

TECHNOLOGY

The Technology to Advance

Our goal is to help the entire AFRH organization maintain security peak protection, while complying with the Federal initiative for E-Gov. So, over the past year, we ramped up our efforts to take the Home's IT systems into the 21st century. These efforts will help us realize our mission, broaden our capabilities and expand the Home to other location in the future. Truly, the AFRH of the future is ready to thrive.

Security Certification & Accreditation

For starters, AFRH contracted the BPD to conduct a rigorous review of our IT system. All resources were tested against benchmarks set by FISMA and the OMB. And all facets of our IT management and oversight process were analyzed.

Thanks to our preparation, the government's guidance and our IT staff's ongoing testing, we have received a "Green" rating. As such, we have earned our official security certification and accreditation, as outlined by the National Institutes of Standards and Technology (NIST). This means we are now in compliance with Federal technology standards.

Specifically, certification and accreditation signifies that management, operational and

technical security controls in our information system all meet all identified security variables. And that the Home's IT operations, technical security controls and continuous risk monitoring are in concurrence with FISMA.

Local and Wide Area Network

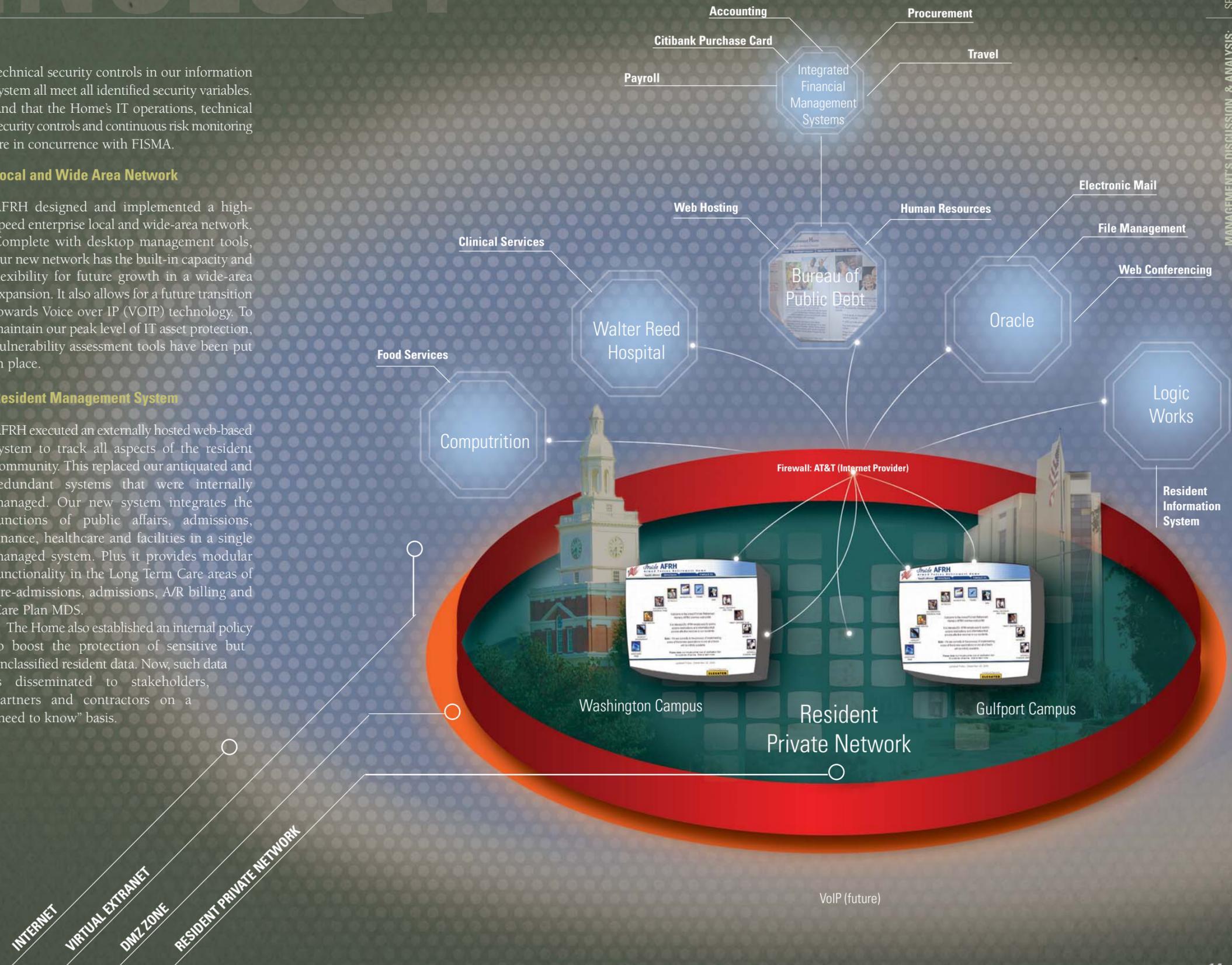
AFRH designed and implemented a high-speed enterprise local and wide-area network. Complete with desktop management tools, our new network has the built-in capacity and flexibility for future growth in a wide-area expansion. It also allows for a future transition towards Voice over IP (VOIP) technology. To maintain our peak level of IT asset protection, vulnerability assessment tools have been put in place.

Resident Management System

AFRH executed an externally hosted web-based system to track all aspects of the resident community. This replaced our antiquated and redundant systems that were internally managed. Our new system integrates the functions of public affairs, admissions, finance, healthcare and facilities in a single managed system. Plus it provides modular functionality in the Long Term Care areas of pre-admissions, admissions, A/R billing and Care Plan MDS.

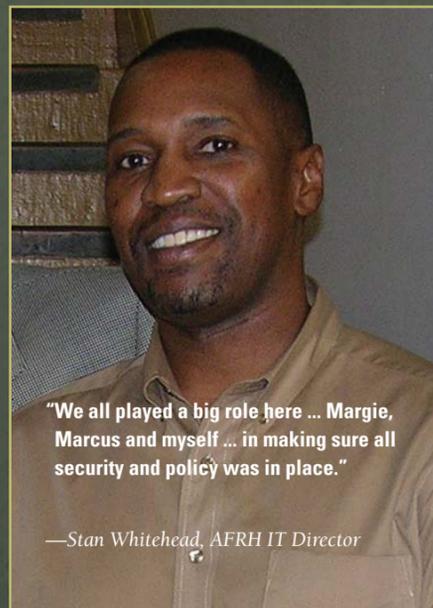
The Home also established an internal policy to boost the protection of sensitive but unclassified resident data. Now, such data is disseminated to stakeholders, partners and contractors on a "need to know" basis.

AFRH Enterprise



"Our IT pros are the architects of our world-class enterprise system. And their amazing efforts have paid the Home big dividends!"

—Steve McManus, AFRH CFO & CIO



"We all played a big role here ... Margie, Marcus and myself ... in making sure all security and policy was in place."

—Stan Whitehead, AFRH IT Director

The Funds to Flourish

A permanent Trust Fund was established nearly 200 years ago to maintain AFRH – so it would not have to rely on taxpayer money. All throughout the Home's history, operational funding has come from the Veterans themselves. It is solely drawn from the AFRH Trust Fund, which is fed monthly by active duty payroll deductions of \$.50 per month from each enlisted and Warrant Officer.

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

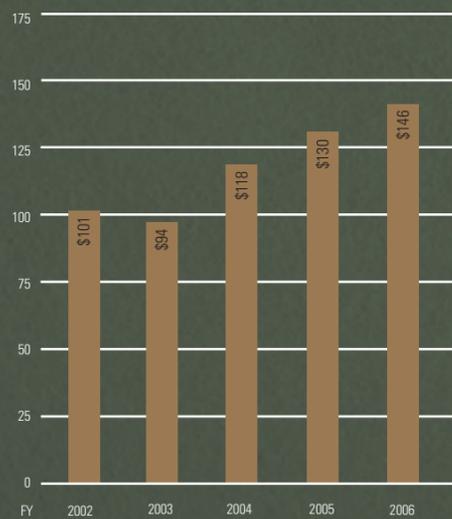
Trust Fund Balance

In 2003, operating costs greatly increased over previous years – eventually outpacing our revenue. 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. And we followed the Federal government's lead for an integrated strategy – linking planning with budget and performance. By the close of FY06, we were up to \$146 million.

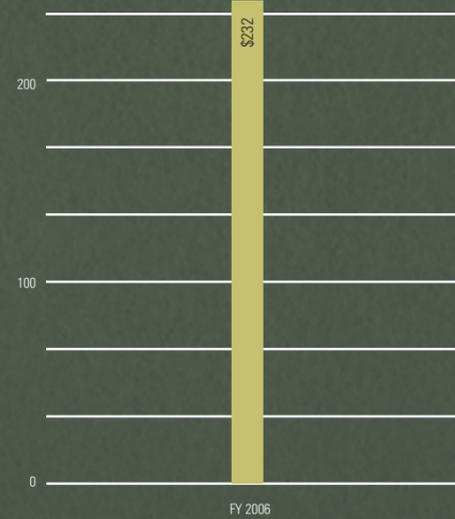
As a result, the AFRH Trust Fund balance grew to \$146 million.

Congress provided Hurricane Supplemental funds to help us meet the residents' needs.

AFRH Trust Fund Balance
In millions of dollars

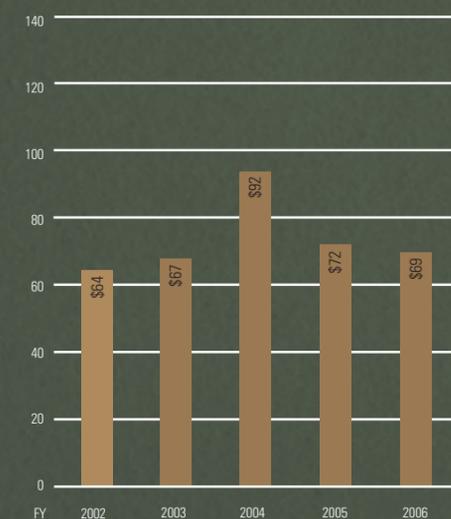


AFRH General Fund Balance
In millions of dollars

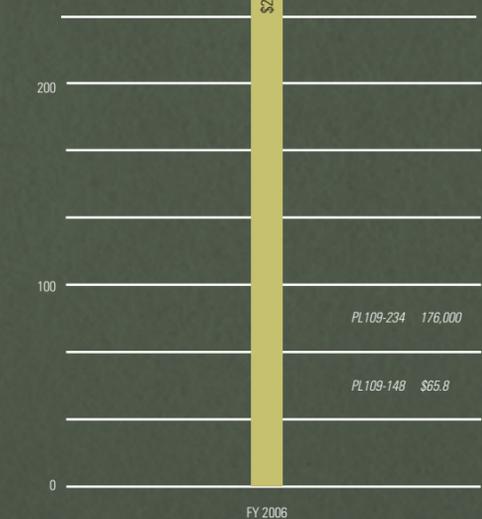


NOTE: This chart does not include Hurricane Supplementals.

AFRH Revenue
In millions of dollars



AFRH General Fund Revenue
In millions of dollars



Congress provided Hurricane Supplementals to help meet the residents' needs.



"I was honored to perform at AFRH. I've met a lot of soldiers and their families – and I truly feel for them. So I'm donating proceeds from my new CD to *The Fallen Heroes Fund*."

—Ty Nelson, rising country star



Ty Nelson schmoozes with Sheila Abarr, our public affairs officer, after his 5-star performance here.

The Confidence to Assure

During the past year, we continued our successful advance with internal controls over financial management. We achieved results in many key actions under the Strategic Goal of "Financial Growth." This can be greatly attributed to our public-to-public transfer of accounting functions to the BPD's ARC division in 2004. That move resulted in our first "unqualified opinion" in FY05 – and a second in FY06.

An independent auditor performed an audit on BPD's financial management systems (e.g. controls placed on the financial management systems and operating effectiveness from July 1, 2005 – June 30, 2006.) This assurance via Standards Number 70 (SAS70) validates the integrity of AFRH management controls and our compliance with Federal financial systems standards.

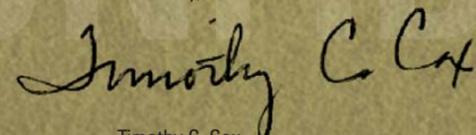
We sought security certification and accreditation for the AFRH IT Enterprise Network, which we received in September 2006. This IT effort began several years ago (as cited during the 2005 inspection by the Air Force Inspector General). Yet, it culminated in corrective actions coupled with our own unique strategy to leverage external web servers for our agency IT enterprise.

We implemented our own directive and questionnaire for Internal Control. This allowed our managers to monitor activities, gain insight into proper reporting for their functions and make corrective actions continuously.

I can provide reasonable assurance that objectives have been achieved for the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA), as well as for the Federal Information Security Management Act (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, 2006



COO Timothy Cox has a casual conversation with W.R. "Kit" Kitson, the newly elected Chair of the AFRH-Washington Resident Advisory Council.

The Federal Manager's Financial Integrity Act (FMFIA)

The FMFIA requires an agency to report on the health and integrity of its financial, program, and related activities. This requirement focuses on ensuring resources are consistent with the overall mission, that programs achieve their intended results, and that programs and resources are free of waste, fraud and mismanagement. Further, the agency head must see that Laws and regulations are followed and financial management complies with Federal standards.

Internal Control

In 2006, AFRH created its own Internal Control Board and established the AFRH Senior Assessment Team. Through the Home's CFO, managers are provided a questionnaire to evaluate their own internal control structure, define effective internal controls and institute improvements for internal control deficiencies (e.g. "Risk Assessment"). Each quarter, the Senior Assessment Team will conduct reviews of internal control progress made by AFRH as an agency, as well as assess the Corporate Resource Offices and the Director of each AFRH campus.

Inspections

Triennial Inspection, Summer 2005 (submitted to Congress in FY06)

"Overall, the inspection team found that AFRH provided quality care and a comfortable resident living environment; AFRH personnel managed the Home effectively and were committed to their core business—running the premiere retirement community for America's veterans. Moreover, AFRH experienced a significant operations transformation in the services provided to the residents and in the working environment for the staff. The change was positive as AFRH evolved from inefficient management practices of the past to the "one model" approach of the future."

—Inspector General Review, Excerpt from the Executive Summary



2006 STATUS:
No "material weaknesses" have been identified.

"I enlisted in the Navy as a 17-year-old in WWII. My ship was harbored off Normandy and my most memorable experiences were there. In my first battle, I didn't know what to think. I was afraid. When the buzzer went off in target practice, I was the last in line, so my job was to close the hatch door. The 14-ft. guns went off before I sealed it – and I was blown back 23 feet. That blast blew the buttons off my shirt and I stung all over. After that, I was never last!"

—Herbert M. Thompson
(ret. Navy, E Division)

CONFIDENTIAL

The Will to Advance

Inspection for Compliance with FISMA

As reported in the PMA E-Gov section, the Home underwent an inspection for certification and accreditation of its IT security (in accordance with FISMA). The AFRH received this distinction as a result of meticulous attention to detail and the united effort of the IT team. The team had been undergoing a continuing self-assessment for several years and benefited from suggested corrective actions from the IG's areas of concern.

JCAHO Inspection

During FY 2006, AFRH-Washington was inspected by JCAHO for its healthcare services. The Commission's standards focus on state-of-the-art performance improvement strategies that help organizations continuously improve the safety and quality of care. This ultimately reduces the risk of low quality care and error. AFRH-Washington received the Gold Seal of Approval™ from JCAHO, designating that the Home complies with the highest national standards for safety and quality of healthcare.

The highlights of the IG visit and our responsive actions include:

AREAS CITED	AFRH Actions
Many directives and policies are not standard or current.	AFRH issued an Agency Cancellation Notice that eliminated 221 Gulfport Healthcare Operational Instructions in September 2006. Since many Gulfport residents are living in Washington indefinitely, they will follow our Washington Instructions. Canceling these duplicate instructions aids our goal of streamlining dual campus policies into one standardized policy (under our Zero Base Review Plan). A total of 13 AFRH Agency Directives have been under review by legal counsel and/or unions(s). Most have been signed by the COO and issued. Our ongoing process to streamline will continue on the remaining Directives for completion in FY07.
No financial audits were conducted in 2003 and 2004.	Under the transfer of accounting functions to BPD's ARC, AFRH received two "unqualified opinions" during separate audits in 2005 and 2006.
No acquisition plan/strategy exists.	AFRH in conjunction with BPD are establishing milestones and activities for an Acquisition Plan. BPD is actively involved with monitoring and managing AFRH contracts.
AFRH Records Management Program does not meet standards.	AFRH in coordination with National Archives and Records Administration (NARA) are developing records schedules for unique files of AFRH. A directive is in draft, which provides an AFRH Records Schedule.
Information security is not in compliance with requirements.	AFRH began identifying and correcting security and infrastructure problems long before the Inspection. With additional input from the IG, AFRH continued to move towards compliance by establishing a Security Program and Information Security Training Program. AFRH received security certification and accreditation for its Information Enterprise Network in September 2006.
Human Resources management is in compliance.	Overall, the IG found HR programs (most of which are franchised to BPD) were in compliance and did not cite any corrective actions. One area of strength was noted in that the new performance forms linked business objectives with performance standards.

Federal Financial Management Improvement Act (FFMIA)

FFMIA is designed to improve federal financial management by requiring that financial management systems provide reliable, consistent disclosure of financial data. This is in accordance with generally accepted accounting principles (GAAP) and standards. FFMIA requires AFRH to implement and maintain a financial management system that substantially complies with:

- Federal requirements for an integrated system
- Applicable Federal accounting standards
- US Standard General Ledger at the transaction level

2006 STATUS: AFRH is in substantial compliance with FFMIA requirements.

As we serve our Veterans with advanced care, the Home strives to be as efficient and economical as possible. We rely on the BPD's ARC division, which recently underwent an SAS70 audit* on its internal control activities and controls over information technology and related processes. The SAS70* is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA), where an organization undergoes an in-depth audit of their control activities. The independent auditor report on activities from July 1, 2005 – June 30, 2006, along with tests of the operating environment, disclosed "no instances of noncompliance" required to be reported under Government Auditing Standards.

An examination of the accounting process, along with general computer controls provided by ARC, provided reasonable assurance that our controls would achieve their objectives in conjunction with Customer Agencies' internal controls.

The independent auditors' AFRH report provides reasonable assurance that our financial statements are free of material misstatement. Further, they noted no matters involving the internal control and its operation that they would consider to be material weaknesses. The two independent auditors reports confirm no material weaknesses in the AFRH internal control.

Financial Management Systems Framework

AFRH benefits from the public-to-public relationship that transferred its financial management to the BPD's ARC division. The Home uses the financial systems that ARC provides: Oracle Financials 11i, Oracle Assets, PRISM and WebTA. Payroll is through the National Finance Center. BPD personnel operate and maintain the system, ensuring top-notch support. Plus, they also developed and implemented several interfaces into Oracle Federal Financials to integrate key activities – such as e-payroll, procurement, purchase card, e-travel, Federal investments and Intragovernmental Payment and Collection System (IPAC) transactions. In FY06, per our request, BPD added Oracle Asset Manager to the Home's integrated suite of tools. Ultimately, BDP is responsible for the financial security and integrity of the system. In the PMA section above, the framework is illustrated in a chart.

Improper Payments Information Act (IPIA) is covered in Part 5: Accompanying Information

Resident Information System (RIS)

Another major achievement in 2006 has been the implementation of Monette – an integrated resident-focused software package. The modules rollout of this UltraCare application includes Admissions, Pre-Admissions, Clinical and Minimum Data Set (MDS) completed in September 2006.

*A Statement on Auditing Standards (SAS) No. 70, Service Organizations

The key to the Lincoln Cottage on the DC campus was once used by our 16th President. This artifact is on display in the AFRH Museum in the Sherman Building. Honestly.



The Performance to Prosper

For us, great performance means fulfilling our mission: providing the best care for Veterans. In a larger sense, our victories also support today's active duty military. When our troops in Afghanistan and Iraq hear about our fine Veterans' care back home, they feel reassured that their service is appreciated. Our success also helps calm service members' deepest, darkest fears – that if they become disabled on the battlefield, they'll be well cared for by their own.

This is yet another reason why we're driven to perform – because it has a bearing on the performance of today's soldiers, who are preserving liberty for today ... and all our tomorrows. As we move forward, many Vietnam and Korean War Veterans will soon be approaching retirement age. Plus our current campaigns in the Middle East are creating many new Veterans who will surely need our care one day. So, ensuring the future success of the AFRH here at home is just as vital as preserving our American interests abroad.

As such, the AFRH and Congress have a moral obligation to honor the original Promise to care for its Veterans. Our goal is to build upon that pledge and provide even greater service in the future. The advances we're now pursuing include campus-wide Internet services, mobile dental services and additional Assisted Living and Memory Support. All of which will help us improve our care and compete with private homes.

This section details our achievements in FY06, namely our triumphs in two key focus areas: Financial Growth and Exceptional Service. We'll show you the linkage from our strategic goals and objectives to our action plans and results. Plus we'll explore our unmet goals – and discuss our action plans for future success.



The King made a surprise appearance at the AFRH Luau in June. Here, Marie Butz puts in a request for "A little less conversation." John Tuggle agrees.



The AFRH of the Future

Our agency-wide Business Plan for 2006 – 2010 outlines the Home's major corporate initiatives. This comprehensive Plan includes our present status, strategic initiatives and a financial report. (Since these are new initiatives, they cannot be compared to prior years.) Ultimately, we'll use this Plan as a guide to build a stronger, more vibrant AFRH.

Our Business Plan is directly linked to the AFRH Strategic Plan, which was recently updated after Hurricane Katrina. It communicates our broader intentions for managing challenges and exploiting opportunities as we march into the future.

Earlier this year, the AFRH held a management offsite to improve teamwork, adapt to the Hurricane's impact and to set our sights on long-term initiatives. We reviewed both Plans, adjusted our Mission, focused on recent achievements and pledged to do even better.

Each day, we focus on the goals and objectives cited below. To achieve them, the following public-to-public partners and contractors support us: the DoD, BPD, NFC, GSA and the OMB. These partners also helped our managers and personnel prepare the Home's performance results.

AFRH Performance Objectives	
Objective	Results by Objectives
GOAL 1 – Financial Growth: Create net growth and stability for the AFRH Trust Fund.	
FG1 Increase revenue resulting in a net increase. FG2 Reduce costs resulting in a net increase. FG3 Enhance fiscal management. FG4 Change corporate operating model.	In 3 of 4 Objectives 31 of 43 Key Actions In Progress or Achieved
GOAL 2 – Exceptional Service: Enhance the AFRH experience to enrich the quality of residents' lives.	
ES1 Craft a resident-focused environment with service measurements. ES2 Enhance customer satisfaction through vibrant community outreach. ES3 Promote resident vitality and independence as long as possible.	In 3 of 3 Objectives 21 of 26 Key Actions In Progress or Achieved
GOAL 3. Improved Processes: Modernize operations to leverage and maximize resources across AFRH.	
IP1 Simplify and standardize processes. IP2 Optimize our use of technology solutions. IP3 Increase timeliness and satisfaction with communications.	In 3 of 3 Objectives 11 of 15 Key Actions In Progress or Achieved
GOAL 4. Learning & Growth: Promote personal excellence and professional growth for all personnel.	
LG1 Provide a comprehensive employee training program tied to performance, competencies and accountability in compliance with OSHA and JCAHO requirements. LG2 Develop and manage workforce talent. LG3 Develop a strategy for employee professional development.	In 2 of 3 Objectives 2 of 8 Key Actions In Progress or Achieved
GOAL 5. Culture of Integrity: Inspire commitment to AFRH Guiding Principles through mutual respect.	
CI1 Increase teamwork and cooperation among AFRH employees. CI2 Engage and motivate the workforce.	In 2 of 2 Objectives 4 of 5 Key Actions In Progress or Achieved

Summary: For all 5 Goals, 63/97 Key Actions show "Progress" or "Achieved Results"

NOTE: Regarding the data quality, AFRH is a small agency with minimum layers of management. The data below has been input, reviewed and validated by managers, followed with a review by the Agency Inspector General.

The Resources to Grow

I am pleased to present the AFRH financial statements for FY06. As always, we have continued to maintain our resident-focused approach – while employing the highest standards to our fiscal management. Now, I have the pleasure of offering the President, Congress and the American people this Report on our stewardship of the public funds entrusted to us.

Leveraging Challenges

In the face of adversity and change this past year, our staff has done an admirable job of safeguarding the funds entrusted to them. In fact, our entire staff has been vigilant about getting the most from every dollar – while also creating programs with tremendous value.

At the close of FY05, the AFRH was saturated with the aftermath of Hurricane Katrina and the ensuing Gulfport closure. Back then we faced many challenges. Now, I am happy to report we have met those challenges head on – and this section is a true reflection of our recent financial rebound. One success makes me especially proud – our second unqualified audit opinion for FY06.

Expanded E-Gov

This year's PAR has a special section devoted to our victory with the President's E-Gov Initiative (See pg. 30, Special IT Feature). We believe the Home has taken E-Gov to a new level as an agency and we are most proud. Our focus has been leveraging the power of the Internet through help desks, maintenance, software updates, training and innovation. In a sense, the Home is a "customer" of our

primary systems – like e-mail, resident information, and financial management. Today, we feel like we've been given a premium upgrade – in the form of a web-based, enterprise IT system with great functionality and integration. And now, it is certified and accredited.

Financial Advances

I personally can vouch for our new financial management system – because it seamlessly integrates accounting, procurement, travel, purchase cards, investments, payroll and asset management. The best part: we have access to all vital systems via the Internet, from anywhere in the world. This advancement has been a strong enabler, dramatically bolstering the Home's core competency: premier retirement services for America's war Veterans.

We made great strides in another PMA Initiative, too: Competitive Sourcing. From 2003 – 2004, we conducted seven competitive sourcing studies for public-to-private partnerships. These studies will generate almost \$18.7 million in savings over five years. Meanwhile, we conducted an additional six public-to-public transfers. Those efforts helped create enviable full-service capabilities in accounting, procurement, human resources, travel, purchase and travel cards, as well as investing.

Boosting Efficiency

This would not have been possible without our unique public partnership with the BPD's ARC division. They helped us gain efficiencies by eliminating waste and minimize system costs by pooling resources. Now, we only pay for the services we use. All told, we developed

a successful public-to-public model that can serve as a benchmark for other Federal agencies as they strive for excellence.

With the added residents from Gulfport, the need for expansion in Washington became evident. The influx caused inefficiencies for part of the year – in medical services and transportation routes, to name a few. Yet, at the close of FY06, we were working toward efficiency. We also started our 10-year financial plan, to be completed in FY07. In our Washington Master Plan, we created a future vision to maximize our buildings and residential areas, while also earning revenue from our holdings. Lastly, management agreed on a set of Guiding Principles that will direct our operational decisions as we move toward even more efficiencies.

Gulfport Grateful

Regarding the fate of Gulfport, Congress has provided funding for the rebuild of the campus. All of us at the AFRH are very excited about this great news. Now, we are diligently working to move forward with GSA, the agent for Gulfport construction and contract administration.

In reflection of the past year, we must send out special thanks to many unsung heroes. All year long, hundreds of volunteers appeared in Gulfport and Washington to aid our residents'

in the aftermath of Hurricane Katrina. We are forever grateful for all they have done. From cleaning up debris, building fences and moving bulky furniture ... to packing personal items, making generous donations and providing moral support. Those good people brought many smiles to our residents' faces and their support and prayers have been invaluable for our morale. We cannot list the name of every volunteer ... but we can offer heartfelt thanks.

Special Thanks

Likewise, Congress has been extremely generous to us. The tremendous support they have shown our Veterans is a testament to the original Promise the military made in 1811 to care for its own. In our long and storied history, we have remained financially independent – mostly using money generated from the men and women of the Armed Forces themselves. Yet, with the appropriated funds for the Gulfport rebuild, Congress has bestowed a unique and noteworthy tribute to those who have served their country so selflessly.

In the end, FY06 was a year of new challenges and more successes. As always, we'll be looking to improve our performance as we advance on our Goals in 2007.

Sincerely,

Steven G. McManus
Chief Financial Officer (CFO), AFRH
November 15, 2006



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 FY06 – including purchasing, payments, accounting, budget and travel service – were administered by BPD. The NFC processed our payroll and time/attendance data entry transactions.

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.

The Funds to Reinforce

Since Hurricane Katrina and throughout FY06, an influx of Congressional Hurricane Supplementals helped the Home financially.

PL 109-62	\$6 M initially given to move and house residents
PL109-148	\$65.8 M to plan and design Gulfport, as well as sustain and expand Assisted Living & Memory Support in DC
PL109-234	\$176 M to rebuild the Gulfport complex
TOTAL	\$247.8 MILLION

We are truly thankful to Congress for supporting the Home at this unique and critical juncture. It can rest assured that these funds will be spent wisely to help us fulfill our mission. Moving forward, GSA is the agent for Gulfport planning, design, construction and contract administration – in consultation with AFRH management and the Naval Facilities Engineering Command.

Strengthening Washington

Katrina funds of \$11 million are now being used to develop a Memory Support unit and to improve Assisted Living facilities in Washington. Katrina funds were also used to transport Gulfport residents' personal belongings to DC and other locations where former residents live.

Prince Charles came to honor our Veterans at a British Embassy WWII Memorial service. He conversed with many residents like Margaret Jirak – and made a royal impression.



The Capacity to Validate



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 consolidated balance sheets of the U.S. Armed Forces Retirement Home as of September 30, 2006 and 2005, and the related consolidated statements of net cost and results of operations and changes in net position, and the combined statements of budgetary resources and financing for each of the years ended September 30, 2006 and 2005. These financial statements are the responsibility of the U.S. Armed Forces Retirement Home. 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements, as amended*. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audit to obtain reasonable assurance about whether the principal 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 U.S. Armed Forces Retirement Home as of September 30, 2006 and 2005, and its net costs, changes in net position, budgetary resources, and financing for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 27, 2006 on our consideration of the U.S. Armed Forces Retirement Home's internal control over financial reporting and a report dated October 27, 2006 on its compliance with 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 and Analysis and Required Supplementary Information sections is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America or 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.

Brown & Company

Largo, Maryland
October 27, 2006

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CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

We have audited the principal statements (hereinafter referred to as "financial statements") of the U.S. Armed Forces Retirement Home as of and for the year ended September 30, 2006, and have issued our report thereon dated October 27, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the U.S. Armed Forces Retirement Home's (AFRH) internal control over financial reporting by obtaining an understanding of AFRH's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide an opinion on internal control and therefore, we do not express an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect AFRH's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

In addition, with respect to internal control objective related to the performance measures included in the "Management's Discussion and Analysis," we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they have been placed in operation. Our procedures were not designed to provide an opinion on internal control over reported performance measures, and, accordingly, we do not express an opinion on such controls.

This report is intended solely for the information and use of the management of the U.S. Armed Forces Retirement Home, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Largo, Maryland
October 27, 2006

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CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

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

We have audited the principal statements (hereinafter referred to as "financial statements") of the U.S. Armed Forces Retirement Home as of and for the year ended September 30, 2006, and have issued our report thereon dated October 27, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

The management of the U.S. Armed Forces Retirement Home (AFRH) is responsible for complying with laws and regulations applicable to AFRH. As part of obtaining reasonable assurance about whether AFRH's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 06-03. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to AFRH.

The results of our tests of compliance disclosed no reportable instances of noncompliance with other laws and regulations discussed in the preceding paragraph that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. However, we noted no noncompliance with laws and regulations, which could have a direct and material effect on the determination of financial statement amounts.

This report is intended solely for the information and use of the management of the U.S. Armed Forces Retirement Home, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Largo, Maryland
October 27, 2006

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AFRH Financial Statements

Armed Forces Retirement Home

BALANCE SHEET

AS OF SEPTEMBER 30, 2006 AND 2005

(In Dollars)

	2006	2005
Assets :		
Intragovernmental:		
Fund Balance with Treasury	\$ 239,123,692	\$ 6,523,911
Investments	139,563,566	124,841,901
Accounts Receivable	2,687,343	3,168,942
Total Intragovernmental	\$ 381,374,601	\$ 134,534,754
Accounts Receivable	554,056	760,959
General Property, Plant and Equipment	75,875,693	77,871,110
Total Assets	\$ 457,804,350	\$ 213,166,823
Liabilities:		
Intragovernmental:		
Accounts Payable	\$ 772,159	\$ 133,340
Other	1,932,247	1,955,574
Total Intragovernmental	\$ 2,704,406	\$ 2,088,914
Accounts Payable	3,471,327	3,256,252
Other	2,075,294	2,487,105
Total Liabilities	\$ 8,251,027	\$ 7,832,271
Net Position:		
Cumulative Results of Operations	\$ -	\$ 205,334,552
Cumulative Results of Operations - Earmarked Funds	449,553,323	-
Total Net Position	\$ 449,553,323	\$ 205,334,552
Total Liabilities and Net Position	\$ 457,804,350	\$ 213,166,823

The accompanying notes are an integral part of these statements.

Lorenzo Seneris celebrates his 101st birthday in grand style — surrounded by family, friends and caring staff members. Apparently, you can have your cake and eat it too.



The spirit of Mardi Gras is alive and well in DC. Here, Calvin Woodwork pays homage to the honorable Queen Edythe Jackman, age 96.

Armed Forces Retirement Home

STATEMENT OF NET COST

FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

(In Dollars)

	2006	2005
Program Costs:		
Chief Operations Office:		
Gross Costs	\$ 2,182,271	\$ 1,388,808
Less: Earned Revenue	543,256	342,567
Net Program Costs	\$ 1,639,015	\$ 1,046,241
Corporate Resource Office:		
Gross Costs	\$ 6,925,162	\$ 5,729,744
Less: Earned Revenue	1,723,955	1,413,318
Net Program Costs	\$ 5,201,207	\$ 4,316,426
Gulfport, MS:		
Gross Costs	\$ 7,533,225	\$ 17,603,692
Less: Earned Revenue	1,875,327	4,342,186
Net Program Costs	\$ 5,657,898	\$ 13,261,506
Washington D.C.:		
Gross Costs	\$ 50,921,900	\$ 47,990,238
Less: Earned Revenue	12,676,537	11,837,434
Net Program Costs	\$ 38,245,363	\$ 36,152,804
Total Program Costs:	\$ 50,743,483	\$ 54,776,977
Less: Earned Revenues Not Attributed to Programs		19,396
Net Cost of Operations	\$ 50,743,483	\$ 54,757,581

The accompanying notes are an integral part of these statements.

The Challenges to Overcome

Management Challenges:

The IG identified the top challenges now facing the Home. As we overcome them, our workforce, partners and contractors are accountable for AFRH Trust Fund dollars. Naturally, oversight and enforcement is needed to ensure progress and fiscal responsibility.

Executing the Washington Master Plan

Throughout the Home's history, we have financed operations with interest from the AFRH Trust Fund. Yet, we must supplement this to ensure fiscal stability for future Veterans.

So, Congress provided AFRH (via DoD) the authority to sell or lease real estate (per the FY02 National Defense Authorization Act). We intend to capitalize by offering portions of our valuable real estate for development.

Our 272-acre campus has buildings and land that no longer serve AFRH operations. So, we created our Master Plan to address development – and a competitive process to choose partners is underway. A sound plan with regular due diligence is a must if we are to generate new and reliable revenue streams.

Deploying the Gulfport Master Plan

Congress just appointed GSA as the agent to rebuild Gulfport. So AFRH and GSA must form a good working relationship. AFRH must also maintain good stewardship over the Congressional rebuild funds and be helpful advisors as GSA oversees construction.

Handling operational, financial and human capital strategies

As we discussed, our strategies for operational, financial, and human capital have not been fully realized. So we must press forward in these areas. We will push to integrate our strategies with our budget. Implement our new performance plans. And work on our capital improvement plans. With consistent oversight and our new Internal Control measures, we expect progress in FY07.

Shuttle transportation is available to residents, especially those with special needs.



**Armed Forces Retirement Home
Office of the Chief Operating Officer
3700 N. Capitol Street, P.O. Box 1303
Washington, DC 20011-8400**

November 14, 2006

Memorandum

To: Timothy C. Cox, Chief Operating Officer

Re: Management Challenges for FY 2007

In accordance with the Reports Consolidation Act of 2000, we have identified the most serious management and performance challenges facing Armed Forces Retirement Home in FY 2007. AFRH is working to address these challenges and improve operations through various initiatives and by implementing recommendations made by my office and other inspection activities.

Those challenges are:

- Implementation of the AFRH-Washington Master Plan
- Implementation of the AFRH-Gulfport Master Plan to rebuild AFRH-Gulfport
- Handling operational, financial, and human capital strategies

To improve the efficiency and integrity of AFRH's programs and operations, we will continue to monitor progress in these areas of concern.

MAURICE SWINTON
Inspector General



ARMED FORCES
RETIREMENT HOME

Protecting a promise *Renewing a trust.*

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