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## PART III: FISCAL YEAR 2003 FINANCIAL REPORT

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## Message from the Executive Director

The executive director of the Appalachian Regional Commission is appointed by the federal co-chair and the governors of the 13 member states to be the chief executive officer of the organization, a responsibility that includes financial management.

The primary focus of the Commission must always be to carry out its mission to serve the people of Appalachia. Yet ARC recognizes its responsibility to demonstrate to the American public that it exercises proper stewardship of the public resources entrusted to it. The financial statements in this Performance and Accountability Report fairly represent the financial position of ARC.

I am very pleased to report that M.D. Oppenheim and Company, the independent auditor of ARC's financial statements for 2003, has rendered an unqualified opinion about the adequacy of the statements. The independent audit was performed in cooperation with the Office of Inspector General (OIG). The clean audit opinion caps a long process of persistent hard work in recent years by the Commission staff to ensure an environment of accountability.

The Commission maintains clearly written financial management guidelines governing accounts, payments, procurement, administration, and travel policy. The guidelines are provided to all staff and are reviewed at least annually and are amended to reflect changes in policy or revised procedures resulting from tests of internal controls.

ARC has developed a plan of internal control review that takes a team approach to analyzing and testing internal controls. In addition, the agency IT security plan was revised on the basis of guidance from the National Institute of Standards and Technology, and security was tested both internally and externally to ensure that appropriate protections are in place for financial and other systems. Wherever possible, technology has been used to enhance program and financial accountability.

Even though the Commission is a very small organization by federal agency standards, it has an Office of Inspector General dedicated to monitoring and auditing ARC programs and grants. The OIG has been an important resource in helping ARC take proactive measures to ensure the integrity of its operations and financial management.

On behalf of the entire Commission, I pledge a continued commitment to promptly addressing all financial management issues that need further attention, and to maintaining the strengths the Commission has achieved.

A handwritten signature in black ink that reads "Thomas M. Hunter".

**Thomas M. Hunter**

January 30, 2004

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## Report of Independent Audit

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January 30, 2004

Memorandum for           The Federal Co-Chair  
                                  ARC Executive Director

Subject:                    2003 Financial Statement Audit  
                                  OIG Report 04-06

The enclosed report presents the results of the audit of the Commission's financial statements for the fiscal year ended September 30, 2003. The report should be read in conjunction with the Commission's financial statements and notes to fully understand the context of the information contained therein.

The Appalachian Regional Commission contracted with the independent certified public accounting firm of M.D. Oppenheim & Company, P.C. to audit the financial statements of the Commission as of and for the year ended September 30, 2003. In its audit, M.D. Oppenheim & Company, P.C found the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.

ARC implemented a process for providing audited financial statements in fiscal year 2002, following the guidance of the Accountability of Tax Dollars Act. ARC, strictly speaking, is not a federal agency as defined in USC 5 and USC 31, and is a 501(c)(3) organization. While the Accountability of Tax Dollars Act applies only to executive branch agencies, the Commission has elected to comply with OMB guidance because full disclosure of financial information is consistent with the governmental nature of ARC's mission and operations and its stewardship of public funds. ARC follows OMB and Treasury financial reporting requirements as appropriate.

As the Commission is a regional development agency designed to function as a federal, state, and local partnership and is not a federal entity, the Commission concluded that the reporting formats established by the Financial Accounting Standards Board (FASB) would provide more meaningful information to users of ARC's financial statements than would be available if standards recommended by the Federal Accounting Standards Advisory Board (FASAB) were followed. Under either set of standards, the Commission determined that the financial condition and results of operations would not result in a significant difference in the recognition and measurement of ARC's accounting transactions and events. Therefore, the Commission's financial statements have been prepared in accordance with standards set by FASB, and accordingly, the audit was conducted in accordance with auditing standards generally accepted in the United States of America.

The results of the audit were discussed with Commission officials and the OIG throughout the audit. Commission officials responded to the findings and recommendations presented in draft reports and changes were incorporated as appropriate.

M.D. Oppenheim & Company, P.C., identified a matter considered to be a reportable condition under standards established by the American Institute of Certified Public Accountants, as well as three matters presenting opportunities for strengthening internal controls and operating efficiency. They are communicated in a separate letter dated January 23, 2004 for management's consideration and is attached under separate cover.

M.D. Oppenheim & Company, P.C. is responsible for the attached auditors' report dated January 23, 2004 and the conclusions expressed in the report. We do not express opinions on the Appalachian Regional Commission's financial statements or internal controls.

In connection with the contract, we reviewed M.D. Oppenheim & Company's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted auditing standards, was not intended to enable us to express, and we do not express, opinions on the Appalachian Regional Commission's financial statements or internal control. M.D. Oppenheim & Company, P.C. is responsible for the attached auditors' report dated January 23, 2004 and the conclusions expressed in the report. However, our review disclosed no instances where M.D. Oppenheim & Company, P.C. did not comply, in all material respects, with auditing standards generally accepted in the United States of America.

As noted in the letter, the consideration of internal controls was for the limited purpose of auditing the financial statements. My office will be performing a more comprehensive audit of the internal controls during the current year.

I appreciate the cooperation given by the Finance and Administration Division to my office and M.D. Oppenheim & Company, P.C., during the audit. I recognize the great amount of work necessary in any enterprise to prepare for a first time audit.



Clifford H. Jennings  
Inspector General

Attachment

cc: Director, Finance and Administration Division

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## Management Note

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## MANAGEMENT NOTE

### Reportable Condition

Commission management is disclosing that the independent auditors, in a management letter separate from the financial statements, identified a reportable condition related to an area of internal control. The funding is not a material weakness in internal control. Nevertheless, ARC is making it part of this Performance and Accountability Report. The following is excerpted from the letter:

#### Grant Advances

ARC records advance payments to grantees as expenses when the disbursements are made. At fiscal year-end, material amounts of grant funds held by grantees and not yet expended are reclassified as advances in the general ledger in order to properly record grant activity on an accrual basis. The amount of outstanding grant advances is obtained from reports from the Project Information System.

We noted that advance payments to non-revolving loan fund grantees recorded in the Project Information System totaled \$4,651,555 as of September 30, 2003 with payment dates ranging from August 18, 1998 to September 29, 2003. This information is only updated when a subsequent grant payment request is received by the Finance and Administration Division. Therefore, the balance as reported in the system does not reflect the current status of these funds.

Information to properly adjust the advance balance to actual was not readily available and required the efforts of the Finance and Administration Division and ARC program personnel, as well as follow-up with grantees, to update the amounts. Based on the additional information obtained, the grant advance balance was reduced by \$3,609,289 to \$1,042,266.

We recommend that policies and procedures be developed to obtain the accurate status of grant funds held by grantees at fiscal year-end in order to facilitate preparation of the financial statements in compliance with federal reporting requirements.

ARC considers all potential weaknesses in internal control as warranting prompt attention.

Management has already taken action to modify procedures and data management to assist with prompt follow-up on all advances made to grantees.



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# Inspector General Summary of Management Challenges

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December 31, 2003

MEMORANDUM FOR FEDERAL CO-CHAIR POPE

FROM: Clifford H. Jennings  
Inspector General

A handwritten signature in black ink, appearing to read "Cliff H. Jennings", with a large, stylized flourish at the end.

SUBJECT: Management and Performance Challenges Facing the  
Appalachian Regional Commission

The Reports Consolidation Act of 2000 requires that we provide you with our perspective on the most serious management and performance challenges facing the Commission, for inclusion in the Commission's annual performance and accountability report.

**Challenge 1—Financial Management**

The Commission is currently working on its first audited financial statement. The ongoing challenge is one of working with Federal agencies that receive ARC allocation accounts through interagency agreements that transfer ARC grant funds to be administered by others. The primary agencies are the U.S. Department of Transportation, the U.S. Department of Commerce, and the U.S. Department of Housing and Urban Development.

There are documented cases where funds have been transferred to the other agency and the grant money distributed to the grantee, the grant performed and closed. However, even after these events, these funds still are shown on federal reports as unobligated, giving a false impression as to funds available. A further complication arises as ARC funds are "no-year" funds while many of the other agencies are dealing with funds that expire at the end of each fiscal year. In most cases, the amounts involved are immaterial to the other agencies. However, given the size of ARC, these funds are quite material when taken as a whole and need to be recovered so the funds can be put to their intended use.

Finally, the Commission will need to work during the upcoming year to rectify issues identified during the conduct of the financial statement audit. While none of the issues identified to date appear to be severe, they still require diligent follow-up and correction, as needed. The issue of using grant advances rather than reimbursable agreements, outstanding advances, and coordination between the financial staff and program staff need to be addressed.

**Challenge 2—Grantee and Grant Oversight**

While the Commission generally does a good job in managing grants it needs to improve its oversight of ongoing grants to ensure that all grantees meet grant requirements for reporting and documentation of results. In recent Semiannual reports to Congress, I have noted this as an area needing continued vigilance to ensure that grantees were not given additional funding until they fully comply with Commission reporting requirements.

Proper oversight will reduce the potential exposures to fraud and will assist grantees learn the requirements of proper business practices. Further, vigilance over grant processes will reduce the incidence of inactive funds remaining allocated to expired grants.

**Challenge 3—Compliance with multiplicity of federal reporting requirements**

While the Commission is not technically a Federal agency, it attempts to comply with federal reporting requirements. The challenge is to report meaningful information to those requesting the information while not expending excessive resources in doing so. Increasing external demands for detailed planning and compliance reporting at times appear to require more staff time than the time taken on the item itself.