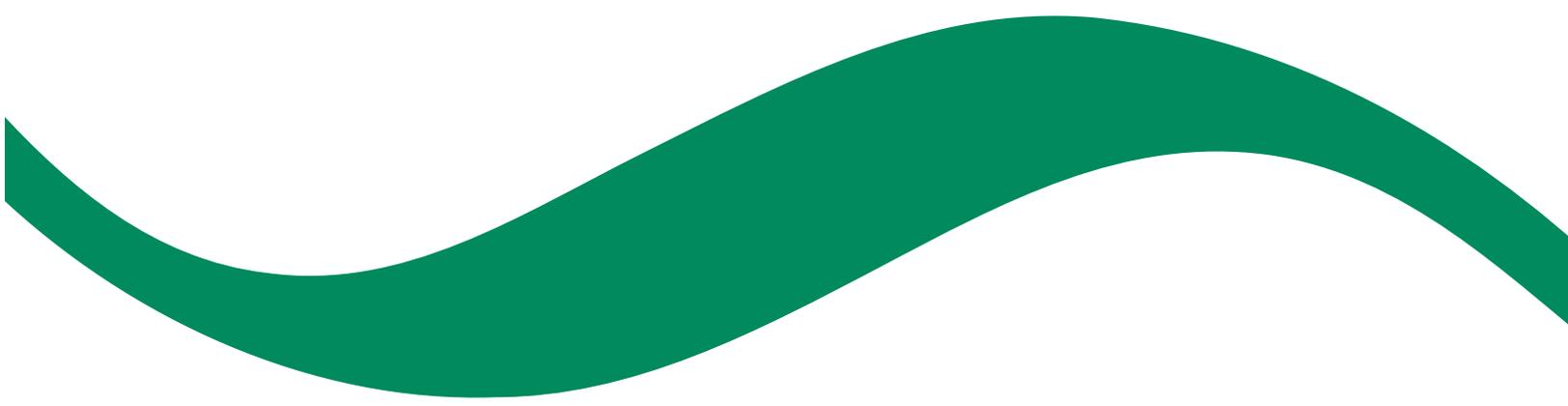




**PART III:  
FISCAL YEAR 2005 FINANCIAL REPORT**





## 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. ARC recognizes its responsibility to demonstrate to the American public that it exercises proper stewardship of the public resources entrusted to it. The financial statement in this Performance and Accountability Report fairly presents the financial position of ARC.

I am very pleased to report that M.D. Oppenheim and Company, the independent auditor of ARC's financial statement for 2005, has rendered an unqualified opinion about the adequacy of the statement. The independent audit was performed in cooperation with the Office of Inspector General (OIG). This is the third consecutive year with an unqualified opinion.

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.

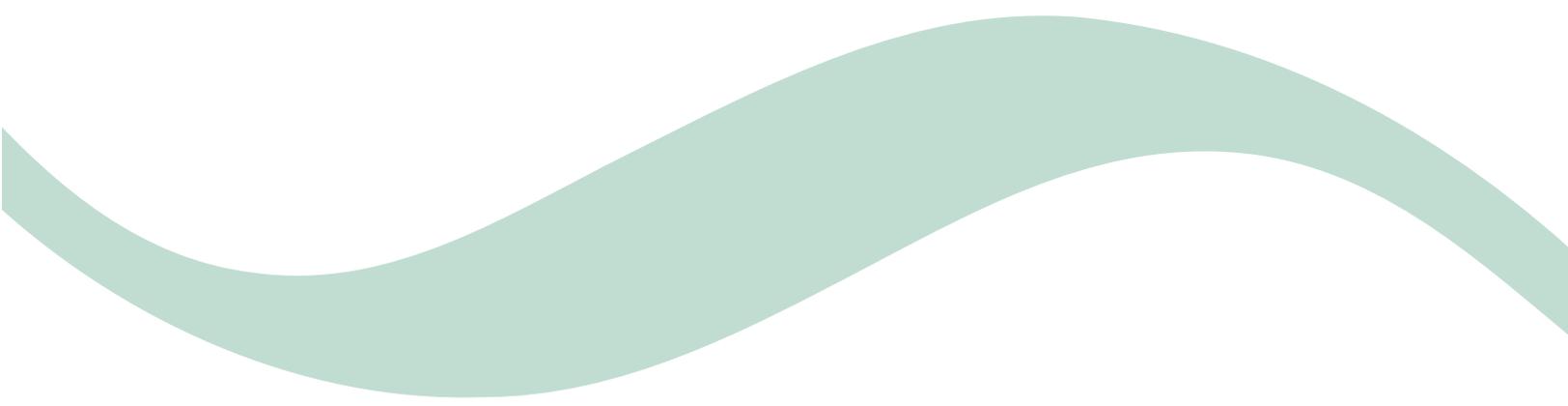
On behalf of the entire Commission, I pledge a continued commitment to promptly address all financial management issues that need further attention and to maintain the strengths the Commission has achieved.

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

**Thomas M. Hunter**

November 15, 2005

Report of Independent Audit





# Financial Report



*Office of Inspector General*

November 14, 2005

Memorandum for           The Federal Co-Chair  
                                  ARC Executive Director

Subject:                    OIG Report 06-01  
                                  FY 2005 Financial Statement Audit  
                                  and Accompanying Documents

The enclosed report presents the results of the audits of the Commission's financial statements for the fiscal years ended September 30, 2005 and 2004. 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 years ended September 30, 2005 and 2004. 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.

The Accountability of Tax Dollars Act of 2002 requires ARC to prepare and submit audited financial statements and to consolidate the audited financial statements and other financial and performance reports into a combined Performance and Accountability Report in accordance with OMB Bulletin 01-09, Form and Content of Agency Financial Statements.

However, because 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.

The audit was conducted in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States. The results of the audit were discussed with Commission officials and the OIG throughout the audit. The auditors' reported that improvement was made during FY 2005 to address the prior year finding and recommendation on compliance, but closure is pending full implementation of the corrective action plan.

## Financial Report

M.D. Oppenheim & Company, P.C., also identified two additional matters presenting opportunities for strengthening internal controls and operating efficiency. They are communicated in a separate letter dated October 28, 2005 for management's consideration and is attached under separate cover.

M.D. Oppenheim & Company, P.C is responsible for the attached auditors' report dated October 28, 2005 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 October 28, 2005 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 and Government Auditing Standards issued by the Comptroller General of the United States.

As noted in the letter, the consideration of internal controls was for the limited purpose of auditing the financial statements. My office is currently performing a more comprehensive audit of the internal controls.

I appreciate the cooperation given by the Finance and Administration Division to my office and M.D. Oppenheim & Company, P.C., during the audit.



Clifford H. Jennings  
Inspector General

Attachments

cc: Director, Finance and Administration Division

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# Appalachian Regional Commission

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Financial Statements and  
Independent Auditors' Report

**September 30, 2005 and 2004**



## APPALACHIAN REGIONAL COMMISSION

SEPTEMBER 30, 2005 and 2004

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# Financial Report



To the Commission Members  
Appalachian Regional Commission  
Washington, DC

## Independent Auditors' Report

We have audited the accompanying balance sheets of the Appalachian Regional Commission ("ARC") as of September 30, 2005 and 2004, and the related statements of operations and changes in net position and cash flows for the years then ended. These financial statements are the responsibility of ARC's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Appalachian Regional Commission as of September 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information on pages 14 and 15 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2005 on our consideration of ARC's internal controls



Affiliated Offices Worldwide



## Financial Report

The Commission Members  
Appalachian Regional Commission  
Washington, DC

over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of the audit.

*M.D. Oppenheim & Company, P.C.*

Silver Spring, Maryland  
October 28, 2005

# Financial Report

## APPALACHIAN REGIONAL COMMISSION Balance Sheets September 30, 2005 and 2004

	2005	2004
<b>ASSETS</b>		
<b>Current assets</b>		
Fund balance with U.S. Treasury	\$ 61,537,066	\$ 59,904,165
Cash in commercial institutions	71,117	88,026
Total cash	61,608,183	59,992,191
Advances to grantees	-	864,383
Total current assets	61,608,183	60,856,574
Business development revolving loan funds	28,942,787	26,541,791
Equipment and software (net)	-	13,394
<b>TOTAL ASSETS</b>	<b>\$ 90,550,970</b>	<b>\$ 87,411,759</b>
<b>LIABILITIES AND NET POSITION</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 1,177,477	\$ 1,949,420
Center for Disease Control and Prevention grants	750,000	-
Accrued pension liability	1,683,124	985,567
Accrued leave	386,370	353,589
Accrued payroll and taxes payable	241,706	211,355
Other accrued liabilities	75,754	92,469
Total current liabilities	4,314,431	3,592,400
<b>Net position</b>	<b>86,236,539</b>	<b>83,819,359</b>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 90,550,970</b>	<b>\$ 87,411,759</b>

*See accompanying notes and Independent Auditors' Report.*

**APPALACHIAN REGIONAL COMMISSION**  
**Statements of Operations and Changes in Net Position**  
**Years ended September 30, 2005 and 2004**

	2005	2004
<b>REVENUES</b>		
Appropriations	\$ 65,472,000	\$ 65,610,600
Less: Grant transfers to other agencies	(26,160,682)	(20,206,551)
Appropriations (net)	39,311,318	45,404,049
Appalachian Development Highway System administrative revenue	1,064,200	691,194
State contributions	3,164,000	3,111,000
Other revenue	273,833	196,819
<b>Total revenues</b>	<b>43,813,351</b>	<b>49,403,062</b>
<b>EXPENSES</b>		
Area development grants	32,170,267	36,856,758
Office of the Federal Co-Chair and Inspector General	1,724,265	1,759,893
Commission management and administration	7,501,639	8,091,546
<b>Total expenses</b>	<b>41,396,171</b>	<b>46,708,197</b>
<b>NET INCOME</b>	<b>2,417,180</b>	<b>2,694,865</b>
<b>Net position, beginning of period</b>	<b>83,819,359</b>	<b>81,124,494</b>
<b>NET POSITION, END OF PERIOD</b>	<b>\$ 86,236,539</b>	<b>\$ 83,819,359</b>

*See accompanying notes and Independent Auditors' Report.*

# Financial Report

## APPALACHIAN REGIONAL COMMISSION Statements of Cash Flows Years ended September 30, 2005 and 2004

	2005	2004
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,417,180	\$ 2,694,865
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation	13,394	25,898
Changes in assets and liabilities:		
Accounts receivable	-	400,000
Business development revolving loan funds	(2,400,996)	(31,320)
Advances to grantees	864,383	177,883
Accounts payable	(771,943)	(563,616)
Center for Disease Control and Prevention grants	750,000	(523,053)
Accrued pension liability	697,557	411,145
Accrued leave	32,781	28,950
Accrued payroll and taxes payable	30,351	36,195
Other accrued liabilities	(16,715)	52,916
<b>Net cash provided by operating activities</b>	<b>1,615,992</b>	<b>2,709,863</b>
<b>Net increase in cash</b>	<b>1,615,992</b>	<b>2,709,863</b>
<b>Cash at beginning of year</b>	<b>59,992,191</b>	<b>57,282,328</b>
<b>CASH AT END OF YEAR</b>	<b>\$ 61,608,183</b>	<b>\$ 59,992,191</b>

**Supplemental disclosures:**

No amounts were paid for Interest and Taxes in 2005 or 2004.

*See accompanying notes and Independent Auditors' Report.*

## APPALACHIAN REGIONAL COMMISSION Notes to Financial Statements Years ended September 30, 2005 and 2004

### Note A – Organization and Mission

The Appalachian Regional Commission (“ARC”) was established under the Appalachian Regional Development Act of 1965, as amended, the Appalachian Regional Development Reform Act of 1998 and the Appalachian Regional Development Act Amendments of 2002. ARC is a regional development agency designed to function as a Federal, state, and local partnership. ARC is not a Federal executive branch agency (as defined in Title 5 and 31 of the United States Code and by the Department of Justice).

Commission members are comprised of a Federal member (Federal Co-Chair), who is appointed by the President, and the governors of each of the thirteen states in the Appalachian Region. The state members elect a State Co-Chair from their members. There is an Executive Director and Program and Administrative Offices that implement the policies and procedures established by the Federal and State Co-Chairs. ARC personnel are comprised of both Federal and non-Federal employees.

ARC supports economic and social development in the Appalachian Region. The Appalachian Region is a 200,000 square mile region from the Appalachian Mountains in Southern New York to Northern Mississippi. The ARC programs affect approximately 410 counties located in thirteen states including all of West Virginia and parts of Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia.

### Note B – Summary of Significant Accounting Policies

- 1. Major Programs** – ARC is authorized to fund area and other development programs including education, workforce training, water and sewer construction, housing, leadership development, small business start-ups and expansions and development of health care resources. In executing its programs, local communities and Federal agencies provide administrative and technical services. ARC utilizes approximately 10 Federal departments and agencies to administer, disburse funds, and account for its infrastructure and other programs including the Department of Housing and Urban Development, Environmental Protection Agency, Rural Development Agency, and the Department of Health and Human Services. ARC is responsible for allocating funds to the projects and for the management and administration of all projects.
- 2. Basis of Accounting** – The accompanying financial statements have been prepared using the accrual method of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred. Appropriations are recognized as revenue when appropriated and available.

**APPALACHIAN REGIONAL COMMISSION**  
**Notes to Financial Statements**  
**Years ended September 30, 2005 and 2004**

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**Note B – Summary of Significant Accounting Policies (continued)**

3. **Financing Sources** – ARC receives annual no-year Federal appropriations to provide grants to the entities within the Appalachian Region and to fund its operations. The state members also contribute funds to ARC operations. Funds are allocated to thirteen states and are available until expended. States can generally decide how their allocations will be used for ARC programs.
4. **Fund Balance with U.S. Treasury** – Cash receipts and disbursements for operations and the area development programs are processed by the U.S. Department of Treasury. Funds held by the Department of Treasury represent funds available for operations.
5. **Cash in Commercial Institutions** – ARC uses commercial bank accounts to accommodate collections and payments that cannot be processed by the U.S. Department of Treasury.
6. **Advances to Grantees** – Unexpended grant funds in the hands of grantees at the end of the fiscal year are reclassified as advances.
7. **Equipment and Software** – Capital assets are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of three to five years.
8. **Retirement Plans** – ARC Federal employees participate in Federal retirement plans. ARC non-Federal employees participate in the ARC Pension and 401(k) plan.
9. **Accrued Pension Liability** – ARC recognizes and records a liability for post-retirement benefits other than pension in accordance with the Statement of Financial Accounting Standards (SFAS) No. 106, *Employer's Accounting for Post-retirement Benefits Other Than Pensions*.
10. **Accrued Leave** – Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year the balance in the accrued annual leave account is adjusted to reflect current accrual at current pay rates.
11. **Use of Estimates** – The preparation of the accompanying financial statements requires management to make estimates and assumptions about certain estimates included in the financial statements. Actual results will invariably differ from those estimates.

**APPALACHIAN REGIONAL COMMISSION**  
**Notes to Financial Statements**  
**Years ended September 30, 2005 and 2004**

**Note B – Summary of Significant Accounting Policies (continued)**

12. **Income Tax Status** – ARC is exempt from Federal income tax under § 501(c)(3) of the Internal Revenue Code and is classified as other than a private foundation.

**Note C – Business Development Revolving Loan Funds**

ARC established business development revolving loan funds (RLF) grants to provide pools of funds to be made available to grantees to create and retain jobs. Various entities (grantees) within the thirteen states were provided with loan capitalization funds. These funds are loaned to borrowers who qualify with program objectives. The earnings (interest and fees) net of expenses (including bad debt) are available to the grantees to make additional loans.

Grantees return the funds to ARC when they terminate the RLF. Grantees that have income in excess of expenses (net income) return the excess funds to ARC, and ARC deposits the net income funds in the U.S. Treasury general fund. Grantees that have net losses return the funds to ARC net of the losses. Grant balances that are returned are added back to the state allocation.

The following summarizes the RLF balances at September 30:

	<u>2005</u>	<u>2004</u>
RLF Funds Obligated	\$ 33,435,470	\$ 31,838,321
RLF Funds Advanced	28,942,787	26,541,791
RLF Loans Outstanding	34,261,278	31,139,964

**Note D – Equipment and Software**

Equipment and software consists of the following at September 30:

	<u>2005</u>	<u>2004</u>
Equipment	\$ 69,194	\$ 69,194
Software	48,422	48,422
Subtotal	117,616	117,616
Less: Accumulated depreciation	(117,616)	(104,222)
Equipment and software (net)	\$ -	\$ 13,394

Depreciation expense for the years ended September 30, 2005 and 2004 was \$13,394 and \$25,898, respectively.

**APPALACHIAN REGIONAL COMMISSION**  
**Notes to Financial Statements**  
**Years ended September 30, 2005 and 2004**

**Note E – Grant Transfers to Other Federal Agencies**

ARC transfers funds to basic agencies to oversee economic and social development projects in the Appalachian Region. ARC records the funds transferred as contra revenue at the time the transfer is made. ARC transferred or received funds as follows:

	<b>2005</b>	<b>2004</b>
Department of Transportation	\$ 688,000	\$ 450,000
US Army Corps of Engineers	(493,000)	-
Economic Development Administration	2,323,298	2,434,102
Environmental Protection Agency		60,000
Department of Agriculture	12,325,976	15,700,000
Department of Housing and Urban Development	11,316,408	1,414,290
Department of Health & Human Services		148,159
	<u>\$ 26,160,682</u>	<u>\$ 20,206,551</u>

**Note F – Retirement and Other Post-Employment Benefit Plans**

Federal

ARC participates in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) for Federal and certain non-Federal employees. The CSRS and FERS plans are administered by the U.S. Office of Personnel Management (OPM). ARC makes contributions at rates applicable to agencies of the Federal government. The contributions do not equal the full service cost of the pension expense, which is the actuarial present value of benefits attributed to services rendered by covered employees during the accounting period. The measurement of service costs requires the use of actuarial cost methods to determine the percentage of the employees' basic compensation sufficient to fund their projected pension benefit. These percentages (cost factors) are provided by OPM.

The excess of total pension expense over the amount contributed by ARC and ARC employees represents the amount which must be financed directly by OPM. ARC does not recognize in its financial statements these excess amounts as they are deemed to be immaterial.

Contributions to these plans for FY 2005 were \$44,099 and \$69,879 for CSRS and FERS, respectively, and contributions for FY 2004 were \$47,094 and \$63,580 for CSRS and FERS, respectively.

**APPALACHIAN REGIONAL COMMISSION**  
**Notes to Financial Statements**  
**Years ended September 30, 2005 and 2004**

**Note F – Retirement and Other Post Employment Benefit Plans (continued)**

Several employees also participate in the Federal Employees Health Benefit plan (FEHB) and the Federal Employees Group Life Insurance program (FEGLI), also administered by OPM. ARC pays the cost of current employees. Post-retirement benefits are paid by OPM. No amounts have been recognized in the financial statements for these imputed costs as they are not deemed material. Contributions to these plans for FY 2005 were \$56,862 and \$2,234 and for FY 2004 \$54,466 and \$2,187 for FEHB and FEGLI, respectively.

ARC does not report in its financial statements CSRS, FERS, FEHB or FEGLI assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees.

ARC also contributed \$25,894 and \$18,390 to the Federal Thrift Savings plan for all eligible employees for the years ended September 30, 2005 and 2004, respectively.

Non-Federal

ARC has a Defined Benefit Pension Plan which was open to all employees not participating in CSRS and FERS. The plan was closed in February 2000 to further entry. The Commission uses a July 1 measurement date for its plan. Plan information at September 30 consists of the following:

		<u>2005</u>		<u>2004</u>
Benefit obligation	\$	(11,415,578)	\$	(8,298,531)
Fair value of plan assets		3,313,848		2,719,287
Funded status	\$	<u>(8,101,730)</u>	\$	<u>(5,579,244)</u>
Accrued benefit cost recognized in the balance sheet	\$	1,683,124	\$	985,567

		<u>2005</u>		<u>2004</u>
Employer contribution	\$	467,777	\$	1,164,693
Participant contribution		25,815		22,700
Benefits paid		121,609		4,487
Net periodic benefit costs		1,165,334		1,575,838

The accumulated benefit obligation was \$9,070,903 and \$6,498,195 at September 30, 2005 and 2004, respectively.

**APPALACHIAN REGIONAL COMMISSION**  
**Notes to Financial Statements**  
**Years ended September 30, 2005 and 2004**

**Note F – Retirement and Other Post-Employment Benefit Plans (continued)**

Additional Information

Weighted-average of assumptions used to determine benefit obligations at September 30:

	<b>2005</b>	<b>2004</b>
Discount rate	4.75%	5.75%
Rate of compensation increase	4.51	4.08

Weighted-average of assumptions used to determine net periodic benefit cost for the years ended September 30:

	<b>2005</b>	<b>2004</b>
Discount rate	5.75%	5.25%
Expected return on plan assets	7.50	7.50
Rate of compensation increase	4.08	4.08

Historical returns of multiple asset classes were analyzed to develop a risk-free real rate of return and risk premiums for each asset class. The overall rate for each asset class was developed by combining a long-term inflation component, the risk-free real rate of return, and the associated risk premium. A weighted average rate was developed based on those overall rates and the target asset allocation plan.

Plan Assets

Pension plan weighted-average asset allocations at September 30, 2005 and 2004 are as follows:

<b>Asset Category</b>	<b>2005</b>	<b>2004</b>
Equity securities	30.00%	31.00%
Debt securities	65.00	64.00
Real estate	5.00	5.00
Total assets	100.00%	100.00%

The Commission's investment strategy is a long-term, risk-controlled approach using diversified investment options with a minimal exposure to volatile investment options like derivatives.

The Commission expects to contribute \$1,003,203 to the plan in FY2006.

**APPALACHIAN REGIONAL COMMISSION**  
**Notes to Financial Statements**  
**Years ended September 30, 2005 and 2004**

**Note F – Retirement and Other Post-Employment Benefit Plans (continued)**

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

	<b>Pension Benefits</b>
2006	\$ 2,320,000
2007	1,870,000
2008	480,000
2009	37,000
2010	570,000
Years 2011 – 2015	6,020,000

ARC also maintains a 401(k) plan covering substantially all non-Federal employees. ARC contributed \$146,018 and \$150,637 for the years ended September 30, 2005 and 2004, respectively.

**Note G – Lease**

ARC's lease for its office space provides for increases in annual base rent based on consumer price index increases, and payment of a portion of the increases in building operating expenses and real estate taxes. The lease commenced on April 30, 1996 and extends through December 31, 2007. Future minimum lease payments required under this non-cancelable lease are as follows:

<u>Year Ended September 30,</u>	<u>Amount</u>
2006	\$ 570,000
2007	142,500
Total	\$ 712,500

Rent expense for the years ended September 30, 2005 and 2004 was \$667,188 and \$686,556, respectively.

**Additional Information**

## APPALACHIAN REGIONAL COMMISSION Additional Information (Unaudited) Years ended September 30, 2005 and 2004

### Appalachian Development Highway System (Appropriated Funds held by the U.S. Department of Transportation)

Congress authorized approximately \$9.7 billion for the construction of the Appalachian Development Highway System (ADHS) through fiscal year 2009. When it is complete, there will be a 3,090 mile regional system. The purpose of the ADHS is to generate economic development in previously isolated areas, supplement the national interstate system, connect Appalachia to the interstate system, and provide access to the Appalachian Region.

The U.S. Department of Transportation (DOT) funds the ADHS primarily through the Highway Trust Fund, from which Congress authorizes annual obligation ceilings for the program. Periodically, additional funds may be provided by direct appropriation to the DOT. ARC exercises policy and programmatic control over the ADHS, including the responsibility to set policy for allocating funds to the states, and DOT is accountable for the funds. The program includes flexibility for states to use some highway funds for access road development, and ARC exercises approval for such projects.

The following is a summary of the balances and activity related to the ADHS for FY 2005:

	Unexpended Authority as of 10/1/2004	FY 2005 Authorizations	FY 2005 Expenditures	Unexpended Authority as of 9/30/2005
DOT Appropriations	\$ 282,721,504	\$ 124,262,500	\$ (199,343,291)	\$ 207,640,713
Highway Trust Fund Obligation Ceiling	1,193,763,879	385,374,150	(206,895,544)	1,372,242,485
Total	\$ 1,476,485,383	\$ 509,636,650	\$ (406,238,835)	\$ 1,579,883,198

Status of budgetary resources as of September 30, 2005:

	Obligated Balance	Unobligated Balance	Total
DOT Appropriations	\$ 113,515,332	\$ 94,125,381	\$ 207,640,713
Highway Trust Fund Obligation Ceiling	531,679,912	840,562,573	1,372,242,485
	\$ 645,195,244	\$ 934,687,954	\$ 1,579,883,198

# Financial Report

## APPALACHIAN REGIONAL COMMISSION Additional Information (Unaudited) Years ended September 30, 2005 and 2004

### Federal Budgetary Data

The following summarizes the budgetary data related to ARC's Federal appropriations for the year ended September 30:

<b>BUDGETARY RESOURCES</b>	<b>2005</b>	<b>2004</b>
Budget authority – appropriation	\$ 66,000,000	\$ 66,000,000
Net transfers	(26,160,682)	(20,206,551)
Unobligated balance brought forward October 1	8,565,932	6,153,777
Spending authority from offsetting collections	1,027,169	466,209
Recoveries of prior year obligations	3,189,101	2,241,564
Permanently not available	(528,000)	(389,400)
Total budgetary resources	52,093,520	54,265,599
 <b>STATUS OF BUDGETARY RESOURCES</b>		
Obligations incurred	46,202,218	45,697,887
Unobligated balance	5,891,302	8,567,712
Total budgetary resources	\$ 52,093,520	\$ 54,265,599



To the Commission Members  
Appalachian Regional Commission  
Washington, DC

## **Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards**

We have audited the financial statements of the Appalachian Regional Commission as of and for the year ended September 30, 2005, and have issued our report thereon dated October 28, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered ARC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### Compliance

As part of obtaining reasonable assurance about whether ARC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which is described in the accompanying audit finding.



Affiliated Offices Worldwide



# Financial Report

The Commission Members  
Appalachian Regional Commission  
Washington, DC

We noted other matters involving the internal control over financial reporting, which we have reported to the management of ARC in a separate letter dated October 28, 2005.

This report is intended solely for the information and use of the Inspector General, the Commission Members, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*M.D. Oppenheim & Company, P.C.*

Silver Spring, Maryland  
October 28, 2005

## APPALACHIAN REGIONAL COMMISSION Follow-up on Prior Audit Finding

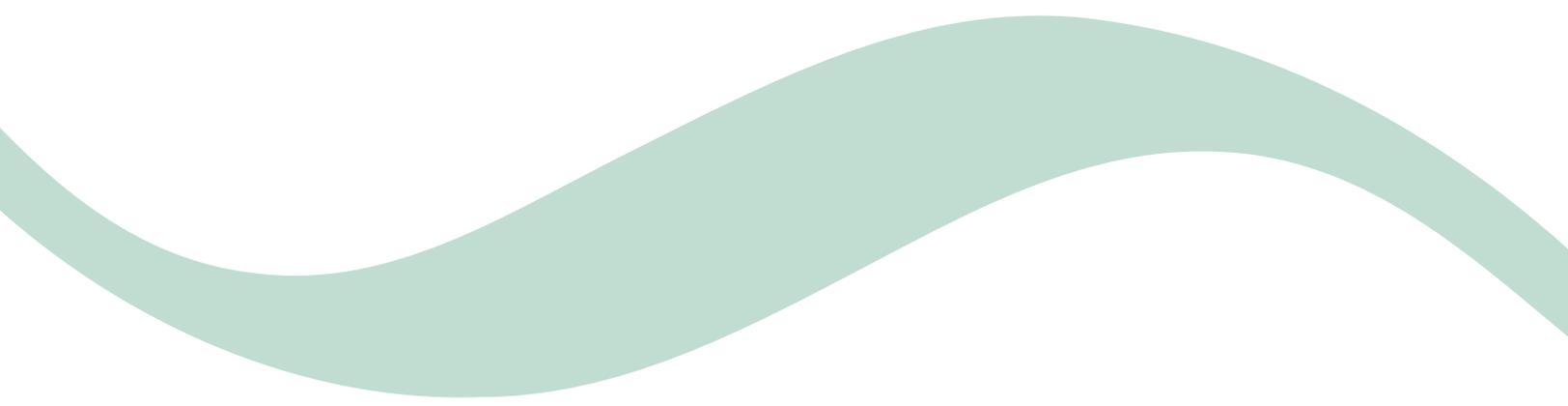
### **Grant Reporting**

*Condition:* During the prior year audit of ARC's grant files, we noted a lack of timely submission of grant progress and final reports. Our FY 2004 testing found that out of the 40 grant files sampled, 24 of the files did not show evidence of timely submission of progress reports and 14 had not received the final reports within the ARC deadline for submission.

*Recommendation:* We recommended ARC develop policies and procedures to effectively monitor grantee compliance with grant reporting requirements and to promptly follow-up with any instances of non-compliance were noted.

*Current Status:* Our current year audit of ARC grant files noted improvement in the submission of progress reports. However, we found that in 7 out of 44 (16%) of the files where the grant period had expired, the final reports were not submitted timely which caused a delay in closing of the grants. Due to the continued late filing of final report submissions, this finding will remain open pending full implementation of the corrective action plan.

**Inspector General  
Summary of Management Challenges**





# Financial Report



*Office of Inspector General*

November 14, 2005

## MEMORANDUM FOR FEDERAL CO-CHAIR POPE

From: Clifford H. Jennings  
Inspector General

Subject: Management and Performance Challenges Facing the  
Appalachian Regional Commission

The Reports Consolidation Act of 2000 requires 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. The challenges remain consistent with the challenges noted from past years.

### **Challenge—Financial Management/ Unobligated Balances**

This ongoing challenge is one of working with federal agencies receiving 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 that may be identified during the conduct of the current financial statement audit. While none of the issues identified previously were severe, they still require diligent follow-up and correction, as needed.

## **Challenge 2—Appalachian Development Highway System**

My office issued a report on the Appalachian Development Highway System (ADHS) (04-08, June 15, 2004). The report recommends further oversight of the ADHS. ARC's, as well as the OIG's, challenge is to work with the various components involved in the ADHS to ensure that the recommended oversight is accomplished. During the time since the issuance of the report, there has been significant progress in the oversight of the ADHS. As the ADHS requires coordination with the U.S. Department of Transportation as well as with the various states, it is imperative ARC continue to take the leadership role in ensuring the desired oversight take place. This will enable ARC to be to assure Congress that the funds provided for the ADHS are being put to their best use.

## **Challenge 3—Grantee and Grant Oversight**

While the Commission generally does a good job managing grants, it needs to continue to improve its oversight of ongoing grants to ensure 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 in learning the requirements of proper business practices. Further, vigilance over grant processes will reduce the incidence of inactive funds remaining allocated to expired grants. There is evidence of progress in this area since this time last year.

## **Challenge 4 - 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.



Clifford H. Jennings  
Inspector General