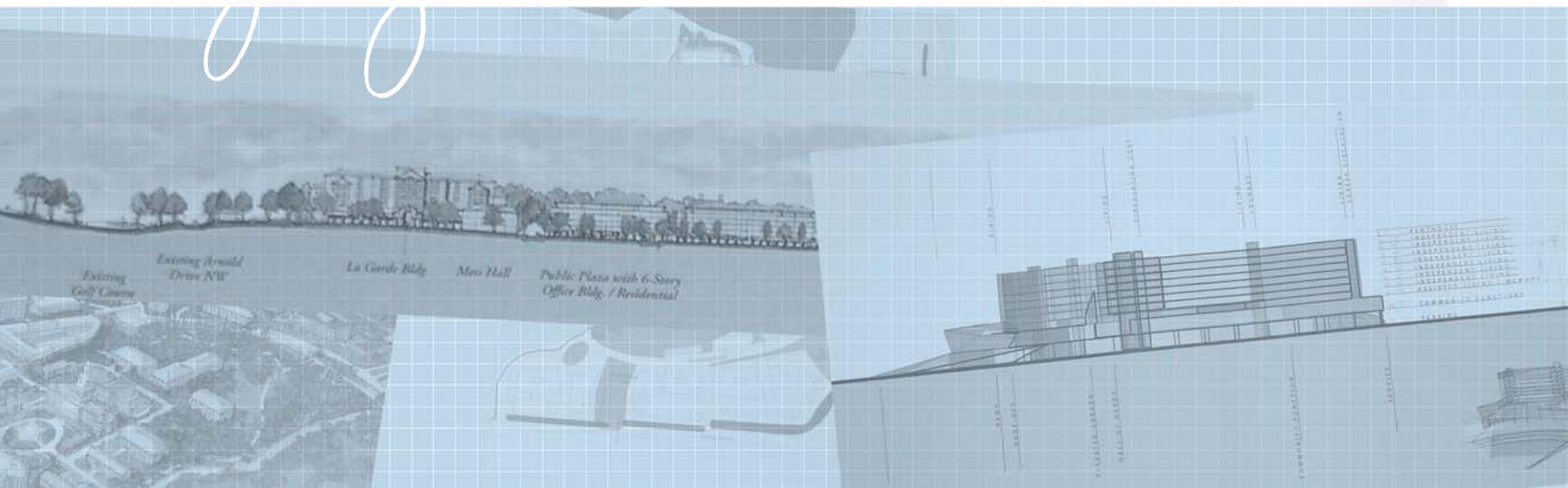




Forging New Foundations

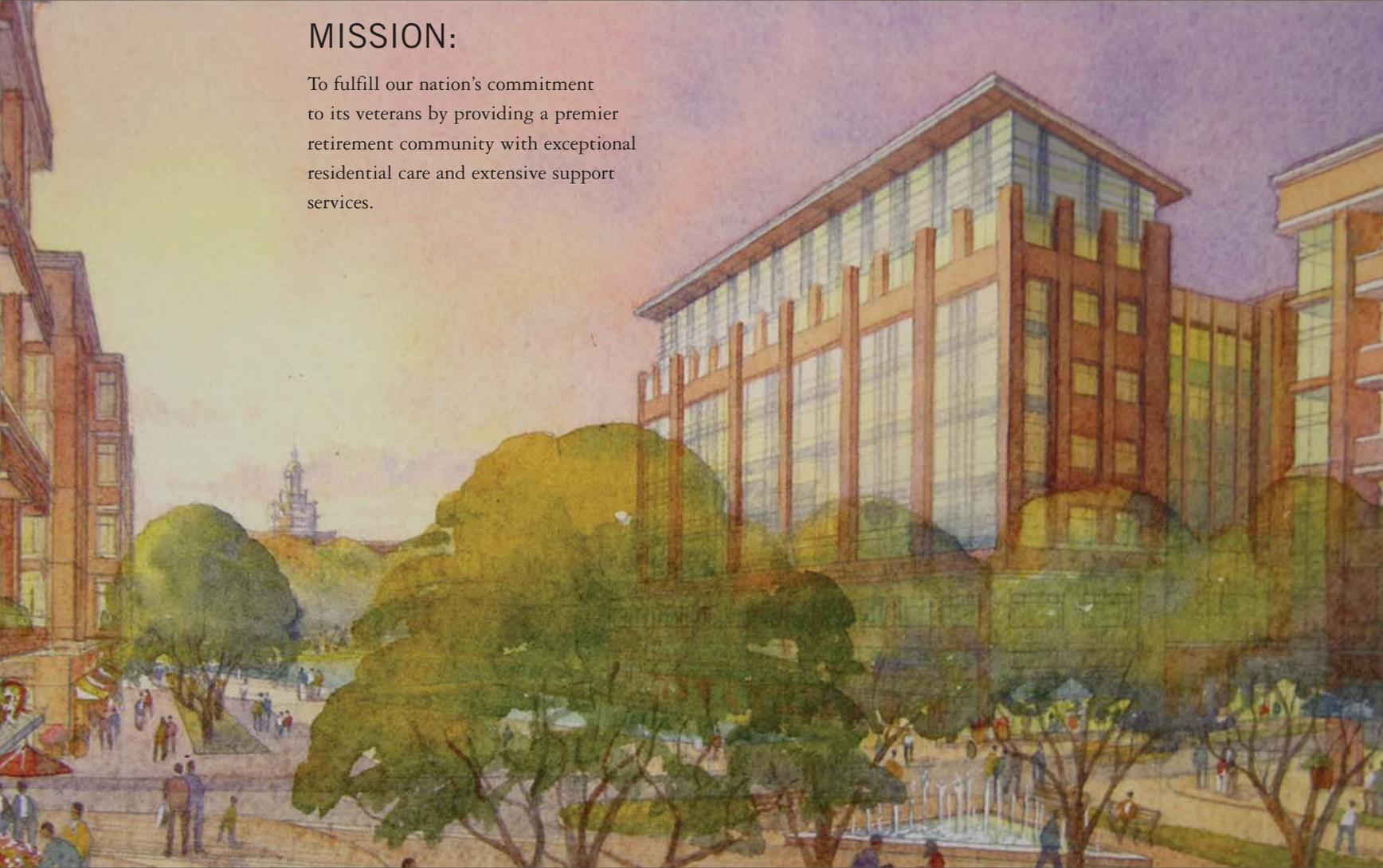


VISION:

To actively nurture the Health and Wellness Philosophy of Aging while providing our nation's heroes with a continuum of Life Care Services in a community setting.

MISSION:

To fulfill our nation's commitment to its veterans by providing a premier retirement community with exceptional residential care and extensive support services.



GUIDING PRINCIPLES:

Establish Accountability

We expect our workforce to achieve what we promise to residents, staff and service partners. To ensure success, we measure progress and provide feedback to our customers.

Honor Heritage

We honor the rich history of the US Armed Forces – from our veterans to our victories. As such, our campus reflects that military heritage with memorabilia and tributes.



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| | <ul style="list-style-type: none"> Building Blocks of our Success 4 Welcome to the AFRH PAR Highlights 6 | <ul style="list-style-type: none"> AFRH Organization 8 AFRH Strategy 10 Performance Achievements 11 <ul style="list-style-type: none"> President's Management Agenda 12 Financial Summary 14 Assets, Liabilities & Cumulative Results of Operations 16 Letter of Assurance 18 Risk Management 20 | <ul style="list-style-type: none"> Message from the Chief Financial Officer 24 Audit Results 26 Balance Sheet 28 Statement of Net Cost 29 Statement of Changes in Net Position 30 Management Challenges 31 |

www.afrh.gov

Inspire Excellence

We continuously work to improve each process, service and its delivery, while striving for excellence in all we do. We expect excellence and reward it.

Maintain Integrity

We will strongly uphold the Mission of AFRH. We are honest and ethical and deliver on our commitments. We recognize that good ethical decisions require individual responsibility enriched by collaborative efforts.

Maximize Workforce

We strive to hire and retain the most qualified people. We maximize their success through training and development as well as maintaining and promoting open communication.

Serve Customers

Success depends on our devotion to consistently serve ever-changing customer preferences. Hence, we vow to be innovative and responsive – while offering exceptional products and services at competitive prices.

Message from the Chief Operating Officer

Fortifying Our Finances

I am pleased to present the AFRH PAR highlights for FY07. For nearly 200 years, the mission of this Home has been to care for our nation's former military service members. All of us here carry a strong sense of pride in serving them. This year, at long last, we can take pride in our financial performance, too.

Today, we are forging a new foundation of financial success at AFRH. This renewal began in 2002, when Congress charged me to apply my CCRC¹ expertise from the private sector to the concerns at AFRH. Ever since, we have been striving to develop it into a self-sufficient retirement home. In this year's report, we will showcase that improved financial performance.

Restructuring our priorities

When I arrived in 2002, many believed that the Home was rapidly approaching financial insolvency, if not already there. So I pulled our team together and we drafted a strategic plan to unify our scattered forces and achieve new goals. Since then, we have focused on revitalizing our financial health via cost-cutting measures and renewing our aging infrastructure in DC. Our Master Plan has been the key to generating new sources of revenue and ultimately refurbishing the campus.

When Hurricane Katrina slammed the Gulf Coast in August 05, our main focus completely shifted from future strategy to daily survival. We resolved to transfer our weary Gulfport residents to Washington and shut down that severely damaged and outdated facility. Since then,

we've found new footing, thanks in part to the great support of Congress. Yet, many of our hard-earned economic efficiencies were again strained, due to the surge in occupancy after Katrina.

In short, we were building the foundations for Trust Fund solvency and financial growth when our entire configuration changed. So in FY07, we decided to conduct several studies to establish the best, most efficient way forward. We gained great insight. One study confirmed the Trust Fund is solvent. Another helped us develop a 10-year Financial Capital Plan. Along the way, we discovered our facility is in greater demand, given the legislation put forth by the Coast Guard to admit their veterans.

Modernizing the Home

Now, we are moving forward with many exciting developments – from the rebuild of Gulfport by 2010, to the renovation of the Scott building which comprises \$81 million of our 10-year Financial Capital Plan. These much-needed renovations will make our entire facility more vibrant and functional.

At the same time, we must keep pace with changing needs in senior care, like complying with the American Disability Act requirements – which includes alterations to the Sheridan residence. Another major decision entailed moving to CARE/CCAC² accreditation to cover all levels of care we provide as a CCRC. These changes will forge an even stronger foundation of care for the residents of today and tomorrow.

“Our ongoing efforts, coupled with our new financial strategy, are the building blocks for success.”

¹Continuing Care Retirement Community

²Commission on Accreditation of Rehabilitation Facilities and the Continuing Care Accreditation Commission

In May, we renewed our commitment to the AFRH Goals and Objectives at a successful management offsite. Moving forward, our business plan will be the blueprint for continued growth. Also, I challenged my staff to dig in and find ways to improve resident services. They responded by forming a variety of teams. One dramatically streamlined the work order process. Another focused on boosting staff retention. Yet another assessed ways to share data among the various levels of care. And another team surveyed ways to promote our military heritage. This synergy is creating a more efficient and dynamic AFRH.

Raising our Performance

Our Inspector General (IG) identified 3 major challenges for FY07:

- 1) - Implementing the Washington Master Plan
- 2) - Executing the Gulfport Master Plan to rebuild the facility
- 3) - Handling operational, financial & human capital strategies

Indeed, we made great progress. We signed a developer contract for our Washington Master Plan and completed the Memorandum of Agreement (MOA) with General Services Administration (GSA) to rebuild Gulfport. Reaching these major milestones gave us the launch pad we needed to move forward.

Further, we exceeded many of the strategic targets we set for FY07 performance. This demonstrates to Congress and our supporters that we

are producing results. Further, it reaffirms the strategies in our business plan and the “One Model” for a unified agency.

We are still in the process of reaching the training goals in our health and wellness model, measuring the success of our acquisition strategy, completing our succession planning for all operations and management and evaluating our organizational climate.

Looking forward, our IG has advised me that we face various new challenges in FY08. They involve staying on course with renovations, the accreditation and implementation of patient goals and keeping our constituents informed of our progress.

Structuring Sound Finances

Our ongoing cost-cutting measures, coupled with our new financial strategy, are the building blocks for future success. In fact, for the third straight year, we received an “unqualified opinion” on our financial statements from an external, independent auditor. So, I am confident that the performance information and financial data included in this PAR are complete and reliable.

In closing, I am proud of our recent achievements – yet I’m even more proud of the veterans who call the AFRH home. Rest assured, we will continue to manage their resources responsibly. Likewise we will continue to enhance the lives of the men and women who defended our nation and preserved our freedom.



Sincerely,

A handwritten signature in gold ink that reads "Timothy C. Cox". The signature is written in a cursive, flowing style.

Timothy C. Cox
Chief Operating Officer (COO)

November 15, 2007

The Building Blocks of Success

Charting Our Development



Major achievements under this framework:

FY03

AFRH commences operating under The National Defense Authorization Act of 2002

The “One Model” standard operating environment is created & launched

The AFRH Strategic Plan is drafted

Our standard operating environment was established after the COO was appointed in September 02. The COO, Mr. Cox, reports to the Secretary of Defense through the Under Secretary of Defense (Personnel & Readiness).

With vast experience in private retirement communities, Mr. Cox immediately standardized our two campuses – with one set of policies and procedures. His “One Model” called for regular assessments of our core competencies, plus determinations on whether to build internal capacity or competitively outsource functions. The result: the AFRH 2003 Strategic Plan, which became our blueprint for recovery and growth.

Before long, we fused that Strategic Plan with The Washington Master Plan, designed to provide additional resources to replenish the Trust Fund. Then, we integrated this dynamic AFRH strategic platform with several Federal strategic mandates:

- 1 - The Program Assessment Rating Tool (PART) to reduce the footprint & identify underutilized space
- 2 - The Federal Activities Inventory Reform (FAIR) Act Of 1998 to identify functions of the Federal government that are not inherently governmental (see www.afrh.gov - About Us)
- 3 - The President’s Management Agenda (PMA), through which we have identified & achieved remarkable gains

In 2004, all of these strategic tools coalesced. Since then, they've helped us form a solid platform for Trust Fund solvency and growth.



FY07

GSA drafts contract to rebuild Gulfport

FY06

Federal security Certification & Accreditation is earned for the AFRH Enterprise Network.

AFRH selects Crescent Resources, LLC as its preferred developer for the Washington Master Plan

FY05

JCAHO accreditation & "Gold Seal of Approval" awarded to both campuses



AFRH 10-year Financial Capital Plan commences

FY04

Strategic Plan is expanded with in-depth business & operational plans

AFRH receives its first "Unqualified Audit" opinion



The "footprint" of both campuses is dramatically reduced

Gulfport is closed due to damage from Hurricane Katrina

Second "Unqualified Audit" opinion is awarded

Financial Performance is improved via accounting with BPD



Congress authorizes \$240 M to rebuild the Gulfport facility

Third "Unqualified Audit" Opinion is awarded

The capital Real Estate Master Plan is developed

Costs are reduced by cutting need-less capital expenses (vehicles & facilities)



Welcome to the AFRH Performance and Accountability Report Highlights

Forging New Foundations

This book is a chance to celebrate our rich heritage and share our recent progress with Congress. It helps us meet various reporting requirements for US government agencies⁴. Plus, it's an opportunity to tell all Americans about the latest developments at the Home.

In recent years, AFRH has evolved into a modern retirement community, rivaling those in the private sector. We have made great strides transforming this agency, operating it more like a business. And we have continually enhanced our programs and services to provide even greater care.

FY07 has been the year of "Forging New Foundations." The strategic groundwork we laid out in 2002 has netted the positive gains we have been seeking. As a result of our recent business planning efforts, AFRH is finally showing concrete improvement in its financial performance.

Now we know the Trust Fund is solvent and the Home is financially sound. So, we've been developing a plan to renovate independent living, assisted living and long term care. Specifically, we're developing

more intimate and accessible living quarters by closing the distances between our buildings. Plus the Gulfport rebuild is under way and will rapidly accelerate in FY08.

Hence the foundation is set: one home in DC, one home in Gulfport – both with roughly the same resident capacity and economic cost. Add to it the Coast Guard's demand for inclusion plus new veterans from Iraq and future campaigns – and the picture is clear: AFRH is forging a very strong base, on top of which we will build our future.

Along with our plans to develop the Washington campus, we have a new landscape management plan for campus beautification. Plus, we are crafting an active communication plan with the residents, in order to understand their ideas and needs for activities, dining and military heritage. Yet, every improvement of our physical "foundation" is geared to benefit our residents – who are forging their own new friendships, activities and lives here at the Home.

AFRH employees & contractors have prepared this report in accordance with Federal guidelines.

⁴*The Accountability of Tax Dollars Act of 2002
The Federal Management Information Security Act of 1998
The Federal Financial Management Improvement Act of 1996
The Government Management Reform Act of 1994
The Government Performance and Results Act of 1993
The Chief Financial Officers Act of 1990
The Federal Managers Financial Integrity Act of 1982, and
The Inspector General Act of 1978*

Introduction to MD&A

Strengthening Our Base

Today's AFRH has sheltered and cared for tens of thousands of veterans spanning two centuries and nine major American conflicts. All along, the option to retire here has been one of the greatest benefits of military service. As our nation expands its military presence around the globe, we must rededicate ourselves to preserving the Home's resources – and ensuring those eligible a safe, comfortable retirement one day.

This mission can only be achieved with sound financial performance. In truth, the Home was bordering on insolvency for decades – mostly from cost inefficiencies on its sprawling Washington campus. Conversely, the Gulfport campus was more condensed and had a waiting list of approved applicants – making it much more cost-effective.

When the Trust Fund balance began to decline in 1995, Congress requested further study. AFRH responded by facilitating and executing many in-depth assessments:

Corporate Philosophy:

Our Vision and Mission are strongly rooted in the Home's heritage – yet they also incorporate modern philosophies in senior care. Plus our Guiding Principles were crafted to preserve the Home's foundation – while also serving as a guide to achieve the Mission. Ultimately, these smart strategic tools will help us meet the needs of a new generation of veterans.



WWII veterans from the DC metro area pose with Queen Elizabeth wreath at the National WWII Memorial.

Authority

[From Public Law] - 24 US Code, Section 411 Establishment of Armed Forces Retirement Home

(b) Purpose - The purpose of the Retirement Home is to provide, through the Armed Forces Retirement Home-Washington and the Armed Forces Retirement Home-Gulfport, residences and related services for certain retired and former members of the Armed Forces.

AFRH Organization

"Our 2002 goals included 're-visioning' AFRH as a modern CCRC."

Mapping Our Structure

The Organization

The AFRH was originally conceived as an "asylum" for old and disabled sailors and soldiers. It started in Philadelphia as the Naval Asylum, in the former country mansion of the prominent Pemberton family on the Schuylkill River. And in Washington as the Soldiers' Home, with a mere three residents in what is now the Lincoln Cottage on our main campus. For six generations thereafter, these Homes have been a beacon of security for America's aging guardians of freedom. Today, that tradition endures. Yet, AFRH has truly developed into a progressive retirement home with sound business practices.

Our Management

The COO manages both campuses with a corporate staff located on the Washington campus. [see figure 1.] Using our successful "One Model" for operations, each Home has a Director who reports directly to the COO. [see figure 2.]

Our Locations

The AFRH has two facilities. Our main campus is located on 272 lush acres in the heart of Washington, DC. Our auxiliary campus is nestled on 49 acres of pristine beachfront property in historic Gulfport, MS. When Gulfport reopens in 2010, both will provide excellent services and amenities that rival those at private retirement homes. For eligible veterans, the AFRH monthly fees are very affordable – and there are no costly registration dues.

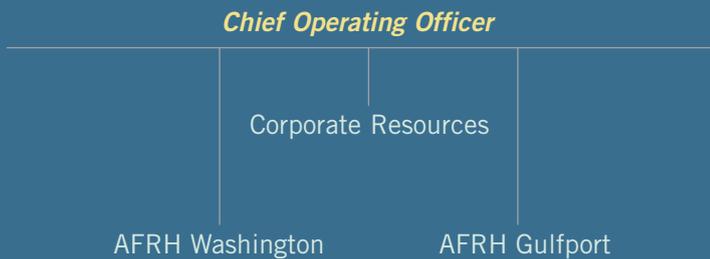


FIGURE 1: CORPORATE MODEL

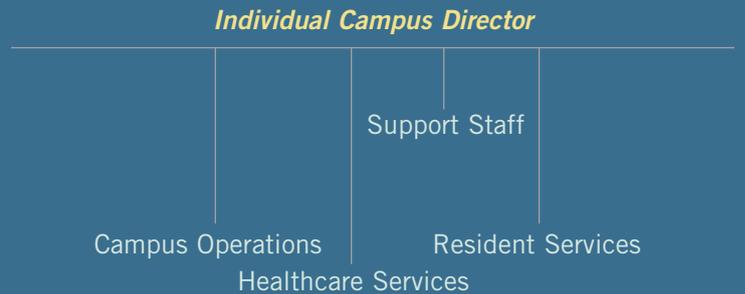


FIGURE 2: CAMPUS MODEL

CFO Steve McManus outlines our corporate strategy.



Both campuses have the same management structure:

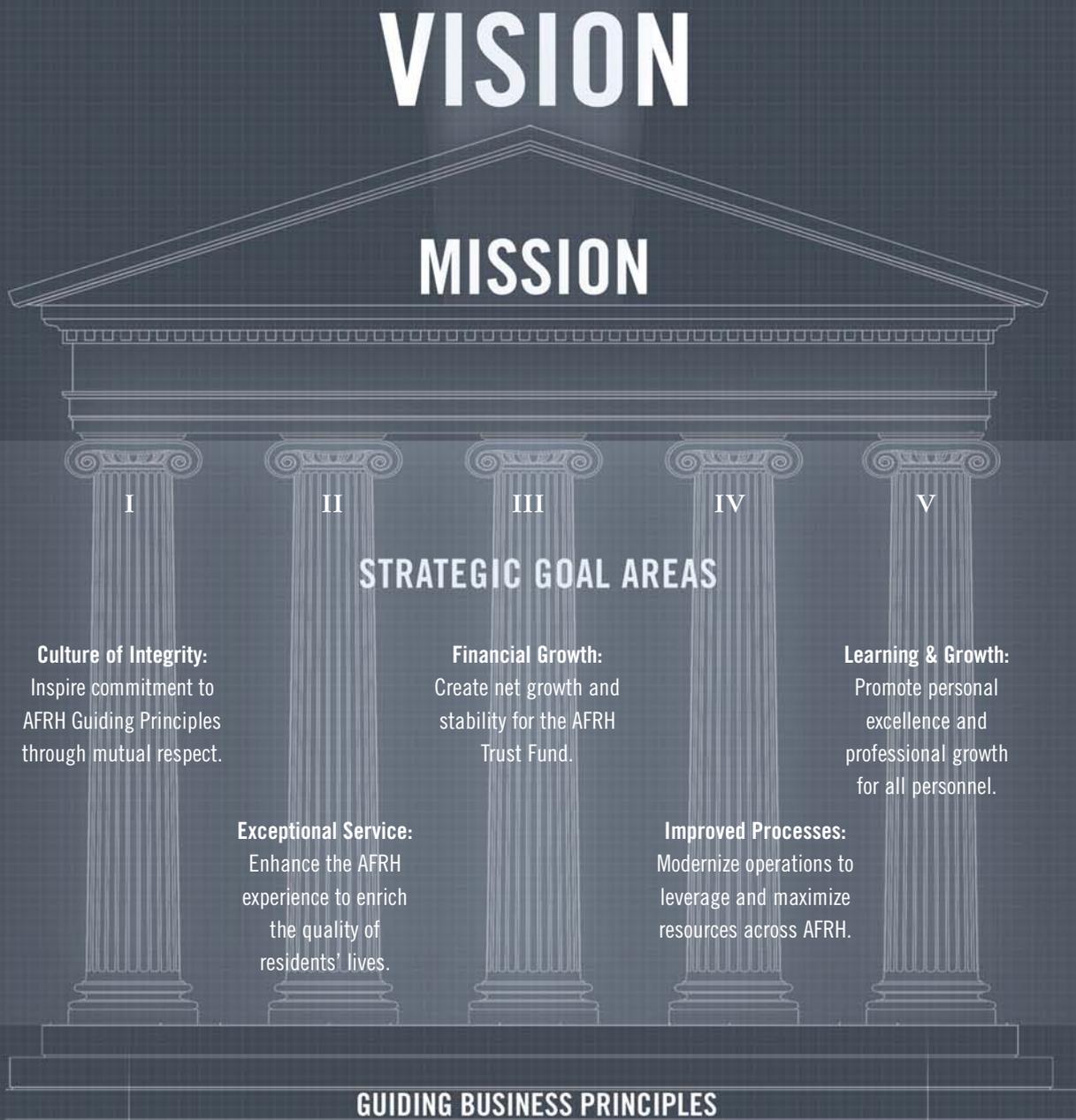
| CAMPUS OPERATIONS | HEALTHCARE SERVICES | RESIDENT SERVICES | SUPPORT STAFF |
|---------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|---------------|
| Facility Maintenance Transportation Logistics Grounds Utilities Custodial Services | Nursing Social Services Community Health Dental Optometry Nutrition Medical Records Assisted Living Long Term Care Memory Support | Admissions Recreational Services Volunteer Coordination Security Dining Services Religious Activities Custodial Services | Safety Office |

AFRH Strategy

Our Strategic Goals

AFRH is a premier retirement community and CCRC for eligible US Armed Forces veterans. We proudly serve them with the same level of honor and commitment that they demonstrated in serving our country. To fulfill our Mission, we have defined Strategic Goals across five major

areas. They serve as the pillars for specific performance objectives – which are connected to Initiatives in the President's Management Agenda (PMA). Plus these Goals continually help us build upon our success for the future.



86%
of goals
achieved

Performance Achievements

| Performance Measure | Baseline FY07 Target | Baseline FY07 ACTUAL | Met/Not Met |
|--------------------------------------------------------------------------------------|--------------------------------------------------------------------|--------------------------------------------------------------------------|-------------|
| Goal: FINANCIAL GROWTH | | | |
| Net growth to AFRH Trust Fund | Any gain over previous year | +\$13 million | Met |
| Cost savings via Asset Management per year | \$500K | Saved \$707K by closing Pipes | Met |
| Accuracy of Financial reporting | Unqualified audit opinion | Unqualified audit opinion | Met |
| Solvency of AFRH Trust Fund | Even balance of resources vs. obligations | Balanced | Met |
| Cost savings initiatives | 4 | 6 | Met |
| Effectiveness of the acquisition strategy | % of award dates that are met or improved | Not measured | Not Met |
| Percentage of inaccuracies found through Internal Controls | 5% or less | .5 % (1/2 of 1%) | Met |
| Goal: IMPROVED PROCESSES | | | |
| OPERATIONAL: Reengineered processes with automated enhancements per year | +2 | 3 | Met |
| ORGANIZATIONAL: Communications enhancements between employees and residents per year | +1 | 1 | Met |
| Goal: LEARNING & GROWTH | | | |
| Evidence of measurable training goals | 100% participation in 4 mandatory training classes 4 for all staff | Less than 100% participation in mandatory training classes for all staff | Not Met |
| Percentage of training written into employee performance plans | 100% | 100% | Met |
| Evidence of a needs based succession plan | Plan | Nursing Plan written | Met |
| GOAL: CULTURE OF INTEGRITY | | | |
| Number of additional cultural/volunteer programs | +1 | +1 | Met |
| Number of employee offsite activities | 2 | 2 | Met |
| Percentage of completed employee performance reviews | 100% | 100% | Met |
| Percentage of Employee Climate Survey responses of "Excellent" or "Very Good" | 70% | - | Not Met |
| Goal: EXCEPTIONAL SERVICE | | | |
| Percentage of Resident Service Survey responses of "Excellent" or "Very Good" | 75% | 75+% | Met |
| Number of new Independent Living residents | +144* | +172 | Met |
| Number of military heritage related events per year | 6 | 10 | Met |
| Number of partnerships with external stakeholders | 5 per year | 5 | Met |
| Percentage of employees trained in health and wellness model of retirement living | 70% | 94% | Met |

Grouped by Strategic Goals, we have several performance measures for our new baseline. FY07 is the first year we will record the results. In future years, we will compare all results to these baseline targets.

Our great success in finances and planning are a prelude to achieving additional goals in the future. (See Part 2 - Performance - for details.)

Improving Our Enterprise

The PMA is a strategic tool to greatly improve the management and performance of the Federal government. This program was modeled after the President's vision for the government to operate like a business – efficiently and effectively. The AFRH heeds the guidance in the

PMA and continues to make significant progress in each of its five Initiatives. The Home has not officially submitted for evaluation, but every year since FY04, we have conducted a self-assessment as of September 30th.

Special Focus on Improved Financial Performance

Background

All spending at the Home comes straight from the AFRH Trust Fund. So, we must maintain a healthy balance between our revenues and expenditures to preserve the Fund's vitality.

Washington Master Plan

This Plan strives for new revenue to support our resident-focused care. It will help grow the Trust Fund and give us more capital to improve the campus. The Plan seeks to attract development at a fair market value that is compatible with the AFRH Mission. In summer 05, an open dialogue with the residents and neighbors began. At the close of FY06, one major milestone was reached: we chose three potential developers for the first AFRH redevelopment project. Initial revenue is planned for 2012 and is forecast to be just over \$1 million. Year 2013 should yield about \$14 million. Years 2014-2016 should yield more than \$24 million each year. Looking further out, our total predictions exceed \$600 million.

Gulfport Master Plan

The cost to rebuild this campus was funded through a Congressional Hurricane Supplemental totaling approximately \$236 million. The GSA, via legislation and an MOA, are managing the rebuild process in tandem with AFRH and NAVFAC.

Progress

At present, progress is "Green" and we are on track. Since FY04, we have been refining our Gulfport and Washington Master Plans. With the PMA as a guide, we literally transformed the way we do business.

Only 43 percent of our budget is in labor. Fortunately, since 2003, our "One Model" for operations has eliminated duplicate functions at each campus. In Washington, we closed excess buildings and outsourced all services that were not resident-focused. The bottom line: we changed how we think and work.

As a result, the Trust Fund balance has grown dramatically – rising from its low of \$94 million in 2003 to \$159 million in 2007. Plus, the FY07 audit produced our third straight "unqualified opinion."

SUMMARY OF PMA PERFORMANCE

| | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---------------------------------------|---------|---------|---------|---------|
| Improved Financial Performance | ● | ● | ● | ● |
| Competitive Sourcing | ● | ● | ● | ●* |
| Strategic Management of Human Capital | ● | ● | ● | ● |
| Budget & Program Integration | ● | ● | ● | ● |
| Expanded Electronic Government | ● | ● | ● | ● |

● Excellent ● Fair ● Poor

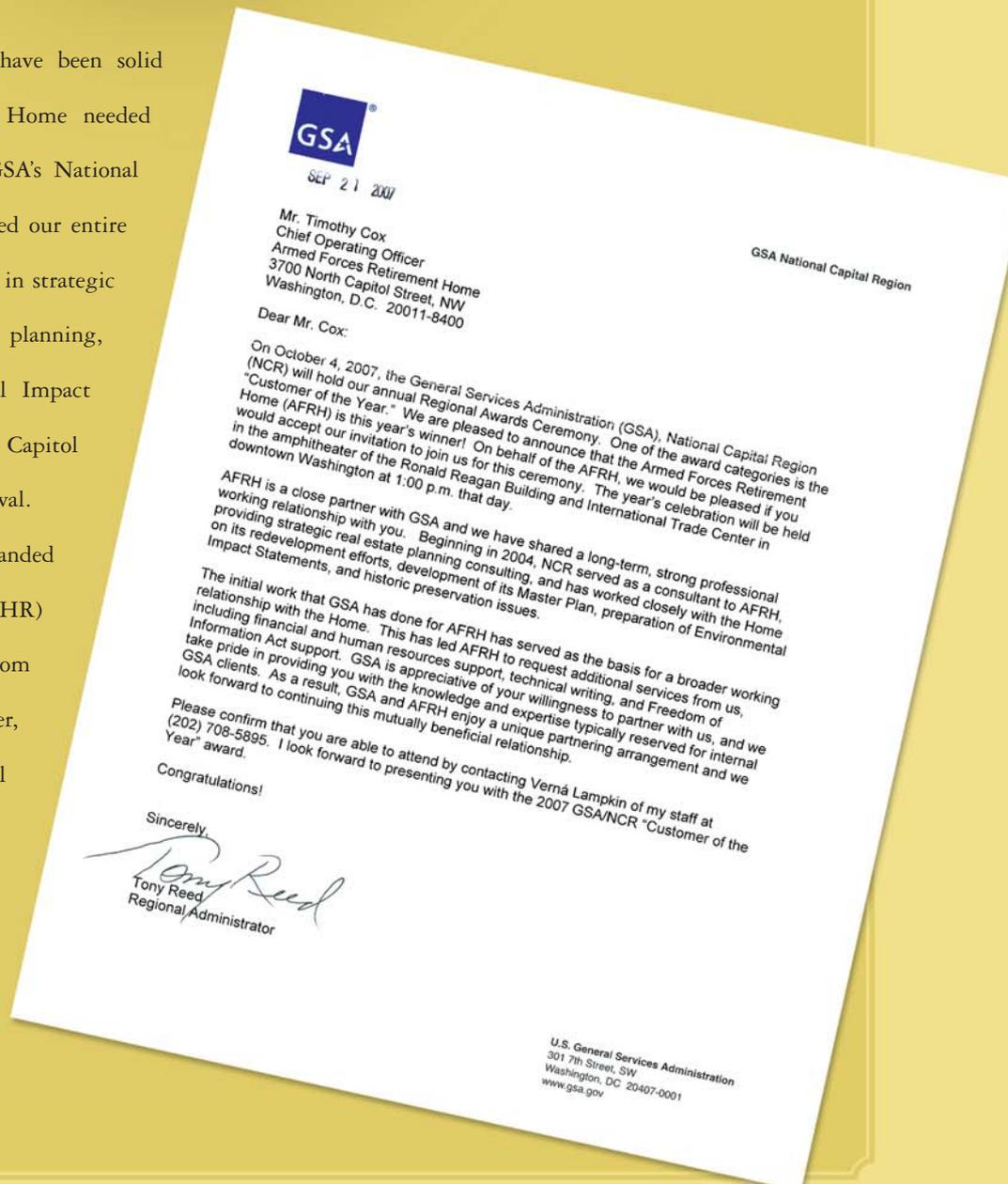
*Inefficiencies arose from Hurricane Katrina



AFRH WINS GSA “CUSTOMER OF THE YEAR” AWARD FOR FY 2007

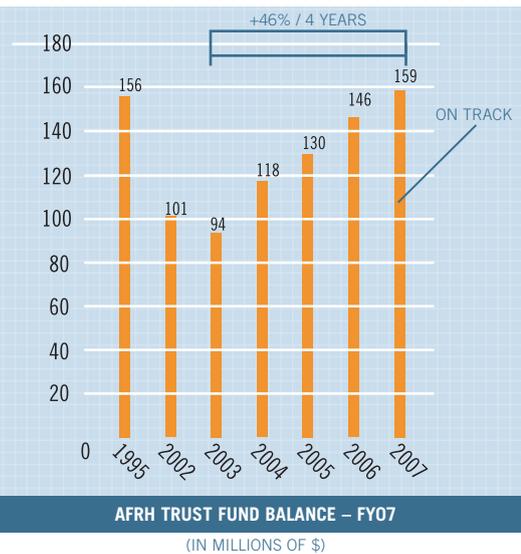
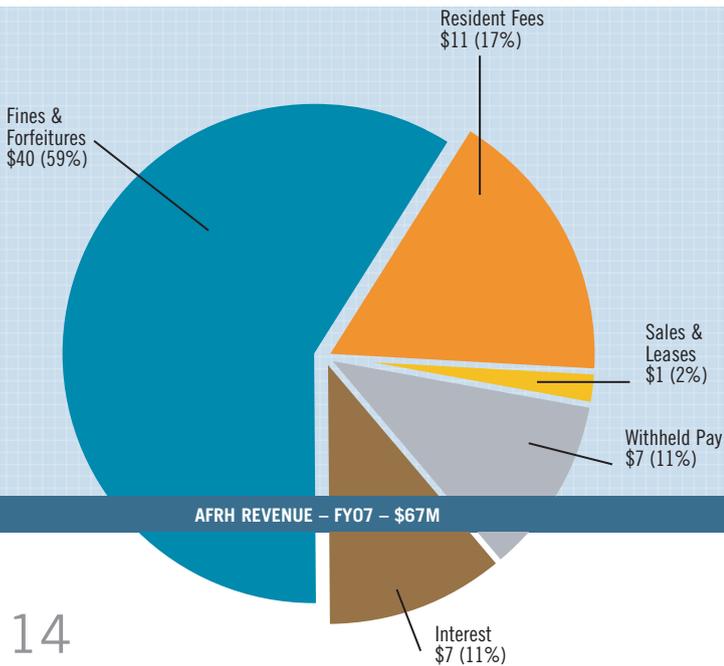
Since 2004, AFRH and GSA have been solid business partners. When the Home needed expert advice, we consulted with GSA’s National Capital Region (NCR). GSA managed our entire Master Plan package, providing help in strategic real estate planning, redevelopment planning, historic preservation, Environmental Impact Statement preparation, plus National Capitol Planning Commission (NCPC) approval.

The success of this initial work expanded into financial and human resources (HR) support, technical writing and Freedom of Information Act support. Together, we have enjoyed a mutually beneficial partnership for four years now. Today, we are excited and honored that GSA has selected the AFRH as its “Customer of the Year” for 2007.



Financial Summary and Highlights

Stanley Sagara (Air Force – Retired) visits with his cousins from Japan, Kumiko and Yuki. In September, the two college students came to visit him and tour America for the first time.



Designing Our Renewal

A permanent Trust Fund was established in the 1800s to maintain the Home – so it wouldn't rely on taxpayer money. Ever since, active duty payroll deductions from enlisted and warrant officers (ranging from \$.10 - \$.50 per month) have funded operations.

The Trust Fund is also fed by fines and forfeitures from all Branches of the Services, monthly resident fees, the sale or lease of underutilized land and buildings, gifts and bequeaths, interest gained on the Trust Fund balance plus certain one-time situational gifts and appropriations from Congress.

Trust Fund Balance

The true gauge of our success is the Trust Fund Balance. By 2003, operating costs greatly increased over previous years – eventually outpacing our revenue. Hence, the Trust Fund balance declined from \$156 million in 1995 to \$94 million in 2003. So renewing it became a critical mandate to retain the Home's solvency. We concluded our operating model had to change. In swift fashion, we followed the Federal government's lead for an integrated strategy – linking

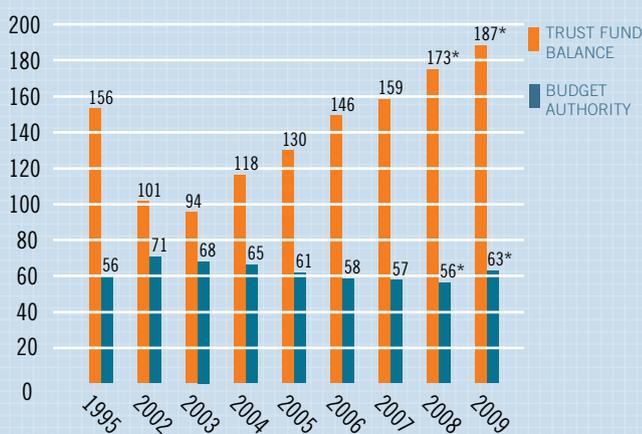
planning with budget and performance. By the end of FY07, we were back on solid ground and the Fund had topped \$159 million.

Appropriations:

Each year, AFRH submits a budget to Congress to withdraw funds from the Trust Fund through an annual appropriation. Although we only requested \$55 million for FY07, we were given \$57 million under the Continuing Resolution Act (CRA).

Staffing

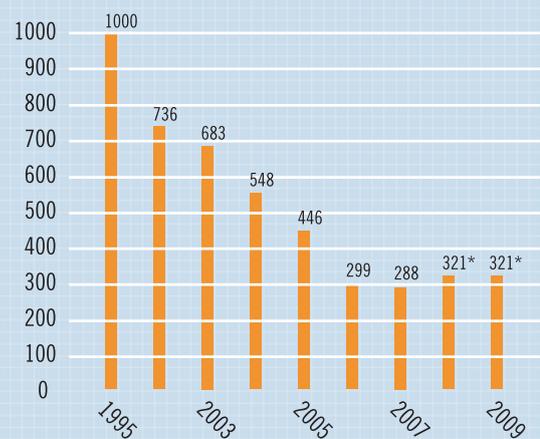
Streamlining the staff has been a Strategic Initiative for several years. The chart below (AFRH Staff) shows our anticipated needs for full time equivalent employees based on the best data available. For now, the Washington campus is the focus of all operations. The Gulfport campus hasn't had any FTEs since early FY07, when the property was turned over to GSA. Yet, we will continue to plan for new staffing when Gulfport reopens in 2010.



AFRH STEWARDSHIP: TRUST FUND & BUDGET AUTHORITY – FY07

(IN MILLIONS OF \$)

*Projected



AFRH STAFF – FY07

*Requested

Assets, Liabilities & Cumulative Results of Operations

Generating Sound Financials

Assets, Liabilities & Cumulative Results of Operations

For FY07, our Consolidated Balance Sheet reflects:

| | |
|---------------------------|-----------------------|
| Total Assets: | \$ 465,615,106 |
| Total Liabilities: | \$ 7,048,896 |

About 15 percent of our assets are property, plant, and equipment (PP&E), with a book value of \$72,018,853. This PP&E is located on the Gulfport, MS campus and the Washington, DC campus.

Limitations of the Principal Financial Statements

These statements were prepared to report our financial position and operations results, pursuant to the requirements of 31 U.S.C. 3515(b). They were prepared following generally accepted accounting principles (as defined by The Chief Financial Officer's Act of 1990 and OMB). Plus these statements are in addition to financial reports prepared from

the same books and records used to monitor and control budgetary resources. We are pleased to report AFRH is in compliance with all relevant laws, statutes and legislation.

We accept the responsibility of reporting performance and financial data accurately and reliably. So all data for this report was gathered and reported through systems of rigorous controls and quality checks. AFRH employs BPD-ARC to perform its financial management. BPD-ARC's expertise is superb and it provides us with outstanding reporting services.

Financial & Performance Results Integration

Led by the Vision and Mission, our COO is ensuring that the Home's carefully crafted Strategic Plan is directing staff to improve performance – as well as the bottom-line.

When it comes to Exceptional Service, AFRH is a cut above.





*"He missed the tag."
Here, residents watch the AFRH Diamondbacks
try to win a close ballgame.*

Financial Statements Summary

Brown and Company, PLLC is a firm of CPAs and Management Consultants. As independent auditors, they have given AFRH an "unqualified opinion" for FY07. They have also reported no material weaknesses.

Assets:

- Net changes between FY06 and FY07 equal \$7,810,756.
- Investments and the Trust Fund Balance equal 84% of our assets.

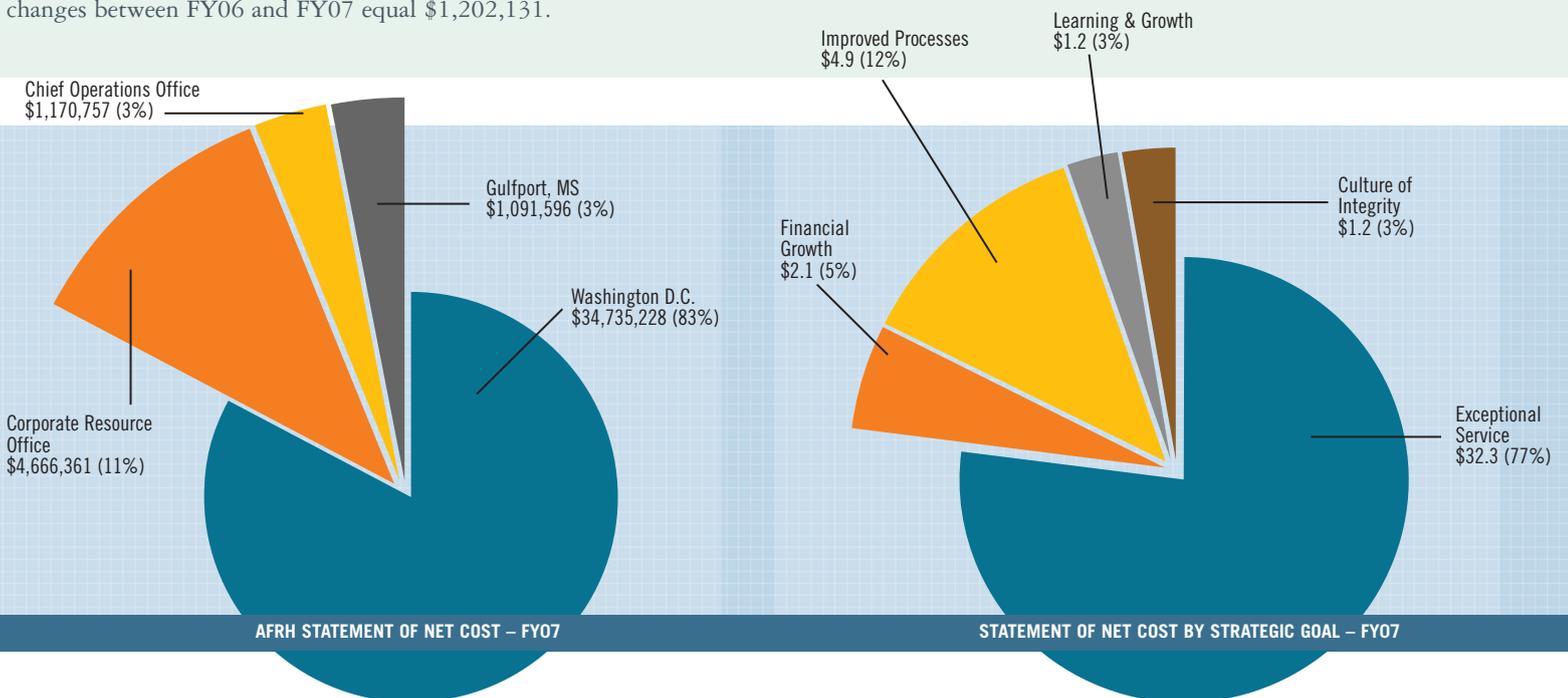
Liabilities:

This represents the money AFRH will likely pay, as a result of transactions or services that have already occurred. No liability can be paid absent an apportionment. Total AFRH Liabilities at the end of FY07, as reported in the financial statements, were \$7,048,896. Net changes between FY06 and FY07 equal \$1,202,131.

Net Cost by Strategic Goal

The Home's net cost of operations is \$41,708,433 for FY07 – down \$9,079,541 from FY06. The majority of costs incurred by AFRH go directly toward Exceptional Service. Costs associated with programs under the COO and the Corporate Resource Office support each campus and all five Strategic Goals.

In FY06, 87% of the net cost went toward operating residential facilities and programs, (including the closure of Gulfport). In FY07, 83% of all net cost was mostly for the Washington campus with minimal support for Gulfport. By Strategic Goal, the major net cost was 77% for Exceptional Service. These figures validate our strategy for resident-focused care.



Letter of Assurance



“I can provide reasonable assurance that objectives have been achieved for FMFIA, FFMIA and FISMA.”

Creating New Confidence

Management is responsible for establishing and maintaining effective internal controls and financial management systems that meet the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA) and the Federal Information Security Management Act (FISMA).

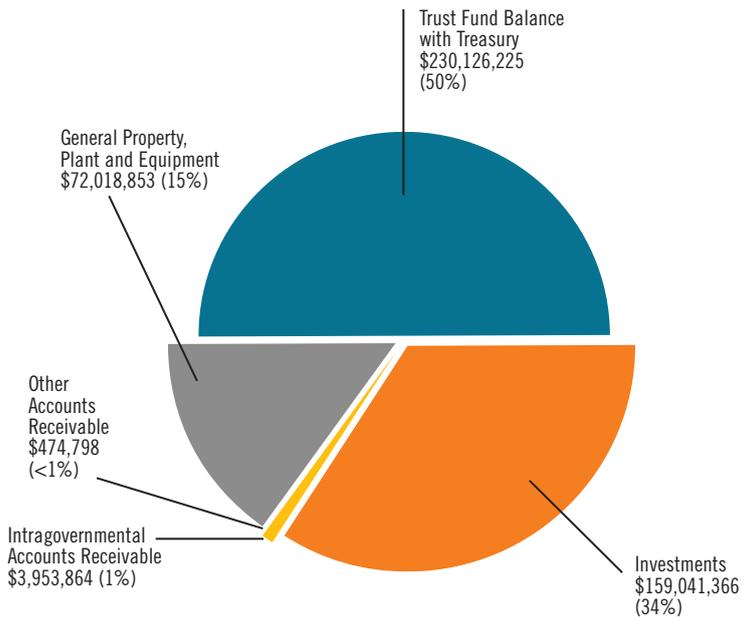
So, AFRH conducted its annual assessment of internal controls and compliance, per the Management's Responsibility for Internal Control

(OMB A-123). Yet, our managers continually monitor activities, gain insight into proper reporting and make corrective actions.

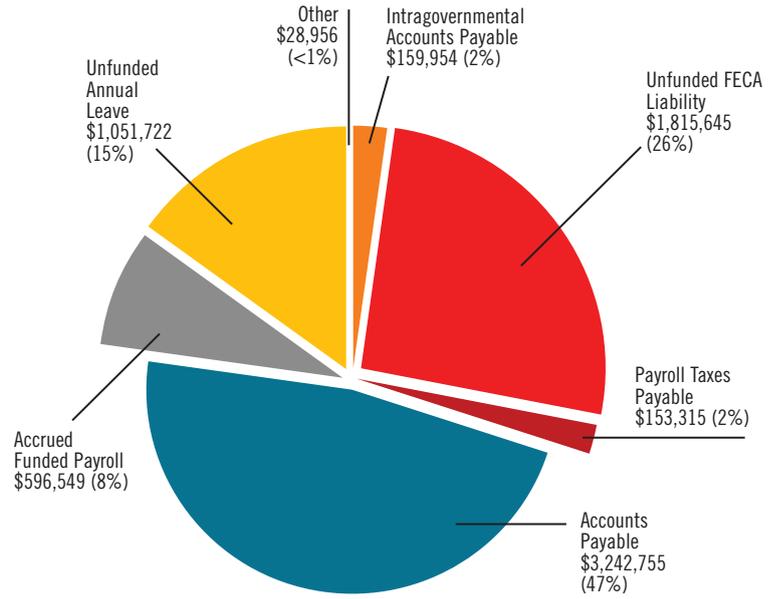
In FY07, we achieved many key actions under the Strategic Goal of Financial Growth. This can be greatly attributed to our public-to-public transfer of integrated services (supporting our financial management system) to BPD-ARC and NFC in 2004 – which has produced three “unqualified opinions.”

| ASSETS | FY07 | FY06 |
|---------------------------------------|-----------------------|-----------------------|
| Trust Fund Balance with Treasury | \$ 230,126,225 | \$ 239,123,692 |
| Investments | \$ 159,041,366 | \$ 139,563,566 |
| Intragovernmental Accounts Receivable | \$ 3,953,864 | \$ 2,687,343 |
| Other Accounts Receivable | \$ 474,798 | \$ 554,056 |
| General Property, Plant & Equipment | \$ 72,018,853 | \$ 75,875,693 |
| TOTAL | \$ 465,615,106 | \$ 457,804,350 |

AFRH ASSETS – FY07



AFRH LIABILITIES – FY07



An independent audit was performed on BPD’s financial management systems (i.e., the controls placed on the financial management systems and operating effectiveness from July 1, 2006 — June 30, 2007). This assurance via Standards Number 70 (SAS70) validates the integrity of AFRH management controls and our compliance with Federal financial systems standards.

In September 06, we sought and received security C&A for the AFRH IT Enterprise Network. That C&A will be renewed in FY08.

I can provide reasonable assurance that objectives have been achieved for FMFIA, FFMIA and FISMA. As of this writing, we have no material weaknesses to report.

I am very pleased with our accomplishments – and I am highly confident that our positive fiscal progress will continue in the future.

Sincerely,

Timothy C. Cox
Chief Operating Officer, AFRH
November 15, 2007

| LIABILITIES | FY07 | FY06 |
|------------------------------------|---------------------|--------------------|
| Intragovernmental Accounts Payable | \$ 159,954 | \$772,159 |
| Unfunded FECA Liability | 1,815,645 | \$1,777,219 |
| Payroll Taxes Payable | 153,315 | \$155,028 |
| Accounts Payable | 3,242,755 | \$3,471,327 |
| Accrued Funded Payroll | 596,549 | \$778,426 |
| Unfunded Annual Leave | 1,051,722 | \$1,162,838 |
| Other | 28,956 | \$134,030 |
| TOTAL | \$ 7,048,896 | \$8,251,027 |

Risk Management

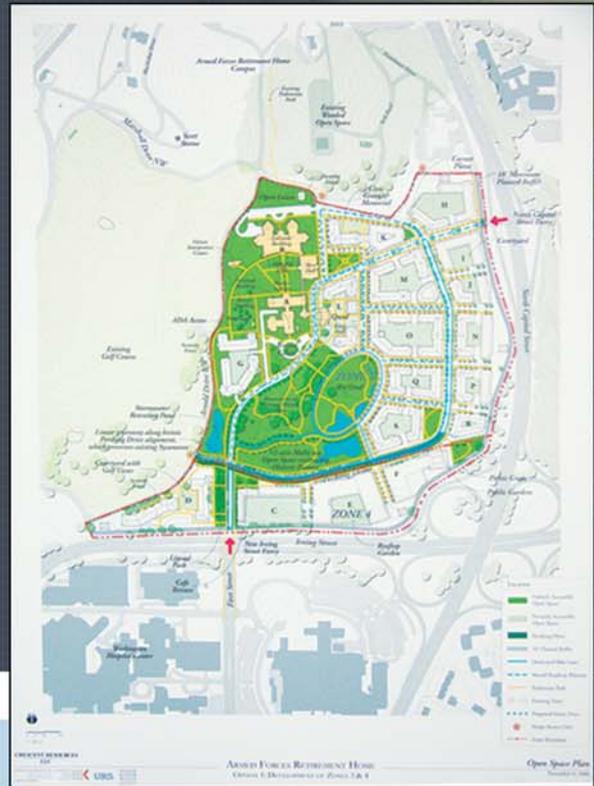
Engineering New Safeguards

Background

The National Defense Authorization Act of 2002 permitted us, through DoD, to sell, lease or otherwise dispose of underutilized buildings and property. So AFRH launched its Master Plan for Washington. This forms the basis of our risk management strategy. The desired outcome of the Master Plan is to provide additional resources to replenish the Trust Fund.

Washington Master Plan

Our agency-wide "One Model," in compliance with PART and the FAIR Act, guided the development of our Washington Master Plan. This key endeavor helped us identify real property essential to the core Mission of AFRH. Likewise, it helped us identify non-critical facilities, target them for lease and establish a future revenue stream. This will enable us to renovate our aging buildings and replenish the AFRH Trust Fund. The current status and updates are available online at afrhdevelopment.com.



Master Plan Objectives

- **Preserve & improve the Home for the residents & staff**
- **Provide revenue to support our Goal of resident-focused care**

Historic Fence Ex. Conditions
READY TO GO FOR CONSTRUCTION

Historic Fence Concept
Not to Scale

New Entrance Sign Concept
Not to Scale

Armed Forces Retirement Home, Master Plan Washington, DC

125 W. Stuyvesant Ave.
Wilmington, North Carolina 27905-2027
Phone: 252-741-2541 FAX: 252-741-2542
E-mail: aj@jordanhill.com



Jyly Landscape Architect
Landscape Architecture, Earth Planning
& Site Facilities Management
125 W. Stuyvesant Ave.
Wilmington, North Carolina 27905-2027
Phone: 252-741-2541 FAX: 252-741-2542
E-mail: aj@jordanhill.com

We are confident we have the resources, leadership and vision to execute or adjust our plans as necessary – regardless of any risk that may arise.



- ***Replenish the partially depleted AFRH Trust Fund***
- ***Grow Trust Fund to meet residents' needs, today & tomorrow***
- ***Attract development that's compatible with our Mission, and***
- ***Ensure an open, inclusive process with residents & community***

Risk Management, continued

Recent Accomplishments

At the end of 2006, an RFP was issued to three developers, as reported in our FY06 PAR. A five-member panel of experts convened by GSA reviewed their proposals. The panel considered each firm's design, financial bid, socio-economic benefits, environmental mitigation and ability to implement the proposal. At last, the panel made its recommendation. AFRH concurred, and in March 07, we selected Crescent Resources, LLC as the preferred developer for 4.3 million SF on the southeast corner of the Washington campus. (See map.)

This dynamic, mixed-use project calls for the adaptive reuse of nine historic buildings and includes about 30 acres of open green space. The project will open portions of the AFRH campus to public enjoyment and recreation for the first time in more than 50 years.

Later in FY07, we consulted our residents, the NCPC, the DC State Historic Preservation Office and Office of Planning, the Advisory Council for Historic Preservation, the Commission of Fine Arts, plus area neighbors and locally elected officials. The NCPC will hopefully approve the plan in December 07.

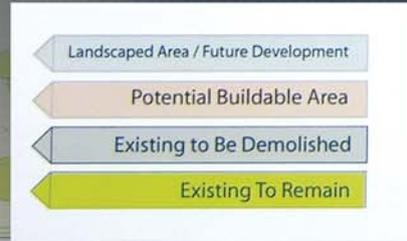
Gulfport Master Plan

GSA is the agent for the design and construction of the new resident facility. Our progress in FY07 is on track and outlined in detail at the beginning of the MD&A.

07 STUDY

10-Year Financial Capital Plan

To strengthen our risk strategy, we first conducted a 10-year Capital Improvement Plan. AFRH engaged URS Corporation to conduct a facility assessment to identify and estimate the costs to remedy deficiencies in our infrastructure and 28 buildings. The largest costs are associated with the Scott residence, which has deficiencies of over \$81 million. Then, with that analysis, we formulated a realistic 10-year Financial Capital Plan as requested by OMB.



07 STUDY

Trust Fund Solvency

This study included an evaluation of risks associated with revenue and costs for existing and planned lines of business. Martin & Wall built a model to forecast a financial future – which identified annual Net Cash flow and annual Trust Fund Balances through 2018 as the key performance measures. Their conclusion: the Trust Fund was solvent through 2018 based on management’s plan to transform operations.

Potential Risks to Trust Fund Solvency:

An unforeseen event could disrupt our Master Plan, Capital Improvement Plan or even our Financial Plan. Also, a variety of adverse market conditions could arise. Even so, the Trust Fund Solvency study concluded that management could act to protect solvency with a) careful monitoring of risk conditions, b) maintaining contingencies and c) taking action to reconfigure operations if conditions change. We are confident that we have the resources, leadership and vision to execute and adjust our plans as necessary - regardless of any risk that may arise.

Message from the Chief Financial Officer

Constructing Strong Figures

I have the distinct pleasure of assuring the President, Congress and the American people of our steadfast stewardship of the public funds entrusted to us. Moreover, AFRH is maintaining its focus on residents. A recent analysis of our spending on Strategic Goals now demonstrates that 86 percent of all expenditures are for the Goal of Exceptional Service.

I am proud and pleased to report that FY07 is the year to tout the Home's success in financial performance. In this PAR, AFRH is showcasing the results of its improved government financial management.

The Overarching Goal

Our objective in 2002 was to become financially efficient, with the goal of continuing optimal service to current and future residents. We were determined to achieve efficiency by leveraging our assets, using our property to its fullest potential, aligning workforce plans with employee standards and redesigning or renovating outdated facilities.

Our 2002 goals also included "re-visioning" AFRH as a modern CCRC. Thus, we were committed to demonstrate best value by modernizing our facilities and equipment – as well as managing our resources to create better living conditions and services for the residents of today and tomorrow.

Accentuating Financial Performance

In 2002, Congress authorized AFRH to use its biggest asset, its land, to replenish our diminishing Trust Fund. We have been good stewards of that money: in four years, we have grown the Fund by \$65 million and our FY07 end balance is \$159 million. In fact, our Trust Fund Solvency study shows that if we follow our current strategy, it will be solvent through 2018.

Utilizing the PART

In the 1990s, AFRH had grown and spread out across more than 300 acres in Washington. With this expanded "footprint" the Home's infrastructure and historic buildings were overwhelming, in terms of

maintenance and cost. Further, these resources were not being used in the wisest manner. However, the PART enabled us to leverage our assets and maximize the use of our property.

According to various studies between 1995-2002, the cost of the Washington Home and its staffing were also excessive. In fact, staff was spread across our numerous buildings with growing infrastructure costs.

Hence, we set out to develop a more efficient Master Plan for the Washington property. Working with the GSA, we built a plan that generated revenue for long-term use and development of our under-used property. Through the PART, we began to redefine our "footprint" on the Washington campus.

Soon, our buildings began to serve multiple purposes: we vacated numerous ones, including those dedicated to administrative functions. The employees were co-located in our dormitories to enhance resident service and promote greater efficiency. In short, these actions resulted in unprecedented cost savings. As a result, in 2004 our PART was rated "moderately effective."

Drawing on the PMA and FAIR Act

To gain added efficiencies, we leveraged the PMA and FAIR Act. Poorly performing functions and programs with significant cost overruns – or those facing capital investment costs – became targets for A-76 studies. In addition, workforce plans were aligned with Business Plans for accountability and performance objectives.

Public-to-public outsourcing allowed us to eliminate integration problems with our network servers and thereby gain efficiencies. We integrated critical functions (such as accounting, travel, payroll, time and attendance, government credit card, procurement and investments) using a system provided by BPD-ARC.

Measuring our Success

Although past measures for our Goals were not set, we have four years of data from our PMA self-assessments that show steady progress from 2004 to present. For our long-term Strategic Goals, we are using FY07

“In four years, we have grown the AFRH Trust Fund by \$65 million.” — Steve McManus, CFO

as the baseline, making concrete targets against which to measure year after year. Finally, we will collect standardized data for comparison and we have developed seven performance indicators especially for Financial Growth.

Shaping the Future

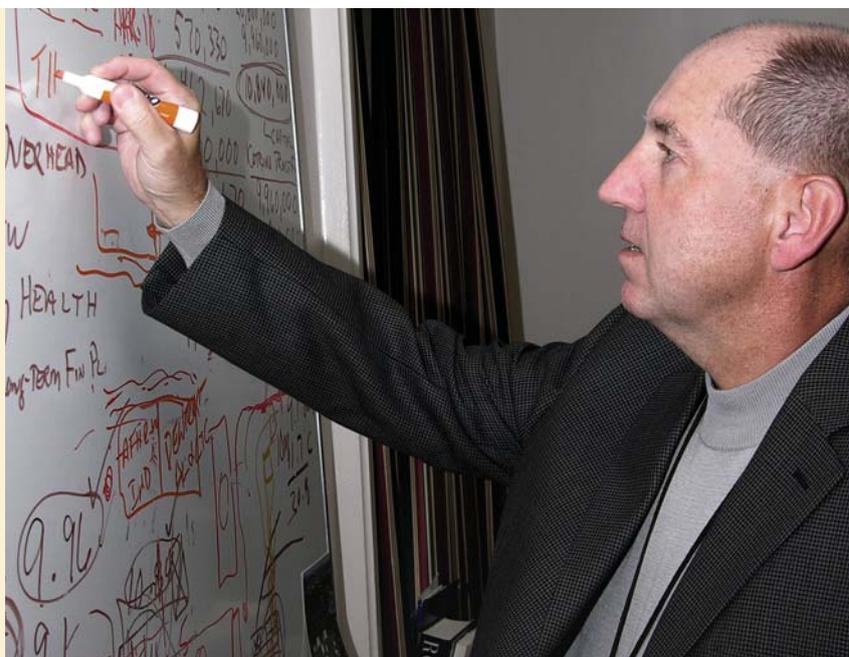
Our financial management successes are noteworthy. Through our efforts, we have postured the Home for continued growth and prosperity. Along with the achievements discussed here, we gained our third consecutive “unqualified” audit opinion. And our Trust Fund balance is healthy.

In accounting, our internal controls have yielded less than one-half of one percent errors. For FY08, we are poised to implement our cost-savings initiatives and continue with our asset management and acquisition strategy.

Undeniably, the future looks bright. Congress approved funds to rebuild Gulfport and the project is underway with a targeted completion date of 2010. Also our Washington Master Plan is on track. Through this Plan, we have selected a preferred developer and are negotiating an agreement to develop the southern end of the Washington campus, with financial returns to begin in 2012.

We are also focusing efforts in Washington to create better living conditions for residents. Management has requested funds from the Trust Fund to renovate our oldest dormitory, the Scott Building, in FY10. To keep pace with our vision of a modern CCRC, we are expanding the size of the rooms from 180 to 400-plus square feet. This move will also reduce our resident capacity in the Washington campus.

In FY19, when we renovate the Sheridan dormitory, our capacity will be reduced to the size of Gulfport, creating the opportunity to build a new resident tower to meet demand. We expect operating costs for both the Washington and the Gulfport homes to be approximately \$18-\$21 million, for an aggregate cost of \$36-\$42 million. This compares favorably to Washington’s FY08 costs of \$47 million. With expected revenue of more than \$70 million, the Home will be positioned to create additional space to meet resident demand.



Final Assessment

We have seen much progress over the past five years. Not just incremental improvements – but far-reaching, sound financial decisions that have led to a healthy present and promise a stable future. We have much to be proud of, because we have forged a solid foundation.

Sincerely,

Steven G. McManus
Chief Financial Officer (CFO)

November 15, 2007

Assembling Reliable Proof

We are pleased to present the AFRH financial statements, which attest to the reliability and accuracy of our recent financial success.

The principal AFRH Financial Statements were carefully prepared to report our financial position and operational results. Independent accountants conducted in-depth statement audits, in accordance with government auditing standards. Our Statements should be read with the understanding they are for a component of the US Government, a sovereign entity.

The AFRH financial management activities in FY07 – including purchasing, payments, accounting, budget and travel service – were administered by BPD. The NFC processed our payroll and time/attendance data entry transactions, integrated with the BPD financial management system.

These operations were managed under mutual agreements with the Departments of Treasury and Agriculture. The AFRH relies on information received from BPD and NFC (plus audits and reviews) to execute its management control.

*“When I saw the great setup here, I said:
‘Man, I’ve got to get back into porcelains.’”
– Paul Schlegel (Navy – Retired)*





BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

U.S. Armed Forces Retirement Home
Washington, D.C.

We have audited the accompanying balance sheet of the U.S. Armed Forces Retirement Home (AFRH) as of September 30, 2007 and 2006, and the related statements of net cost, changes in net position, and budgetary resources and financing for the years then ended. These financial statements are the responsibility of AFRH's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirement for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the AFRH as of September 30, 2007 and 2006, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with U.S. Government Auditing Standards and OMB Bulletin No. 07-04, we have also issued a report dated November 9, 2007 on our consideration of the AFRH's internal control over financial reporting and its compliance with provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with U.S. Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The information in "Management's Discussion & Analysis" is presented for the purpose of additional analysis and is required by OMB Circular No. A-136, revised *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, express no opinion on it.

A handwritten signature in black ink that reads "Brown & Company".

Largo, Maryland
November 9, 2007

Financial Statements

| BALANCE SHEET | As of September 30, 2007 and 2006 (In Dollars) | 2007 | 2006 |
|-------------------------------------------------------------|------------------------------------------------|-----------------------|-----------------------|
| Assets: | | | |
| Intragovernmental: | | | |
| Fund Balance with Treasury (Note 2) | | \$ 230,126,225 | \$ 239,123,692 |
| Investments (Note 3) | | 159,041,366 | 139,563,566 |
| Accounts Receivable, Net (Note 4) | | <u>3,953,864</u> | <u>2,687,343</u> |
| Total Intragovernmental | | 393,121,455 | 381,374,601 |
| Accounts Receivable, Net (Note 4) | | 474,798 | 554,056 |
| General Property, Plant and Equipment (Note 5) | | <u>72,018,853</u> | <u>75,875,693</u> |
| Total Assets | | <u>\$ 465,615,106</u> | <u>\$ 457,804,350</u> |
| Liabilities: | | | |
| Intragovernmental: | | | |
| Accounts Payable | | \$ 159,954 | \$ 772,159 |
| Unfunded FECA Liability | | 1,815,645 | 1,777,219 |
| Payroll Taxes Payable | | <u>153,315</u> | <u>155,028</u> |
| Total Intragovernmental | | 2,128,914 | 2,704,406 |
| Accounts Payable | | 3,242,755 | 3,471,327 |
| Accrued Funded Payroll | | 596,549 | 778,426 |
| Unfunded Annual Leave | | 1,051,722 | 1,162,838 |
| Other (Note 6) | | <u>28,956</u> | <u>134,030</u> |
| Total Liabilities | | <u>\$ 7,048,896</u> | <u>\$ 8,251,027</u> |
| Net Position: | | | |
| Cumulative Results of Operations - Earmarked Funds (Note 9) | | \$ 458,566,210 | \$ 449,553,323 |
| Total Net Position | | <u>458,566,210</u> | <u>449,553,323</u> |
| Total Liabilities and Net Position | | <u>\$ 465,615,106</u> | <u>\$ 457,804,350</u> |

The accompanying notes are an integral part of these statements.

“It’s a great place. The best part is the friendliness and how they look out for you.”
– Herbert Thompson (Navy – WWII)

“I have a pretty good life here. My quarters are good and so is the medical care.”
– Bill Sorince (Army – WWII)

| STATEMENT OF NET COST | For the years ended September 30, 2007 and 2006 (In Dollars) | 2007 | 2006 |
|-----------------------------------|--------------------------------------------------------------|----------------------|----------------------|
| Program Costs: | | | |
| <i>Chief Operations Office:</i> | | | |
| Gross Costs | | \$ 1,685,561 | \$ 2,182,271 |
| Less: Earned Revenue | | <u>514,804</u> | <u>543,256</u> |
| Net Program Costs | | <u>1,170,757</u> | <u>1,639,015</u> |
| <i>Corporate Resource Office:</i> | | | |
| Gross Costs | | 6,718,250 | 6,925,162 |
| Less: Earned Revenue | | <u>2,051,889</u> | <u>1,723,955</u> |
| Net Program Costs | | <u>4,666,361</u> | <u>5,201,207</u> |
| <i>Gulfport, MS:</i> | | | |
| Gross Costs | | 1,571,591 | 7,533,225 |
| Less: Earned Revenue | | <u>479,995</u> | <u>1,875,327</u> |
| Net Program Costs | | <u>1,091,596</u> | <u>5,657,898</u> |
| <i>Washington D.C.:</i> | | | |
| Gross Costs | | 50,008,976 | 50,921,900 |
| Less: Earned Revenue | | <u>15,273,748</u> | <u>12,676,537</u> |
| Net Program Costs | | <u>34,735,228</u> | <u>38,245,363</u> |
| Total Program Costs: | | 41,663,942 | 50,743,483 |
| Costs Not Assigned to Programs | | <u>44,491</u> | <u>-</u> |
| Net Cost of Operations | | <u>\$ 41,708,433</u> | <u>\$ 50,743,483</u> |

The accompanying notes are an integral part of these statements.



| STATEMENT OF CHANGES IN NET POSITION | 2007 | 2007 | 2006 | 2006 |
|--------------------------------------------------------------|-----------------|--------------------|-----------------|--------------------|
| For the years ended September 30, 2007 and 2006 (In Dollars) | Earmarked Funds | Consolidated Funds | Earmarked Funds | Consolidated Total |
| Cumulative Results of Operations: | | | | |
| Beginning Balances | \$ 449,553,323 | \$ 449,553,323 | \$ 205,334,552 | \$ 205,334,552 |
| Beginning Balances, as Adjusted | \$ 449,553,323 | \$ 449,553,323 | \$ 205,334,552 | \$ 205,334,552 |
| Budgetary Financing Sources: | | | | |
| Appropriations Used | \$ - | \$ - | \$ 241,800,000 | \$ 241,800,000 |
| Nonexchange Revenue | 47,801,049 | 47,801,049 | 49,744,164 | 49,744,164 |
| Donations and Forfeitures of Cash and Cash Equivalents | 1,425,392 | 1,425,392 | 973,267 | 973,267 |
| Transfers-in/out Without Reimbursement | - | - | 800,000 | 800,000 |
| Other | (44,491) | (44,491) | - | - |
| Other Financing Sources (Non-Exchange): | | | | |
| Imputed Financing Sources | 1,494,879 | 1,494,879 | 1,644,823 | 1,644,823 |
| Total Financing Sources | 50,676,829 | 50,676,829 | 294,962,254 | 294,962,254 |
| Net Cost of Operations | (41,663,942) | (41,663,942) | (50,743,483) | (50,743,483) |
| Net Changes | \$ 9,012,887 | \$ 9,012,887 | \$ 244,218,771 | \$ 244,218,771 |
| Cumulative Results of Operations | 458,566,210 | 458,566,210 | 449,553,323 | 449,553,323 |
| Budgetary Financing Sources | | | | |
| Appropriations Received | - | - | 241,800,000 | 241,800,000 |
| Appropriations Used | - | - | (241,800,000) | (241,800,000) |
| Total Budgetary Financing Sources | - | - | - | - |
| Net Position | \$ 458,566,210 | \$ 458,566,210 | \$ 449,553,323 | \$ 449,553,323 |

The accompanying notes are an integral part of these statements.



Who can do the most sit-ups? Our money is on top AFRH athlete Curt Young (left) ... or maybe 90-year old Hugh Wingo (center).



Armed Forces Retirement Home
Office of the Inspector General
3700 N. Capitol Street, P.O. Box 1303
Washington, DC 20011-8400

November 1, 2007

Memorandum

To: Timothy C. Cox, Chief Operating Officer

Re: Management Challenges for FY 2008

Over the past year, the AFRH has had to respond to some serious allegations lodged at its healthcare management and oversight by an anonymous source. The allegations were later found to have no merit by the various inspections teams that were dispatched by the Office of the Secretary of Defense to investigate the allegations. The AFRH took additional measure to ensure that the allegations were investigated thoroughly by requesting an independent audit of its healthcare facilities from the Joint Commission on Accreditation of Healthcare Organizations (JCAHO). JCAHO also found no evidence to support the alleged allegations.

The Armed Forces Retirement Home's Inspector General (AFRH IG) hotline has served the agency well in allowing anyone to report occurrences of waste, fraud or abuse. As a result of the reported incidents, the AFRH IG has worked with the agency's management to correct the infractions which have led to the implementation of policies and procedures that will effect oversight to reduce or eliminate any reoccurrences. The AFRH IG has also established a great working relationship with the Department of Defense's Office of Inspector General. Residents at the AFRH may also access their hotline to report abuse, waste or fraud found at the agency.

In accordance with the Reports Consolidation Act of 2000, we have identified the most serious management and performance challenges facing the Armed Forces Retirement Home (AFRH) in FY 2008. Through various AFRH initiatives and programs, significant progress and improvements have been demonstrated as a result of recommendations made by my office and other inspection activities.

- Implement and monitor the Scott building renovation
- Implement and monitor the National Patient Safety Goals
- Implement Succession Planning for all strategic areas of operations and management
- Transition the accreditation review for the AFRH from JCAHO to CARF/CCAC
- Continue to educate our constituents and congressional oversight committees on the AFRH mission and services that will be needed to support our next generation of heroes

In order to sustain the progress that has been made by the AFRH through its initiatives and programs, we will continue to monitor the outcomes of the areas identified.

A handwritten signature in black ink, appearing to read "Maurice Swinton".

Maurice Swinton
Inspector General

AFRH-Gulfport

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