

*OK
Channing*

MEMO FOR THE RECORD
CPA REVIEW

Date: January 29, 2004

CPA Firm: M.C. Oppenheim & Co. P.C.
8403 Colesville Rd.
Suite 340
Silver Spring, Md.

Contact: Nancy Davis
301.585.7990

Subject: OIG Report 04-06
FY 2003 Financial Statement Audit

Ms. Davis had the workpapers for their audit of ARC's financial statements available. Workpapers were signed off, in order and very neat. The final report in the file had not yet been cross-referenced. I requested a copy of the report and traced the figures to the workpapers, all figures traced in the report agreed with the workpapers.

I obtained a copy of the contractor's conflict of interest statement, current peer review letter, evidence of auditor qualifications, and the management letter.

Our review disclosed no instances where M.D. Oppenheim & Co., P.C. did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Dottie Cupp

Dottie Cupp
Auditor
ARC/OIG

Cupp, Dorothy

From: Jennings, Clifford
Sent: Thursday, January 29, 2004 11:03 AM
To: 'ndavis@mdocpa.com'
Cc: Cupp, Dorothy
Subject: RE: ARC Audit Report

OK.. Dottie will aim to be there at 1pm today.

Thanks

-----Original Message-----

From: Nancy Davis [mailto:ndavis@mdocpa.com]
Sent: Thursday, January 29, 2004 10:51 AM
To: Jennings, Clifford
Subject: RE: ARC Audit Report

That's fine. Dottie should see me directly. The firm uses a second partner review as needed under our quality control process. In this instance, a second review was not deemed necessary. We will provide evidence of auditor qualifications, a conflict of interest statement and current peer review letter to Dottie when she comes. I will also give her another copy of the management letter.

Nancy

December 15, 2003

Appalachian Regional Commission
2003 Financial Statement Audit
Order No. 03P37

Conflict of Interest

M.D. Oppenheim & Company, P.C. warrants that at all times during its service to the Appalachian Regional Commission, there will be no conflict or apparent conflict of interest between the interests of the firm and the interests of the Commission with respect to the firms' duties or responsibilities under its professional standards. We understand that conflicts of interests may involve personal, business or professional activities. This warranty covers the firm and its principals as well as its employees.

Independence

The firm is deeply concerned with the concept of auditors' independence, both in fact and in appearance. We certify that M.D. Oppenheim & Company, P.C. is independent as it regards any audit work performed for the Appalachian Regional Commission. We will continue to ensure that in fact and in appearance, the firm will remain independent as regards the Commission.

Peer Review

The firm has demonstrated its commitment to excellence by accepting the challenge of a Quality review under the American Institute of Certified Public Accountants' Quality Review Program. Since we entered the program fifteen years ago each triennial quality review has resulted in an unqualified opinion being issued upon our operations and systems of quality control. A copy of our current opinion, which is valid through December 2004, is attached.

Qualification of Personnel

The audit team proposed to work on this audit all has extensive experience in auditing federal and nonprofit agencies, grantees and contractors. Additionally, the partner and supervisor have twelve years combined experience providing services to the Appalachian Regional Commission's Office of Inspector General. Nancy E. Davis, Partner, is designated as key personnel for the purpose of this audit. A copy of her resume is attached.

M.D. OPPENHEIM & COMPANY, P.C.



Nancy E. Davis CPA
Partner



Affiliated Offices Worldwide



Lilling & Company LLP

Certified Public Accountants

October 22, 2001

To the Owners
M.D. Oppenheim & Company, P.C.

We have reviewed the system of quality control for the accounting and auditing practice of M.D. Oppenheim & Company, P.C. (the firm) in effect for the year ended June 30, 2001. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (AICPA). The design of the system and compliance with it are the responsibility of the firm. Our responsibility is to express an opinion on the design of the system, and the firm's compliance with the system based on our review.

Our review was conducted in accordance with standards established by the Peer Review Board of the AICPA. In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures to the extent we considered appropriate. These tests covered the application of the firm's policies and procedures on selected engagements. Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the system of quality control for the accounting and auditing practice of M.D. Oppenheim & Company, P.C. in effect for the year ended June 30, 2001, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA and was complied with during the year then ended to provide the firm with reasonable assurance of conforming with professional standards.



LILLING & COMPANY LLP

Résumé

NAME: Nancy Davis CPA, CGFM **POSITION:** Partner

EDUCATION: Bachelor of Science - UNIVERSITY OF CALIFORNIA-DAVIS (Liberal Arts)
Additional Post Graduate Courses in Accounting

PROFESSIONAL STATUS: Certified Public Accountant
Certified Government Financial Manager

CAREER EXPERIENCE: Twelve years of experience in the public accounting profession.
Eleven years in executive internal audit and management positions at a major not-for-profit organization.

AUDITING BACKGROUND: Ms. Davis began her professional career with a well-known, not-for-profit, international educational organization. During her eleven years of employment there, she held numerous financial, managerial and internal audit positions culminating in two and a half years as the organization's Director of State Operations for the State of Ohio. The State Director's position involved responsibility for a multi-million dollar annual budget, planning and directing the educational and programmatic activities of the organization, and responsibility for supervising a large staff. During those eleven years, Ms. Davis gained extensive expertise in handling funding provided by various levels of government.

In 1988, Ms. Davis made a career change and returned to college to qualify her to take the Certified Public Accountant examination. She later joined Williams, Young & Associates (WYA) and became a staff member of M.D. OPPENHEIM & COMPANY, P.C. on our absorption of the Washington, D.C. office of WYA. In 1999 she was elected a Partner of the firm and became the Partner-in-Charge of the firm's office in Silver Spring, Maryland.

Since entering public accounting she has concentrated her efforts on audits of government agencies and not-for-profit organizations. Her governmental assignments have included, among others, audits for the U.S. DEPARTMENT OF LABOR, the PEACE CORPS, the NATIONAL SCIENCE FOUNDATION, THE SECURITIES AND EXCHANGE COMMISSION and the APPALACHIAN REGIONAL COMMISSION.

During the last five years she has served as the Partner for the firm's participation in auditing the financial statements of THE U.S. DEPARTMENT OF LABOR, part of the Congressionally-mandated effort to produce audited financial statements for the entire U.S. government. Most recently in FY2003 Ms. Davis has had specific responsibility for the audit of the Federal Employees' Compensation Act Special Benefit Fund

PROFESSIONAL MEMBERSHIPS: American Institute of Certified Public Accountants
Maryland Association of Certified Public Accountants
Virginia Society of Certified Public Accountants
Association of Government Accountants

M.D. OPPENHEIM & COMPANY, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

8403 Colesville Road, Suite 340
Silver Spring, MD 20910
301.585.7990
FAX 301.585.7975
mdo-md@mdocpa.com www.mdocpa.com

FAX COVER SHEET

TO:	<u>Cliff</u>	DATE:	<u>1/30</u>
FAX #	<u>202-884-7696</u>	TIME:	<u>-</u>
FROM:	<u>Nancy</u>	# OF PAGES (INCLUDING COVER)	<u>5</u>

ADDITIONAL INFORMATION:

Confidentiality Note: The information contained in this facsimile message is privileged and confidential information, intended only for the use of the individual or entity named above. If the reader of the message is not the intended recipient, you are hereby notified that any dissemination, distribution, or copy of this telecopy is strictly prohibited. If you have received this telecopy in error, please immediately notify us by telephone and return the original message to us at the address above via the United States Postal Service. Thank you.



**APPALACHIAN
REGIONAL
COMMISSION** *A Proud Past.
A New Vision*

M.D. Oppenheim & Company, P.C.
8403 Colesville Road
Suite 340
Silver Spring, MD 20910

We are providing this letter in connection with your audit of the balance sheet of the Appalachian Regional Commission (ARC) as of September 30, 2003, and the related statements of operations and changes in net position and cash flows for the year then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of ARC in conformity with accounting principles generally accepted in the United States of America (US GAAP). We confirm that we are responsible for the fair presentation in the financial statements of the financial position, results of operations, and cash flows in conformity with US GAAP. We are also responsible for adopting sound accounting policies, establishing and maintaining internal control, and preventing and detecting fraud.

We confirm to the best of our knowledge and belief, as of January 23, 2004 the following representations made to you during your audit:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America and include all assets and liabilities under the organization's control.
2. We have made available to you all-
 - a. Financial records and related data and all audits and review reports issued by the ARC OIG; and
 - b. Minutes of the meetings of the Appalachian Regional Commission or summaries of actions of recent meetings for which minutes have not been prepared.
3. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
5. There have been no-
 - a. Fraud involving management or employees who have significant roles in internal control.

M.D. Oppenheim & Company, P.C.
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- b. Fraud involving others that could have a material effect on the financial statements.
6. ARC has no plans or intentions that may materially affect the carrying value of classification of assets and liabilities.
7. The following, if any, have been properly recorded or disclosed in the financial statements:
 - a. Related party transactions, including revenues, expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
 - b. Guarantees, whether written or oral, under which ARC is contingently liable.
 - c. Expenses have been appropriately classified in or allocated to functions and programs in the statement of operations, and allocations, if applicable, have been made on a reasonable basis.
 - d. Revenues are appropriately classified in the statement of operations.
 - e. Capital assets are properly capitalized, reported, and, if applicable, depreciated.
8. There are no estimates that may be subject to a material change in the *near term* that have not been properly disclosed in the financial statements. We understand that near term means the period within one year of the date of the financial statements. In addition, we have no knowledge of concentrations existing at the date of the financial statements that make the organization vulnerable to the risk of severe impact that have not been properly disclosed in the financial statements.
9. ARC is an exempt organization under Section 501(c)(3) of the Internal Revenue Code. Any activities, of which we are aware that would jeopardize ARC's tax-exempt status, and all activities subject to tax on unrelated business income or excise tax or other tax, have been disclosed to you. All required filings with tax authorities are up-to-date
10. There are no-
 - a. Violations or possible violations of laws and regulations and provisions of contracts and grant agreements whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

M.D. Oppenheim & Company, P.C.
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- b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No.5, "Accounting for Contingencies."
 - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Financial Accounting Standards No.5.
 - d. Designations of fund balances disclosed to you that were not properly authorized and approved, or reclassifications of fund balances that have not been properly reflected in the financial statements.
11. ARC has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
 12. We are responsible for and have complied with the laws, regulations, and provisions of contracts and grant agreements applicable to us; and we have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that would have a material effect on the financial statements in the event of noncompliance.
 13. No events have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to, or disclosure in, the financial statements.
 14. ARC is not subject to the guidelines and regulations of Office of Management and Budget (OMB) Circular A-133 *Audits of States, Local Governments, and Non-Profit Organizations*.
 15. Management has identified the following compliance requirements:
 - a. Reprogramming of funds; and
 - b. Distribution of funds to recipients.

Non-compliance with these requirements would have a material effect on the financial statements. ARC has complied, in all material respects, with these requirements.
 16. Management has considered the results of grantee audits and, where necessary, adjustments to the Commission's own books and records have been made.
 17. Management has followed applicable laws and regulations in adopting, approving, and amending budgets.

M.D. Oppenheim & Company, P.C.
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18. Management is responsible for establishing and maintaining effective internal control over financial reporting.

19. We will notify you in advance of our intent to print your report, in whole or in part, and you will have the opportunity to review such printed matter before its issuance.



Robert Decker
Director, Finance and Administration Division
Appalachian Regional Commission

Date 1/27/04

To the Commission Members
Appalachian Regional Commission
Washington, D.C.

In planning and performing our audit of the financial statements of the Appalachian Regional Commission (ARC) for the year ended September 30, 2003, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control. However, we noted a certain matter involving the internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily disclose all matters that might be reportable conditions. In addition, because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected by such controls.

Reportable Condition

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.

Other Comments and Recommendations

During our audit, we also became aware of other matters that are opportunities for strengthening internal controls and operating efficiency.

Financial Management System

We noted that the financial records of detailed grants activity is maintained in the Project Information System which is independent of the general ledger. This requires the duplicate entry of financial information in each system, and there are currently no reconciliations performed between the systems to ensure the data is accurately recorded and complete. This duplicate entry increases the risk of errors in the financial information recorded in the general ledger and reduces operating efficiency. We recommend that these two systems be integrated electronically. Grant obligations and payments should be entered into the general ledger and automatically recorded in the Project Information System.

Unrecorded Liabilities

We found nine unpaid grant payment requests totaling \$747,403 that were received by ARC as of the end of the fiscal year but were not properly accrued in the general ledger. Because grantees submit their payment requests directly to ARC program personnel for approval, the Finance and Administration Division was unaware these payment requests had been received by ARC. In addition, when the payments were processed, they were not recorded in the general ledger to the correct fiscal year.

We recommend that the Finance and Administration Division work with program personnel to ensure grant payment requests are approved and submitted timely, especially at the end of the fiscal year. We also recommend that accountability between fiscal years be improved by developing proper cut-off procedures to ensure accrued transactions are recorded in the correct fiscal year.

Commercial Bank Accounts

We noted that bank reconciliations were not performed monthly for ARC's three commercial bank accounts. In addition, no independent review of these accounts is performed by anyone other than accounting personnel. We recommend that management open the bank statements and review them for any unusual checks or other transactions before giving them to accounting to perform the reconciliations. Management's review of the bank statements is necessary to ensure that unusual items are investigated on a timely basis. A cash reconciliation that reconciles from the bank balance to the general ledger balance should be prepared and also reviewed by management to determine that all cash transactions have been recorded properly and to discover bank errors.

We wish to thank Robert Decker, Polly Law, and the ARC staff for their assistance during our audit.

This report is intended solely for the information and use of the Commission, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

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

January 23, 2004

Appalachian Regional Commission

Financial Statements and
Independent Auditors' Report

September 30, 2003

APPALACHIAN REGIONAL COMMISSION

SEPTEMBER 30, 2003

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To the Commission Members
Appalachian Regional Commission
Washington, DC

Independent Auditors' Report

We have audited the accompanying balance sheet of the Appalachian Regional Commission as of September 30, 2003, and the related statement of operations and net position and cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information 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 audit of the basic financial statements, and accordingly, we express no opinion on it.

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

Silver Spring, Maryland
January 23, 2004

APPALACHIAN REGIONAL COMMISSION
Balance Sheet
September 30, 2003

ASSETS

Current assets

Fund balance with Treasury	\$	57,222,347
Cash		59,981

Total cash		57,282,328
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Accounts receivable		400,000
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Business development revolving loan funds		26,510,471
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Advances to grantees		1,042,266
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Total current assets		85,235,065
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Equipment and software (net)		39,292
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TOTAL ASSETS		85,274,357
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LIABILITIES AND NET POSITION

Current liabilities

Accounts payable		2,513,036
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Center for Disease Control and Prevention grants		523,053
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Accrued pension liability		574,422
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Accrued leave		324,639
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Accrued payroll and taxes payable		175,160
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Other accrued liabilities		39,553
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Total current liabilities		4,149,863
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Net position		81,124,494
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TOTAL LIABILITIES AND NET POSITION	\$	85,274,357
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See accompanying notes and Independent Auditors' Report.

APPALACHIAN REGIONAL COMMISSION
Statement of Operations and Changes in Net Position
Year ended September 30, 2003

REVENUES	
Appropriations	\$ 70,826,675
Less: Allocation transfer out	(26,854,510)
Appropriations (net)	43,972,165
Appalachian Development Highway System administrative revenue	612,804
State contributions	2,959,000
Other revenue	418,279
Total revenues	47,962,248
EXPENSES	
Area development grants	34,751,957
Office of the Federal Co-Chair and Inspector General	4,342,780
Commission management and administration	7,040,681
Total expenses	46,135,418
NET INCOME	1,826,830
Net position, beginning of period	79,297,664
NET POSITION, END OF PERIOD	\$ 81,124,494

See accompanying notes and Independent Auditors' Report.

APPALACHIAN REGIONAL COMMISSION
Statement of Cash Flows
Year ended September 30, 2003

Cash flows from operating activities:	
Net income	\$ 1,826,830
Adjustments to reconcile income to net cash provided by operating activities:	
Depreciation	29,980
Changes in assets and liabilities:	
Accounts receivable	(397,414)
Business development revolving loan funds	(22,092)
Advances to grantees	1,894,067
Accounts payable	1,264,349
Center for Disease Control and Prevention grants	123,053
Accrued pension liability	574,422
Accrued leave	(55,589)
Accrued payroll and taxes payable	40,462
Other accrued liabilities	4,290
Net cash provided by operating activities	5,282,358
Net increase in cash	5,282,358
Cash at beginning of year	51,999,970
CASH AT END OF YEAR	\$ 57,282,328
Supplemental disclosures:	
Income taxes paid	\$ 0
Interest paid	\$ 0

See accompanying notes and Independent Auditors' Report.

APPALACHIAN REGIONAL COMMISSION

Notes to Financial Statements

Year ended September 30, 2003

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.

ARC is comprised of a federal member (Federal Co-Chair), appointed by the President, and the governors of each of 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 co-chairmen. ARC personnel are comprised of 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 the management and administration of all projects.
- 2. Reporting Entity** – These financial statements include all of the activities of ARC including the Office of the Federal Co-Chair, Area Development Programs and administrative/operational activities performed by ARC.

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Year ended September 30, 2003

Note B – Summary of Significant Accounting Policies (continued)

3. **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 revenues when they are received.
4. **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.
5. **Fund Balance with Treasury** – Cash receipts and disbursements for operations and the Area Development Programs are processed by the Department of Treasury. Funds held by the Department of Treasury represent funds available for operations.
6. **Cash** – ARC uses commercial bank accounts to accommodate collections and payments that cannot be processed by the Department of Treasury.
7. **Accounts Receivable** – Management considers all receivables to be fully collectible at year-end. Accordingly, no allowance for doubtful accounts has been recorded.
8. **Advances to grantees** – Payments to grantees are recorded as expenses when disbursements are made. Material amounts of unexpended grant funds in the hands of grantees at the end of the fiscal year are reclassified as advances.
9. **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.
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. **Retirement Plans** – ARC federal employees participate in federal retirement plans. ARC non-federal employees participate in the ARC Pension.

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Year ended September 30, 2003

Note B – Summary of Significant Accounting Policies (continued)

12. **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*.
13. **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.
14. **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 Fund (RLF) grants to provide pools of funds 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, 2003:

<u>RLF Funds Obligated</u>	<u>RLF Funds Advanced</u>	<u>RLF Loans Outstanding</u>
<u>\$ 31,322,784</u>	<u>\$ 26,510,471</u>	<u>\$ 31,374,838</u>

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Year ended September 30, 2003

Note D – Equipment and Software

Equipment and software consists of the following at September 30, 2003:

Equipment	\$	69,194
Software		48,422
Subtotal		117,616
Less: Accumulated depreciation		(78,324)
Equipment and software (net)	\$	39,292

Depreciation expense for the year ended September 30, 2003 is \$29,980.

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. In FY 2003, ARC transferred \$ 26,854,510 as follows:

Department of Transportation	\$	473,686
Department of Education		576,805
Economic Development Agency		2,384,540
Department of Energy		(46,811)
Department of Agriculture		15,633,968
Department of Housing and Urban Development		6,893,076
Department of Health & Human Services		939,246
	\$	26,854,510

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 United States Office of Personnel Management (OPM). ARC's 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.

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Year ended September 30, 2003

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

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 2003 were \$45,358 and \$44,809 for CSRS and FERS, respectively.

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 2003 were \$42,437 and \$2,437 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 \$9,987 to the Federal Thrift Savings plan for all eligible employees for the year ended September 30, 2003.

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. Plan information consists of the following:

Benefit obligation at September 30, 2003	\$ (9,927,601)
Fair value of plan assets at September 30, 2003	<u>3,523,136</u>
Funded status	<u>\$ (6,404,465)</u>
Accrued benefit cost recognized in the balance sheet	\$ 574,422

Weighted-average of assumptions as of September 30, 2003

Discount rate	5.25%
Expected return on plan assets	7.50%
Rate of compensation increase	4.08%
Benefit costs	\$ 995,636
Employer contribution	\$ 421,214
Benefits paid	\$ 788,761

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Year ended September 30, 2003

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

ARC also maintains a 401(k) plan covering substantially all non-federal employees. ARC contributed \$134,219 for the year ended September 30, 2003.

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, 2006. Future minimum lease payments required under this lease are as follows:

<u>Year Ended September 30,</u>	<u>Amount</u>
2004	\$ 570,000
2005	570,000
2006	570,000
2007	142,500
Total	\$ <u>1,852,500</u>

Additional Information

APPALACHIAN REGIONAL COMMISSION
Additional Information
Year ended September 30, 2003

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

Congress authorized approximately \$8 billion for the construction of the Appalachian Development Highway System (ADHS) through fiscal year 2003. When it is complete, there will be a 3,025 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 (USDOT) 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 2003:

	Unexpended Authority as of 10/1/2002	FY 2003 Authorizations	FY 2003 Expenditures	Unexpended Authority as of 9/30/2003
DOT Appropriations	\$	\$ 186,778,000	\$	\$ 186,778,000
Highway Trust Fund Obligation Ceiling	815,481,671	433,215,674	(310,239,391)	938,457,954
Total	\$ 815,481,671	\$ 619,993,674	\$ (310,239,391)	\$ 1,125,235,954

Status of budgetary resources as of September 30, 2003:

	Obligated Balance	Unobligated Balance	Total
DOT Appropriations	\$ 38,758,524	\$ 148,019,476	\$ 186,778,000
Highway Trust Fund Obligation Ceiling	540,768,164	397,699,790	938,457,954
	\$ 579,526,688	\$ 545,719,266	\$ 1,125,235,954

APPALACHIAN REGIONAL COMMISSION
Additional Information
Year ended September 30, 2003

Federal Budgetary Data

The following summarizes the budgetary data related to ARC's federal appropriations for the year ended September 30, 2003:

BUDGETARY RESOURCES

Budget authority – appropriation	\$ 71,290,000
Net transfers	(26,854,510)
Unobligated balance brought forward October 1	6,768,028
Spending authority from offsetting collections	1,134,720
Advance received	150,000
Recoveries of prior year obligations	2,278,322
Permanently not available	(463,385)
Total budgetary resources	<u>54,303,175</u>

STATUS OF BUDGETARY RESOURCES

Obligations incurred	\$ 48,149,398
Unobligated balance	<u>6,153,777</u>
Total budgetary resources	<u>\$ 54,303,175</u>