



November 23, 2016

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 17-07
Fiscal Year 2016 Financial Statement Audit

The enclosed report presents the results of the audit of the Commission's financial statements for the fiscal year ended September 30, 2016. 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 (ARC) contracted with the independent certified public accounting firm of Key & Associates, P.C., to audit the financial statements of the Commission as of and for the fiscal year ended September 30, 2016. The contract required that the audit be conducted in accordance with U.S. generally accepted government auditing standards and OMB audit guidance. ARC's Office of Inspector General monitored audit activities to help ensure audit quality.

The following results were noted from Key's audit of ARC's financial statements for the fiscal year ended September 30, 2016.

- Key stated it was their opinion that ARC's financial statements were presented fairly in all material respects, in accordance with U.S. generally accepted accounting principles.
- Key was not contracted for and did not provide an opinion on the effectiveness of ARC's internal controls over financial reporting. However, Key did state that they did not identify any deficiencies in internal control that were considered to be material weaknesses, relative to their expressing an opinion on ARC's financial statements.
- No significant deficiencies were reported.
- Key did not express an opinion on compliance with laws and regulations, but noted no instances of non-compliance with laws or regulations required to be reported under the provisions of OMB audit guidance.

In connection with the contract, we reviewed Key's report and related documentation and inquired of its representatives. Our involvement in the audit process consisted of monitoring of audit activities, reviewing auditor independence and qualifications, attending meetings, participating in discussions, and reviewing audit planning and conclusion workpapers and reports. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on the Appalachian Regional Commission's financial statements, conclusions about the effectiveness of internal control, or conclusions about compliance with laws and regulations. Key is responsible for the attached auditor's report dated November 17, 2016 and the conclusions expressed in the report. However, our review disclosed no instances where Key did not comply, in all material respects, with U.S. generally accepted government auditing standards.



Hubert Sparks
Inspector General

Attachment

cc: Director, Finance and Administration Division
Key & Associates, LLP



Key & Associates, P.C.

November 17, 2016

Mr. Hurbert Sparks, Inspector General
Mr. Earl F. Gohl, Federal Co-Chair
Mr. Scott T. Hamilton, Executive Director
Appalachian Regional Commission
1666 Connecticut Avenue, N.W.
Suite 700
Washington, DC 20009-1068

RE: Final Audited Financial Statements for FY 2016

Dear Mr. Sparks:

Pursuant to our engagement letter dated May 16, 2016, enclosed, please find the final audited financial statements for the Appalachian Regional Commission (ARC) for the year ended September 30, 2016.

Per our audit report, the Commission has received an unqualified report and we have addressed the prior year audit findings in Exhibit -I.

We appreciate the opportunity to work with Mr. Bill Grant and the rest of the staff at ARC. They were extremely responsive in assisting us to provide an efficient and timely audit.

Please contact me at (240) 641-5197 should you have any questions.

Sincerely,

Beatrice P. Key, CPA
Key & Associates, P.C.

Enclosure

W W W . B K E Y C P A . C O M

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FAX 240.641.5199
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8720 GEORGIA AVE, SUITE 800
SILVER SPRING, MD 20910



Key & Associates, P.C.

November 17, 2016

Mr. Hurbert Sparks, Inspector General
Mr. Earl F. Gohl, Federal Co-Chair
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1666 Connecticut Avenue, N.W.
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**APPALACHIAN
REGIONAL
COMMISSION**

APPALACHIAN REGIONAL COMMISSION

FINANCIAL STATEMENTS

As of and For The Years Ended September 30, 2016 and 2015

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Key & Associates, P.C.

INDEPENDENT AUDITOR'S REPORT

To the Federal Co-Chair and the Executive Director
The Appalachian Regional Commission

In accordance with the Accountability of Tax Dollars Act of 2002 and at the request of the Inspector General, we are responsible for conducting the audit of the financial statements of the Appalachian Regional Commission. We have audited the accompanying balance sheet of the Appalachian Regional Commission as of September 30, 2016 and the related statements of net cost, changes in net position, and budgetary resources for the years then ended, and the related notes to the financial statements (hereinafter referred to as "financial statements").

Management's Responsibility for the Financial Statements

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

Auditor's Responsibilities

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the agency's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Appalachian Regional Commission internal control. Accordingly, we do not express such an opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on Financial Statements

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, 2016, and its net costs, changes in net position, and budgetary resources for the years then ended, in accordance with U.S. generally accepted accounting principles.

The financial statements of the Appalachian Regional Commission as of September 30, 2015 were audited by other auditors whose report dated November 16, 2015 expressed an unqualified opinion on those statements.

Other Matters

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis section be presented to supplement the basic financial statements. Such information although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures, to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of Management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Chairperson's message and other information sections of the Appalachian Regional Commission's *Agency Financial Report* are presented for purposes of additional analysis and are 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 do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Appalachian Regional Commission's internal control over the financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion of the effectiveness of the Appalachian Regional Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Appalachian Regional Commission's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by *the Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a significant deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the Responsibility section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Appalachian Regional Commission's financial statements are free from 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, and certain provisions of other laws and regulations specified in OMB bulletin No. 15-02. 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 of compliance disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 15-02.

Purpose of Other Reporting Required by Government Auditing Standards

The purpose of the communication provided in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the agency's internal control or on compliance. Accordingly, this communication is not suitable for any other purpose.

Restriction of Use of the Report on the Financial Statements

This report is intended solely for the information and use of the management and members of the Appalachian Regional Commission, U.S. Department of Treasury, the U.S. Office of Management and Budget, the U.S. Government Accountability Office, and the U.S. Congress in connection with the preparation and audit of the Financial Report of the U.S. Government and is not intended to be and should not be used by anyone other than these specified parties.

Key & Associates, PC

Silver Spring, Maryland
November 10, 2016

The prior year report on internal control over financial reporting and compliance and other matters was presented in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. The internal control weaknesses and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our audit of the Appalachian Regional Commission(ARC's) financial statements as of, and for the year ended, September 30, 2015. This exhibit presents our assessment of the current status of each prior year finding.

Significant Deficiencies from FY 2015 audit:

1. Review of Financial Transactions Needs Improvement

A. Recording and Reviewing of Advances Related to Local Development Districts Grants

On September 11, 2015 ARC made an advance of approximately \$1.8 million to LDD grant recipients. The advance was made for expenditures related to October 1, 2015 through December 31, 2015. Management stated that the advance was made to the LDD grantees earlier than usual due to the uncertainty surrounding the FY 2016 budget process. Management also indicated, as we observed, that payment prior to the beginning of a new fiscal year is not typical.

In recording the disbursement of \$1.8 million to the LDD grant recipients, ARC did not modify its current procedures as it related to advances, given that advance payment prior to the start of a fiscal year is not common practice. Accordingly, as of September 30, 2015, expenses were overstated and advances were understated by \$1.8 million, as the funds pertained to FY 2016 expenditures. Although this matter was identified by management, the misstatement in the financial records was not determined through the standard financial reporting procedures or related internal controls. It should be noted that there was no impact on Fund Balance with Treasury, as a result of the manner in which ARC processed disbursements to the LDD grant recipients.

Key & Associates' Response

We performed extensive testing of internal controls as required as part of a federal financial statement audit. During our audit fieldwork, we re-performed the monthly reconciliations as of March and September 2016 as well as tested the details of sampled obligations from the total population. Our test results did not identify any errors or omissions and therefore, we consider this finding as being cleared.

B. Review of Unexpended Appropriations and Cumulative Results of Operations

During our review of the FY 2015 financial statements, we noted a variance of \$936,000 between the financial statements and ARC's year-end trial balance as it related to Unexpended Appropriations and Cumulative Results of Operations. Specifically, line items of Unexpended Appropriation and Cumulative Results of Operations reflected on the Balance Sheet and the Statement of Changes in Net Position did not agree with the supporting documentation.

Management indicated that an on-top adjustment was posted to the trial balances of ARC and ARC's child agencies at year-end. However, the on-top adjusting entries posted to ARC and the child agency accounts were not included in the supporting schedule of adjusting entries. Therefore, financial statement line items did not materially agree to the supporting documentation. Furthermore, account balances for Unexpended Appropriation and Cumulative Results of Operations were misstated; however, total Net Position was accurately reflected.

Key & Associates' Response

During our audit fieldwork, we observed that management obtained a copy of the reconciliation being performed by the accounting contractor and reviewed the reconciliation as of September 2016. Based on our procedures, management has properly reviewed the reconciliation at year end and therefore, we consider this finding as being cleared.

C. Recording and Reviewing Obligations Related to Grants

During the financial statement audit, ARC discovered a grant in the amount of \$273,000 that was approved in August 2015, but not recorded as an obligation in its accounting system. This resulted in obligations incurred being understated, as well as unexpended appropriations to be misstated. Accordingly, the Balance Sheet and the Statements of Changes in Net Position and the Budgetary Resources included certain lines items that were misstated by the \$273,000.

Upon discovery in November 2015, management immediately notified the auditors and recorded the obligation in its accounting system. However, initially, the grant was recorded as a FY 2016 transaction rather than a FY 2015 obligation. Therefore, an adjustment was necessary to the FY 2015 financial statements, in the amount of \$273,000 to properly reflect obligations incurred.

Key & Associates' Response

During our audit fieldwork, we re-performed the monthly reconciliations as of March and September 2016. Based on our review, management has properly recorded obligations and therefore, we consider this finding as being cleared.

APPALACHIAN REGIONAL COMMISSION

BALANCE SHEETS

As Of September 30, 2016 and 2015

	2016	2015
Assets:		
Intragovernmental:		
Fund Balance With Treasury	(Note 1 & 2) \$ 261,826,010.06	\$ 179,381,387.31
Accounts Receivable	869.42	
Advances and Prepayments	(Note 1 & 3) 3,821,991.49	8,166,738.39
Total Intragovernmental	265,648,870.97	187,548,125.70
Assets With The Public:		
Cash, Foreign Currency and Other Monetary Assets	(Note 1) 1,434,740.66	1,360,382.20
Advances and Prepayments	(Note 1 & 3) 38,807,862.28	41,069,866.54
Total Assets	\$ 305,891,473.91	\$ 229,978,374.44
Liabilities:		
Intragovernmental:		
Other:	(Note 4 & 5)	
Employer Contributions and Payroll Taxes Payable	\$ 23,744.20	\$ 17,080.73
Liability for Advances and Prepayments	803,022.59	646,490.05
Total Intragovernmental	826,766.79	663,570.78
Liabilities With the Public:		
Accounts Payable	(Note 1 & 4) 8,297,296.36	7,481,391.17
Other:	(Note 1, 4 & 5)	
Accrued Funded Payroll and Leave	255,968.34	179,479.43
Employer Contributions and Payroll Taxes Payable	1,805.94	1,246.24
Unfunded Leave	464,188.40	464,188.40
Liability for Advances and Prepayments	392,254.12	186,494.80
Other Liabilities Without Related Budgetary Obligations	1,522,063.45	1,447,704.99
Total Liabilities	\$ 11,760,343.40	\$ 10,424,075.81
Net Position:		
Unexpended Appropriations - All Other Funds		
(Consolidated Totals)	292,154,635.17	217,367,835.29
Cumulative Results of Operations - All Other		
Funds (Consolidated Totals)	1,976,495.34	2,186,463.34
Total Net Position - All Other Funds	294,131,130.51	219,554,298.63
(Consolidated Totals)	294,131,130.51	219,554,298.63
Total Net Position	\$ 305,891,473.91	\$ 229,978,374.44

The accompanying notes are an integral part of these statements.

APPALACHIAN REGIONAL COMMISSION

STATEMENTS OF NET COST

As of and For The Years Ended September 30, 2016 and 2015

	2016	2015
Program Costs:		
ARC:		
Gross Costs	\$ 76,063,512.36	\$ 65,263,214.25
Less: Earned Revenue	4,461,363.00	4,794,697.74
Net Program Costs	71,602,149.36	60,468,516.51
Net Cost of Operations	\$ 71,602,149.36	\$ 60,468,516.51

(Note 8)

The accompanying notes are an integral part of these statements.

APPALACHIAN REGIONAL COMMISSION

STATEMENTS OF CHANGES IN NET POSITION

As of and For The Years Ended September 30, 2016 and 2015

FY 2016 (CY)

	Funds From Dedicated Collections (Consolidated Totals)	All Other Funds (Consolidated Totals)	Eliminations	Consolidated Total
Cumulative Results of Operations:				
Beginning Balances		\$ 2,186,463.34		\$ 2,186,463.34
Beginning balance, as adjusted		2,186,463.34		2,186,463.34
Budgetary Financing Sources:				
Appropriations used		71,213,200.12		71,213,200.12
Other Financing Sources (Non-Exchange):				
Imputed financing		178,981.24		178,981.24
Total Financing Sources		71,392,181.36		71,392,181.36
Net Cost of Operations		71,602,149.36		71,602,149.36
Net Change		(209,968.00)		(209,968.00)
Cumulative Results of Operations		1,976,495.34		1,976,495.34
Unexpended Appropriations:				
Beginning Balance		217,367,835.29		217,367,835.29
Beginning Balance, as adjusted		217,367,835.29		217,367,835.29
Budgetary Financing Sources:				
Appropriations received		146,000,000.00		146,000,000.00
Appropriations used		(71,213,200.12)		(71,213,200.12)
Total Budgetary Financing Sources		74,786,799.88		74,786,799.88
Total Unexpended Appropriations		292,154,635.17		292,154,635.17
Net Position		\$ 294,131,130.51		\$ 294,131,130.51

The accompanying notes are an integral part of these statements.

APPALACHIAN REGIONAL COMMISSION

STATEMENTS OF CHANGES IN NET POSITION
As of and For The Years Ended September 30, 2016 and 2015

FY 2015 (PY)

	Funds From Dedicated Collections (Consolidated Totals)	All Other Funds (Consolidated Totals)	Eliminations	Consolidated Total
Cumulative Results of Operations:				
Beginning Balances		\$ 2,493,959.47		\$ 2,493,959.47
Adjustments:				
Changes in accounting principles		<u>(1,185,774.28)</u>		<u>(1,185,774.28)</u>
Beginning balance, as adjusted		1,308,185.19		1,308,185.19
Budgetary Financing Sources:				
Appropriations used		61,173,868.87		61,173,868.87
Other Financing Sources (Non-Exchange):				
Imputed financing		172,925.79		172,925.79
Total Financing Sources		<u>61,346,794.66</u>		<u>61,346,794.66</u>
Net Cost of Operations		<u>60,468,516.51</u>		<u>60,468,516.51</u>
Net Change		878,278.15		878,278.15
Cumulative Results of Operations		2,186,463.34		2,186,463.34
Unexpended Appropriations:				
Beginning Balance		<u>188,541,704.16</u>		<u>188,541,704.16</u>
Beginning Balance, as adjusted		188,541,704.16		188,541,704.16
Budgetary Financing Sources:				
Appropriations received		90,000,000.00		90,000,000.00
Appropriations used		<u>(61,173,868.87)</u>		<u>(61,173,868.87)</u>
Total Budgetary Financing Sources		<u>28,826,131.13</u>		<u>28,826,131.13</u>
Total Unexpended Appropriations		<u>217,367,835.29</u>		<u>217,367,835.29</u>
Net Position		<u>\$ 219,554,298.63</u>		<u>\$ 219,554,298.63</u>

The accompanying notes are an integral part of these statements.

APPALACHIAN REGIONAL COMMISSION
STATEMENTS OF BUDGETARY RESOURCES

As of and For The Years Ended September 30, 2016 and 2015

	2016 Budgetary	2015 Budgetary
BUDGETARY RESOURCES		
Unobligated balance brought forward, October 1	\$ 25,478,161.75	\$ 37,213,490.38
Unobligated balance brought forward, October 1, adjusted	25,478,161.75	37,213,490.38
Recoveries of prior year unpaid obligations (unobligated balances)	9,074,669.76	10,511,876.68
Unobligated balance from prior year budget authority, net	34,552,831.51	47,725,367.06
Appropriations (discretionary and mandatory)	146,000,000.00	89,719,096.00
Spending authority from offsetting collections	6,433,758.68	4,552,122.60
Total budgetary resources	\$ 186,986,590.19	\$ 141,996,585.66
 STATUS OF BUDGETARY RESOURCES		
Obligations incurred	\$ 123,196,503.75	\$ 116,518,423.91
Apportioned	54,972,214.18	25,478,161.75
Unapportioned	8,817,872.26	
Unobligated balance brought forward, end of year	63,790,086.44	25,478,161.75
Total budgetary resources	\$ 186,986,590.19	\$ 141,996,585.66
 CHANGE IN OBLIGATED BALANCE		
Unpaid obligations, brought forward, October 1 (gross)	\$ 153,208,915.56	\$ 115,824,478.34
Obligations incurred (Note 9)	123,196,503.75	116,518,423.91
Outlays (gross) (-)	(69,788,266.51)	(68,622,110.01)
Recoveries of prior year unpaid obligations (-)	(9,074,669.76)	(10,511,876.68)
Unpaid obligations, end of year	197,542,483.04	153,208,915.56
Change in uncollected pymts, Fed sources	(200,869.42)	
Uncollected pymts, Fed sources, end of year (-)	(200,869.42)	
Obligated balance, start of year (net)	153,208,915.56	115,824,478.34
Obligated balance, end of year (net)	\$ 197,341,613.62	\$ 153,208,915.56
 BUDGET AUTHORITY AND OUTLAYS, NET		
Budget authority, gross (discretionary and mandatory)	\$ 152,433,758.68	\$ 94,271,218.60
Actual offsetting collections (discretionary and mandatory) (-)	(6,232,889.26)	(4,552,122.60)
Change in uncollected payments from Federal Sources (discretionary and mandator	(200,869.42)	
Budget authority, net (discretionary and mandatory)	146,000,000.00	89,719,096.00
Outlays, gross (discretionary and mandatory)	69,788,266.51	68,622,110.01
Actual offsetting collections (discretionary and mandatory) (-)	(6,232,889.26)	(4,552,122.60)
Outlays, net (discretionary and mandatory)	\$ 63,555,377.25	\$ 64,069,987.41
Agency outlays, net (discretionary and mandatory)	\$ 63,555,377.25	\$ 64,069,987.41

The accompanying notes are an integral part of these statements.

Note 1 – Summary of Significant Accounting Policies

Reporting Entity

The Appalachian Regional Commission (ARC) was established under the Appalachian Regional Development Act of 1965, as amended. 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 of the United States, and the governors of each of the 13 states in the Appalachian Region. The state members elect a State Co-Chair from their members. ARC has 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 205,000 square mile region from Southern New York to Northern Mississippi. The ARC programs affect 420 counties located in 13 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.

Fund Accounting Structure

ARC's financial activities are accounted for by utilizing individual funds and fund accounts in reporting to the U.S. Treasury and the Office of Management and Budget (OMB). For financial statement purposes, these funds are classified as other funds, which consist of area development program funds and funding for the Office of the Federal Co-Chair and the Office of Inspector General.

Funds from Dedicated Collections

Statement of Federal Financial Accounting Standards (SFFAS) 43 replaced SFFAS 27 and resulted in a significant change in the definition of what was previously known as "earmarked funding." SFFAS 43 states that funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the government's general revenues.

Budgets and Budgetary Accounting

ARC programs and activities are funded through no-year appropriations and contributions from the 13 states in the Appalachian Region. Federal funds are available without fiscal year limitation and remain available until expended. Because of the no-year status of the funds, unobligated amounts are not returned to the U.S. Treasury.

Basis of Accounting and Presentation

These financial statements present the financial position, net cost of operations, changes in net position, and budgetary resources of ARC in accordance with U.S. generally accepted accounting principles (GAAP) and form and content requirements of OMB Circular A-136 Financial Reporting Requirements. GAAP for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official standard-setting body for the federal government. The financial statements have been prepared from the books and records of ARC, and include the accounts of all funds under the control of the ARC reporting entity.

U.S. generally accepted accounting principles encompass both accrual and budgetary transactions. Under accrual accounting, revenues are recognized when earned, and expenses are recognized when incurred. Budgetary accounting facilitates compliance with legal constraints on, and controls over, the use of federal funds. These financial statements are prepared by ARC pursuant to OMB directives and used to monitor ARC's use of budgetary resources.

Fund Balance with U.S. Treasury

ARC's cash receipts and disbursements are processed by the U.S. Treasury. Funds with U.S. Treasury represent obligated and unobligated no-year funds available to finance allowable current and future expenditures.

Cash in Commercial Institutions

ARC uses commercial bank accounts to accommodate collections and payments that cannot be processed by the U.S. Treasury. Cash in commercial institutions totaled \$1,434,740.66 and \$1,360,382.20 at September 30, 2016 and 2015, respectively.

Advances

ARC advances funds to federal agencies for work performed on its behalf under various reimbursable agreements. These intra-governmental advances are recorded as an asset, which is reduced when actual expenditures or the accrual of unreported expenditures are recorded.

ARC also has advances made to grantees. These are primarily made to non-federal entities operating revolving loan fund payments in order to provide pools of funds to be made available to grantees to create and retain jobs. These advance payments are recorded by ARC as an asset, which is reduced if the revolving fund is terminated.

Equipment

ARC's equipment is recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The capitalization threshold is \$35,000. All equipment was fully depreciated at September 30, 2016 and 2015.

Liabilities

Liabilities represent probable amounts to be paid by ARC as a result of past transactions. Liabilities covered by budgetary or other resources are those for which Congress has appropriated funds or funding is otherwise available to pay amounts due.

Liabilities not covered by budgetary or other resources represent amounts owed in excess of available congressionally appropriated funds or other amounts. The liquidation of liabilities not covered by budgetary or other resources is dependent on future congressional appropriations or other funding.

Accounts Payable

Accounts payable consists of amounts owed to grantees and amounts owed to federal and nonfederal entities for goods and services received by ARC.

Benefits Due and Payable:

Unfunded Annual 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 leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as taken.

Retirement Benefits

ARC's federal and certain non-federal employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). FERS was established by the enactment of Public Law 99-335. Pursuant to this law, FERS and the Social Security and the Thrift Savings Plan program automatically cover most employees hired after December 31, 1983. Employees hired before January 1, 1984 elected to participate in the FERS and Social Security or to remain in CSRS.

All federal and certain non-federal employees are eligible to contribute to the Thrift Savings Plan (TSP). For those employees participating in the FERS, a TSP account is automatically established and ARC makes a mandatory one percent contribution to this account. In addition, ARC makes matching contributions, ranging from one to four percent, for FERS eligible employees who contribute to their TSP accounts. Matching contributions are not made to the TSP accounts established by CSRS employees. FERS employees and certain CSRS reinstatement employees are eligible to participate in the Social Security program after retirement. In these instances, ARC remits the employer's share of the required contribution.

The Office of Personnel Management (OPM) actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicate these factors to ARC. OPM also provides information regarding the full cost of health and life insurance benefits. Reporting amounts such as plan assets, accumulated plan benefits, and related unfunded liabilities, if any, is the responsibility of OPM.

ARC also has a Defined Benefit Pension Plan which was open to all employees not participating in CSRS and FERS. ARC uses an October 1 measurement date for its plan.

In February 2000 ARC established a 401(k) retirement plan that mirrors FERS. The plan covers substantially all non-federal employees. Employees are eligible to participate in and are fully vested in the plan upon employment. ARC's funding policy is to make a 3% contribution of total salary and a matching 3% of the first 50% of the participants' contributions to the plan up to 6% of total salary.

Parent Child Reporting

ARC is a party to allocation transfers with federal agencies as both a transferring (parent) entity and receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority,

appropriations and budget apportionments are derived. ARC allocates funds, as the parent agency, to the U.S. Department of Transportation, Housing and Urban Development, the Rural Development Agency, U.S. Army Corps of Engineers and the Economic Development Agency. Additionally, ARC receives allocation transfers, as the child agency from the U.S. Department of Transportation to cover Appalachian Development Highway System administrative costs.

Net Position

Net position is the residual difference between assets and liabilities and is comprised of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent the amount of unobligated and unexpended budget authority. Unobligated balances are the amount of appropriations or other authority remaining after deducting the cumulative obligations from the amount available for obligation. The cumulative results of operations are the net results of ARC's operations since inception.

Net Cost of Operations

Earned revenues arise from the collection of state contributions and are deducted from the full cost of ARC's major programs to arrive at net program cost. Earned revenues are recognized by ARC to the extent reimbursements are payable from the public, as a result of costs incurred or services performed on the public's behalf.

Budgetary Financing Sources

Budgetary financing sources other than earned revenues provide funding for ARC's net cost of operations and are reported on the Statement of Changes in Net Position. These financing sources include amounts received from Congressional appropriations to support its operations. A financing source is recognized for these appropriated funds received.

Use of Estimates

Management has made certain estimates when reporting assets, liabilities, revenue, and expenses, and in the note disclosures. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Tax Exempt Status

As an instrumentality of the federal government, ARC is exempt from income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government and exempt from sales and use taxes of the District of Columbia.

Note 2 – Fund Balance With Treasury

ARC's fund balance with treasury at September 30 consisted of the following:

A. Fund Balances	2016	2015
Trust Fund	\$ 413,406.00	\$ 413,406.00
Appropriated Funds	261,412,604.06	178,967,981.31
Total Fund Balance with Treasury	<u>261,826,010.06</u>	<u>179,381,387.31</u>
B. Status of Fund Balance with Treasury		
1) Unobligated Balance		
a) Available	54,972,214.18	25,478,161.75
b) Unavailable	8,817,872.26	
2) Obligated Balance not yet Disbursed	197,341,613.62	153,208,915.56
3) Temporary Sequestration	694,310.00	694,310.00
Total	<u>\$ 261,826,010.06</u>	<u>\$ 179,381,387.31</u>

A trust fund was once established to receive, hold, and disburse monies collected to cover the administrative expenses of ARC. This fund has not been used since FY 2014. The balance in the trust fund is the amount sequestered in prior years.

Note 3 – Advances

Advances at September 30 consist of the following:

	2016	2015
1. Intragovernmental		
Advances to the Tennessee Valley Authority	\$ 3,490,307.62	\$ 8,160,054.52
Advances to the Environmental Protection Agency	256,683.87	6,683.87
Advances to the Corps of Engineers	75,000.00	
	<u>3,821,991.49</u>	<u>8,166,738.39</u>
2. Other		
Advances to grantees to finance future program expenditures		
-Revolving Loan Fund	27,861,432.49	28,934,613.97
-Non-Revolving Loan Fund	7,373,497.79	8,487,756.57
Prepaid Pension Expense	3,572,932.00	3,647,496.00
	<u>38,807,862.28</u>	<u>41,069,866.54</u>
Total	<u>\$ 42,629,853.77</u>	<u>\$ 49,236,604.93</u>

Intragovernmental: ARC advances funds to federal agencies for work performed on its behalf under various reimbursable agreements for construction projects. These intra-governmental advances are recorded as an asset, which is reduced when actual expenditures or the accrual of unreported expenditures are recorded.

Other: ARC also has advances made to grantees that are not federal entities. The majority of these advances are disbursed to grantees operating revolving loan funds, the remaining amounts are to all other grantees.

- Revolving Loan Fund Grantees - ARC provides grants to revolving loan funds operating in its region for the purpose of saving and creating private-sector jobs. Because of the revolving nature of the funds, the grants have no fixed end date. Grant funds provided to revolving loan funds retain their federal identity and are subject to the Cash Management Improvement Act of 1990 (Public Law 101-453), for which the Appalachian Regional Commission has established a policy on excess cash. Accounting treatment of RLF transactions is that cash outlays are recorded as increases to SGL 1410 Advances and Prepayments and refunds of excess cash are recorded as decreases to SGL 1410 Advances and Prepayments.
- Non-Revolving Loan Fund Grantees – ARC advances funds to non-federal grantees for work performed on its behalf under various grant agreements. These advances are recorded as an asset, which is reduced when actual expenditures or the accrual of unreported expenditures are recorded.

Note 4 – Liabilities Not Covered by Budgetary Resources

The accrued liabilities of ARC are comprised of program expense accruals, payroll accruals and unfunded annual leave earned by employees. Program expense accruals represent expenses that were incurred prior to year-end but were not paid. Similarly, payroll accruals represent payroll expenses that were incurred prior to year-end but were not paid.

Appalachian Regional Commission
Notes to Financial Statements
September 30, 2016 and 2015

Liabilities at September 30, 2016 and 2015 consist of the following:

	<u>2016</u>	<u>2015</u>
With the Public		
Unfunded annual leave	\$464,188.40	\$464,188.40
Total liabilities not covered by budgetary resources	<u>464,188.40</u>	<u>464,188.40</u>
<u>Advances</u>		
Advances from Centers for Disease Control	773,022.59	646,490.05
Advances from the National Endowment for the Arts	30,000.00	
Advances from Non Federal Vendors	392,254.12	186,494.80
Total Advances	<u>1,195,276.71</u>	<u>832,984.85</u>
<u>Benefits Due</u>		
Accrued health and flexible spending benefits	87,322.79	87,322.79
Accrued salaries and benefits	281,518.48	197,806.40
Total benefits due	<u>368,841.27</u>	<u>285,129.19</u>
Payments Due to grantees to finance program expenditure	8,297,296.36	7,481,391.17
Commercial Bank Balance	<u>1,434,740.66</u>	<u>1,360,382.20</u>
Total liabilities covered by budgetary resources	<u>11,296,155.00</u>	<u>9,959,887.41</u>
Total Liabilities	<u><u>\$11,760,343.40</u></u>	<u><u>\$10,424,075.81</u></u>

Note 5 – Other Liabilities

As of September 30, 2016, other liabilities with the public consist of Accrued Funded Payroll and Leave of \$464,188.40; Employer Contribution and Taxes Payable of \$1,805.94; Benefits Due and Payable of \$255,968.34; Advances from Non Federal Sources of \$392,254.12; and Accrued Health and Flexible Spending Benefits of \$87,322.79 and Commercial Bank Balance of \$1,434,740.66. Other Liabilities Federal consists of Advances from Other – Federal in the amount of \$803,022.59; and Employer Contributions and Taxes Payable of \$23,744.20.

As of September 30, 2015, other liabilities with the public consist of Accrued Funded Payroll and Leave of \$464,188.40; Employer Contribution and Taxes Payable of \$1,246.24; Benefits Due and Payable of \$179,479.43; Advances from Non Federal Sources of \$186,494.80; and Accrued Health and Flexible Spending Benefits of \$87,322.79 and Commercial Bank Balance of \$1,360,382.20. Other Liabilities Federal consists of Advances from Other – Federal in the amount of \$646,490.05; and Employer Contributions and Taxes Payable of \$17,080.73.

Appalachian Regional Commission
Notes to Financial Statements
September 30, 2016 and 2015

	<u>With the Public</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
2016	Other Liabilities	2,378,505.97	257,774.28	\$ 2,636,280.25
2015	Other Liabilities	2,098,388.19	180,725.67	\$ 2,279,113.86
	<u>Intragovernmental</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
2016	Other Liabilities	803,022.59	23,744.20	\$ 826,766.79
2015	Other Liabilities	646,490.05	17,080.73	\$ 663,570.78

Note 6 – Retirement 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 OPM. ARC's contributions to these plans for FY 2016 were \$5,472 and \$136,313 for CSRS and FERS, respectively and contributions for FY 2015 were \$5,244 and \$114,304 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 a portion of the cost of current employees. Post-retirement benefits are paid by OPM. ARC's contributions to these plans for FY 2016 were \$43,757 and \$783 and for FY 2015 were \$43,757 and \$783 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 \$32,601 and \$39,981 to the Federal Thrift Savings plan for all eligible employees for the years ended September 30, 2016 and 2015, respectively.

Non-Federal

The following table presents the pension benefit expense for the defined benefit pension plan by component for fiscal years 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Service cost	\$701,404.00	\$ 745,859.00
Interest cost	1,004,440.00	904,837.00
Expected return	(1,509,109.00)	(1,462,247.00)
Amortization of prior service cost	415,646.00	415,646.00
Recognized loss	307,643.00	49,412.00
Net periodic benefit cost	<u>\$ 920,024.00</u>	<u>\$ 653,507.00</u>