



U.S. Department of Defense



A MISSION THAT MATTERS



EXCHANGE

2022 MISSION REPORT



EXCHANGE STRONG! REMAINING STEADFAST IN A MISSION THAT MATTERS

In a time of continued unprecedented challenges, the Army & Air Force Exchange Service remains steadfast in providing mission-essential support to Warfighters and their families worldwide.

Despite inflationary challenges, the Exchange exceeded sales and earnings targets for FY 2022, recording \$8.5 billion in revenue with \$356 million in dividend-eligible earnings. This enabled the Exchange to contribute \$214 million in dividends to the Services for Quality-of-Life programs for Soldiers, Airmen, Guardians and their families.

In 2022, the Exchange team once again showed its dedication to serving the military community. Highlights include:

- Supporting 28 military exercises at the tip of the spear.
- Launching self-checkout at more than 100 PXs, BXs and Expresses.
- Intensifying national brands.
- Opening more than 40 restaurants worldwide.
- Expanding DoorDash delivery service.
- Committing to hiring 75,000 Veterans and military spouses by 2030.

Team Exchange remains resilient, resourceful and strong, upholding a more than 127-year legacy of service and support.

Tom Shull
Director/Chief Executive Officer

2022 BOARD OF DIRECTORS

Per Army Regulation 215-8/Air Force Instruction 34-211 (I), the Secretary of the Army and the Secretary of the Air Force have oversight responsibility of the Army & Air Force Exchange Service Board of Directors and Exchange operations.

EXECUTIVE COMMITTEE



LTG CHARLES R. HAMILTON, USA
CHAIRMAN
Deputy Chief of Staff, G-4, HQDA
(DALO-ZA)



LT GEN CAROLINE M. MILLER, USAF
VICE CHAIR
Deputy Chief of Staff, Manpower,
Personnel & Services (HQ USAF/A1)



TOM SHULL, SES
Director/CEO,
Army & Air Force Exchange Service

BOARD MEMBERS



LTG PAUL A. CHAMBERLAIN, USA
Military Deputy for Budget
(HQDA ASA FM)



LTG KEVIN VEREEN, USA
Deputy Chief of Staff, G-9, HQDA
DCS (DAIN-ZA)



SMA MICHAEL A. GRINSTON, USA
Sergeant Major of the Army
(DACS/SM)



CMSAF JOANNE S. BASS, USAF
Chief Master Sergeant of the Air Force
(AF/CCC)



MAJ GEN JOHN N. TREE, USAF
Mobilization Assistant to the Air Force
Chief of Staff (HQ USAF/CC-MA)



MG KRIS A. BELANGER, USA
Special Assistant, Assistant Secretary of
the Army (Manpower and Reserve
Affairs) (ASA (M&RA)) & Director,
Quality of Life (DASA-MPQ)



MAJ GEN MICHAEL A. GREINER, USAF
Deputy Assistant Secretary of the Air
Force, Budget (SAF/FMB)



MG ISAAC JOHNSON, USA
Commanding General, Army Civil Affairs
and Psychological Operations Command
(Airborne) (AFRC-CPC-CG)



MR. HORACE L. "H.L." LARRY, SES
Director, Air Force Services
(HQ USAF/A1S)



MR. TODD L. REMINGTON, SES
Deputy Chief Human Capital
Officer, U.S. Space Force (USSF/S1)



MR. ANDREW K. WEAVER
Executive Secretary

MILITARY COMMUNITY SUPPORT

DEPARTMENT OF DEFENSE'S LARGEST RETAILER

Serving those who serve since
1895

33.4M
authorized shoppers

Operating almost entirely on the sale of goods and services —not tax dollars

85%
of 28,700 associates connected to the military

Career opportunities through the DoD Military Spouse Employment Partnership



50th Anniversary Vietnam War Commemorative Partner

Ceremonies to honor Vietnam-era Veterans on **NATIONAL VIETNAM WAR VETERANS DAY**

Giveaways, sweepstakes, activities and more every April in honor of **MONTH OF THE MILITARY CHILD**

VITAL NONPAY BENEFIT

TAX-FREE SHOPPING

MILITARY-EXCLUSIVE PRICING

LIFETIME BENEFIT

3M+
items at [ShopMyExchange.com](https://www.shopmyexchange.com)



MISSION SUPPORT

609K
military uniforms outfitted at cost

300+
facilities in austere locations in Southwest Asia and Eastern Europe

76K
troops served in austere locations

OVERSEAS SUPPORT

7
bakeries and water plants

5.6M
baked goods produced

4M
school meals served in Department of Defense Education Activity schools

VETERAN AND MILITARY SPOUSE EMPLOYMENT

46%
of the workforce are Veterans, military spouses or dependents

10,816 VETERANS & 46,279 MILITARY SPOUSES
have joined the Exchange workforce since 2013

2,056
Wounded Warriors hired since 2010

RETAIL

30+
countries

50
50 states

4
U.S. territories

120
PXs/BXs with national brands

561
convenience stores (Expresses, gas stations, troop stores, specialty stores, Class Six)

164
Military Clothing stores

ONLINE SHOPPING, INCLUDING PRIVILEGES FOR HONORABLY DISCHARGED VETERANS

RESTAURANTS

1,500+
restaurants

41
restaurants opened in 2022

77M
meals served

SERVICES

2,785
mall stores and kiosks, including wellness services like dentistry and optometry

51
movie theaters

396M
gallons of fuel dispensed



WORLDWIDE LOGISTICS

3RD-LARGEST
shipper in the Defense Transportation System

10
distribution centers

41M
cases shipped

12M
fleet miles driven

13TH-LARGEST
private retail fleet in U.S.

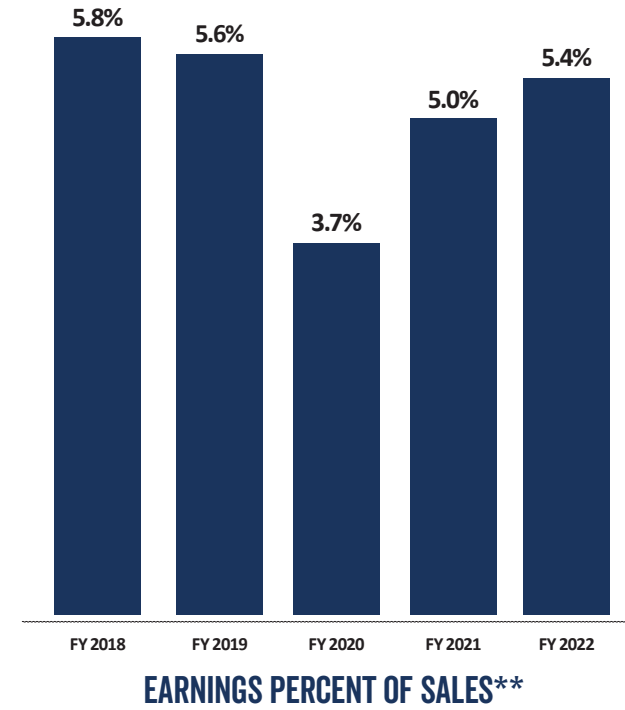
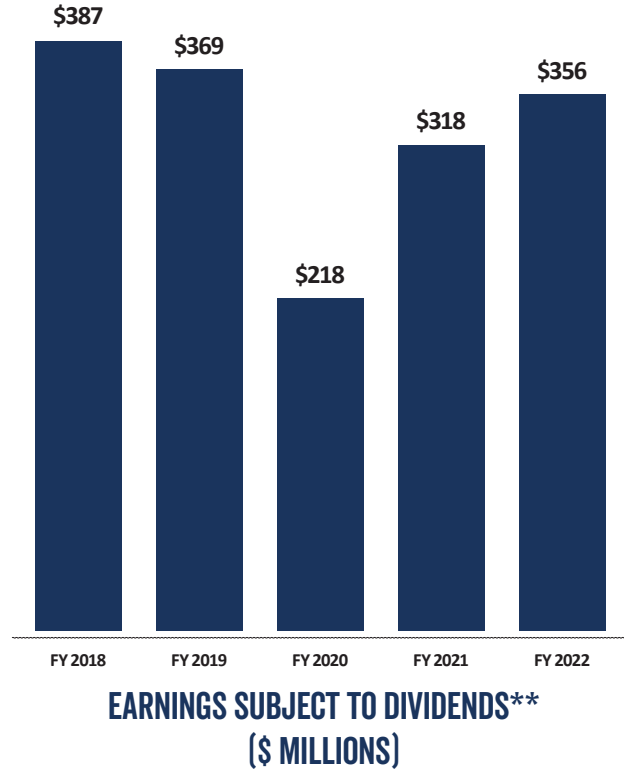
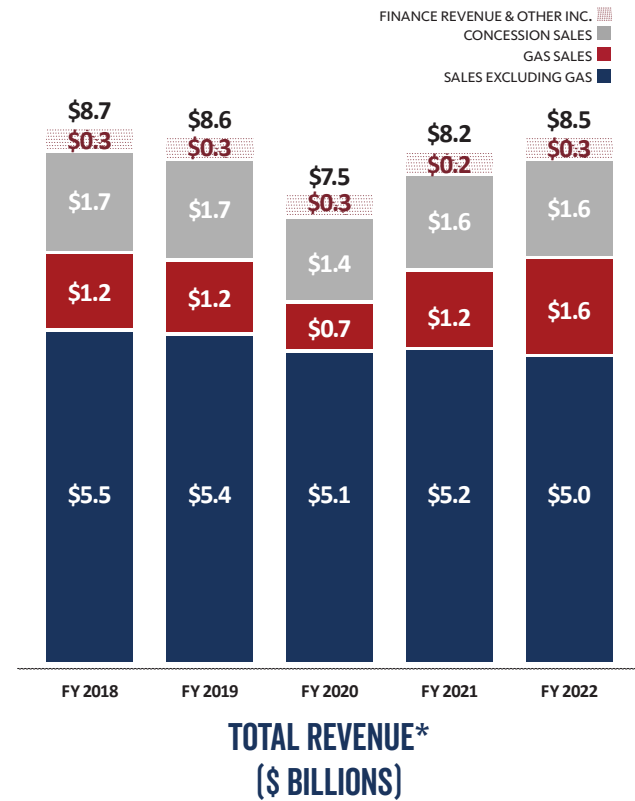
TOTAL SUPPORT

\$3.5B
in earnings to Quality-of-Life programs in the last 10 years

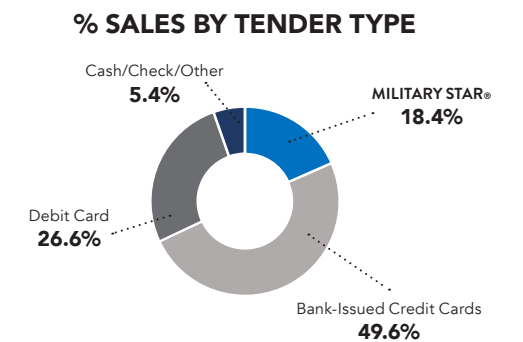
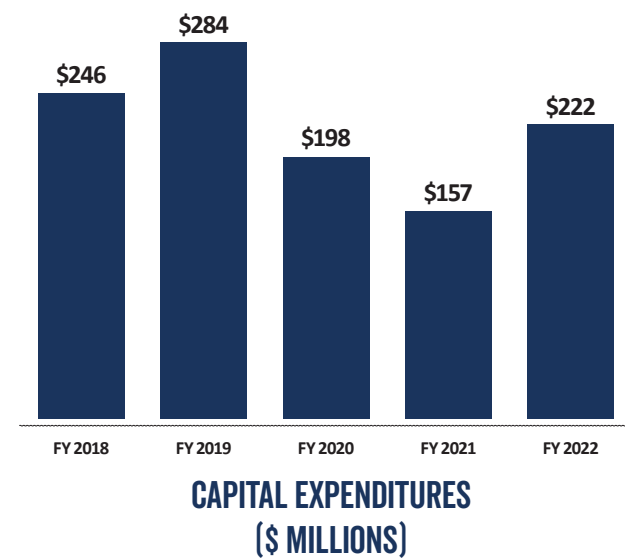
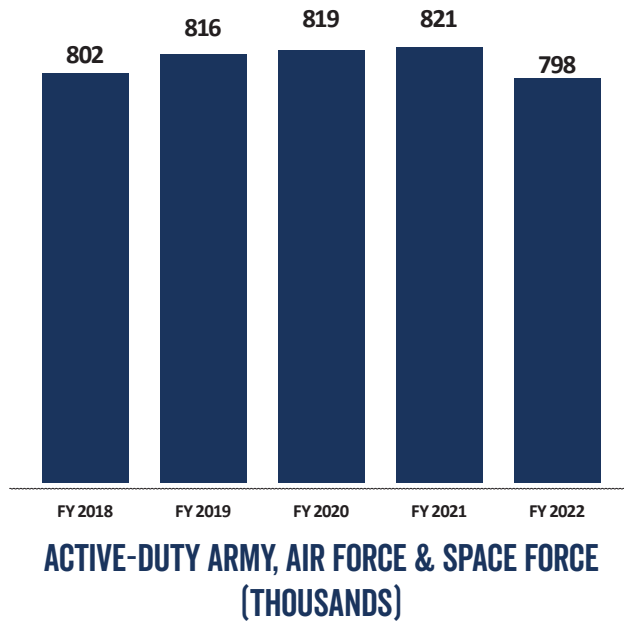
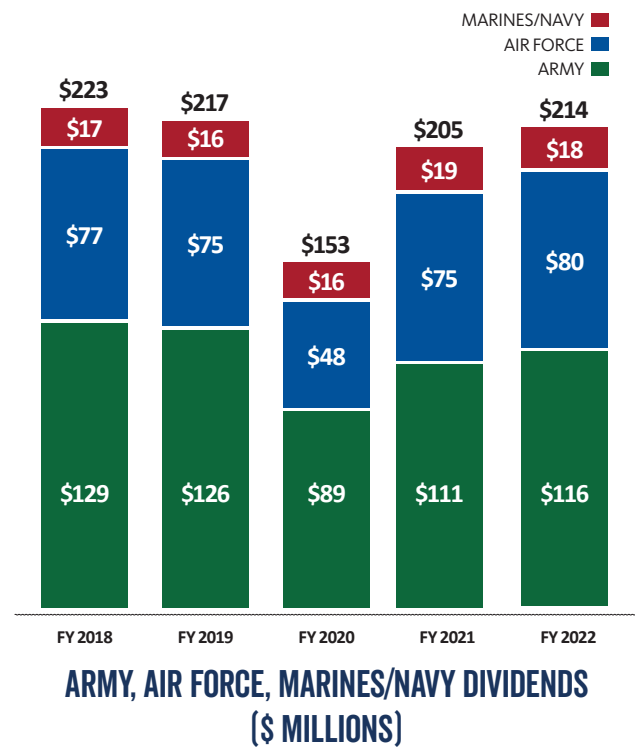
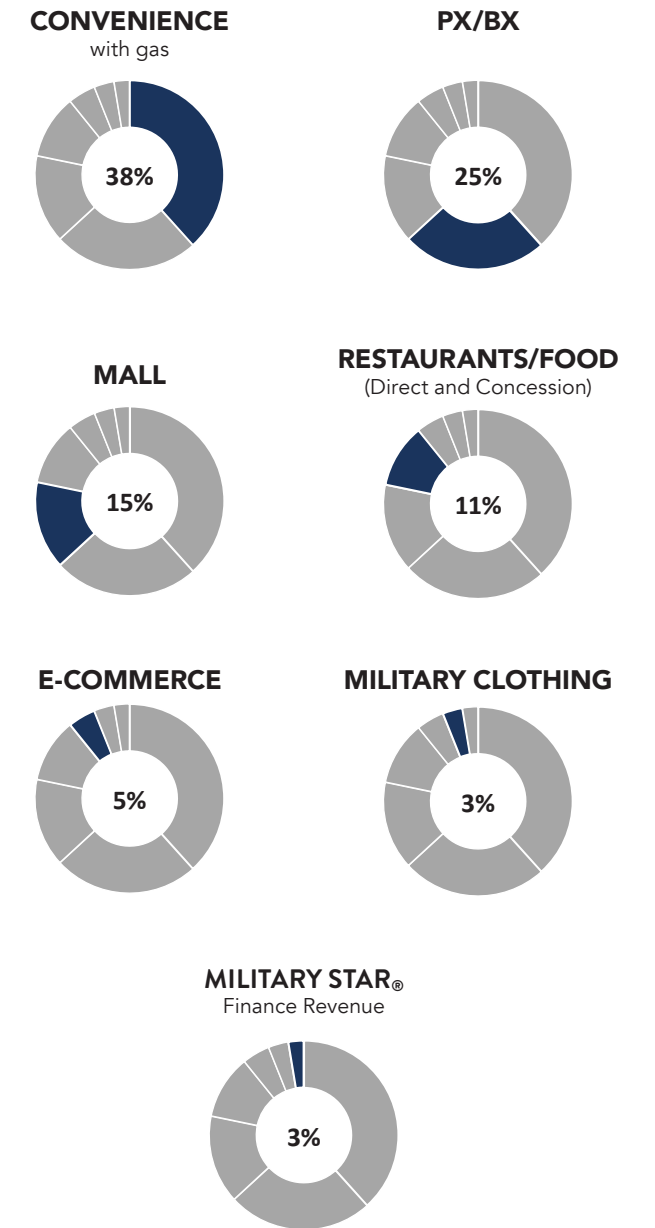
100%
of Exchange earnings support the military community



FINANCIAL HIGHLIGHTS



TOTAL 2022 REVENUE COMPOSITION



*Total Revenue includes concession sales (non-GAAP measure).

**Earnings Subject to Dividends and Earnings % of Sales reports show adjusted earnings pursuant to AAFES BoD dividend policy and exclude certain non-operating expenses

INDUSTRY ACCOLADES AND RECOGNITIONS

SERVING AT THE TIP OF THE SPEAR



**Ranked
54th
of Top 100 Retailers**
NRF NATIONAL RETAIL FEDERATION

VETS Indexes
☆☆☆☆
BASED ON PRIDE, BUILT ON INTEGRITY®
**2022
4 Star Employer**

**STANDARD
& POOR'S**
AA-/A-1+
2022 Rating
long term/short term
with a stable outlook;
third-highest-rated retailer
behind only Amazon and
Walmart

The Exchange lives its “We Go Where You Go” motto through mobile field Exchanges (MFEs), small storefronts and imprest fund activities overseas.

30+ COUNTRIES WITH EXCHANGE-SUPPORTED OPERATIONS	EUROPE AND NORTH AFRICA	
	12 exercises	54K troops supported
	PACIFIC	
	16 exercises	22K troops supported

**Military
Times**
**Best for Vets:
Employer**
(9th year in a row)

 
VIQTRY
(publisher of G.I. Jobs and Military Spouse Magazines):
Military Friendly® Employer
(13th year)
and
**No. 1 Military Friendly®
Spouse Employer**
(10th year on list)


**Best of the
Best list**
(9th year in a row)

Associate
Engagement and
Job Satisfaction
Survey:
**Associates rated
the Exchange
81 out of 100,
leading
civilian retailers
by 20 points**

**50 Best Companies
for Latinas**
(15th year in a row)


Customer
Satisfaction
Index:
**Scored 91 out of
100, leading
industry by
15 points**



TASK FORCE DRAGON, POLAND



FIELD TRAINING EXERCISE, RODRIGUEZ RANGE LIVE FIRE COMPLEX, KOREA

IMPROVING IN-STORE EXPERIENCES

SELF-CHECKOUT

Self-checkout was one of 2022's biggest success stories, with some stores reporting adoption rates of nearly 100%. The technology reduces customer wait times, increases productivity and frees associates to assist shoppers on the sales floor.

117 PXs, BXs and Expresses with self-checkout

500 Self-checkout registers rolled out

1,100 Registers scheduled to open in 2023-'24

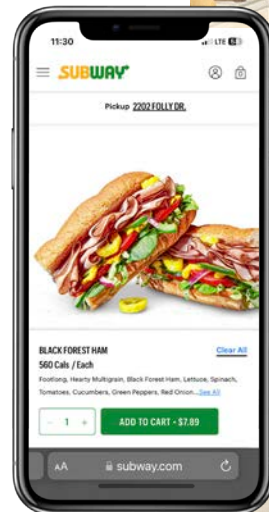


RESTAURANT POINT-OF-SALE UPGRADE

Integrating with the point-of-sale systems at its name-brand restaurants allows for compatibility with the restaurants' smartphone apps and self-order kiosks, providing a seamless customer experience, including mobile ordering, delivery, rewards programs and more.



2023 PLANS



REINVESTING IN THE SHOPPING EXPERIENCE

Exchange construction and renovation projects improve the quality of life for those who work and live on military installations. The Exchange—not taxpayers—finances the majority of these projects.

In 2022, the Exchange built or renovated 24 stores, with \$61 million in installation-level capital investments. Here are a few of the major projects:



FORT NOVOSEL (FORT RUCKER)

- 65,000+ square feet
 - 39,000 eligible shoppers
- BE FIT concept shop in main store; enhanced PowerZone section; upgraded food court including the additions of Starbucks and Qdoba Mexican Eats; and more.

"THE PROJECT REALLY CAME TOGETHER, AND IT LOOKS SO NICE. THIS IS MY FIRST TIME BACK IN THE STORE SINCE CONSTRUCTION FINISHED, SO I'M GOING TO CHECK OUT THE HOLIDAY DEALS!"
— Rosaura Nino, Army wife



CARLISLE BARRACKS

- Nearly 40,000 square feet
 - 378,000+ shoppers
- New food court with Hunt Brothers Pizza, Chopz and Eddie Peppers quick-serve restaurants. In-store BE FIT and PowerZone concept shops.

"I LIKE THE WAY IT'S SO WELL-LIT, AND THERE SEEMS TO BE A MUCH GREATER SELECTION. THIS IS GREAT FOR THE MILITARY COMMUNITY, AND PEOPLE WILL BE MORE LIKELY TO SHOP HERE RATHER THAN OUTSIDE THE GATE."
— Lawrence Derr, Navy Veteran and Carlisle Barracks shopper



YARBOROUGH EXPRESS

- 7,500 square feet
 - 7,400 shoppers
- Four pumps offering TOP TIER™-certified BP/Amoco-branded fuel, bringing fuel to the Yarbrough Complex area for the first time. Hunt Brothers Pizza, fresh fruit, salads and more.

"THIS HAS BEEN A TEAM EFFORT FROM THE START ... [WITH] AAFES BEING OUR GREAT PARTNER HERE ON FORT BRAGG AND PUTTING ESTABLISHMENTS LIKE THIS WHERE THE SOLDIERS AND LEADERS NEED THEM. THIS IS REALLY A GOOD SUCCESS STORY ... AND WE'RE SO PROUD TO BE HERE AND BE LUCKY ENOUGH TO CUT THIS RIBBON TODAY."
— Col. Scott Pence, Fort Bragg Garrison Commander



NAVAL AIR STATION JOINT RESERVE BASE FORT WORTH EXPRESS

- 2,800 square feet
 - 86,000 shoppers
- Hunt Brothers Pizza and Eddie Peppers quick-serve programs; expanded Snack Avenue; self-checkout registers and expanded retail sales floor; revamped fuel pumps now offering TOP TIER™-certified Valero-branded fuel.

"I THINK [THE EXCHANGE] DID A PHENOMENAL JOB. ... I JUST WANT TO THANK YOU RIGHT HERE FOR ALL THE SUPPORT YOU'VE GIVEN TO THE BASE. I THINK YOU'RE GOING TO GET A RETURN ON INVESTMENT, NOT ONLY FINANCIALLY, BUT IN THE MORALE OF ALL THESE MEN AND WOMEN WHO SERVE OUR COUNTRY."
— Capt. Mark McClean, NAS JRB Fort Worth Commanding Officer

INTENSIFYING NATIONAL BRANDS

The Exchange expanded its name-brand assortment in store and at ShopMyExchange.com, bringing brands shoppers know and love to the military community, tax-free.

The Exchange broadened its appeal online to capture a larger share of e-commerce sales. Expanded vendor and retail partnerships allow the Exchange to ship tax-free items directly to the consumer from third-party suppliers. Shipping directly to consumers lowers costs for the Exchange, increasing dividends that are passed on to military communities.

2022 BRAND LAUNCHES



AMERICAN EAGLE



JOURNEE COLLECTION



SOL DE JANEIRO



BRANDS TO LOOK FORWARD TO IN 2023 INCLUDE:



BRANDED FUEL

The addition of TOP TIER-certified branded fuel gained momentum in 2022. By year-end, 164 out of a planned nearly 180 gas stations had begun offering Valero, BP/Amoco and Marathon branded fuel, with the transition to Amoco nearly completed.

The transition provides customers with the highest-quality fuel in the industry and improves the Exchange's already-secure supply chain, enhancing support for military communities during emergencies and disasters.



EXPANDING HEALTHCARE SERVICES

The Exchange continues to expand supplemental healthcare services for active-duty troops, family members, retirees, and service-connected disabled Veterans and Department of Defense civilians, building on a nearly 40-year legacy.

In 2022, the Exchange added:

- 8 durable medical equipment stores
- 7 dental offices
- 1 chiropractic care office
- 1 nutrition center
- 1 optical shop



The new DOCS Dental at Joint Base McGuire-Dix-Lakehurst, opened in January 2023, is the Exchange's 20th dental office.



The Exchange opened its third Joint Chiropractic clinic in December at Fort Hood.

AT A GLANCE: HEALTH AND WELLNESS



FEEDING THE MILITARY COMMUNITY

The Exchange delivers a taste of home through 1,500+ restaurants. More than 40 restaurants opened worldwide in 2022, including the Exchange's first Five Guys, which opened in November at Ramstein Air Base. About 70% of new openings were from better-for-you brands.

Restaurants that opened in 2022 include:



“BEING IN GERMANY IS A PHENOMENAL EXPERIENCE FOR OUR FAMILY. BUT THE ANTICIPATION OF PANDA EXPRESS OPENING REALLY GOT MY CHILDREN EXCITED. IT WAS A RESTAURANT THAT WE ENJOYED FREQUENTLY IN THE STATES, SO TO HAVE IT HERE IS WONDERFUL—IT’S A TASTE OF HOME.”

— Nataki Jones, wife of Brig. Gen. Otis C. Jones, 86th Airlift Wing commander, at the opening of the first Panda Express in Europe at the Kaiserlautern Military Community Center Exchange



The military community welcomed the Exchange's first Five Guys on opening day at Germany's Ramstein Air Base.

GROWING QUICK-SERVE PROGRAMS

In its Expresses, the Exchange aggressively expanded its quick-serve program, which includes Hunt Brothers Pizza, Eddie Peppers, Chopz and J. Walken Chicken.

25

quick-serve programs opened in FY22

112

total quick-serve programs

\$32.6M

in sales

↑42%

increase from prior year



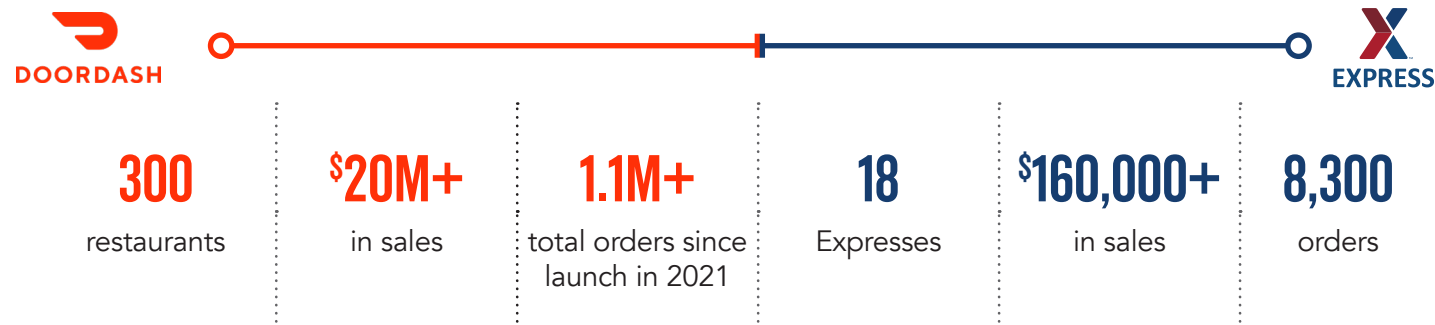
Chopz offers better-for-you, convenient meals for the military community.



Teammates opened the Hunt Brothers Pizza at the Edwards Air Force Base Express—the restaurant's first location in California.

DOORDASH DELIVERY EXPANDS

DoorDash delivery service expanded to include food, snacks and meals from Express stores in 2022.



ENHANCING THE EXCHANGE CREDIT PROGRAM

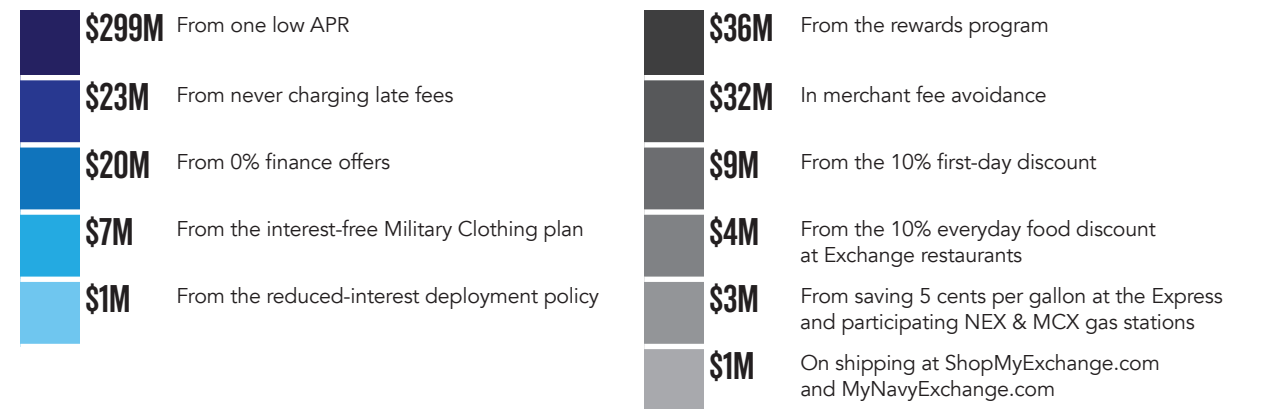
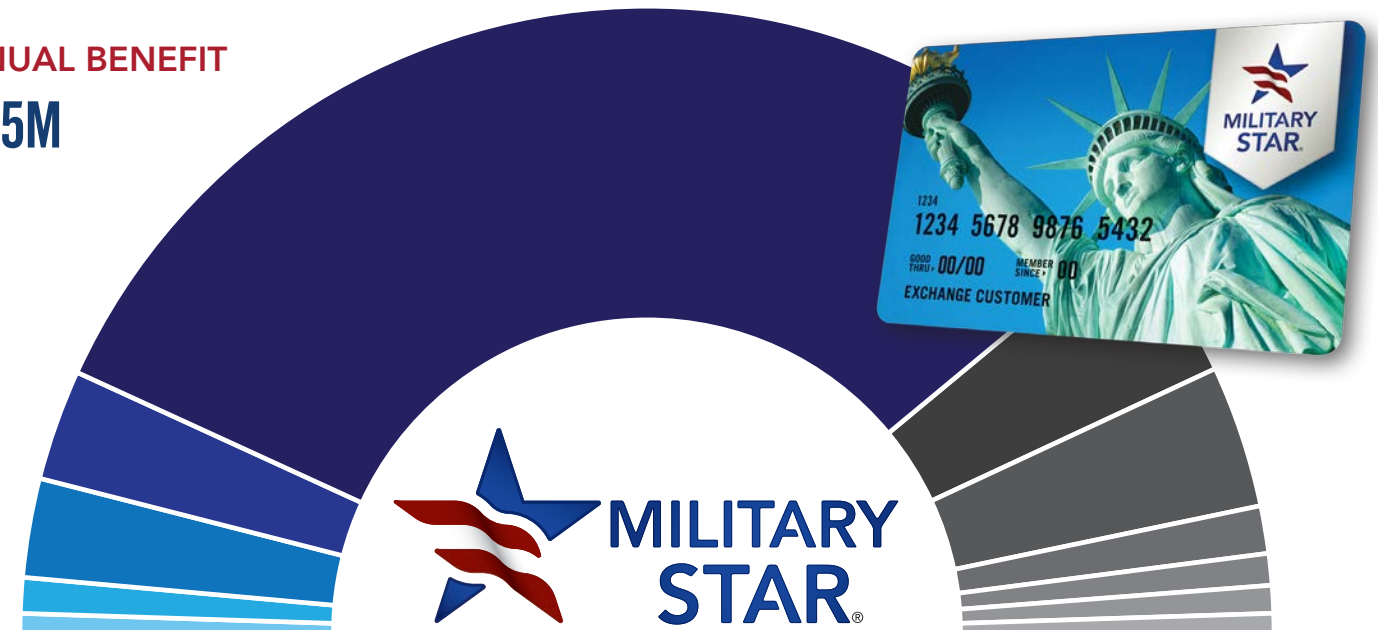
The MILITARY STAR® card, an affordable credit solution administered by the Exchange Credit Program (ECP), delivered nearly \$435 million in value to the military community. The card is often troops' first line of credit, and ECP helps troops build credit faster than other credit sources.

Because the card has no transaction fees, it saved the military resale community more than \$32 million in credit-card processing fees in 2022. The card is accepted at all military exchanges and commissaries and is a shining example of collaboration among the resale partners.

In 2022, ECP worked toward an agreement with Discover Financial Services to provide tap-to-pay, secure EMV and mobile wallet options. The agreement will allow ECP to retain full control of the program, ensuring trusted and safe credit options for the military community.

ANNUAL BENEFIT

\$435M



“WE’VE HAD TO MOVE TO MULTIPLE LOCATIONS, AND NOT ONCE DID THE EXCHANGE TELL ME, ‘WE DON’T HAVE ANYTHING FOR YOU.’”

–Kris Cubacub, Express manager and military spouse, Joint Base San Antonio-Lackland



HIRING VETERANS AND MILITARY SPOUSES

Veterans and military spouses bring valuable experience to the Exchange. Since 2013, the Exchange has hired more than 57,000 Veterans and military spouses with a goal to hire 75,000 by 2030.

Meaningful careers for military spouses are a force multiplier for military recruiting and retention. Exchange careers are portable, improving the quality of life for military families as associates build toward retirement.

FORGING STRATEGIC PARTNERSHIPS

Military exchanges and the Defense Commissary Agency entered the fourth year of the Military Resale Joint Buying Alliance, which brings together collective buying power and resale experience to benefit authorized shoppers. Since 2019, the alliance has achieved more than \$140 million in value for the military community, with \$93 million passed on to shoppers through discounts, promotions and military-exclusive pricing. The alliance continues to look for new ways of strengthening exchange and commissary benefits through exceptional value, exclusive pricing and more.

\$44M
saved in FY22

\$140M
saved since 2019



COLLABORATIVE EVENTS

The exchanges and DeCA continued a tradition that began in 2020 by partnering to honor those who served with a Veterans Day coin giveaway. Other collaborations include the Month of the Military Child, the MILITARY STAR Your Holiday Bill is On Us sweepstakes and more.



Col. Don Nowlin, Exchange Europe/Southwest Asia/Africa region commander, presented a coin to a Veteran on Veterans Day.

SUPPORTING VETERANS AND MILITARY FAMILIES

The Exchange partners with several organizations that support Veterans and military families, including:



MILITARY RELIEF FUNDS

The Exchange continued its partnership with Army Emergency Relief (AER) and the Air Force Assistance Fund (AFAF). The funds, which the Exchange has partnered with since 2017, provide financial assistance, sponsor educational scholarship grants and offer community programs to make life better for service members and their families. Shoppers donated to the relief funds at PX, BXs and ShopMyExchange.com.

\$1.5M
donated in FY22

\$6.5M+
donated since FY17



“WHEN I COME TO WORK, I DON’T FEEL LIKE I’M WORKING. I FEEL LIKE I’M SERVING A MISSION. THIS IS SOMETHING WHERE I CAN SAY, ‘I HAVE A PURPOSE HERE.’”

–Army Veteran Roneice Hines, Express manager, Ellsworth Air Force Base



HONORING QUALITY-OF-LIFE CHAMPIONS



WARFIGHTER QUALITY-OF-LIFE CHAMPION AWARD
CMSAF JOANNE BASS

Chief Master Sgt. of the Air Force JoAnne Bass received the Exchange's inaugural Warfighter Quality-of-Life Champion Award during the Commanders' Classic football game. The award recognizes those who have made significant contributions to Warfighters and their families. Bass is the first woman to serve as the highest-ranking noncommissioned officer in any of the military Services. She focuses on building the Total Force with a focus on people, readiness and culture. She also serves on the Exchange's Board of Directors. Director/CEO Tom Shull and Exchange Senior Enlisted Advisor Chief Master Sgt. Kevin Osby presented the award to Bass.



QUALITY-OF-LIFE FORCE MULTIPLIER AWARD
MARK WAHLBERG

Actor and producer Mark Wahlberg earned the 2022 Quality-of-Life Force Multiplier Award, honoring those who have made significant contributions to the morale of Warfighters and their families. Wahlberg, the son of a Korean War Army Veteran, is a staunch supporter of our Nation's heroes. Since 2017, he has lent his star power to the Exchange's awareness campaign for the Veterans online shopping benefit, which launched on Veterans Day that year. Wahlberg received the award during the 123rd Army-Navy Game.

SHARING THE EXCHANGE BENEFIT ON A NATIONAL STAGE

For the fifth year, the Exchange's Digital Media Networks team produced commercials that aired during nationally broadcast service academy football games. The spots shared the Exchange message with millions of viewers.



Sgt. Maj of the Army Michael Grinston, Chief Master Sgt. of the Air Force JoAnne Bass and Chief Master Sgt. of the Space Force Roger Towberman lent military star power to a commercial about the Exchange's lifelong benefit for the military community.



Associates, not paid actors, starred in commercials about the benefits of working for the Exchange. Kris Cubacub, an Air Force husband and Express manager at Joint Base San Antonio-Lackland, and Roneice Hines, an Air Force Veteran and Express manager at Ellsworth Air Force Base, gave their perspective on why the Exchange is a place where heroes shop—and work.



Through sign language and an interpreter, Stacey Brown, a materials handler at the Waco Distribution Center, talked about the Exchange's culture of inclusivity.



Another ad highlighted the MILITARY STAR® card, including reward points, savings at gas stations and restaurants and more.

BENEFIT IN ACTION



1) The Exchange brought relevancy and mission information to 9,000 Cadets and Midshipmen—the Nation’s future military leaders— before the Army-Navy Game. 2) The Andersen AFB BX and Exchanges worldwide saluted our youngest heroes with Month of the Military Child Events. 3) The Al Udeid Blatchford/Preston Complex Exchange team in Kuwait joined stores worldwide in the Exchange’s 127th anniversary celebration. 4) Exchange BE FIT Ambassador Roy Montez (left) took the “BE FIT Live” program on the road at Fort Hood. 5) Col. Robert Haas Jr. (right), 80th Flying Training Wing commander, and 80th FTW Vice Commander Col. Scott Gunn felt the “need for speed” as Sheppard AFB Exchange General Manager Mikel Hunter introduced a screening of “Top Gun: Maverick” at the newly reopened Sheppard BX theater. 6) For Hispanic Heritage Month, the Camp Foster Exchange in Okinawa hosted Colombian dancers with instructor Laura Rodriguez.

7) Grafenwoehr Exchange General Manger Brian Smith, left, and USAG Bavaria Deputy to the Commander Michael Daniels presented Staff Sgt. Collin Tinchler with the Your Holiday Bill is On Us sweepstakes grand prize. 8) Exchange shared relevancy messages to runners at the Air Force Marathon at Wright-Patterson AFB. 9) You Made the Grade grand-prize winner Naya Johnson celebrated with her dad, naval aviator Cmdr. Aaron Johnson; her mom, Colette; and siblings at the Panzer PX. 10) Santa and the Grinch lifted basic military trainees’ spirits at Joint Base San Antonio-Lackland. The shopping extravaganza gave thousands of trainees—who usually can’t leave their dormitories—time to shop for loved ones. 11) Customers shop at a mobile field Exchange after its grand opening at Chabelley Airfield in Djibouti. 12) Claudia Cristina Leon wears a “Badge of Honor” at the Fort Belvoir PX, telling shoppers that she is an Army spouse. Associates wear the badges to celebrate those who serve.

FINANCIAL STATEMENTS

Army and Air Force Exchange Service
Years Ended January 28, 2023 and January 29, 2022
With Report of Independent Auditors

Ernst & Young LLP



Army and Air Force Exchange Service

Financial Statements

Years Ended January 28, 2023 and January 29, 2022

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Report of Independent Auditors

The Board of Directors
 Army and Air Force Exchange Service
 Departments of the Army and Air Force

Opinion

We have audited the financial statements of Army and Air Force Exchange Service (the Exchange), which comprise the balance sheets as of January 28, 2023 and January 29, 2022, and the related statements of earnings, comprehensive income, changes in net assets and cash flows for the years then ended, and the related notes (collectively referred to as the “financial statements”).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Exchange at January 28, 2023 and January 29, 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Exchange and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Exchange’s ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Exchange's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Exchange's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Ernst & Young LLP

May 24, 2023

Army and Air Force Exchange Service

Balance Sheets

(Dollars in Thousands, Unless Otherwise Noted)

	January 28, 2023	January 29, 2022
Assets		
Current assets:		
Cash and cash equivalents	\$ 129,475	\$ 136,616
Trade and other accounts receivable, less allowance for uncollectible accounts of \$29,152 and \$28,144 at January 28, 2023, and January 29, 2022, respectively	2,473,588	2,396,558
Merchandise inventories	1,154,918	1,181,167
Short-term investments	58,990	11,290
Supplies and other current assets	105,090	87,950
Total current assets	<u>3,922,061</u>	<u>3,813,581</u>
Property and equipment:		
Buildings and improvements	3,189,509	3,083,796
Fixtures and equipment	1,380,310	1,355,203
Construction-in-progress	174,946	232,649
Total property and equipment, gross	4,744,765	4,671,648
Less accumulated depreciation	(3,171,136)	(3,036,345)
Total property and equipment, net	<u>1,573,629</u>	<u>1,635,303</u>
Operating lease right-of-use assets	14,617	-
Other assets	1,290	13,620
Overfunded retirement plans	1,517,800	647,561
Long-term investments and supplemental plan assets	22,989	73,892
Total assets	<u>\$ 7,052,386</u>	<u>\$ 6,183,957</u>

Army and Air Force Exchange Service

Statements of Earnings
(Dollars in Thousands, Unless Otherwise Noted)

	January 28, 2023	January 29, 2022
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 384,708	\$ 476,520
Commercial paper and current maturities of long-term debt	157,987	88,602
Accrued salaries and other employee benefits	173,808	122,610
Dividends payable	68,548	26,208
Operating lease liabilities	2,364	-
Other current liabilities	207,043	198,652
Total current liabilities	<u>994,458</u>	<u>912,592</u>
Long-term debt, less current portion	106,255	114,242
Noncurrent operating lease liabilities	12,254	-
Accrued pension and other benefits	45,273	48,201
Other noncurrent liabilities	74,257	96,471
Total liabilities	<u>1,232,497</u>	<u>1,171,506</u>
Net assets:		
Accumulated other comprehensive (loss) gain:		
Pension and postretirement benefit liability	30,381	(503,311)
Derivative instruments	2,430	(1,073)
Total accumulated other comprehensive loss	<u>32,811</u>	<u>(504,384)</u>
Retained earnings	5,787,078	5,516,835
Total net assets	<u>5,819,889</u>	<u>5,012,451</u>
Total liabilities and net assets	<u>\$ 7,052,386</u>	<u>\$ 6,183,957</u>

See accompanying notes.

	Year Ended	
	January 28, 2023	January 29, 2022
Net sales	\$ 6,620,013	\$ 6,412,948
Finance revenue	249,395	207,958
Concession income	219,996	219,523
Other operating income	28,907	30,263
Total revenue	<u>7,118,311</u>	<u>6,870,692</u>
Cost of sales and operating expenses:		
Cost of goods sold	5,059,437	4,792,366
Selling, general, and administrative:		
Employee compensation and benefits	1,043,771	1,135,767
Depreciation and amortization	243,026	241,221
Other	540,441	572,037
Total selling, general, and administrative expenses	<u>1,827,238</u>	<u>1,949,025</u>
Interest expense	1,914	1,301
Bad debt expense	17,002	14,184
Total expenses	<u>6,905,591</u>	<u>6,756,876</u>
Operating income	212,720	113,816
Other income	6,413	10,022
Non-service pension and postretirement income	268,263	122,484
Net earnings	<u>\$ 487,396</u>	<u>\$ 246,322</u>

See accompanying notes.

Army and Air Force Exchange Service

Statements of Comprehensive Income
(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 28, 2023	January 29, 2022
Net earnings	\$ 487,396	\$ 246,322
Other comprehensive income (loss):		
Reclassification of unrealized gain (loss) on derivative instruments to earnings	3,503	(1,267)
Pension and postretirement benefits adjustments:		
Actuarial gain arising during the period	520,752	1,527,947
Amortization of net loss	12,940	126,893
Other comprehensive income	537,195	1,653,573
Comprehensive income	<u>\$ 1,024,591</u>	<u>\$ 1,899,895</u>

See accompanying notes.

Army and Air Force Exchange Service

Statements of Changes in Net Assets
(Dollars in Thousands, Unless Otherwise Noted)

	Retained	Accumulated	Net
	Earnings	Other Comprehensive Loss	Assets
Balance at January 30, 2021	\$ 5,475,479	\$ (2,157,957)	\$ 3,317,522
Net earnings	246,322	–	246,322
Pension and postretirement benefits adjustments	–	1,654,840	1,654,840
Reclassification of unrealized gain on derivative instruments to earnings	–	(1,267)	(1,267)
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps	(204,966)	–	(204,966)
Balance at January 29, 2022	5,516,835	(504,384)	5,012,451
Net earnings	487,396	–	487,396
Pension and postretirement benefits adjustments	–	533,692	533,692
Reclassification of unrealized loss on derivative instruments to earnings	–	3,503	3,503
Dividends to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps	(217,153)	–	(217,153)
Balance at January 28, 2023	<u>\$ 5,787,078</u>	<u>\$ 32,811</u>	<u>\$ 5,819,889</u>

See accompanying notes.

Army and Air Force Exchange Service

Statements of Cash Flows
(Dollars in Thousands, Unless Otherwise Noted)

	Year Ended	
	January 28, 2023	January 29, 2022
Operating activities		
Net earnings	\$ 487,396	\$ 246,322
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	275,058	269,826
Loss (gain) on disposals of property and equipment	307	76
Loss (gain) on supplemental pension plan assets	(1,893)	1,892
Bad debt expense	17,002	14,184
Change in operating assets and liabilities:		
Accounts receivable	(94,032)	96,794
Merchandise inventories	26,249	(47,108)
Supplies and other assets	(17,787)	(16,369)
Pension assets and liabilities	(337,487)	(170,957)
Long-term investments and supplemental plan assets	1,893	(1,892)
Accounts payable	(89,159)	84,266
Change in cash overdraft	(26)	(10)
Accrued salaries and other employee benefits	52,074	2,576
Other liabilities	(2,833)	40,509
Net cash provided by operating activities	316,762	520,109
Investing activities		
Purchases of property and equipment	(224,355)	(160,103)
Proceeds from the sale of property and equipment	10,664	19,578
Purchases of investments	(48,680)	(51,445)
Proceeds from the disposition of investments	51,883	86
Net cash used in investing activities	(210,488)	(191,884)
Financing activities		
Proceeds from line-of-credit agreement	100,000	—
Proceeds from (payments under) commercial paper agreement	69,000	(106,000)
Payment of long-term debt	(107,602)	(117,237)
Payment of dividends	(174,813)	(209,617)
Net cash used in financing activities	(113,415)	(432,854)
Net decrease in cash and cash equivalents	(7,141)	(104,629)
Cash and cash equivalents at beginning of year	136,616	241,245
Cash and cash equivalents at end of year	\$ 129,475	\$ 136,616

See accompanying notes.

Army and Air Force Exchange Service

Notes to Financial Statements
(Dollars in Thousands, Unless Otherwise Noted)

January 28, 2023

1. Description of Business and Summary of Significant Accounting Policies

General

The Army and Air Force Exchange Service (the Exchange) is a joint non-appropriated fund instrumentality (NAFI) of the United States (U.S.) organized under the Departments of the U.S. Army and the U.S. Air Force. The Exchange provides retail services (including e-commerce) to soldiers, airmen, and their families through a network of stores located on U.S. Government installations in the U.S., Europe, the Pacific Rim, and the Middle East. In addition to providing merchandise and services of necessity and convenience to authorized patrons at competitively low prices, the Exchange's mission is to generate reasonable earnings to supplement appropriated funds for the support of Army and Air Force morale, welfare, and recreation programs. The Exchange maintains custody of and control over its non-appropriated funds. Funds that are not distributed as dividends are reinvested in the Exchange's operations. The Exchange is exempt from direct state taxation and from state regulatory laws. Such laws include licensing and price control statutes.

The Exchange utilizes accounting principles generally accepted in the U.S. (U.S. GAAP) applicable to "for-profit" organizations because of the nature of its commercial-type operations. The Exchange's financial statements include the operations of all Exchange activities worldwide.

Fiscal Year

The Exchange's fiscal year-end is the Saturday nearest January 31. References to fiscal year 2022 and fiscal year 2021 herein are to the fiscal years ended January 28, 2023, and January 29, 2022, respectively.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Net sales by geographic region are summarized below:

	Year Ended	
	January 28, 2023	January 29, 2022
Continental U.S., including Alaska	\$ 4,547,849	\$ 4,380,910
Pacific Rim	971,590	963,756
Europe, primarily Germany	676,073	629,739
Middle East	130,169	147,958
Other countries	294,332	290,585
Total net sales	<u>\$ 6,620,013</u>	<u>\$ 6,412,948</u>

Appropriated Funds

In accordance with applicable U.S. Army and Air Force regulations, the Exchange is not required to pay rent for the use of properties owned by the U.S. Government or utility costs associated with overseas exchanges. Permanent structures that are constructed by the Exchange and paid for from Exchange funds become the property of the U.S. Government. The structures cannot be used for other than the Exchange's purposes without prior approval by the Exchange Director/Chief Executive Officer and the relevant department of the U.S. Government. As such, the Exchange has included the cost of the structures on its balance sheets and depreciates the cost of the structures on a straight-line basis over their estimated useful lives. Services, such as ocean transportation of merchandise to certain locations on U.S. chartered vessels and performance of administrative and supervisory functions by military personnel, have been provided without charge to the Exchange.

Management has estimated the value of transportation costs paid by the U.S. Government for Exchange materials shipped to and from overseas Exchange facilities (excluding the Middle East) to be approximately \$99,928 and \$90,168 for fiscal years 2022 and 2021, respectively. In addition, Middle East transportation costs of \$6,677 and \$10,911 were paid by the U.S. Government for fiscal years 2022 and 2021, respectively.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

The Exchange receives reimbursements from the U.S. Government of certain incremental costs incurred by the Exchange in relation to support provided to United States Central Command (CENTCOM) area operations. Appropriated fund (APF) reimbursements are recorded when an incremental cost that qualifies for reimbursement has been incurred and reimbursement by responsible agency is probable. Such APF reimbursement receivables are classified as trade and other accounts receivable on the accompanying balance sheets and are recorded as an offset to the related expenses (as described below) on the statement of earnings. In fiscal years 2022 and 2021, the Exchange recorded APF reimbursements of \$14,649 and \$17,437, respectively. These amounts include expenses related to inventory markdowns and shortages, personnel costs, in-theater transportation, and other expenses.

In compliance with the Biden Administration's Executive Order 14003, "Protecting the Federal Workforce," which directed the Office of Personnel Management (OPM), through special salary and special wage rate authorities in title 5, to implement a \$15 minimum wage for Federal employees, effective January 31, 2022. The Exchange implemented the \$15 an hour federal minimum wage on February 5, 2022. Working in close coordination with the Under Secretary of Defense for Personnel and Readiness (P&R), as well as the Comptroller office, in May 2022, the Exchange received \$52,000 in appropriated funds support for February through September of government fiscal year (GFY) 2022. In October 2022, the Exchange received an additional \$100,000 for GFY 2023. In fiscal year 2022, the Exchange received \$152,000, of which \$106,269 was recognized as an offset to personnel costs in employee compensation and benefits as costs were incurred. The remaining balance of \$45,731 is classified in accrued salaries and other employee benefits on the balance sheet. The appropriated funds received does not have any associated commitments or contingencies.

Subsequently, the Exchange received \$66,000 in February 2023 in support for the rest of GFY 2023. The Exchange is uncertain of additional support for Executive Order 14003 for GFY 2024 onward.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements and accompanying notes. Key estimates made by Exchange management include the level of allowance needed for potentially uncollectible accounts receivable and discount rates, long-term rate of return on assets, health care trend assumptions, and mortality assumptions used to determine obligations associated with pension plans and postretirement benefit plans.

In pension accounting, the most significant actuarial assumptions are the discount rate, the long-term rate of return on plan assets, health care trend assumptions, and mortality rates. In determining the long-term rate of return on plan assets, the Exchange considers the nature of the plans' investments, an expectation of the plans' investment strategies, and the expected rate of return. Pension assets include investments in limited partnerships; real estate properties; and private equity, timber, agriculture, and debt, which do not have readily available market values. These investments are valued based on amounts reported to management by the respective general partners, investment managers, or appraisers, using net asset value (NAV) as a practical expedient for fair value or an equivalent measure. See Note 6 for additional information about benefit plans.

Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand in stores, deposits in banks, and third-party credit card receivables, which generally are collected within a week. Cash and cash equivalents are carried at cost, which approximates fair value.

Accounts Receivable, Finance Revenue, and Allowance for Credit Losses

As of January 28, 2023 and January 29, 2022, \$2,139,783 and \$2,048,438, respectively, of the Exchange's accounts receivable balance represents amounts due from cardholders under its in-house credit program, the MILITARY STAR[®] Card. The MILITARY STAR[®] Card program extends credit to eligible Exchange customers for the purchase of retail goods and services at Exchange activities worldwide.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Minimum payments are calculated based on 1.5% of the unpaid balance as of the customer's last purchase date. These payments are applied in accordance with the Credit CARD Act of 2009.

Concentrations of credit risk, with respect to customer accounts receivable, are limited due to the large number of customers comprising the Exchange's credit card base and their dispersion throughout the world. The Exchange believes the carrying amount of existing customer receivables approximated its fair value due to the short-term nature of those receivables.

The Exchange's trade and accounts receivable balance also includes \$129,674 and \$130,322 of receivables from the Marine Exchange (MCX) for Marine MILITARY STAR[®] Card outstanding balances and related processing fees as of January 28, 2023 and January 29, 2022, respectively.

Finance revenue is calculated based upon the customer account balance outstanding during the period after consideration of the applicable grace period, typically 30 days following the billing date. The finance rate charged is a variable interest rate calculated at a variable amount above the U.S. Prime Rate reported in *The Wall Street Journal*. The standard annual percentage rate (APR) for retail purchases was 14.49% as of January 28, 2023 and 10.24% as of January 29, 2022. Beginning at 90 days past due, the delinquency rate of 22.49% applies. Finance revenue is recorded unless an account balance has been without any activities on individual accounts for an extended period of time, generally 150 days. Customer receivables past due 90 days or more and still accruing interest were approximately \$21,568 and \$16,303 as of January 28, 2023 and January 29, 2022, respectively.

Accounts past due for 30 days or more are considered delinquent. Accounts delinquent for 150 days are placed on nonaccrual status whereby finance income is no longer accrued and submitted to the Exchange's collection department. The Exchange utilizes various means to collect past-due accounts, as well as nonaccrual status accounts, including some methods not available to other commercial credit card financial institutions. The Exchange has agreements with other U.S. Government entities that allow the Exchange to garnish wages of service personnel, as well as claim the debtors' future payments from such U.S. Government entities, including U.S. Treasury income tax refunds. Personal contact, external collection agencies, and letters to service personnel superiors are also used to pursue delinquent accounts. The outstanding receivables related to accounts previously charged off (previously submitted to the collection department) were \$115,215 and \$125,377 at January 28, 2023 and January 29, 2022, respectively. These accounts are at least 150 days past due and are generally outstanding for one to five years.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

The Exchange's credit card portfolio consists of smaller-balance, homogeneous loans. Due to the homogeneous nature of the credit card portfolios, a provision for credit loss is recorded related to the Exchange's current credit card portfolio based on a percentage of total projected charge-offs that are considered uncollectible.

The Exchange periodically evaluates the adequacy of the allowance using such factors as prior account loss experience, changes in the volume of the account portfolio, changes in the estimates of anticipated recoveries on delinquent or written-off balances, and changes in credit policy. These factors were considered in establishing the Exchange's allowance for credit losses, and the net receivable related to accounts previously written-off as of January 28, 2023 and January 29, 2022. It is reasonably possible that the amounts the Exchange will ultimately recover on delinquent balances could differ materially in the near term from the amounts assumed in arriving at the allowance for credit losses and net receivable related to accounts previously written-off. Bad debt expense of \$17,002 recorded in fiscal year 2022 is primarily related to the Exchange's current credit card portfolio. This is compared with \$14,184 in bad debt expense recorded in fiscal year 2021.

With respect to accounts previously written-off, the Exchange records and evaluates collectability of a net receivable using a portfolio approach pooled by year based on estimated probable recoveries. Finance income and cash collections are applied to outstanding balances until 100% of the net receivables from each portfolio year has been collected. Subsequent cash collections in excess of amounts previously charged off are recorded as finance revenue upon collection. Collections on accounts previously written-off and submitted to U.S. Government entities totaled approximately \$112,291 and \$135,349 in fiscal years 2022 and 2021, respectively. Finance revenue recognized in fiscal year 2022 related to nonaccrual accounts totaled approximately \$23,251 compared with approximately \$21,055 in fiscal year 2021.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

The following table sets forth the age of the Exchange's credit card receivables that have not yet been submitted to U.S. Government entities for collection:

	January 28, 2023		January 29, 2022	
	Amount	Percentage of Receivables	Amount	Percentage of Receivables
	<i>(In Millions)</i>		<i>(In Millions)</i>	
Current	\$ 1,978	87.3%	\$ 1,923	88.4%
1–29 days past due	162	7.2	141	6.5
30–59 days past due	68	3.0	69	3.2
60–89 days past due	35	1.5	26	1.2
90+ days past due	22	1.0	16	0.7
Period-end gross credit card receivables	<u>\$ 2,265</u>	<u>100%</u>	<u>\$ 2,175</u>	<u>100.0%</u>

Generally, an account is considered past due if payment due is not received by the billing statement due date. The following table sets forth the provision for possible credit loss related to the Exchange's current credit card portfolio and does not include the net receivable related to accounts submitted to U.S. Government entities for collection. In addition, this table does not include the allowance for credit losses for other trade accounts receivable that are unrelated to the Exchange's credit card portfolio.

	2022	2021
	<i>(In Millions)</i>	
Allowance at beginning of period	\$ 23	\$ 25
Provision for bad debt	17	14
Net write-offs	(14)	(16)
Allowance at end of period	<u>\$ 26</u>	<u>\$ 23</u>

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

The following table sets forth the credit scores of the Exchange's credit card portfolio that have not yet been submitted to U.S. Government entities for collection as reported by the Fair Isaac Corporation (FICO).

	January 28, 2023	January 29, 2022
	<i>(In Millions)</i>	
Nondelinquent accounts (current and 1–29 days past due):		
FICO score of 700 or above	\$ 745	\$ 700
FICO score of 600 to 699	1,058	1,022
FICO score below 600	337	342
Total nondelinquent accounts	<u>2,140</u>	<u>2,064</u>
Delinquent accounts (30+ days past due)	<u>125</u>	<u>111</u>
Period-end gross credit card receivables	<u>\$ 2,265</u>	<u>\$ 2,175</u>

Merchandise Inventories

The Exchange's inventories are valued at the lower of cost or net realizable value, as determined by the retail inventory method of accounting (RIM). Certain warehousing and distribution expense costs are included in the cost of inventory, which amounted to \$13,108 and \$15,558 at January 28, 2023 and January 29, 2022, respectively.

Inherent in the RIM calculation are certain significant management judgments and estimates, including, among others, merchandise mark-ons, markups, markdowns, and shrinkage, which significantly impact the ending inventory valuation at cost, as well as resulting gross margins. The methodologies utilized by the Exchange in the application of the RIM calculation are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the groupings of homogenous classes of merchandise, the development of shrinkage and obsolescence reserves, and the accounting for price changes.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Buildings and Improvements

Buildings and improvements primarily represent permanent structures constructed and paid for by the Exchange and owned by the U.S. Government. These assets are recorded by the Exchange at cost with depreciation provided using the straight-line method over the estimated useful lives of the assets. The useful lives are governed, to a large extent, by the deployment of Army and Air Force personnel and, to some extent, by the requirements of the Departments of the Army and the Air Force with respect to space occupied by the Exchange. Buildings are generally depreciated over 30 years, and improvements are depreciated over periods from 7 to 15 years. The Exchange loses its rights to buildings and improvements in the event of base closures and accelerates depreciation of its assets when such closures are probable.

The carrying value of long-lived assets, including property and equipment, is evaluated annually or whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or asset group. Factors that could result in an impairment review include, but are not limited to, a current period cash flow loss combined with a history of cash flow losses or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the assets, or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value. The Exchange has not recorded any long-lived asset impairment charges during fiscal years 2022 or 2021.

Leases

The Exchange determines whether an arrangement is a lease at inception and leases primarily consist of real estate and information technology leases for use in operations. For the purposes of measurement and amortization of the right-to-use asset and associated lease liabilities over the terms of the leases, the Exchange uses the date it takes possession of the asset based on the terms of the contract. As most leases do not provide an implicit rate, the Exchange uses an incremental borrowing rate based on current financial information available at the commencement date in determining the present value of lease payments. Additionally, the Exchange leases certain equipment under short-term leases with initial terms of less than twelve months. These short-term leases are not recorded on the balance sheet.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Fixtures and Equipment

Fixtures and equipment are carried at cost with depreciation provided using the straight-line method over the estimated useful lives of the assets. Motor vehicles are depreciated over periods from 5 to 10 years, and equipment is depreciated over periods from 2 to 15 years.

Self-Insurance

The Exchange self-insures for property, automobile, public liability, workers' compensation, comprehensive casualty losses, ocean marine, and other casualty losses. However, the Exchange has commercial property insurance covering the buildings, contents, and inventories at certain locations. The reserve for certain self-insurance losses is based on calculations performed by the Exchange's independent actuarial consultants using loss development factors to estimate ultimate loss. The Exchange's self-insurance reserves were \$56,644 and \$68,316 as of January 28, 2023 and January 29, 2022, respectively.

Reserves were discounted at the following weighted average rates:

	January 28, 2023	January 29, 2022
Workers' compensation	5.02%	3.12%
Property liability	4.92	1.37
Public liability	4.91	1.29
General liability	4.92	0.4

Separation Pay and Vacation Leave Accruals

Separation pay and vacation leave for local national employees in foreign countries are accrued as earned based upon the labor laws of host countries and upon agreements between the U.S. and foreign governments. In order to estimate this liability, the Exchange and its actuaries make certain assumptions, including the amounts considered recoverable from foreign governments under existing agreement terms. Actual results may vary from these assumptions. Additionally, the liability for vacation leave earned by U.S. citizens is accrued as earned.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Advertising Costs

Advertising costs are expensed when the advertisement first occurs. Advertising expenses were \$30,324 and \$31,957 for the years ended January 28, 2023, and January 29, 2022, respectively, and are included in selling, general, and administrative expenses. The Exchange's cooperative advertising allowances are generally accounted for as a reduction in the purchase price of inventory.

Revenue Recognition

The Exchange recognizes revenue when control of the merchandise is transferred to customers in an amount that reflects the consideration received in exchange for such merchandise. For sales at the retail locations, control is transferred at the point at which the customer receives and pays for the merchandise at the register. For e-commerce sales, control is transferred when merchandise is tendered to a third-party carrier for delivery to the customer. Cash is typically received on the day of or, in the case of credit or debit card transactions, within several days of the related sales. Finance revenue includes finance charges and administrative fees on credit sales. Concession income includes fees charged to concessionaires based on a percentage of their sales and is recognized at the time of sale.

Income Taxes

The Exchange is a non-appropriated fund instrumentality of the U.S. and, as such, is not subject to the payment of income taxes, to include federal, state, local and foreign taxes.

401(k) Plan

The Exchange has a 401(k) voluntary savings and investment plan open to regular full- and part-time employees who meet certain minimum requirements. New hire associates are automatically enrolled in the 401(k) savings plan after a 30-day- waiting period during which they may opt out. The employees can make voluntary contributions to the plan not to exceed the lesser of 99% of eligible participant compensation or the applicable 401(k) maximum deferral contribution limit for the year.

1. Description of Business and Summary of Significant Accounting Policies (continued)**Foreign Currency Hedging**

As part of an overall risk management strategy, the Exchange uses foreign currency exchange contracts to hedge exposures to changes in foreign currency rates on the Exchange's payroll and foreign vendor obligations denominated in foreign currencies. These derivative instruments are recognized in the accompanying financial statements and measured at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in net assets until the hedged item is recognized in earnings. Hedged items are reclassified from accumulated other comprehensive income (loss) and into earnings using the specific identification method. The Exchange's policy is that it does not speculate in hedging activities. The maximum length of time over which the Exchange is hedging its exposure to the variability of future cash flows for forecasted transactions is one year.

As of January 28, 2023, the Exchange had various foreign exchange contracts (option collars) outstanding related its forecasted payroll and inventory purchase liabilities. Unrealized gains and losses on foreign exchange hedges that are included in accumulated other comprehensive loss are recognized into earnings as the related payroll expenses are paid or the related inventory is sold through. As of January 28, 2023, and January 29, 2022, total derivatives designated as hedging instruments recorded on the accompanying balance sheet were \$(2,430) and \$1,073, respectively. The Exchange has recognized approximately \$4,848 in gain on foreign currency hedge transactions settled during fiscal year 2022, compared with \$1,206 in gain during fiscal year 2021.

Benefit Plans

Liabilities and expenses related to the Exchange's benefit plans are determined based on a number of actuarial assumptions, which are reviewed and determined on an annual basis. These assumptions include discount rates, health care cost trend rates, compensation increase rate, benefits earned, mortality rates, number of participants, certain demographics, and other factors. Actual results that differ from assumptions are accumulated and amortized to expense over future periods and, therefore, generally affect recognized expense in future periods. The projected benefit obligation is recognized on the accompanying balance sheets. Actuarial gains and losses are recognized as components of accumulated other comprehensive loss in net assets until amortized as a component of net periodic benefit cost.

1. Description of Business and Summary of Significant Accounting Policies (continued)**Fair Value Measurements**

Under Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition under ASC 820 focuses on an exit price, which is the price that would be received to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. See Note 2 for additional information regarding fair value measurements.

Financial instruments that potentially subject the Exchange to concentrations of credit risk consist principally of investments held by a noncontributory supplement deferred compensation plan (Supplemental Plan) and derivative financial instruments. The Exchange uses high-credit-quality counterparties when executing derivative transactions.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires all leases that have a term of over 12 months to be recognized on the balance sheet with the liability for lease payments and the corresponding right-of-use asset initially measured at the present value of amounts expected to be paid over the term. Recognition of the costs of these leases on the income statement will be dependent upon their classification as either an operating or a finance lease. Costs of an operating lease will continue to be recognized as a single operating expense on a straight-line basis over the lease term. Costs for a financing lease will be disaggregated and recognized as both an operating expense (for the amortization of the right-of-use asset) and interest expense (for interest on the lease liability). The Exchange adopted the requirements of the new standard on January 29, 2022, using the modified retrospective approach. The Exchange also elected the package practical expedients permitted under the transition guidance, which allowed the Exchange to maintain historic lease classification for leases in effect at the date of adoption. Upon adoption, the Exchange recorded operating lease right-of-use assets of \$16,705 and operating lease liabilities of \$16,705. The adoption of this standard did not materially affect the Exchange's financial statements.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

1. Description of Business and Summary of Significant Accounting Policies (continued)

In November 2021, the FASB issued ASU 2021-10, *Disclosures by Business Entities about Government Assistance*. This guidance requires annual disclosures about transactions with a government that are accounted for by applying a grant or contribution model by analogy, including information about the nature of the transactions and the related accounting policy used, the financial statement line items affected by the transactions and significant terms and conditions associated with the transactions. The ASU is effective for financial statements issued for annual periods beginning after December 15, 2021. The Exchange adopted this standard January 30, 2022 and has applied the amendments prospectively to all transactions within the scope of the amendments reflected in the financial statements for the fiscal year ended January 28, 2023.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This guidance will replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The Exchange will be required to use a forward-looking expected credit loss model for accounts receivable, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The ASU is effective for fiscal years beginning after December 15, 2023. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein. The Exchange does not expect ASU 2016-13 to have a material effect on its financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*, which amends the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The amendments in this update removed disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. The adoption of this standard did not materially affect the Exchange's financial statements.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

2. Fair Value Measurements

ASC 820 establishes a framework for measuring fair value. The inputs used to measure fair value are prioritized based on a three-level hierarchy as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities. The Exchange uses the unadjusted quoted prices in active markets for identical assets or liabilities to which the Exchange has access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.
- Level 2 – Observable inputs other than quoted prices in Level 1. The Exchange determines the value of the investment holding by evaluating its pro rata share of investments where it does not own the underlying securities but rather a proportional share of the fund, such as mutual fund and common collective trusts. Significant inputs, other than quoted market prices included in Level 1 that are observable, impact either directly or indirectly the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk, and default rates.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Inputs are unobservable for the assets or liabilities. The Exchange invests only with managers that provide financial statements that are independently audited at least once a year. The financial statements are accompanied by a report from the independent audit firm, which discloses the accounting basis as well as an opinion regarding the reliability of the financial statements. In addition to the audited financial statements, the fund managers have provided the type of investments as well as the methods used to value and appraise all investments in the fund's portfolio. The Exchange's benefit plan Level 3 assets and liabilities are measured at fair value on a recurring basis.

Cash and cash equivalents, accounts payable, and accrued liabilities are reflected on the accompanying balance sheets at cost, which approximates fair value due to the short-term nature of these instruments. Trade and other accounts receivable are reflected on the accompanying balance sheets at cost less an allowance for credit losses, which approximates fair value due either to the short-term nature of the instruments or the variable market rate of interest that is charged on outstanding credit card balances. The fair value of the Exchange's debt is disclosed in Note 3.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

2. Fair Value Measurements (continued)

The Exchange holds investments related to the Supplemental Plan totaling \$22,844 and \$25,235 at January 28, 2023 and January 29, 2022, respectively, which are included in long-term investments and Supplemental Plan assets on the accompanying balance sheets. Supplemental Plan assets are classified as trading securities since gains and losses from these investments are intended to offset the cost of the Supplemental Plan. Earnings on trading securities were (\$1,893) and \$1,892 in fiscal years 2022 and 2021, respectively. The cost of securities sold is determined primarily on a specific identification method. Refer to Note 6 for further discussion of the supplemental plan, and refer to Note 4 for further discussion of the Exchange's derivative positions.

3. Indebtedness

Lines of Credit

The Exchange maintains three lines of credit aggregating to \$1,500,000. The first is a committed unsecured revolving line of credit that is facilitated by a ten-bank syndicate led by Wells Fargo Bank, N.A. aggregating to \$750,000 that was entered into on May 19, 2022, and expires on May 19, 2027. As a part of the accordion agreement the Exchange can request up to an additional \$250,000 but approval for any request is not guaranteed. As of January 28, 2023, there is a zero-balance outstanding and there were no borrowings under this line of credit during fiscal year 2022.

In addition, the Exchange has a committed line of credit for \$500,000 with Installation Management Command G9 (IMCOM G9). This agreement was renewed on December 4, 2019, for a five-year term. Borrowings under the IMCOM G9 line of credit had interest rates of 1.40% during fiscal year 2022 and 0.14% during fiscal year 2021. Renewal reviews will take place 24 months prior to expiration in order to have the renewal of future agreements in place prior to the one-year expiration time frame.

The third line of credit is an uncommitted Master Note Facility with New York Life for \$250,000 that was entered into on October 15, 2020, and expires on October 15, 2023. As of January 28, 2023, there is a zero-balance outstanding and there were no borrowings under this facility during fiscal year 2022.

During fiscal year 2022, daily borrowings were generally due within 30 to 260 days. As of January 28, 2023, there is \$100,000 balance outstanding under the IMCOM G9 line of credit.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

3. Indebtedness (continued)

Commercial Paper

In June 2013, the Exchange implemented a commercial paper program. As of January 28, 2023 and January 29, 2022, the outstanding commercial paper obligations, inclusive of original issue discount, were \$150,000 and \$81,000, respectively. The commercial paper program is an open-ended agreement; however, outstanding balances as of January 28, 2023, have maturity dates that range from 1 to 270 days and, as such, were classified as current. Borrowings under the commercial paper program had interest rates ranging from 0.07% to 4.32% during fiscal year 2022, and 0.07% to 0.15% during fiscal year 2021.

Senior Notes

In October 2009, the Exchange completed a private placement debt offering of \$90,000 of 4.95% senior notes due in 2024 (the senior notes), which comprise a 15-year amortization of principal. As of January 28, 2023, the senior notes have a total remaining outstanding obligation of \$14,242.

Term Loans

A three-year syndicated term loan of \$250,000 was entered into as part of the Wells Fargo syndication agreement on June 15, 2018, with original maturity on June 15, 2021. During fiscal year 2021, the syndicated term loan agreement was amended to reduce the loan amount to \$200,000 and extend maturity to be coterminous with the syndication agreement on June 15, 2023. The loan was paid in full pre-maturity March 31, 2022. As part of the amendment in fiscal year 2021, the interest rate was increased 12.5 basis points to the London Interbank Offered Rate plus 0.875%.

The average interest rates for all indebtedness, including lines of credit (both committed and uncommitted), commercial paper, senior notes and term loans, were 3.92% and 0.64% for the Years Ended January 28, 2023, and January 29, 2022, respectively.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

3. Indebtedness (continued)

Outstanding debt obligations consisted of the following:

	January 28, 2023	January 29, 2022
Outstanding debt principal balances:		
IMCOM G-9 committed line of credit	\$ 100,000	\$ –
Senior notes	14,242	21,844
Term loan – Wells Fargo	–	100,000
Commercial paper – Truist	–	–
Commercial paper – Wells Fargo	70,000	–
Commercial paper – Fifth Third Bank	–	–
Commercial paper – Citibank	80,000	81,000
Total debt obligations	<u>264,242</u>	202,844
Current maturities	<u>(157,987)</u>	(88,602)
Total long-term debt obligations	<u>\$ 106,255</u>	\$ 114,242

The Exchange believes that the carrying values of amounts outstanding under its commercial paper and term loan agreements approximate fair value given the term of the debt and floating interest rates. As of January 28, 2023, the estimated fair value for the 2024 senior notes is \$14,718. Fair value is calculated using a discounted cash flow analysis (Level 2), with estimated interest rates offered for notes with similar terms and maturities.

Cash paid for interest for fiscal years 2022 and 2021 was approximately \$4,541 and \$2,563, respectively. The Exchange has complied with all financial and nonfinancial covenants per loan agreements as of January 28, 2023, and expects to comply through the period ending January 27, 2024.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

3. Indebtedness (continued)

Principal maturities of debt obligations as of January 28, 2023, are as follows:

2023	\$ 157,987
2024	106,255
2025	–
2026	–
2027	–
	<u>\$ 264,242</u>

4. Leases and Rental Obligations

The Exchange's operating lease and rental commitments primarily include real estate and information technology leases. The Exchange recorded rent expense of \$6,525 and \$3,099 for the fiscal years ended January 28, 2023, and January 29, 2022, respectively. The Exchange does not have finance leases. The Exchange expects operating lease and rental expenses of \$4,021 in 2023 and \$16, 869 over the next 5 years (2023-2027).

5. Benefit Plans

The Exchange has a defined benefit pension plan, the Retirement Annuity Plan (the Basic Plan), covering regular full-time civilian employees of the Exchange who are citizens or residents of the U.S. In addition, the Supplemental Plan provides for selected benefits to employees in the Executive Management Program. The Exchange's policy is to annually fund actuarially determined postretirement expense unless the respective plan is fully funded or unless an asset-liability model has shown the respective plan will likely become fully funded even in the absence of future contributions. The benefits are based on years of service and the employees' highest three-year average compensation. Assets of the plans consist primarily of marketable debt and equity securities.

In addition to the Exchange's benefit plans discussed above, certain medical and dental (health care) and life insurance benefits are also provided to retired employees through the Postretirement Medical/Dental and Life Insurance (Postretirement) plans for employees of the Exchange. All regular full-time U.S. civilian employees who are paid on the U.S. dollar payroll may become

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

eligible for these benefits if they satisfy eligibility requirements during their working lives. The Exchange's policy is to annually fund actuarially determined postretirement expense unless the respective plan is fully funded or unless an asset-liability model has shown the respective plan will likely become fully funded, even in the absence of future contributions.

On January 1, 2022, the Exchange began the new Medicare Advantage with Prescription Drug (MAPD) plan for all Exchange retirees who are enrolled in Medicare (Parts A & B). This Medicare program is administered by the Aetna Life Insurance Company. All claims will be processed and funded through premiums paid by the Exchange and government subsidy from the Centers for Medicare and Medicaid Services (CMS). As a result of this plan amendment, the Exchange reduced the Postretirement benefit obligations by \$727 million during fiscal year 2021. The Exchange will no longer provide health coverage to those not enrolled in Medicare Parts A & B when eligible, unless they reside in a country/location outside of the continental United States and Hawaii, where Medicare is not offered.

The Exchange also provides certain life insurance and other disability benefits for active employees. Benefits are paid from a Voluntary Employee Beneficiary Association (VEBA) trust maintained by the Exchange and to which the Exchange contributes each year. As of January 28, 2023, the Exchange recorded a net asset of approximately \$39,740, which represents an estimated liability of \$17,682 less trust assets of \$57,422. As of January 29, 2022, the Exchange recorded a net asset of approximately \$17,840, which represents an estimated liability of \$27,843 less trust assets of \$45,683.

In addition, the Exchange provides a noncontributory defined benefit pension plan to its employees in the United Kingdom (UK Plan). With the UK Plan, the Exchange also provides postemployment benefits (e.g., separation pay) through its Local National benefit plans to employees in Germany, Japan, Okinawa, Azores, Italy, and Turkey (collectively, referred to as Foreign Plans).

The Exchange measures the cost of its pension plans and other postretirement benefit plans in accordance with ASC 715, *Compensation – Retirement Benefits*. As the Exchange's fiscal year-end does not coincide with a month-end, the Exchange has elected to measure plan assets and benefit obligations using the month-end that is closest to the Exchange's fiscal year-end. The assets of the Supplemental Plan are not effectively restricted from being used by the Exchange for other purposes. Therefore, these assets do not qualify as plan assets as defined in ASC 715 and, as a result, are accounted for in accordance with ASC 320, *Investments – Debt and Equity Securities*.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

The following table provides a reconciliation of the changes in the plans' benefit obligations and fair value of assets for fiscal years 2022 and 2021. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2022	2021	2022	2021	2022	2021	2022	2021
Change in projected benefit obligations (PBO)								
PBO at prior measurement date	\$ 5,383	\$ 5,495	\$ 22	\$ 24	\$ 1,684	\$ 2,481	\$ 83	\$ 91
Service cost	112	117	2	1	26	33	2	3
Interest cost	176	161	1	1	55	68	1	1
Plan participants' contributions	4	4	–	–	–	–	–	–
Actuarial (gain) loss	(867)	(112)	1	(4)	(480)	(74)	(19)	(7)
Foreign exchange impact	–	–	–	–	–	–	(8)	(3)
Benefits paid	(274)	(260)	–	–	(75)	(88)	(2)	(2)
Administrative expenses paid	(20)	(22)	–	–	(7)	(9)	(1)	(1)
Plan amendments	–	–	–	–	–	(727)	–	–
PBO at current measurement date	4,514	5,383	26	22	1,203	1,684	56	82
Change in plan assets								
Fair value of assets at prior measurement date	5,564	4,865	–	–	2,150	1,939	65	66
Actual return on assets	(230)	777	–	–	(76)	306	(17)	–
Employer contributions	200	200	–	–	–	–	2	2
Plan participants' contributions	4	4	–	–	–	1	–	–
Benefits paid	(274)	(260)	–	–	(75)	(88)	(2)	(2)
Foreign exchange impact	–	–	–	–	–	–	(6)	(1)
Administrative expenses paid	(21)	(22)	–	–	(8)	(9)	(1)	(1)
Fair value of assets at current measurement date	5,243	5,564	–	–	1,991	2,149	41	64
Over/(under)-funded status at fiscal year-end	\$ 729	\$ 181	\$ (26)	\$ (22)	\$ 788	\$ 465	\$ (15)	\$ (18)

Supplemental Plan assets do not qualify as plan assets as discussed above.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

The following table reflects amounts recognized on the balance sheets as of fiscal years 2022 and 2021. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2022	2021	2022	2021	2022	2021	2022	2021
Amounts recognized on the balance sheets								
Other current liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3
Net accrued pension and other benefits asset (liability)	729	181	(26)	(22)	788	465	(15)	(18)
Accumulated other comprehensive (gain) loss	580	924	2	(1)	(622)	(432)	9	12

A summary of the components of net periodic benefit cost (income) for the benefit plans is as follows for fiscal years 2022 and 2021. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2022	2021	2022	2021	2022	2021	2022	2021
Net periodic cost								
Service cost	\$ 112	\$ 117	\$ 1	\$ 1	\$ 26	\$ 33	\$ 2	\$ 3
Interest cost	176	161	1	1	55	68	1	1
Expected return on assets	(374)	(344)	-	-	(138)	(135)	(1)	(2)
Other adjustments	-	-	-	-	(84)	(15)	-	-
Net loss amortization	82	120	-	-	15	20	-	2
Net periodic benefit (income) cost	\$ (4)	\$ 54	\$ 2	\$ 2	\$ (126)	\$ (29)	\$ 2	\$ 4

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

Information for benefit plans with an accumulated benefit obligation in excess of plan assets is as follows for fiscal years 2022 and 2021. Amounts are stated in millions.

	Pension Benefits				Other Benefits			
	The Basic Plan		Supplemental Plan		Postretirement		Foreign Plans	
	2022	2021	2022	2021	2022	2021	2022	2021
Projected benefit obligation	\$ 4,514	\$ 5,383	\$ 26	\$ 22	\$ 1,203	\$ 1,684	\$ 56	\$ 82
Accumulated benefit obligation	4,322	5,050	6	8	1,203	1,684	52	76
Fair value of plan assets	5,243	5,564	-	-	1,991	2,149	41	64

Amounts included in accumulated other comprehensive loss for all plans at January 28, 2023, consist of a net actuarial gain of \$30,381. Amortization of this amount expected to be recognized in fiscal year 2024 is \$15.

Actuarial Assumptions

Actuarial weighted average assumptions used in determining plan obligations and the related expense are as follows for fiscal years 2022 and 2021:

	Pension Benefits				Other Benefits	
	The Basic Plan		Supplemental Plan		Postretirement	
	2022	2021	2022	2021	2022	2021
Assumptions used to determine expense and liabilities:						
Discount rate	3.38%	3.01%	3.38%	3.01%	3.43%	3.07%
Long-term rate of return on assets	7.45	7.38	-	-	7.62	7.49
Compensation increase rate	4.63	4.47	10.06	9.74	-	-
Assumptions used at disclosure:						
Discount rate	5.13	3.38	5.13	3.38	5.16	3.43
Compensation increase rate	4.20	4.47	10.09	9.90	-	-

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

Assumed Health Care Cost Trend Rates at Fiscal Year-End

	<u>2022</u>	<u>2021</u>
Pre-65 health care cost trend rate assumed for next year	6.50%	6.50%
Rate to which the cost trend rate is assumed to decline (ultimate trend rate):		
Pre-65	4.50%	4.50%
Post-65	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2031	2030

	<u>Other Benefits</u>		<u>Other Benefits</u>	
	<u>UK Plan</u>		<u>Local National Plan</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Assumptions used to determine expense:				
Discount rate	2.20%	1.50%	2.23%	0.72%
Long-term rate of return on assets	2.90	2.80	–	–
Compensation increase rate	3.10	2.50	2.31	2.40
Assumptions used at disclosure:				
Discount rate	4.50	2.20	1.08	0.91
Compensation increase rate	2.80	3.10	2.31	2.40

Actuarial assumptions are based on management's best estimates and judgment. The Exchange reassesses its benefit plan assumptions on a regular basis. The expected rate of return for the plan assets represents the average rate of return to be earned on the plan assets over the period that the benefits included in the benefit obligation are to be paid. In developing the expected rate of return, the Exchange considers the impact of long-term compound annualized returns on the plan assets.

Pension Plan Assets

The Exchange's investment objectives for the benefit plans are designed to generate asset returns that will enable the plans to meet their future benefit obligations. The precise amount for which these obligations will be settled depends on future events, including interest rates, salary increases, and the life expectancy of the plans' members. The obligations are estimated using actuarial assumptions, based on the current economic environment.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

The benefit plans seek to achieve total returns sufficient to meet expected future obligations, as well as returns greater than their policy benchmark reflecting the target weights of the asset classes used in their targeted strategic asset allocation. The plans' targeted strategic allocation to each asset class was determined through an asset-liability modeling study.

The following table sets forth the target allocations of plan assets for the fiscal years 2022 and 2021:

	<u>Pension Benefits</u>		<u>Other Benefits</u>			
			<u>Postretirement</u>		<u>UK Plan</u>	
	<u>The Basic Plan</u>		<u>Plan</u>		<u>2022</u>	<u>2021</u>
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Domestic equity securities	14%	14%	15%	15%	–%	–%
International equity securities	10	10	10	10	20	20
Emerging market equity securities	3	3	4	4	–	–
Low-volatility global equity	9	9	10	10	–	–
Investment-grade fixed income	25	25	25	25	80	80
High-yield fixed income	4	4	–	–	–	–
Treasury inflation protected securities (TIPS)	3	3	3	3	–	–
Real estate – private	4	4	4	4	–	–
Real estate – public	1	1	1	1	–	–
Private equity	9	9	10	10	–	–
Commodities	3	3	3	3	–	–
Alternative debt	5	5	5	5	–	–
Master Limited Partnerships (MLPs)	5	5	5	5	–	–
Timber/farmland	5	5	5	5	–	–
Total	100%	100%	100%	100%	100%	100%

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

The Exchange's benefit plan actual asset allocations at January 28, 2023 and January 29, 2022, by asset class category, are as follows:

	Pension Benefits		Other Benefits			
			Postretirement		UK Plan	
	The Basic Plan		Plan		2022	2021
	2022	2021	2022	2021	2022	2021
Domestic equity securities	13%	14%	14%	14%	–%	–%
International equity securities	9	8	9	9	20	20
Emerging market equity securities	3	3	4	4	–	–
Low-volatility global equity	9	9	10	10	–	–
Investment-grade fixed income	24	24	21	22	80	80
High-yield fixed income	4	4	–	–	–	–
Treasury inflation protected securities (TIPS)	3	3	3	3	–	–
Real estate – private	4	3	4	4	–	–
Real estate – public	1	1	1	1	–	–
Private equity	11	11	13	12	–	–
Commodities	3	5	3	4	–	–
Alternate debt	7	7	9	8	–	–
Master Limited Partnerships (MLPs)	6	5	5	5	–	–
Timber/farmland	3	3	4	4	–	–
Total	100%	100%	100%	100%	100%	100%

The Exchange uses the fair value hierarchy discussed in Note 2 to measure the fair value of assets held by pension and postretirement benefit plans.

Equity securities are diversified across various industries and comprise common and preferred stocks of U.S. and international companies and equity positions in privately held companies controlled through limited partnerships. Common and preferred stocks are based on market quotations and are classified as Level 1 in the fair value hierarchy. The fair values of the investments in the collective investment funds represent the net asset values of the shares or units

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

of such funds as determined by the issuer. Limited partnerships are valued based on net asset value as determined by the general partners and represent the plans' proportionate share of the estimated fair value of the underlying net assets limited partnership. The limited partnerships are valued based on purchase price when recently acquired; valuation models such as discounted cash flows or market multiples; financial measures, such as free cash flow or earnings before interest, taxes, depreciation and amortization (EBITDA); or market comparisons for similar assets and are classified as Level 3 investments. Foreign obligations are foreign equities traded on U.S. exchanges as American Depository Receipts (ADRs), are valued based on market quotations, and are classified as Level 1 investments.

Debt securities comprise corporate bonds, government securities, and asset-backed or collective investment funds and limited partnerships with underlying debt securities. U.S. Government obligations are valued at the closing price reported on the active market on which the individual securities are traded. U.S. Government obligations are classified as Level 1 investments. U.S. Government agency securities are usually traded in active markets; however, they may not trade with sufficient frequency to rely on a single price of the same security. As such, broker quotes may be used based on similar assets in active markets with these assets classified as Level 2.

Corporate bonds are usually traded in active markets; however, they may not trade with sufficient frequency to rely on a single price of the same security. As such, broker quotes may be used based on similar assets in active markets. Asset-backed securities are publicly traded securities with coupon payments based on the performance of the underlying assets and are usually traded in active markets; however, they may not trade with sufficient frequency to rely on a single price of the same security. As such, broker quotes may be used based on similar assets in active markets. Corporate bonds and asset-backed securities are classified as Level 2 investments.

Real estate and commodities comprise investments whose underlying value is based on real estate or commodities. Publicly traded securities are equity shares in Real Estate Investment Trusts (REITs) or Master Limited Partnerships (MLPs) and are valued based on market quotations. Collective investment funds with underlying investments in exchange-traded positions are classified as Level 2 investments. The net asset values of collective investment funds and limited partnerships with underlying investments in real estate are based on the selling price of the property, income the property is expected to generate, and the market values of any commodities currently on the land.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

Other investments consist primarily of investment contracts and are valued at the quoted price as determined by the issuer. Such contracts are classified as Level 2 investments.

The following table sets forth by level within the fair value hierarchy, the Exchange's benefit plan assets and liabilities that are measured at fair value as of January 28, 2023:

	Benefit Plans			
	Total	Level 1	Level 2	Level 3
Assets				
Temporary investments ^(a)	\$ 702	\$ 702	\$ —	\$ —
Equity securities:				
Common and preferred stock ^(b)	781,133	781,133	—	—
Debt securities:				
Common and preferred stock ^(b)	2,078	2,078	—	—
Corporate bonds ^(d)	556,376	—	556,376	—
U.S. Government obligations ^(e)	230,155	230,155	—	—
Asset-backed securities ^(f)	100	—	100	—
Real estate and commodities:				
Common and preferred stock ^(b)	386,485	386,485	—	—
Other investments ^(m)	9,144	—	9,144	—
Total investments at fair value	<u>1,966,173</u>	<u>\$ 1,400,553</u>	<u>\$ 565,620</u>	<u>\$ —</u>
Investments measured at net asset value:				
Collective investment funds:				
Equity securities ^(g)	1,970,279			
Debt securities ^(h)	1,000,312			
Real estate and commodities ⁽ⁱ⁾	695,611			
Short-term investment funds ^(j)	133,600			
Limited partnerships:				
Equity securities ^(k)	794,669			
Debt securities ^(k)	619,774			
Real estate and commodities ^(k)	90,900			
Total investments measured at net asset value	<u>5,305,145</u>			
Plan assets not measured at fair value or net asset value ^(l)	<u>3,289</u>			
Total assets	<u>\$ 7,274,607</u>			

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

The following table sets forth by level within the fair value hierarchy, the Exchange's benefit plan assets and liabilities that are measured at fair value as of January 29, 2022:

	Benefit Plans			
	Total	Level 1	Level 2	Level 3
Assets				
Temporary investments ^(a)	\$ 10,159	\$ 10,159	\$ —	\$ —
Equity securities:				
Common and preferred stock ^(b)	910,526	910,526	—	—
Foreign obligations ^(c)	11,811	11,811	—	—
Debt securities:				
Common and preferred stock ^(b)	2,470	2,470	—	—
Corporate bonds ^(d)	606,917	—	606,917	—
U.S. Government obligations ^(e)	239,429	239,429	—	—
Asset-backed securities ^(f)	235	—	235	—
Real estate and commodities:				
Common and preferred stock ^(b)	361,532	361,532	—	—
Other investments ^(m)	7,786	—	7,786	—
Total investments at fair value	<u>2,150,865</u>	<u>\$ 1,535,927</u>	<u>\$ 614,938</u>	<u>\$ —</u>
Investments measured at net asset value:				
Collective investment funds:				
Equity securities ^(g)	1,835,669			
Debt securities ^(h)	1,228,862			
Real estate and commodities ⁽ⁱ⁾	617,990			
Short-term investment funds ^(j)	90,823			
Limited partnerships:				
Equity securities ^(k)	1,018,954			
Debt securities ^(k)	547,243			
Real estate and commodities ^(k)	280,432			
Total investments measured at net asset value	<u>5,619,973</u>			
Plan assets not measured at fair value or net asset value ^(l)	<u>6,393</u>			
Total assets	<u>\$ 7,777,231</u>			

Army and Air Force Exchange Service

Notes to Financial Statements (continued)

(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

- (a) Primarily consist of cash held in foreign currencies.
- (b) 2022: Holdings are diversified as a percentage of total equity as follows: Domestic Markets (73%) and Developed International Markets (27%). Domestic Markets are diversified by Large Cap (41%), Small Cap (6%), Public Real Estate – REIT (13%), and low-volatility investments (40%). There are no significant concentrations of holdings by the Exchange.
2021: Holdings are diversified as a percentage of total equity as follows: Domestic Markets (62%) and Developed International Markets (38%). Domestic Markets are diversified by Large Cap (28%), Small Cap (3%), Public Real Estate – REIT (12%), low-volatility investments (13%), and MLPs (44%). There are no significant concentrations of holdings by the Exchange.
- (c) 2021: Holdings include International (77%) and Domestic (23%) securities in the form of American Depository Receipts that represent underlying securities, traded on non-U.S. exchanges.
- (d) 2022: Includes 88% and 12% of investments in corporate high-yield debt with S&P rating of B- and below as of January 28, 2023. The remaining investments are in investment-grade corporate bonds.
2021: Includes 89% and 11% of investments in corporate high-yield debt with S&P rating of B- and below as of January 29, 2022. The remaining investments are in investment-grade corporate bonds.
- (e) Includes fixed-income treasury securities backed by the full faith and credit of the U.S. Government. There are no significant foreign currency risks within this segment.
- (f) Holdings consist primarily of publicly traded fixed-income securities whose payments are based on the performance of an underlying asset.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)

(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

- (g) 2022: 58% of holdings consist of BlackRock index funds, which are passive in nature and employ a strategy of investing in securities that provide beta (market) exposure to a specific index, including the S&P 500 and MSCI EAFE. The remaining 42% consists of international, small cap, and low-volatility investments in the form of mutual funds. The collective investment funds consist of Domestic (46%) and International (54%). Investments have a required notice of three days for any sales or liquidation. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. There are no restrictions on withdrawals.
2021: 68% of holdings consist of BlackRock index funds, which are passive in nature and employ a strategy of investing in securities that provide beta (market) exposure to a specific index, including the S&P 500 and MSCI EAFE. The remaining 32% consists of international, small cap, and low-volatility investments in the form of mutual funds. The collective investment funds consist of Domestic (58%) and International (42%). Investments have a required notice of three days for any sales or liquidation. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. There are no restrictions on withdrawals.
- (h) 2022: 93% of the holdings consist of two core fixed-income index funds, which both employ a strategy that seeks to match the performance of the Barclays Long Credit Index, and a Loomis Sayles high yield fund (7%), which employs a strategy that seeks to match the performance of the CS High Yield Index. Issuances and redemptions are made on each business day. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. The BlackRock funds have a required notice of three days for any sales or liquidation.
2021: 94% of the holdings consist of two core fixed-income index funds, which both employ a strategy that seeks to match the performance of the Barclays Long Credit Index, and a Loomis Sayles high yield fund (6%), which employs a strategy that seeks to match the performance of the CS High Yield Index. Issuances and redemptions are made on each business day. Distributions may be made in cash or in kind or partly in cash or partly in kind at the sole discretion of the fund's trustee. The BlackRock funds have a required notice of three days for any sales or liquidation.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

⁽ⁱ⁾ 2022: Investments include both commodities and real estate, which provide diversified returns relative to stocks and bonds. The underlying commodity investments are actively traded futures, which have full pricing transparency and daily liquidity and are reported at net asset value. Real estate holdings include direct real estate investments in properties that are valued by appraisal and reported as Level 3. The investments are diversified by core 29% and value-added or opportunistic 11% investments. Commodity investments include farmland and timber, which represent 60% of the allocation. There is quarterly redemption available for the real estate investments with a 60-day notice.

2021: Investments include both commodities and real estate, which provide diversified returns relative to stocks and bonds. The underlying commodity investments are actively traded futures, which have full pricing transparency and daily liquidity and are reported at net asset value. Real estate holdings include direct real estate investments in properties that are valued by appraisal and reported as Level 3. The investments are diversified by core 27% and value-added or opportunistic 10% investments. Commodity investments include farmland and timber, which represent 63% of the allocation. There is quarterly redemption available for the real estate investments with a 60-day notice.

^(j) The State Street Bank and Trust Company Short-Term Investment Fund employs a strategy to provide safety of principal, daily liquidity, and a competitive yield by investing in high-quality money market instruments. Issuances and redemptions are made on each business day. The fund's management may impose restrictions on cash redemptions in the fund outside the normal course of business. Distributions may be made in cash or in kind or partly in cash or partly in kind at the discretion of the fund's trustee.

^(k) Includes limited partnerships that invest primarily in U.S. buy-out opportunities, as well as opportunistic debt of a range of privately held companies. The fund does not have to redeem its limited partnership investment at its net asset value. Instead, the fund receives distributions as the underlying assets of the fund are liquidated.

^(l) Holdings consist of net amounts due to or from brokers for the sale of securities as of the balance sheet date.

^(m) Includes two immediate participation guarantee contracts at contract value.

At January 28, 2023, the Exchange had commitments to fund limited partnerships held by the Exchange's benefit plans of \$604,798.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)
(Dollars in Thousands, Unless Otherwise Noted)

5. Benefit Plans (continued)

Employer Contributions

The Exchange made cash contributions totaling \$200,000 to the Basic plan in fiscal year 2022.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Fiscal Years	Basic Plan	Supplemental Plan	Postretirement	Foreign Plans
2024	\$ 289,514	\$ 464	\$ 73,133	\$ 4,574
2025	292,899	470	74,796	3,662
2026	295,757	476	75,978	3,544
2027	298,034	482	77,226	3,941
2028	299,959	488	78,054	3,746
2029–2033	1,529,483	2,868	388,696	18,090

6. Dividends

The Exchange is required, under various agreements, to distribute a portion of each year's net earnings before performance bonuses in the form of dividend payments to the Central Welfare Funds, Departments of the Army, the Air Force, the Navy, and the Marine Corps.

Under the current dividend policy, noncash pension expenses, noncash pension income and employee benefit plan expenses are excluded from net earnings subject to dividends. The Exchange Board of Directors are responsible for establishing dividend policy.

The Exchange's policy is to annually fund actuarially determined postretirement expense unless the plan is fully funded or unless an asset-liability model has shown the plan will likely become fully funded, even in the absence of future contributions. Therefore, each year, pension expense generally reduces the net earnings subject to dividends to the extent cash contributions have actually been made.

Army and Air Force Exchange Service

Notes to Financial Statements (continued)

(Dollars in Thousands, Unless Otherwise Noted)

7. Commitments and Contingencies

The Exchange is a defendant in various lawsuits and claims. In the opinion of management, the amounts, if any, which might ultimately be paid in connection with settlement of the litigation would not have a material effect on the financial condition, results of operations, or cash flows of the Exchange.

8. Middle East, United States Central Command

The Exchange's presence in Iraq, Qatar, Saudi Arabia, UAE, Jordan, and Kuwait was supported by 26 stores as of January 28, 2023, and 36 stores as of January 29, 2022. Approximately \$129,474 (2%) and \$145,983 (2%) of the Exchange's net revenues in the fiscal years 2022 and 2021, respectively, were derived from sales to U.S. troops stationed in the Middle East. The Exchange's inventory balance in this region, at cost, was \$13,745 and \$19,965 at January 28, 2023, and January 29, 2022, respectively. In the event the U.S. must quickly exit a country, any related loss on inventory would adversely affect the Exchange's results; however, such losses are eligible for reimbursement appropriations that are reasonably assured of collection.

9. Subsequent Events

The Exchange has evaluated subsequent events through May 24, 2023, the date at which the accompanying financial statements were available to be issued and determined that no additional disclosures to those presented were necessary.

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2022 BY THE NUMBERS

\$8.5B
REVENUE

\$356M
EARNINGS

\$214M
DIVIDENDS

85%

ASSOCIATES CONNECTED
TO THE MILITARY

57,000+

VETERANS/SPOUSES
HIRED SINCE 2013

4,900+

ASSOCIATES DEPLOYED TO COMBAT ZONES
SINCE 9/11

2,056

WOUNDED WARRIORS
HIRED SINCE 2010

609K

COMBAT UNIFORMS
OUTFITTED AT COST

7 PLANTS

PROVIDING BAKED GOODS & WATER
OVERSEAS

5.6M

BAKERY ITEMS PRODUCED OVERSEAS

4.4M

GALLONS OF WATER BOTTLED

1,500

RESTAURANTS

77M

MEALS SERVED AT
EXCHANGE RESTAURANTS

4M

SCHOOL LUNCHES SERVED AT
OR BELOW COST

5M

HAIRCUTS PROVIDED

396M

GALLONS OF FUEL
DISPENSED

10

DISTRIBUTION CENTERS

41M

CASES SHIPPED

12M

FLEET MILES DRIVEN



EXCHANGE