

AAFMAA

2003 Annual Report



125 YEARS

Growth built on trust



AAFMAA Board of Directors

(As of 31 December 2003)

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

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Joe R. Reeder
MAJ, USAR



John A. Dubia
LTG, USA, Retired



Richard S. Hassan
Brig Gen, USAF



Mike O'Connell
BG, USA, Retired



Donald W. Shepperd
Maj Gen, USAF, Retired



Elisabeth J. Strines
Col, USAF



John A. Shaud
Gen, USAF, Retired



Tyrus W. Cobb
COL, USA, 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
Maj Gen, USAF



James P. Gerstenlauer
COL, USA

OUR MISSION

AAFMAA

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

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, CFP®, USA, Retired
President and Treasurer

LTC Tom E. Hargis, USA, Retired
Secretary

CMSgt Brady M. Gruler, USAF, Retired
Vice President for Insurance

MESSAGE *from the Chairman*

Re-invigorated AAFMAA. Two words that mean so much. Our success in 2003, and over the past several years, reflects a re-invigorated AAFMAA. By aggressively implementing improvements, focusing on what you, the members, need and want, we have been able to exceed even our own expectations. In 2003 we achieved record growth in every area; membership, lives insured, policies in force, and insurance in force. On top of that, we achieved record high levels in assets. Every member and every policyholder benefits from the re-invigorated AAFMAA.

How does this record growth benefit our members? First, by having more policies in force, operating costs are spread across a larger base of policies thereby reducing the cost per policy. This contributes to either larger partial premium refunds for eligible term policyholders or faster cash value accumulation for Value-Added Whole Life policyholders. Second, increased assets permit higher coverage limits. For example, recently we were able to raise the maximum initial coverage limit on Value-Added Whole Life insurance policies to \$800,000.

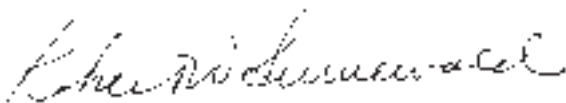
Your Association exists solely for you. It is our job to deliver to you the best benefits possible. Some recent additions to these benefits are:

- Long Term Care Settlement Option, with our Value-Added Whole Life policies
- Increasing the coverage age for existing members and spouses to buy additional Value-Added Whole Life insurance to age 79
- The Trade-Up Program, where insurable policyholders can increase their coverage and still retain their previous premiums

Remember, our financial success also allows us to provide our unique Survivor Assistance Services, which are included with every member's policy. These are designed to help your survivors in their time of need. AAFMAA remains steadfast in its commitment to our two objectives: low-cost insurance and services. Your re-invigorated AAFMAA has produced efficiencies, which are essential to provide low-cost insurance, while maintaining our commitment to assisting your survivors.

This has been a great year. For 125 years, AAFMAA has stood with its members through good and bad times. Your trust in us has allowed us to succeed and grow. You can rely upon AAFMAA to stand ready for at least another 125 years! Thank you for your continued support and confidence.

Yours very truly,



Robert W. Sennewald
General, USA, Retired



OUR VISION
IS TO BUILD
AAFMAA
INTO A
FULL SERVICE
INSURANCE
COMPANY.



YOUR
ASSOCIATION
HAS EARNED
OUR DEEPEST
RESPECT AND
GRATITUDE
FOR ITS
IMPORTANT
WORK...

MESSAGES *to the Army and Air Force Mutual Aid Association*

UNITED STATES AIR FORCE

15 March 2004

Since 1879 the Army and Air Force Mutual Aid Association has been an invaluable resource for our military in times of personal need. Congratulations on 125 years of excellence.

A central concern of the Air Force leadership is the financial and emotional welfare of our military members and their families. The Army and Air Force Mutual Aid Association's legacy of support, commitment, deeds and service 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 the work that you perform and best wishes for continued success.

John P. Jumper
General, USAF

UNITED STATES ARMY

March 22, 2004

I would like to express my most sincere appreciation to the Army and Air Force Mutual Aid Association for 125 years of dedicated assistance and support provided to the Soldiers of America's Army and their families.

Today, our Armed Forces enjoy the undisputed distinction of being the best in the world. The readiness of our young men and women is inextricably linked to their well-being. Since 1879, the Army and Air Force Mutual Aid Association has played an important role in making its services available in times of need. Our Soldiers can face the hazards of duty and separation from loved ones knowing, that if needed, their family members will receive competent and compassionate assistance and support from your organization.

Thank you and best wishes for continued success. God bless you and your families, our Soldiers and our Nation.

Sincerely,

Peter J. Schoomaker
General, United States Army

AAFMAA... 125 Years

	<i>Members</i>	<i>Insurance in Force</i>
2003 <i>Operation Iraqi Freedom</i>	67,138	\$7.13 Billion
<i>AAFMAA sets records in growth of new members, policies issued, insurance in force and assets</i>		
2002 <i>Long Term Care Settlement Option offered</i>		
2001 <i>AAFMAA launches "Get a Quote" on website. Instant quotes for all AAFMAA's policies with descriptions of each policy</i>		
2000 <i>Enlisted service members eligible for membership</i>		
1997 <i>AAFMAA offers term insurance in addition to permanent insurance</i>		
1995 <i>NCOs eligible for membership. Age limit for admitting new members raised from 60 to 66</i>		
1991 <i>Gulf War</i>	58,858	\$1.28 Billion
1987 <i>Name changed to Army and Air Force Mutual Aid Association (AAFMAA)</i>		
1984 <i>Air Force officers eligible for membership</i>		
1965 <i>Vietnam War</i>	33,717	\$238.7 Million
1950 <i>Korean Conflict</i>	14,642	\$69.0 Million
1941 <i>World War II</i>	8,741	\$36.6 Million
1917 <i>World War I</i>	1,865	\$5.6 Million
1898 <i>Spanish American War</i>	1,248	\$3.7 Million
1879 <i>LTC Roger Jones founded AMAA after the battle of Little Big Horn (1876) with the purpose to aid bereaved families in their time of need. AMAA's expressed purpose was "to aid the families of the deceased members in a prompt, simple and substantial manner."</i>	305	\$0.2 Million



2003



1987



1965



1950



1917



1898



1876

Photos Courtesy of U.S. Army



REPORT *of the President and Treasurer*

As General Sennewald illustrated, a vital, growing AAFMAA benefits all members and policyholders. As testament to its newfound vigor, AAFMAA achieved record growth across the board.

- **Insurance in Force.** A net increase of \$1.9 billion in one year! This is the largest increase in AAFMAA's history.
- **Policies in Force.** Another record. Net increase of 2,694 policies for a total of 94,966 policies in force.
- **Membership and Lives Insured.** Two records! Net membership grew by 1,823 to an all-time high of 67,138. The number of spouses, children and grandchildren insured increased by a net of 754. This illustrates AAFMAA's importance and relevance to the Army and Air Force communities.

AAFMAA also achieved record financial success in 2003. Income of \$70.4 million supported \$24.5 million in death benefit payments to survivors, \$0.7 million in term insurance partial premium refunds, \$16.8 million in additions to members' policy cash values, plus additions to our other reserves. Our financial success also enabled the creation of a Beneficiary Assistance Team. This team exists solely to provide information about settlement options for beneficiaries of AAFMAA policies. With a single call, your surviving beneficiary can now obtain all information on lump sum, interest only, or annuity payment options for AAFMAA policies. Further, our financial results allowed for the continuation of the 7% crediting rate on Value-Added policies for 2004.

For 125 years, AAFMAA has been ready for any eventuality. In 2003, we took two additional steps to ensure that AAFMAA can prosper under any scenario.

- **War Risk Reserve.** We established a separate \$40.1 million War Risk Reserve to ensure additional contingency coverage for risks associated with war. Although, military conflicts, even WWII and Vietnam, have had no disruptive impact on AAFMAA's mortality experience, we took this "belt and suspenders" step as an added precaution.
- **Retiree Costs.** We have minimized all retiree medical, dental, life insurance and pension obligations. Remaining cumulative, projected retiree costs total only \$66,410. There are no future retiree obligations being incurred.

Is AAFMAA re-invigorated? Definitely. Record growth plus a Total Portfolio Return of 12.2% illustrate that vigor.

Your Association is fortunate to have a dedicated, experienced and well-trained staff focused on meeting your needs. As President and Treasurer, I am honored to report the success they generated for your benefit in 2003.

Walter R. Lincoln, CFP[®], USA, Retired
President and Treasurer

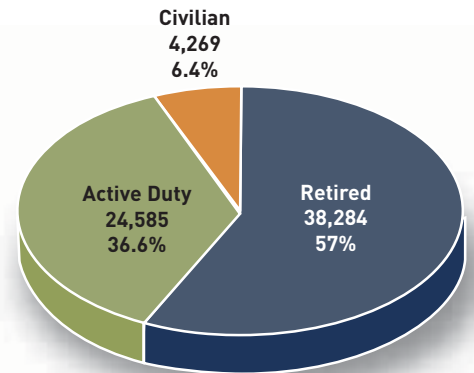
IS AAFMAA
RE-INVIGORATED?
DEFINITELY.
RECORD GROWTH
PLUS A TOTAL
PORTFOLIO
RETURN OF 12.2%.

AAFMMA *Overview 2003*

Comparative Highlights

	Year ended 31 December	
	2003	2002
Insurance in Force (\$ millions)	\$7,130	\$5,243
Total Reserves (\$ millions)	\$754.0	\$672.4
Number of members	67,138	65,315
Number of member deaths	842	856
Death benefits paid (\$ millions)	\$24.5	\$23.4
Net Yield on Assets	6.9%	6.5%
Total Portfolio Return	12.2%	7.5%
Expenses (% of gross revenue)	7.6%	7.1%

Member Profile



Surviving Spouses: 11,145

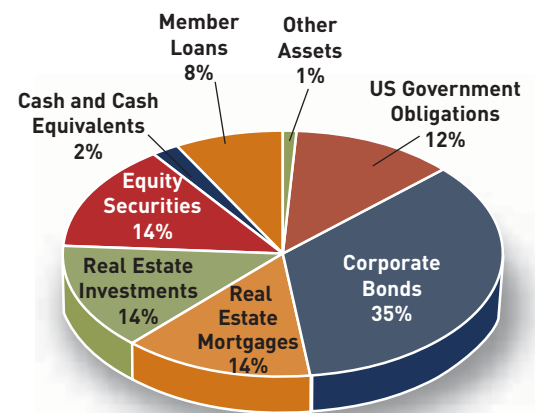
Statement of the Association Actuary A.C. Eddy, Inc., Norcross, GA

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.

2003 *Assets*

Summary of Assets

Securities	Year ended 31 December	
	Amortized Value	Market Value
U.S. Government Obligations	\$ 90,936,070	\$ 92,279,351
Corporate Bonds	269,282,193	300,045,228
Real Estate Mortgages	105,002,997	105,002,997
Real Estate Investments	103,226,488	124,343,713
Equity Securities	102,752,323*	102,752,323
Cash and Cash Equivalents	15,287,128	15,287,128
Accrued Investment Income	8,249,352	8,249,352
Total Securities	694,736,551	747,960,092
Member Loans	64,599,354	64,599,354
Property & Equipment Net of Accumulated Depreciation	541,154	541,154
Other Assets	583,059	583,059
Total Assets	\$ 760,460,118	\$ 813,683,659



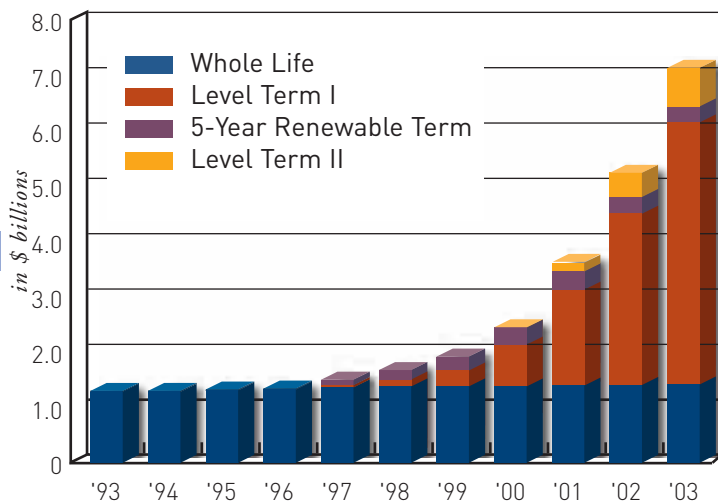
Total Assets: \$760 Million

*Equity Securities are valued at market.

INSURANCE *in Force*

Includes family coverages

Insurance in force, beginning of year	\$5,242,924,006
Insurance sold in 2002	\$2,339,728,021
Death benefit growth	13,870,581
Death benefits incurred	(24,545,314)
Other terminations	(442,304,299)
Insurance in force, end of year	\$7,129,672,995

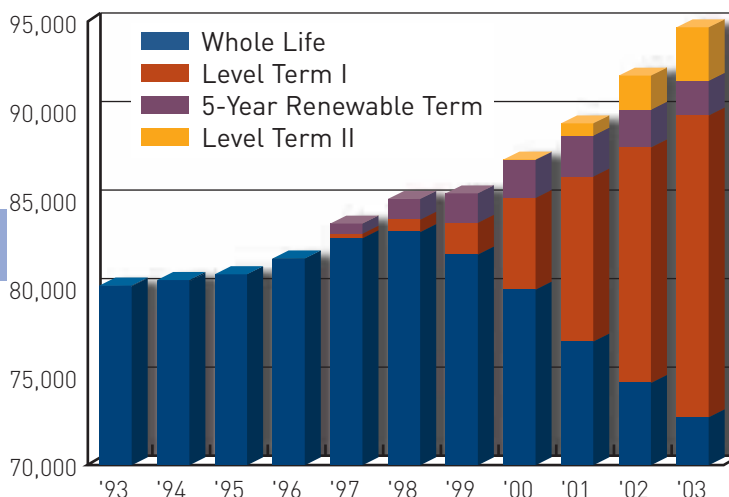


POLICIES *in Force*

Includes family coverages

Insurance policies in force, beginning of year	92,272
New policies issued	7,583
Policies matured by death	(1,239)
Other policy net terminations	(3,650)
Insurance policies in force, end of year	94,966

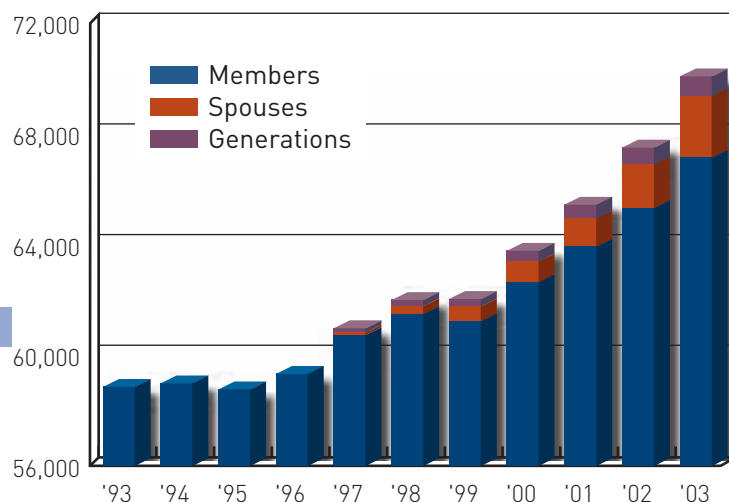
Note: Beginning balance includes 267 Service Only (SO) policies and ending balance includes 243 SO policies.



MEMBERS *and Lives*

Includes family coverages

Members, beginning of year	65,315
Gains	5,046
Losses	(3,223)
Members, end of year	67,138
Spouses and Generations, beginning of year	2,190
Gains	829
Losses	(75)
Spouses and Generations, end of year	2,944
Total Lives	70,082



STATEMENT of Assets, Liabilities and Reserves

Statutory Basis

For the year ended 31 December 2003

Assets

Bonds

U.S. Government Obligations	\$ 90,936,070
Corporate Bonds	<u>269,282,193</u>

Total Bonds \$ 360,218,263

Real Estate Mortgages 105,002,997

Real Estate Investments 103,226,488

Equity Securities 102,752,323

Member Loans 64,599,354

Cash and Cash Equivalents 15,287,128

Accrued Investment Income 8,249,352

Property and Equipment, at cost

(less accumulated depreciation of \$936,828)..... 541,154

Other 583,059

Total Assets **\$ 760,460,118**

Liabilities and Reserves

Liabilities

Death Benefits Payable \$ 2,167,224

Accounts Payable 1,057,134

Deferred Revenue 1,644,984

Settlement Options Payable 1,141,941

Accrued Post-Retirement Benefits 434,908

Total Liabilities \$ 6,446,191

Reserves

Insurance and Other \$ 568,355,898

Interest Maintenance 50,813,441

Asset Valuation 29,795,015

War Risk Reserve 40,123,581

General Contingency 64,925,992

Total Reserves 754,013,927

Total Liabilities and Reserves **\$ 760,460,118**

See Notes to Financial Statements

STATEMENT of Income and Reserves

Statutory Basis

For the year ended 31 December 2003

Income

Premiums	\$ 21,661,818	
Dues	99,706	
Consideration for supplemental contracts	200,450	
Net investment income	46,303,786	
Amortization of interest maintenance reserve	2,179,533	\$ 70,445,293

Benefits and Expenses

Death benefits	\$ 24,545,314	
Surrender benefits	6,347,928	
Services benefits	2,375,089	
Premium refunds, term insurance	728,257	
Annuity payments	73,125	
Insurance expense		
Increase in aggregate reserves for life policies	13,208,428	
Decrease in reserves for annuities	59,010	
Increase in dues reserves	41,091	
General administrative and operating expenses	5,322,480	(52,700,722)

Net Income Before Excess Interest Credits

and Investment Transactions		17,744,571
Excess interest credited to members' policies		(6,470,850)

Net Income After Excess Interest Crediting

Net realized gain on investments		
(excluding interest maintenance reserve gains of \$27,717,271)		1,015,175

Net Income **\$ 12,288,896**

Reserve Transactions

Insurance and Other Reserves, Beginning of Year		\$ 588,700,100
Increase in reserves for life policies	\$ 13,208,428	
Increase in reserves for annuities	59,010	
Increase in dues reserves	41,091	
Excess interest credited	6,470,850	
Decrease to reflect war risk reserve separately	(40,123,581)	
Net change in reserves for the year		(20,344,202)

Insurance and Other Reserves, End of Year **\$ 568,355,898**

General Contingency Reserve

General Contingency Reserve, Beginning of Year		\$ 46,251,736
Net Income	\$ 12,288,896	
Change in unrealized depreciation of equity securities	24,048,786	
Change in asset valuation reserve	(17,612,454)	
Change in survivor reserves	(50,972)	
Net change in reserves for the year		18,674,256

General Contingency Reserve, End of Year **\$ 64,925,992**

See Notes to Financial Statements

STATEMENT of Cash Flows

Statutory Basis

For the year ended 31 December 2003

Cash Flows from Operating Activities

Net income		\$ 12,288,896
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of interest maintenance reserve	\$ (2,179,533)	
Equity earnings in subsidiaries	(9,594,570)	
Realized net gains from investments	(28,695,773)	
Amortization/accretion of bond discounts/premiums	(501,885)	
Depreciation	315,856	
Bad debt expense	172,599	(40,483,306)
Changes in operating assets and liabilities:		
Increase in accrued investment income	\$ (474,088)	
Decrease in other assets	121,245	
Decrease in death benefits payable	(182,109)	
Increase in accounts payable	512,545	
Decrease in deferred revenue	(207,214)	
Decrease in accrued post-retirement benefits	(113,392)	
Increase in settlement options payable	614,336	
Net increase in life, annuities and other reserves	19,830,351	20,101,674

Net Cash Used by Operating Activities **\$ (8,092,736)**

Cash Flows from Investing Activities

Member loans issued	\$ (26,764,089)
Member loan repayments	24,673,711
Securities purchased	(313,049,901)
Securities sold/redeemed	346,501,342
Capital Contributions to subsidiaries	(25,093,023)
Distribution from subsidiaries	8,530,000
Property and Equipment purchased	(36,804)

Net Cash Provided by Investing Activities **14,761,236**

Increase in cash and cash equivalents	6,668,500
Cash and cash equivalents at beginning of year	8,618,628

Cash and Cash Equivalents at End of Year **\$ 15,287,128**

See Notes to Financial Statements

NOTES to Financial Statements

31 December 2003

1. Significant Accounting Policies

These notes summarize major accounting policies followed by AAFMAA to prepare our financial statements. The accompanying financial statements conform to statutory accounting practices. Although AAFMAA is not subject to insurance regulation, these financial statements conform to 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 (GAAP). Because a major objective of 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. Management believes statutory accounting practices more conservatively measure AAFMAA'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 are reported at fair market value. Investments in bonds are reported at amortized cost, in accordance with the National Association of Insurance Commissioners.

Real estate mortgages, member loans and Career Assistance Program (CAP) loans are reported at unpaid principal balances, or cost. 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 \$421,900 were written off due to non-performance during the year. This number represents about 1.6% 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 below. 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 AAFMAA. Mortgages are private placements for which quoted market values are not available. For mortgages and member loans, cost is used as the market value. Equity securities are reported at cost of \$120,947,239 less unrealized losses of \$18,194,916.

AAFMAA has two types of real estate mortgage loans: fixed interest rate and variable interest rate. The fixed interest rate loans have characteristics similar to conventional single-family home 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 obligate the borrower 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.

AAFMAA has two wholly owned subsidiaries, Consolidated Realty LLC (CRLLC) and Riverside Property LLC. CRLLC holds real estate properties and, with its other net assets, has a total estimated market value of \$95,422,000. The investment in this wholly owned LLC is accounted for using the equity method. The properties and other assets of CRLLC are held in a single limited liability company (LLC). On January 1, 2004 AAFMAA formed Starco Properties Holding LLC. Starco Properties Holding LLC is the single member LLC holding the LLC for each separate property, e.g., Starco Properties I LLC holds a separate property, Starco Properties II LLC holds a different property, etc. CRLLC was converted into a Starco entity. This form of ownership limits risks and liabilities from one commercial real property affecting the other commercial real properties. Riverside Property LLC was formed in September 2003 as a single purpose entity owning one office property in Washington, DC. The property is 100% leased to a single tenant. The tenant has an option to purchase the property at a predetermined price. The lease and purchase option expires in September of 2006.

Property, Equipment and Depreciation

Certain office equipment, furniture and applications software are expensed in the year of purchase. Under statutory accounting practices, the un-depreciated costs of these assets are considered "non-admitted assets," i.e. assets accorded no value. Accordingly, the Association expensed the remaining value, \$235,241, of these assets in 2003. The building, land improvements and certain other equipment will continue to be depreciated on a monthly basis. Total depreciation for the year was \$315,857.

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 plans of insurance are equal to the sum of the individual benefit plan accumulation values but not less than the minimum cash value for each certificate. AAFMAA held certain additional reserves at 31 December 2003 such that the sum of accumulation values and these additional reserves were equal to or greater than minimum reserves for such certificates as prescribed by the NAIC for regulated insurers. Excess interest credits, as reflected in the Statement of Income and Reserves, equaled the amount credited to cash value accounts in excess of statutory minimums.

Interest Maintenance Reserve/Asset Valuation Reserve

An 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 amortized into income over the approximate remaining life of the investments had they not been sold. An AVR is maintained based upon a formula prescribed by the NAIC for the purpose of providing for default and equity risks related to AAFMAA's invested assets.

Concentration of Credit Risk

AAFMAA has a concentration of credit risk. 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 assets 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

AAFMAA was formed in 1879. It provides life insurance benefits and survivor services. Members consist of active, retired, reserve, and guard, officers, warrant officers, non-commissioned officers and soldiers and airmen of the US Army and US Air Force, cadets serving at the US Military Academy and US Air Force Academy, and cadets with ROTC scholarships and contracts. AAFMAA also insures the spouses, children and grandchildren of members. Spouses, children, and grandchildren are NOT members unless qualified as such in their own right. AAFMAA provides interest-sensitive and term life insurance and Survivor Assistance Services.

3. Related-Party Transactions

Armed Forces Services Corporation (AFSC) is a for-profit, Virginia non-stock corporation created July 1, 2000. AFSC was created to provide living services and survivor services. For AAFMAA members before July 1, 2000, who maintain their grandfathered status, these services will continue to be provided. AAFMAA signed a ten-year contract with AFSC to provide these continuing services. For the year ended December 31, 2003, AAFMAA incurred servicing expenses of \$2,375,089.

The initial valuation amount of \$644,800, for the property, credit enhancement and intangible benefits provided by AAFMAA to AFSC, is excluded from the Statement of Assets, Liabilities and Reserves. AAFMAA received \$43,161 of interest income during 2003 from AFSC on their liability. The interest received 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: 6.1% for 1 July 2002 - 30 June 2003 and 7.5% for 1 July 2003 - 31 December 2003.

Accumulated interest for calendar year 2003 was \$48,081. The total of the AFSC debt (principal and accrued interest) is \$731,385 as of 31 December 2003. AAFMAA and AFSC have entered into negotiations which may result in a modification of the Services Contract providing greater flexibility for the members and expanded survivor services for select beneficiaries in exchange for conversion of this debt to preferred stock and a license agreement for AFSC to use certain AAFMAA-owned software.

4. Other Assets

Other Assets on the Statement of Assets, Liabilities and Reserves, consist of the following:

• Prepaid Expenses	\$189,511
• Other receivable-Real Estate Mortgages	\$522,818
• Other receivable-AFSC	\$ 23,828
• Deferred Compensation Assets	\$368,498

5. Employee Benefits

Retirement Plan

AAFMAA has a 401(k) and profit-sharing plan that covers all employees who meet certain minimum eligibility requirements. AAFMAA 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 31 December 2003 was \$375,167, which includes \$189,196 of employees' elective deferrals.

Life Insurance

AAFMAA self-insures each employee for \$50,000 after one year of employment. Employees may obtain additional life insurance coverage with AAFMAA at their own expense if they qualify. Employees are NOT members of AAFMAA unless qualified as such in their own right.

6. Post-Retirement Benefits

AAFMAA discontinued the retiree dental plan. Previously, retirees contributed 60% of the dental insurance premiums; AAFMAA paid 40%. AAFMAA paid each affected retiree an amount representing future premium costs for their estimated life span, plus an additional amount to cover approximate tax impacts. The amount paid totaled \$42,685. With this most recent cost containment effort, all retiree benefits have been eliminated except for those retirees and/or surviving spouses of retirees previously covered under the retiree health care plan. There are currently seven retirees covered under the retiree health care plan, two will be covered until age 65, and five will be covered until death. Retiree health care plan costs to AAFMAA in 2003 were \$12,649.

The retiree health care plan costs AAFMAA 40%; the retiree contributes 60% or a fixed monthly amount for select retirees. Projected, cumulative obligations follow:

5 Retirees until death	\$52,822
2 Retirees until age 65	13,588
7 Total projected retiree costs	\$66,410

The deferred compensation plan has been eliminated. Three (3) retirees will receive payouts of the amounts the retirees funded and deferred from their compensation.

7. Commitments

AAFMAA has committed \$2,380,164 to AFSC to provide services to AAFMAA's members for 2004. Since December 31, 2003, the Association has committed to fund approximately \$15,423,64 for commercial real estate loans.

8. Land Lease

In December 1998, AAFMAA entered into a 30-year lease with the Department of the Army to lease the land upon which AAFMAA'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.

To the Board of Directors, Army and Air Force Mutual Aid Association

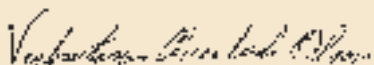
We have audited the accompanying statutory basis statements of assets, liabilities and reserves of Army and Air Force Mutual Aid Association as of December 31, 2003, and the related statutory basis statements of income and reserves and cash flows for the year then ended. These financial statements are 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 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 reasonable 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, 2003, or the results of its operations or its cash flows for the year then ended.

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 2003) 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.



VERKOOTEREN, AUERBACH & OLSON, L.L.P.
Silver Spring, MD
March 15, 2004



Charles M. Betancourt
General Manager
Consolidated Realty LLC

**CONSOLIDATED
 HELPS TO
 DIVERSIFY
 AAFMAA'S
 INVESTMENT
 PORTFOLIO...**

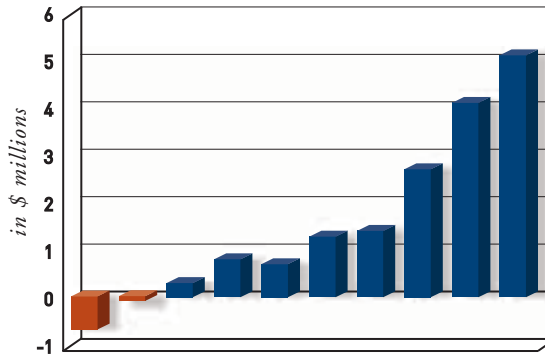


CONSOLIDATED *Realty LLC*

Consolidated Realty LLC is wholly owned by AAFMAA and serves as AAFMAA's real estate equity investment arm. Consolidated 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 either 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

Annual Net Rental Income



to be responsible for improved performance: (1) greater attention by management, and (2) successful leasing.

During 2003, Consolidated Realty distributed to AAFMAA \$8.1 million earned from its operations.

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

In January of 2004, AAFMAA restructured its ownership of Consolidated Realty into multiple single purpose entities under the brand name of Starco Properties. The purpose of this restructuring was to insulate each of the commercial properties so that risks and liabilities from one commercial real property do not spill over and adversely

affect other commercial real properties owned by AAFMAA. AAFMAA still retains 100% ownership of the assets.

In addition to the Consolidated Realty and Starco Properties logos, the company logos on this page represent some of the businesses that Consolidated Realty is proud to list as tenants occupying space in our portfolio of buildings.

SELECTED TENANT LOGOS FROM CONSOLIDATED REALTY PROPERTIES



AAFMAA's *Products and Services...2003*

WHO All Army and Air Force personnel, active, retired, Guard and Reserve below the age of 66, USMA and USAFA cadets, ROTC contract and scholarship cadets are eligible for membership. Member's spouse, children and grandchildren can be insured.

WHAT *Low-Cost Life Insurance and Survivor Assistance Services*

Value-Added Whole Life Insurance: Coverage up to \$800,000

- Level premiums – guaranteed to never increase
- Strong crediting rate increases cash value and death benefit
- Long Term Care Settlement Option
- Useful in estate planning
- Borrow up to 75% of cash value

Term Insurance: Coverage up to \$600,000

Level Term I:

- Level premiums to age 50 for non-smokers (age 40 for smokers)
- Up to 50% savings over SGLI

Level Term II:

- Generally for ages 45 and over
- Fixed rates up to 25 years

Five-Year Renewable Term:

- Rates fixed every 5 years
- Save up to 70% over VGLI

Survivor Assistance Services: Helping in their time of need

- Included with each member's policy
- Expeditious benefit payment
- Claims initiation
- Claims representation
- Lifetime notification of benefit changes provided annually

WHEN The sooner you start, the lower the cost - the more you save

WHERE 102 Sheridan Ave. Ft. Myer, VA 22211-1110
Phone: 1-800-336-4538 or www.aafmaa.com

WHY No agents/No commissions
No coverage limitations by rank
No war clause/No aviation clause/No terrorist clause
No aviation surcharges/limitations
All policies continue after retirement/separation
AAFMAA's 100% money back guarantee on Value-Added policies
Eligible children get \$10,000 coverage with member's LTI Policy



Photo Courtesy of U.S. Army

“If all companies and organizations operated with the efficiency, courtesy, and compassion of your association, the world would be a far better place.”

**MRS. THOMAS E. MARRIOTT,
WIDOW**

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.



*“I greatly appreciate and value your able assistance.
Without you, my claims process would have dragged
on for at least a year and I doubt I would have
attained the same result.”*

LTC EDWARD L. BENNETT, USA, RETIRED

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: 8:30am – 4:30pm * Monday – Friday
Membership and Insurance Sales Telephone Hours until 7:00pm at 1-877-398-2263



Insurance from a name you can trust... AAFMAA

STABILITY • REPUTATION • LOW COST • SINCE 1879

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