered status. Every member's policy still includes Survivor Assistance Services to the member's family. To maintain current grandfathered services, no action is necessary so long as the two requirements are satisfied.

AAFMAA Mission

To be the premier provider of insurance and survivor services to the Army and Air Force communities.



Over 10,000 spectators drove from Washington, D.C. to watch the air trials. Even President Taft frequently watched. This picture was taken during the 1909 time trials looking over the parade field towards Arlington Cemetery. The tree line marking the cemetery made flying at Ft Myer difficult and dangerous. The airfield was later moved to College Park, Maryland, and still exists today as the oldest airfield in continuous operation in the country.

VERKOUTEREN, AUERBACH & OLSON, L.L.P.

Certified Public Accountants

**850 SLIGO AVENUE, SUITE 400
SILVER SPRING, MARYLAND 20910-4703**

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(301) 588-5572

FAX (301) 588-5262

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Army and Air Force Mutual Aid Association
Arlington, Virginia

We have audited the accompanying statutory basis statements of assets, liabilities and reserves of Army and Air Force Mutual Aid Association as of December 31, 2002, and the related statutory basis statements of income and reserves and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described more fully in Note 1 to the financial statements, the Association prepared these financial statements using accounting practices prescribed or permitted by the National Association of Insurance Commissioners, which practices differ from generally accepted accounting principles (GAAP). The effects on the financial statements of the variances between the statutory basis of accounting and GAAP, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present, and are not intended to present, in conformity with GAAP, the financial position of Army and Air Force Mutual Aid Association as of December 31, 2002, or the results of its operations or its cash flows for the year then ended.

In our opinion, the statutory basis financial statements referred to above do present fairly, in all material respects, the financial position of Army and Air Force Mutual Aid Association as of December 31, 2002, and the results of its operations and its cash flows for the year then ended, on the basis of accounting described in Note 1.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information (Summary of Assets - 31 December 2002) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



VERKOUTEREN, AUERBACH & OLSON, L.L.P.
SILVER SPRING, MARYLAND

March 14, 2003

Statement of Assets, Liabilities and Reserves

Statutory Basis
31 December 2002

Assets

Bonds	
U.S. Government Obligations	\$129,028,420
Corporate Bonds	<u>237,197,165</u>
Total Bonds	\$ 366,225,585
Real Estate Mortgages	83,594,623
Real Estate Investments	77,068,895
Equity Securities	71,267,305
Member Loans, net of allowance	62,157,314
Cash and Cash Equivalents	8,618,628
Accrued Investment Income	7,775,264
Property and Equipment, at cost	
(less accumulated depreciation of \$1,162,170)	820,206
Other	<u>704,304</u>
Total Assets	<u>\$678,232,124</u>

Liabilities and Reserves

Liabilities	
Death Benefits Payable	\$ 2,349,333
Accounts Payable	544,589
Deferred Revenue	1,852,198
Settlement Options Payable	527,605
Accrued Post-Retirement Benefits	<u>548,300</u>
Total Liabilities	\$ 5,822,025
Reserves	
Insurance and Other	\$588,700,100
Interest Maintenance	25,275,702
Asset Valuation	12,182,561
General Contingency	<u>46,251,736</u>
Total Reserves	<u>672,410,099</u>
Total Liabilities and Reserves	<u>\$ 678,232,124</u>

See Auditor's Report and Accompanying Notes to the statutory basis Financial Statements

Statement of Income and Reserves

Statutory Basis

For the year ended 31 December 2002

Income

Premiums	\$ 18,410,321	
Dues	137,307	
Consideration for Supplemental Contracts	88,844	
Net investment income	43,650,978	
Amortization of interest maintenance reserve	<u>1,188,366</u>	\$ 63,475,816

Benefits and Expenses

Death benefits	\$ 23,351,697	
Surrender benefits	3,478,828	
Services benefits	2,408,375	
Premium refunds, term insurance	520,299	
Annuity payments	69,325	
Insurance expense		
Increase in aggregate reserves for life policies	11,204,511	
Decrease in reserves for annuities	(81,264)	
Increase in dues reserves	59,224	
General administrative and operating expenses	<u>4,496,871</u>	<u>(45,507,866)</u>

Net Income Before Excess Interest Credits

and Investment Transactions	17,967,950	
Excess interest credited to members' policies	<u>(9,896,055)</u>	

Net Income After Excess Interest Crediting

Net realized loss on investments (excluding interest maintenance reserve gains of \$1,294,402)	<u>(6,975,878)</u>	
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Net Income

	<u>\$ 1,096,017</u>	
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Reserve Transactions

Insurance and Other Reserves, Beginning of Year

Increase in reserves for life policies	\$ 11,204,511	
Decrease in reserves for annuities	(81,264)	
Increase in dues reserves	59,224	
Excess interest credited	<u>9,896,055</u>	
Net change in reserves for the year		<u>21,078,526</u>

Insurance and Other Reserves, End of Year

	<u>\$ 588,700,100</u>	
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General Contingency Reserve, Beginning of Year, as Restated (Note 3)

Net Income	\$ 1,096,017	
Change in unrealized depreciation of equity securities	(18,684,812)	
Change in asset valuation reserve	17,079,853	
Change in survivor reserves	<u>(216,795)</u>	
Net change in reserves for the year		<u>(725,737)</u>

General Contingency Reserve, End of Year

	<u>\$ 46,251,736</u>	
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See Auditor's Report and Accompanying Notes to the statutory basis Financial Statements

Statement of Cash Flows

Statutory Basis
For the year ended 31 December 2002

Cash Flows from Operating Activities

Net income		\$ 1,096,017
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of interest maintenance reserve	\$ (1,188,366)	
Equity earnings in subsidiaries	(4,391,024)	
Realized net losses from investments	7,794,867	
Amortization/accretion of bond discounts/premiums ...	(6,867,198)	
Depreciation	117,842	
Bad debt expense	<u>487,493</u>	(4,046,386)
Changes in operating assets and liabilities:		
Increase in accrued investment income	\$ (590,936)	
Increase in other assets	(36,560)	
Increase in death benefits payable	1,016,071	
Increase in accounts payable	35,356	
Increase in deferred revenue	279,873	
Increase in accrued post-retirement benefits	347,280	
Increase in settlement options payable	527,605	
Net increase in life, annuities and other reserves	<u>21,295,321</u>	<u>22,874,010</u>
Net Cash Provided by Operating Activities		19,923,641

Cash Flows from Investing Activities

Member Loans Issued	\$ (28,418,258)	
Member Loan Repayments	25,044,901	
Securities Purchased	(130,164,244)	
Securities Sold/Redeemed	108,579,028	
Capital Contributions to subsidiaries	(66,686)	
Distribution from subsidiaries	6,200,000	
Property and Equipment Purchased	<u>(50,874)</u>	
Net Cash Used in Investing Activities		<u>(18,876,133)</u>

Increase in Cash and Cash Equivalents		1,047,508
Cash and Cash Equivalents at Beginning of Year		<u>7,571,120</u>
Cash and Cash Equivalents at End of Year		<u><u>\$ 8,618,628</u></u>

Non-Cash Investing Activities: During the year, the Association acquired land parcels through deeds in lieu of foreclosure with values totaling \$10,806,483. The Association contributed these parcels to its wholly owned subsidiary, Consolidated Realty LLC.

See Auditor's Report and Accompanying Notes to the statutory basis Financial Statements

Notes to Financial Statements

31 December 2002

1. Significant Accounting Policies

The major accounting policies followed by the Association in the preparation of the financial statements are summarized herein. The accompanying financial statements have been prepared in conformity with statutory accounting practices. Although Army and Air Force Mutual Aid Association is not regulated by a state insurance department, these financial statements were prepared in conformity with accounting practices used by insurance companies for regulatory reporting purposes. Such accounting practices, referred to as prescribed or permitted practices, are a comprehensive basis of accounting other than generally accepted accounting principles. Because a major objective of state regulatory authorities is to protect the interests of policyholders, statutory accounting practices are oriented toward demonstrating the solvency of insurance companies and their ability to pay policyholder claims when those claims come due. Generally accepted accounting principles (GAAP) focus on a company's operating performance from period to period on a going-concern basis. Management of the Association believes statutory accounting practices more conservatively measure the Association's financial position and results of operations. The more significant categories of differences between statutory accounting practices and GAAP are summarized below:

- Valuation of investments in bonds
- Accounting for the costs of acquiring new business
- Calculation of certain reserves for policy contract benefits
- Designation of certain assets as "non-admitted" under statutory accounting practices
- Accounting for investment in subsidiaries
- Recording of an asset valuation reserve (AVR) and interest maintenance reserve (IMR).

Cash and Cash Equivalents

Cash includes currency on hand and demand deposits with banks or other financial institutions. Cash equivalents are short-term highly liquid investments with original maturities of three months or less.

Investments

Investments are reported according to prescribed valuation procedures. Equity mutual funds and common stocks are reported at fair market value. Investments in bonds are reported at amortized cost, except for those with an NAIC (National Association of Insurance Commissioners) designation of 6. Since the Association maintains an Asset Valuation Reserve (AVR), a bond with the designation of 6 is reported at the lower of amortized cost or fair value. An NAIC designation of 6 is a bond rating that indicates severe impairment as to the ability of the bond issuer to repay its debt to the bondholder. Per NAIC guidelines, an impaired bond is written down to fair value as its new cost basis as of the date it received the designation of 6. The amount of the write down is accounted for as a realized loss, and is included in the Statement of Income and Reserves. The new cost basis is not increased for subsequent recoveries in fair value.

Real estate mortgage loans, member loans and Career Assistance Program (CAP) loans are reported at unpaid principal balances. The carrying values of loans are periodically evaluated and adjusted for any perceived impairment in value.

Interest on bonds is recorded as investment income when earned and adjusted for any amortization of premium or accretion of discount. Dividends are recorded as income when earned. Interest income from loans is recorded when earned, except on loans in foreclosure or where collection is uncertain. CAP loans are non-collateralized. CAP loans of approximately \$438,000 were written off due to non-performance during the year. This number represents about 1 ½% of total CAP loans outstanding as of year-end.

Realized gains and losses on sales of investment securities are included in the Statement of Income and Reserves, except as noted in the Interest Maintenance Reserve section. Unrealized gains and losses are included in the Contingency Reserves in the Statement of Assets, Liabilities and Reserves.

The Summary of Assets shows the amortized value and market value of each category of securities held by the Association. The mortgages held by the Association are private placements for which quoted market values are not available. For such securities, as well as member loans, cost is used as the market value. Equity securities are reported at cost of \$113,376,762, less unrealized losses of \$42,109,457.

The Association has two different types of real estate mortgage loans: those with a fixed interest rate and those with a variable interest rate. The fixed interest rate loans have the same characteristics as conventional single-family mortgage loans, except that certain loans also require the borrower to pay a fixed amount of additional interest at prepayment or maturity of the loan. The variable interest rate loans have the borrower's obligation to pay both minimum fixed interest and contingent interest. The contingent interest is either a stated amount within the terms of the loan or a stated percentage of one or more of (i) the net cash flow from the property, (ii) excess net refinancing proceeds from the property, (iii) net appreciation on the disposition of the property, (iv) gross proceeds from the sale of the property above a threshold amount, and/or (v) initial principal.

The Association has one wholly owned subsidiary, Consolidated Realty Limited Liability Company (CRLLC). CRLLC holds real estate properties and, with its other net assets, has a total estimated market value of \$94,598,000. The investment in this wholly owned LLC is accounted for using the equity method.

Property and Depreciation

Property and equipment are capitalized as purchased and depreciated on a straight-line basis over their useful life, ranging from three to fifty years. Under statutory accounting practices, the depreciated cost of furniture, equipment and applications software are considered to be "non-admitted assets," i.e. assets accorded no values because they are expensed in the year of purchase. Since the Association is not regulated by any state due

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to its special exempt status, management has chosen not to reflect these categories of property and equipment as non-admitted assets. The Association holds \$240,426 of net assets categorized in Property and Equipment on the Statement of Assets, Liabilities and Reserves, which would otherwise be reported as non-admitted.

Use of Estimates

The process of preparing financial statements requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Actuarial Reserves

Actuarial reserves for all insurance plans are equal to the sum of the individual benefit plan accumulation values but not less than the minimum cash value for each certificate. The Association holds certain additional reserves at December 31, 2002 such that the sum of accumulation values and these additional reserves are equal to or greater than minimum reserves for such certificates of insurance as prescribed by the NAIC for regulated insurers.

Excess interest credits, as reflected in the Statement of Income and Reserves, equal the amount credited to cash value accounts in excess of statutory minimums.

Interest Maintenance Reserve/Asset Valuation Reserve

An interest maintenance reserve (IMR) is maintained based upon a formula prescribed by the NAIC for the purpose of capturing the realized gains and losses resulting from changes in the overall level of interest rates. These realized gains and losses are then amortized into income over the approximate remaining life of the investments had they not been sold. An asset valuation reserve (AVR) is maintained based upon a formula prescribed by the NAIC for the purpose of providing for default and equity risks related to the Association's invested assets.

Concentration of Credit Risk

The Association has a concentration of credit risk in that a majority of its Real Estate Mortgages is held for properties or construction in the Washington, DC metropolitan area. Likewise, the Real Estate Investments consist of real estate located in the Northern Virginia area.

Income Taxes

The Association is a tax-exempt, non-profit association as described in section 501(c)(23) of the Internal Revenue Code.

2. Nature of Business

The Association is a 124-year-old non-profit service organization with over 65,000 members. The Association is dedicated to aiding its members and the families of deceased members in a prompt, simple and substantial manner. Members consist of active, reserve, guard, retired officers, warrant officers, non-commissioned officers and soldiers and airmen of the United States Army and United States Air Force, as well as cadets serving at

the United States Military and United States Air Force Academies, and cadets with ROTC scholarships and contracts. The Association may also insure the spouses, children and grandchildren of members. However, spouses, children, and grandchildren are not members unless qualified as such in their own right. The Association provides interest-sensitive and term life insurance protection.

3. Security Impairments and Prior Period Adjustment

At December 31, 2002, the Association held two bonds in default of principal and interest and having an NAIC designation of 6. It held a \$10,500,000 par value WorldCom, Inc. bond bearing interest at 6.95%, purchased for \$10,486,665, due to mature August 15, 2028. The bond was ruled an NAIC 6 on June 26, 2002, and written down at that time to \$0.12 per par dollar. At that date, the amortized cost of this holding was \$10,487,239. The bond was written down to a carrying value of \$1,260,000, for a loss of \$9,227,239. The entire holding was liquidated on January 9, 2003 at a price of \$0.265 per par dollar, or \$2,782,500.

The Association also held at year end a \$4,000,000 par value Federal Mogul Corporation bond bearing interest at 7.5%, purchased for \$3,982,640, due to mature January 15, 2009. At September 30, 2001, it was ruled an NAIC 6 and its fair value at that date was \$0.07 per par dollar. Erroneously it was not reflected at its fair value of \$280,000 in the financial statements at December 31, 2001. In addition, the accrued interest income due on the bond was not written off at the end of 2001. The combination of the bond write down and accrued interest income, totaling \$3,844,833, is part of a prior period adjustment to the beginning balance in the General Contingency Reserves.

Further, the 2001 income from the wholly owned subsidiary, Consolidated Realty LLC, was overstated in the 2001 Statement of Income and Reserves by \$465,250, due to a revision in the method of revenue recognition in certain situations concerning tenant leasehold improvements. The combination of the Federal Mogul Corp. bond write down, accrued interest write off, and the decreased income from Consolidated Realty total \$4,310,082. The beginning balance to General Contingency Reserves has been decreased by this amount.

Six mortgage loans (acquisition and development loans each on three properties) were in default as of December 31, 2001. The Association reached a settlement with the borrower of these six mortgage loans. The borrower arranged the sale of one of the properties. The Association was repaid in cash plus additional Floor Area Ratio (FAR) for the two mortgage loans on this property. FAR is the development rights which allow for a larger square foot building to be erected. The cash proceeds received from the borrower as a result of the borrower's successful sale of the property (\$1,255,000), plus additional FAR (valued at \$216,753), covered the Association on the two loans secured by that property. The Association accepted deed-in-lieu of foreclosure for the settlement of the four remaining loans on the two remaining properties. The assessed value on these two remaining properties covered the Association's principal exposure on the loans. These two properties were transferred to

Consolidated Realty along with the additional FAR from the settlement of the first loan.

4. Related-Party Transactions

Armed Forces Services Corporation (AFSC) is a for-profit, Virginia non-stock corporation created July 1, 2000. This organization was created from the spin-off of the services department of the Association. As part of the Association, this department provided various services to the Association's members, i.e., financial awareness and income protection counseling, assistance in applying for entitlement benefits, and storage of documents. For all Association members who were such before July 1, 2000, and maintain their grandfathered status, these services will continue to be provided.

The Association signed a ten-year contract with AFSC to provide these continuing services. For the year ended December 31, 2002, the Association incurred servicing expenses of \$2,408,375.

In 2000, when AFSC was organized, AAFMAA guaranteed a six-year term loan for start-up expenses for AFSC. AFSC's outstanding balance on that note remains at its initial borrowing of \$1,000, and it cannot be increased from that balance.

The initial valuation amount of \$644,800, for the property, credit enhancement and intangible benefits provided by AAFMAA to AFSC, is not reflected in the Statement of Assets, Liabilities and Reserves. It will be reflected in the financial statements at such time when payment is received. AAFMAA received \$55,310 of interest income during 2002 and the beginning of 2003 from AFSC on their liability, which is included in net investment income on the Statement of Income and Reserves. The initial valuation amount incurs interest at a rate based upon AAFMAA's total return from the previous year (10.6% from July 1, 2001 through June 30, 2002 and 6.1% from July 1, 2002 through December 31, 2002). Accumulated interest for calendar year 2002 amounted to \$52,623. The total amount of the AFSC debt (principal and accrued interest) is \$726,840 as of December 31, 2002.

5. Other Assets

Other on the Statement of Assets, Liabilities and Reserves, consists of the following, which were previously included in Accrued Investment Income:

Prepaid Expenses	\$ 78,305
Receivable-RE Mortgages	300,158
Interest Receivable-AFSC	19,283
Deferred Compensation Assets	306,558

6. Employee Benefits

Retirement Plan

The Association has a 401(k) and profit-sharing plan that covers

all employees who meet certain minimum eligibility requirements. The Association may contribute, as a matching contribution, up to 6% of employee compensation. In addition, it may contribute an amount equal to 3% of compensation. The total retirement plan expense for the year ended December 31, 2002 was \$277,794, which includes \$139,284 of employees' elective deferrals.

Life Insurance

During 2002, the Association terminated the life insurance coverage for employees that it had previously offered through an independent insurance provider. The coverage offered was \$50,000 per employee. The Association began self-insuring employees for the same \$50,000 amount on July 1, 2002, as a cost containment measure. Employees are also eligible to obtain additional life insurance coverage with the Association at their own expense if they qualify. Employees are not members of the Association unless qualified as such in their own right.

7. Post-Retirement Benefits

For many years, AAFMAA has sponsored post-retirement health care and life insurance benefits for its retirees. During 2002, in another cost containment measure, AAFMAA discontinued all retiree benefits except benefits for those retirees who had taken advantage of the plan before the discontinuance. The health care plan for the retirees already participating requires a 60% contribution by them. The life insurance plan provided coverage of 25% of their annual salary at retirement. An offer was outstanding at the end of 2002 to the retirees to buy-out this obligation. All retirees accepted, and a liability of \$147,074 was established to cover the cost of this offer. The post-retirement liability for continuing health care coverage is \$94,668. Also included in the post-retirement liability on the Statement of Assets, Liabilities and Reserves is \$306,558 for deferred compensation payable to retired officers eligible to participate. Effective January 1, 1997, upon implementation of the 401(k) plan, the deferred compensation plan was closed to new participants. All participants are retired.

8. Commitments

The Association has committed \$2,354,000 to the Armed Forces Services Corporation for the performance of services to our members for 2003. Since December 31, 2002, the Association has committed to fund approximately \$29,346,500 for commercial real estate loans.

9. Land Lease

In December 1998, the Association entered into a 30-year lease with the Department of the Army to lease the land upon which the Association's building rests. The annual lease payment is \$11,700, with an evaluation of the fair market rental value to be performed every five years.

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The most popular photo from this period shows Orville flying solo in practice tests around the Ft Myer parade field. Wilbur was in France demonstrating the Wright Flyer to the Europeans during this same period. From the time of the Wright Brothers' first flights at Kitty Hawk in 1903 until these flights at Ft Myer in 1908, the U.S. Army had shown little interest in the Wright Brothers' new invention. It is remarkable to compare the Wright flyer with today's military aircraft.



Consolidated Realty LLC

Consolidated Realty LLC is wholly owned by AAFMAA and serves as AAFMAA's real estate equity investment arm. Consolidated Realty helps to diversify AAFMAA's investment portfolio and strives to generate a rate of return equal to or exceeding the historical rate of return on real estate equity, adjusted for inflation. This is accomplished by offering exceptional value to tenants through a focus on providing class A office space and superior services. Consolidated Realty expands its holdings by constructing buildings on its own land or by purchasing existing properties.

Consolidated Realty was formed in 1994 to eliminate losses and introduce efficiencies among real estate investment properties owned by AAFMAA. Two factors continue to be responsible for improved performance: (1) greater attention by management, and (2) additional capital contributions.

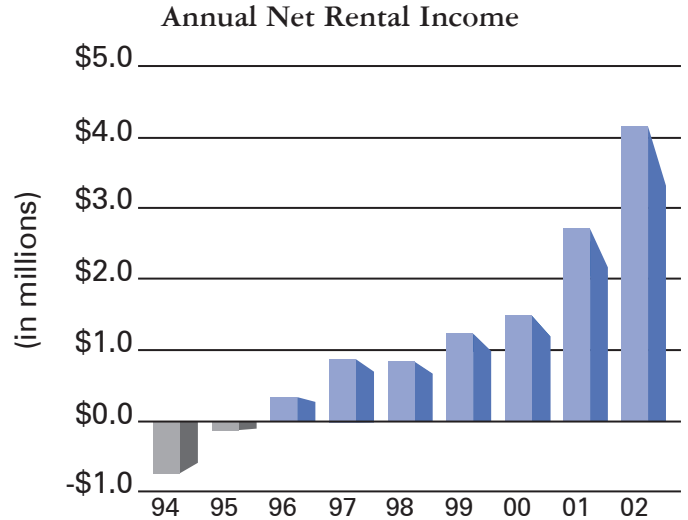
Management's attention is focused on maintaining high occupancy rates. As of December 2002, Consolidated Realty's occupancy rate of 100% was well above the local market occupancy rate of 73%. High occupancy rates increase net rental income and also provide consistent cash flow which improves overall performance.

During 2002, Consolidated Realty distributed \$6.2 million earned from its operations to AAFMAA.

In August of 2002, as a result of a settlement agreement in AAFMAA's mortgage portfolio, Consolidated Realty acquired 60 acres of prime developable land located in the Westfields Corporate Center in Northern Virginia. This land provides the basis for Consolidated Realty's future growth in Northern Virginia's premier business park.

The graph on this page depicts the growth in net rental income since Consolidated Realty's formation in 1994.

These photos are a representative sample of some of the 414,755 rentable square feet of office space owned by Consolidated Realty.



14150 Newbrook Drive – Completed in August 1999



14155 Newbrook Drive – Completed in November 2000



1775 Wieble Avenue – Completed in June 2001



At Ft Myer, VA on 17 September 1908, LT Selfridge was a passenger in the Wright Flyer with Orville. After taking off and circling the parade field once, a snap was heard. One of the propellers broke and damaged guide wires to the rear stabilizers. The plane fell about 60 feet onto its left wing, crashing near the gates of Arlington Cemetery. LT Selfridge became the first air passenger fatality. Orville was taken to the Post Hospital and recovered after 6 months. The Army granted the Wright Brothers an extension to repair the plane and complete the air trials.

History

In 1876 Lieutenant Colonel George Armstrong Custer (former brevet Major General) led his ill-fated expedition against the Cheyenne and Sioux in Dakota Territory. The ensuing massacre of the 7th Cavalry at the Battle of Little Big Horn starkly emphasized the desperate circumstances of bereaved Army families of that era.

When a death occurred on the frontier, the family was usually in need, and the Army's method of resolving those needs was a literal "passing of the hat" to raise money to transport dependents "back East" to the care of relatives and friends. In the case of the 7th Cavalry, the old system collapsed. There were no survivors; there was no hat to pass-and no one to pass it to! Thence came the impetus to establish an in-house benefit society. As a result, on 13 January 1879, the Army Mutual Aid Association was created and adopted its Constitution. Those documents were prepared by a Committee chaired by Lieutenant Colonel Roger Jones, Assistant Inspector General of the Army. They expressed the purpose of the Association as "to aid the families of the deceased members in a prompt, simple and substantial manner". The first Certificate of Membership and Insurance was issued to the first President of the Association, the same Lieutenant Colonel Roger Jones, on 3 February 1879.

Since then, its active supporters and officers have included Generals Philip H. Sheridan, Abner N. Doubleday, John J. Pershing, George C. Marshall, Dwight D. Eisenhower, Henry H. (Hap) Arnold, Carl A. (Tooe) Spaatz, Omar N. Bradley, Maxwell D. Taylor, Lyman L. Lemnitzer, George H. Decker, Harold K. Johnson, William C. Westmoreland, Creighton W. Abrams, Fred C. Weyand, Bernard W. Rogers, Edward C. Meyer, John A. Wickham, Jr., Walter T. "Dutch" Kerwin, Michael S. Davison, H. Norman Schwarzkopf, Ronald R. Fogleman, and Michael E. Ryan.

In 1984, the Association's members voted to make Air Force officers eligible to join. In 1987, the name was officially changed to the Army and Air Force Mutual Aid Association (AAFMAA). In 1995, the Association's members voted to expand membership to include noncommissioned officers and raise the age limit for admitting new members from 60 to 66 years. In 2000, the Association's members voted to include all enlisted ranks of the Army and Air Force within the eligible categories of membership. Also, in 2000, a corporation comprised of former AAFMAA employees was created and member services were contracted out to the Armed Forces Services Corporation (AFSC), based upon approval at the Annual Meeting.

For more than 124 years, the Association has offered its members permanent life insurance at a minimum cost and has provided immediate cash to the bereaved families of its members. It has withstood the losses of various military campaigns and weathered the financial crises of those years. Today the Association is even more sound and secure and also offers term life insurance. Spouses, children, and grandchildren of members are also eligible to purchase these life insurance plans.

Each member's policy includes Survivor Assistance Services to assist with expeditious payment, claims initiation, claims representation and lifetime generic benefit notification for the bereaved spouses and children of its members.

With no paid agents, AAFMAA relies on its members for support and assistance in bringing the benefits of membership to the attention of those eligible for membership.

Every eligible U.S. Army and Air Force Officer, Warrant Officer, Noncommissioned Officer and soldier and airman should become a member of AAFMAA. Every member is urged to inform their families of the assistance the Association provides at the time of death, and recommend membership to others eligible for membership.

Army and Air Force Mutual Aid Association

102 Sheridan Avenue • Ft Myer, VA 22211-1110

Toll Free: 1-866-4AAFMAA (422-3622) • Local: 703-522-3060 • FAX: 703-522-1336

E-mail: info@aafmaa.com • Web Site: www.aafmaa.com

Main Office Hours: 8:30 a.m. – 4:30 p.m. • Monday – Friday

Sales Telephone Hours until 7:00 p.m. at 1-877-398-2263

Night depository at Fort Myer

AAFMAA member Frank P. Lahm, Brigadier General, Ret., the first military passenger to ever fly, returns with his wife to Ft Myer in 1958 to help dedicate a monument to the location where these first military flights took place. AAFMAA takes great pride in providing our insurance and services to all Army and Air Force members who fly. They enjoy the same low-cost insurance as all other members with no increase in premiums or coverage limitations.



AAFMAA Survivor Assistance Services

For more than 124 years, AAFMAA has protected the families of Army and Air Force personnel with critical Survivor Assistance Services. In the event of your death, AAFMAA will be there for your family with:

- Expeditious payment. Death benefit is usually initiated on the day we receive the death certificate. Other settlement options are available upon request.
- Claims initiation. For government and life insurance claims, upon notification of death, AAFMAA sends appropriate forms for prompt receipt of benefits.
- Claims representation. We make initial inquiries and provide points of contact for resolution of all claims.
- Lifetime generic benefit notification. We provide an annual notice of changes in laws affecting benefits.

Are you eligible to become an AAFMAA member?

Eligibility extends to those who are:

- Active duty or retired Army or Air Force personnel below age 66.
- Active Army or Air Force Guard or Reserve personnel below age 66.
- USMA and USAFA cadets.
- Army or Air Force ROTC contract or scholarship cadets.

Is a member's family eligible?

Yes, if:

- Your spouse is below age 81.
- Your children or grandchildren are below age 24 (for Value-Added Whole Life insurance).

Shop around. There's just no comparison.

AAFMAA is always great coverage for a low price. Here are just some of the reasons:

- No aviation clause, No war clause, and No terrorist clause.
- AAFMAA's insurance continues after you leave the military. SGLI stops 120 days after you separate or retire.
- Your spouse is eligible for AAFMAA's low-cost coverage.
- Survivor Assistance Services are provided with each member's policy.
- Your children and grandchildren are eligible for low-cost AAFMAA coverage, too.
- AAFMAA's representatives are ready to assist you with your best interests in mind.

Let us answer your questions and provide quotes over the phone, without obligation.



Insurance from a name you can trust... AAFMAA

STABILITY • REPUTATION • LOW COST • SINCE 1879

AAFMAA Direct (toll free) 877-398-2263

Five minutes on the phone NOW could save you thousands of dollars for the life of your policy.



Reproduced courtesy of Air Force Art Program

Artist: John T. McCoy, Jr.

The Wright Brothers at Ft Myer - July 30, 1909

Wilbur Wright holds the Army Signal Corps flag as he talks to (L to R) LT Foulois, LT Lahm, and Orville Wright. AAFMAA member LT Lahm made history a year earlier as the first military airplane passenger. LT Foulois was chosen to be Orville's passenger on this occasion, the only time that both Orville and Wilbur were together at Ft Myer. On this test, the Wright Flyer was required to fly 5 miles at 40 mph, round trip, on a course set between Ft Myer and Alexandria, VA. Approximately 7,000 spectators were present to witness the event. After disappearing over the horizon, everyone waited anxiously for the plane's return. Almost 15 minutes passed before someone sighted them momentarily on the horizon, but they quickly disappeared between two ridges causing another wave of anxiety from the crowd. Rising over the treetops, the plane crossed the finish line to applause and cheering so loud that Orville and LT Foulois could hear it over the roar of the engine. President Taft did not arrive in time for the start but was present to witness the successful completion. Their speed out was 37.7 mph and the return was 47.4 mph for an average of 42.5 mph. This completed the last and most important specification of the Army contract awarded more than a year earlier. The Army paid \$25,000 for the plane plus another \$2,500 for each mph achieved over 40 mph, \$30,000 total.

A Special Offer to all AAFMAA Members

Reprints suitable for framing available. All proceeds above cost donated to Army and Air Force art programs.

Reprints of this picture can be purchased for \$10.00 each. The 22"x34" full-color poster is printed on a smooth cover-weight paper. All proceeds after costs (postage, printing, mailing tube and handling estimated to be \$5.00) will be donated equally between the U.S. Army Center of Military History and the U.S. Air Force Art Program. **Donations are not tax-deductible.**

Please fill out the information requested on the bottom of the mail back card attached to this cover. Allow 6 weeks for processing and delivery. **Please do not send cash.** Pay by check or credit card (Visa/MasterCard only). If you pay by check please enclose payment in an envelope along with the attached return card with name and address.

Word of mouth remains our most cost-effective form of advertising for attracting new members. Please don't forget to mention us to your friends and colleagues. More members result in lower-cost insurance for everyone. *Thank you.*



Insurance from a name you can trust... AAFMAA
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