



December 5, 2012

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 13-01
Fiscal Year 2012 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, 2012. 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 Martin & Wall, which became a division of Chortek & Gottschalk, LLP (C&G), to audit the financial statements of the Commission as of and for the fiscal year ended September 30, 2012. 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 C&G's audit of ARC's financial statements for the fiscal year ended September 30, 2012.

- C&G 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.
- C&G was not contracted for and did not provide an opinion on the effectiveness of ARC's internal controls over financial reporting. However, C&G 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.
- C&G did not express an opinion on compliance and other matters, but noted no instances of non-compliance required to be reported under the provisions of OMB audit guidance.

In connection with the contract, we reviewed Chortek & Gottschalk's report and related documentation and inquired of its representatives. Our involvement in the audit process consisted of monitoring of audit activities, reviewing organization and auditor independence and qualifications, attending meetings, participating in discussions, and reviewing audit planning and conclusion

workpapers and reports as deemed appropriate. 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. Chortek & Gottschalk is responsible for the attached auditor's report dated November 21, 2012 and the conclusions expressed in the report. However, our review disclosed no instances where Chortek & Gottschalk 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
Chortek & Gottschalk, LLP



**APPALACHIAN
REGIONAL
COMMISSION**

APPALACHIAN REGIONAL COMMISSION

FINANCIAL STATEMENTS

For The Years Ended September 30, 2012 and 2011

APPALACHIAN REGIONAL COMMISSION

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Independent Auditor's Report

Inspector General, Commission Members, and Executive Director
Appalachian Regional Commission
Washington, DC

In accordance with the Accountability of Tax Dollars Act of 2002, we are responsible for conducting audits of the Appalachian Regional Commission (ARC). We have audited the accompanying balance sheets of the Appalachian Regional Commission as of September 30, 2012 and 2011 and the related statements of net cost, changes in net position, and budgetary resources for the years then ended.

The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered the Appalachian Regional Commission's internal control over financial reporting and tested the Appalachian Regional Commission's compliance with selected provisions of applicable laws and regulations that could have a direct and material effect on these financial statements.

Summary

In our audits of the Appalachian Regional Commission for the fiscal years ended September 30, 2012 and 2011, we found:

- the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- no material weaknesses in internal control over financial reporting (including safeguarding assets);
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss our opinion on the Commission's financial statements; our consideration of the Commission's internal controls over financial reporting; our tests of the Commission's compliance with certain provisions of applicable laws; regulations, contracts and grant agreements; and management's and our responsibilities.

Opinion on Financial Statements

We have audited the accompanying balance sheets of the Appalachian Regional Commission as of September 30, 2012 and 2011, and the related statements of net cost, changes in net position, and budgetary resources for the years then ended.



In our opinion, the financial statements referred to above, including the accompanying notes, present fairly, in all material respects, the financial position of the Appalachian Regional Commission, as of September 30, 2012 and 2011, and its net costs, changes in net position, and budgetary resources for the years then ended, in conformity with U.S. generally accepted accounting principles.

The information in the Management's Discussion and Analysis section and required supplementary stewardship information is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Circular A-136, *Financial Reporting Requirements, revised*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and the presentation of the supplementary information and analysis of the consistency with the financial statements. However, we did not audit the information and express no opinion on it. The Performance and Accountability Report, except for Management's Discussion and Analysis, is presented for the 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.

Internal Control Over Financial Reporting

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 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, fraud, or noncompliance in amounts that would be material to the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the Responsibilities section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2012 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses or significant deficiencies, as defined above.

Compliance and Other Matters

The results of our tests of compliance as described in the Responsibilities section of this report disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.



Responsibilities

Management Responsibilities: Appalachian Regional Commission's management is responsible for (1) preparing the financial statements in conformity with U.S. generally accepted accounting principles, (2) establishing and maintaining effective internal control, (3) complying with laws, regulations, contracts and agreements applicable to the Commission.

Auditor's Responsibilities: Our responsibility is to express an opinion on the fiscal years 2012 and 2011 financial statements of the Appalachian Regional Commission based on our audits.

We conducted our audits 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 OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin 07-04, as amended, 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 consideration of internal control over financial reporting as a basis for designing 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's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management;
- Evaluating the overall financial statement presentation;
- Obtaining an understanding of the entity and its operations, including its internal control related to financial reporting (including safeguarding assets), and compliance with laws and regulations (including execution of transactions in accordance with budget authority);
- Considering the design of the process for evaluating and reporting on internal control;
- Testing compliance with selected provisions of laws, regulations, contracts and agreements applicable to the Commission that could have a direct and material effect on the financial statements.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal years 2012 and 2011 audits, we considered the Appalachian Regional Commission's internal control over financial reporting by obtaining an understanding of the Commission's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

As part of obtaining reasonable assurance about whether the Appalachian Regional Commission's fiscal years 2012 and 2011 financial statements are free of material misstatement, we performed tests of the Commission's compliance with certain provisions of laws, regulations, contracts and 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. 07-04, as amended. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts and grant agreements applicable to the Commission. However, providing an opinion on compliance with laws, regulations, contracts and agreements was not an objective of our audits, and accordingly, we do not express such an opinion. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

Agency Comments and Our Evaluation

In commenting on a draft of this report (see Appendix A), the Appalachian Regional Commission concurred with the facts and conclusions in our report.

Use and Distribution of Report

This report is intended solely for the information and use of the Appalachian Regional Commission's management and Commission members, the U.S. Office of Management and Budget, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Chortof + Gattabule, LLP

Washington, DC
November 21, 2012

APPALACHIAN REGIONAL COMMISSION

BALANCE SHEETS

As Of September 30, 2012 and 2011

		2012	2011
Assets:			
Intragovernmental:			
Fund Balance With Treasury	(Notes 1 & 2)	\$ 152,811,656	\$ 167,528,946
Advances	(Notes 1 & 3)	12,607,359	9,343,287
Total Intragovernmental		165,419,015	176,872,233
With the Public:			
Cash in commercial institutions	(Note 1)	67,799	60,136
Accounts Receivable, net	(Notes 1 & 4)	-	1,022,750
Advances	(Notes 1 & 3)	33,702,901	31,296,826
Total Assets		\$ 199,189,714	\$ 209,251,946
 Liabilities:			
(Note 5)			
Intragovernmental:			
Accounts Payable	(Notes 1 & 5)	\$ 25,000	\$ -
Other	(Notes 5 & 6)	221,275	202,720
Total Intragovernmental		246,275	202,720
With The Public:			
Accounts Payable	(Notes 1 & 5)	7,703,108	6,540,853
Other	(Notes 1, 5 & 6)	944,346	1,651,997
Total Liabilities		8,893,729	8,395,569
 Net Position:			
Unexpended Appropriations - Other Funds		187,638,756	199,772,812
Cumulative Results of Operations - Earmarked Funds	(Note 9)	2,816,477	1,247,394
Cumulative Results of Operations - Other Funds		(159,249)	(163,828)
Total Net Position		190,295,985	200,856,378
 Total Liabilities and Net Position		\$ 199,189,714	\$ 209,251,946

*Amounts may be off by a dollar due to rounding.

APPALACHIAN REGIONAL COMMISSION
STATEMENTS OF NET COST
For The Years Ended September 30, 2012 and 2011

	2012	2011
Program Costs:		
Program A:		
Gross Costs	(Note 10) \$ 83,140,254	\$ 82,927,382
Less: Earned Revenue	4,295,030	4,137,540
Net Program Costs	78,845,224	78,789,842
Net Cost of Operations	\$ 78,845,224	\$ 78,789,842

*Amounts may be off by a dollar due to rounding.

APPALACHIAN REGIONAL COMMISSION
STATEMENTS OF CHANGES IN NET POSITION
For The Years Ended September 30, 2012 and 2011

2012				
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations:				
Beginning Balances	\$ 1,247,394	\$ (163,828)	\$ -	\$ 1,083,565
Adjustments:				
(a) Corrections of Errors (+/-)	-	(26,057)	-	(26,057)
Beginning Balances, as Adjusted	1,247,394	(189,885)	-	1,057,508
Budgetary Financing Sources:				
Appropriations Used	-	80,423,113	-	80,423,113
Transfers-In/Out Without Reimbursement	4,106,500	(4,106,500)	-	-
Other Financing Resources (Non-Exchange):				
Imputed Financing	-	21,831	-	21,831
Total Financing Sources	4,106,500	76,338,444	-	80,444,944
Net Cost of Operations (+/-)	2,537,416	76,307,808	-	78,845,224
Net Change	1,569,084	30,636	-	1,599,720
Cumulative Results of Operations	\$ 2,816,477	\$ (159,249)	\$ -	\$ 2,657,228
Unexpended Appropriations:				
Beginning Balances	\$ -	\$ 199,772,812	\$ -	\$ 199,772,812
Adjustments:				
(a) Corrections of Errors (+/-)	-	26,057	-	26,057
Beginning Balances, as Adjusted	-	199,798,869	-	199,798,869
Budgetary Financing Sources:				
Appropriations Received	-	68,263,000	-	68,263,000
Appropriations Used	-	(80,423,113)	-	(80,423,113)
Total Budgetary Financing Sources	-	(12,160,113)	-	(12,160,113)
Total Unexpended Appropriations	-	187,638,756	-	187,638,756
Net Position	\$ 2,816,477	\$ 187,479,507	\$ -	\$ 190,295,985

*Amounts may be off by a dollar due to rounding.

APPALACHIAN REGIONAL COMMISSION
STATEMENTS OF CHANGES IN NET POSITION
For The Years Ended September 30, 2012 and 2011

	2011			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations:				
Beginning Balances	\$ 843,602	\$ (220,109)	\$ -	\$ 623,493
Budgetary Financing Sources:				
Appropriations Used	-	79,177,174	-	79,177,174
Transfers-In/Out Without Reimbursement	4,091,000	(4,091,000)	-	-
Other Financing Resources (Non-Exchange):				
Imputed Financing	-	72,740	-	72,740
Total Financing Sources	4,091,000	75,158,915	-	79,249,915
Net Cost of Operations (+/-)	3,687,208	75,102,634	-	78,789,842
Net Change	403,792	56,280	-	460,072
Cumulative Results of Operations	<u>\$ 1,247,394</u>	<u>\$ (163,828)</u>	<u>\$ -</u>	<u>\$ 1,083,565</u>
Unexpended Appropriations:				
Beginning Balances	\$ -	\$ 210,686,787	\$ -	\$ 210,686,787
Budgetary Financing Sources:				
Appropriations Received	-	68,400,000	-	68,400,000
Other Adjustments	-	(136,800)	-	(136,800)
Appropriations Used	-	(79,177,174)	-	(79,177,174)
Total Budgetary Financing Sources	-	(10,913,974)	-	(10,913,974)
Total Unexpended Appropriations	-	199,772,812	-	199,772,812
Net Position	<u>\$ 1,247,394</u>	<u>\$ 199,608,984</u>	<u>\$ -</u>	<u>\$ 200,856,378</u>

*Amounts may be off by a dollar due to rounding.

APPALACHIAN REGIONAL COMMISSION
STATEMENTS OF BUDGETARY RESOURCES
For The Years Ended September 30, 2012 and 2011

	2012	2011
BUDGETARY RESOURCES		
Unobligated balance brought forward, October 1	\$ 19,908,520	\$ 27,765,799
Recoveries of prior year unpaid obligations (unobligated balances)	9,535,756	6,262,853
Unobligated balance from prior year budget authority, net	29,444,276	34,028,652
Appropriations (discretionary and mandatory)	77,565,555	75,422,450
Spending authority from offsetting collections	1,047,537	400,591
Total budgetary resources	\$ 108,057,368	\$ 109,851,693
STATUS OF BUDGETARY RESOURCES		
Obligations incurred	(Note 12) \$ 85,309,253	\$ 89,943,174
Apportioned	20,327,295	18,723,271
Exempt from apportionment	2,162,548	927,545
Unapportioned	258,271	257,703
Unobligated balance brought forward, end of year	22,748,114	19,908,520
Total budgetary resources	\$ 108,057,368	\$ 109,851,693
CHANGE IN OBLIGATED BALANCE		
Unpaid obligations, brought forward, October 1 (gross)	\$ 147,606,819	\$ 140,686,735
Obligation incurred	85,309,253	89,943,174
Outlays (gross) (-)	(93,316,774)	(76,760,237)
Recoveries of prior year unpaid obligations (-)	9,535,756	6,262,853
Unpaid obligations, end of year (gross)	(Note 13) 130,063,541	147,606,819
Obligated balance, end of year (net)	\$ 130,063,541	\$ 147,606,819
BUDGET AUTHORITY AND OUTLAYS, NET		
Budget authority, gross (discretionary and mandatory)	\$ 78,613,092	\$ 75,823,041
Actual offsetting collections (discretionary and mandatory) (-)	(1,047,537)	(400,591)
Budget authority, net (discretionary and mandatory)	77,565,555	75,422,450
Outlays, gross (discretionary and mandatory)	93,316,774	76,760,237
Actual offsetting collections (discretionary and mandatory) (-)	(1,047,537)	(400,591)
Outlays, net (discretionary and mandatory)	92,269,237	76,359,646
Distributed offsetting receipts (-)	4,106,500	4,091,000
Agency outlays, net (discretionary and mandatory)	\$ 88,162,737	\$ 72,268,646

*Amounts may be off by a dollar due to rounding.

APPALACHIAN REGIONAL COMMISSION

NOTES TO FINANCIAL STATEMENTS – SEPTEMBER 30, 2012 AND 2011

NOTE 1 – 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. For financial statement purposes, these funds are classified as an earmarked fund and all other funds. Earmarked funds are financed by specifically identified revenues 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. ARC's earmarked fund and all other funds are identified as follows:

Earmarked Fund

A trust fund was established by the U.S. Treasury under the authority of the Appalachian Regional Development Act of 1965, to receive, hold, invest, and disburse monies collected to cover the administrative expenses of ARC excluding Federal Co-Chair's office and Inspector General's office. These trust fund administrative expenses are paid equally by the federal government and the ARC states as determined annually by the Commission members.

All Other Funds

All other funds consist of area development program funds and funding for the Office of the Federal Co-Chair and the Office of Inspector General.

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 \$67,799 and \$60,136 at September 30, 2012 and 2011, respectively.

Advances

ARC advances funds to other 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 primarily include revolving loan fund payments 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, 2012 and 2011.

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 other 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, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
A. Fund Balances		
Trust Fund	\$ 2,644,633	\$ 1,572,117
Appropriated Funds	<u>150,167,023</u>	<u>165,943,221</u>
Total Entity Fund Balance with Treasury	152,811,656	167,515,338
Non-Entity Fund Balance with Treasury	-	13,608
Total Fund Balance with Treasury	<u><u>152,811,656</u></u>	<u><u>167,528,946</u></u>
B. Status of Fund Balance with Treasury		
1) Unobligated Balance		
a) Available	22,489,843	19,650,816
b) Unavailable	258,271	257,703
2) Obligated Balance not yet Disbursed	130,063,541	147,606,819
3) Non-Budgetary	-	13,608
Total	<u><u>\$ 152,811,656</u></u> *	<u><u>\$ 167,528,946</u></u>

*Rounding

NOTE 3 – ADVANCES

Advances at September 30, 2012 and 2011 consist of the following:

	<u>2012</u>	<u>2011</u>
1. Intragovernmental		
Advances to the U.S. Army Corps of Engineers	\$ 59,387	\$ 298,752
Advances to the Tennessee Valley Authority	12,480,353	9,044,535
Advances to the Environmental Protection Agency	67,619	-
	<u>12,607,359</u>	<u>9,343,287</u>
2. Other		
Advances to grantees to finance future program expenditures		
-Revolving Loan Fund	27,752,792	27,221,652
-Non-Revolving Loan Fund	5,082,909	4,075,174
Prepaid Pension Expense	867,200	-
	<u>33,702,901</u>	<u>31,296,826</u>
Total	<u>\$ 46,310,260</u>	<u>\$ 40,640,113</u>

Intragovernmental: ARC advances funds to other 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 RFL 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 – ACCOUNTS RECEIVABLE

The line item represents the gross amount of monies owed to ARC. The receivable of \$1,022,750 in FY2011 is monies owed by the States. This amount represents the fourth quarter contribution to the Trust Fund which was fully paid in October 2011.

	<u>FY 2012</u>	<u>FY 2011</u>
Accounts Receivable	\$ -	\$ 1,022,750

NOTE 5 – 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.

Liabilities at September 30, 2012 and 2011 consist of the following:

	<u>2012</u>	<u>2011</u>
With the Public		
Unfunded annual leave	\$ 452,794	\$ 506,448
Unfunded pension liability	-	659,117
Intragovernmental		
Liability for Deposit Funds	-	1,128
Total liabilities not covered by budgetary resources	<u>452,794</u>	<u>1,166,692</u>
<u>Advances</u>		
Advances from Centers for Disease Control	163,275	142,500
Advances from the National Endowment for the Arts	30,000	30,000
Total Advances	<u>193,275</u>	<u>172,500</u>
<u>Benefits Due</u>		
Accrued health and flexible spending benefits	87,323	87,323
Accrued salaries and benefits	364,431	368,064
Total benefits due	<u>451,754</u>	<u>455,387</u>
Intragovernmental Accounts Payable	25,000	
Payments Due to grantees to finance program expenditures	7,703,108	6,540,853
Commercial Bank Balance	67,799	60,136
Total liabilities covered by budgetary resources	<u>8,440,936</u>	<u>7,228,876</u>
Total Liabilities	<u>\$ 8,893,729 *</u>	<u>\$ 8,395,569</u>

*Rounding

NOTE 6 – OTHER LIABILITIES

As of September 30, 2012, other liabilities with the public consist of Accrued Funded Payroll and Leave of \$334,558; Employer Contribution and Taxes Payable of \$1,873; Benefits Due and Payable of \$452,794; and Accrued Health and Flexible Spending Benefits of \$87,323 and Commercial Bank Balance of \$67,799. Other Liabilities Federal consists of Advances from Other – Federal in the amount of \$193,275; and Employer Contributions and Taxes Payable of \$28,000.

As of September 30, 2011, other liabilities with the public consist of Accrued Funded Payroll and Leave of \$336,580; Employer Contribution and Taxes Payable of \$2,393; and Benefits Due and Payable of \$1,313,024. Other Liabilities Federal consists of Advances from Other – Federal in the amount of \$172,500; and Employer Contributions and Taxes Payable of \$30,220.

	<u>With the Public</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
2012	Other Liabilities	\$ 607,915 *	\$ 336,431	\$ 944,346
2011	Other Liabilities	\$ 1,313,024	\$ 338,973	\$ 1,651,997
	<u>Intragovernmental</u>	<u>Non-Current</u>	<u>Current</u>	<u>Total</u>
2012	Other Liabilities	\$ 193,275	\$ 28,000	\$ 221,275
2011	Other Liabilities	\$ 172,500	\$ 30,220	\$ 202,720

*Rounding

NOTE 7 – 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 2012 were \$9,515 and \$94,159 for CSRS and FERS, respectively and contributions for FY 2011 were \$16,429 and \$91,724 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 2012 were \$43,728 and \$1,033 and for FY 2011 were \$50,425 and \$1,246 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 \$35,754 and \$37,087 to the Federal Thrift Savings plan for all eligible employees for the years ended September 30, 2012 and 2011, respectively.

Non-Federal

The following table presents the pension benefit expense for the defined benefit pension plan by component for fiscal years 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Service cost	\$ 722,661	\$ 697,334
Interest cost	843,130	812,277
Expected return	(903,104)	(733,140)
Amortization of prior service cost	-	414,676
Recognized loss	248,985	335,340
Net periodic benefit cost	<u>\$ 911,672</u>	<u>\$ 1,526,487</u>

The following table presents the pension liability or prepayment by component for fiscal years 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Pension liability at October 1	\$ 659,117	\$ 870,581
Net periodic benefit expense	911,673	1,526,487
Contributions	(2,437,990)	(1,737,951)
Pension (Prepayment) / Liability at September 30	<u>\$ (867,200)</u>	<u>\$ 659,117</u>

	<u>2012</u>	<u>2011</u>
<u>Additional Information</u>		
Benefit obligation	\$ (20,871,386)	\$ (16,333,674)
Fair value of plan assets	14,727,373	11,357,236
Funded status	(6,144,013)	(4,976,438)
Employer contribution	2,408,350	1,710,447
Participant contribution	29,640	27,504
Benefits paid	239,252	236,063
Net periodic benefit expense	911,672	1,526,487

The accumulated benefit obligation was \$18,593,072 and \$14,503,027 at September 30, 2012 and 2011, respectively.

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

	<u>2012</u>	<u>2011</u>
Discount rate	3.85%	5.20%
Rate of compensation increase	3.00%	3.00%

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

	<u>2012</u>	<u>2011</u>
Discount rate	3.85%	5.20%
Expected return on plan assets	7.25%	7.25%
Rate of compensation increase	3.00%	3.00%

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, 2012 and 2011 are as follows:

<u>Asset Category</u>	<u>2012</u>	<u>2011</u>
Cash	0.22%	73.49%
Debt securities	45.63%	8.54%
Equity securities	46.07%	16.98%
Other	8.08%	0.99%
Total assets	<u>100.00%</u>	<u>100.00%</u>

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

<u>Fiscal Year</u>	<u>Amount</u>
2013	\$ 7,493,947
2014	2,909,164
2015	1,969,421
2016	181,905
2017	1,977,565
Years 2018-2022	4,779,543
	<u>\$ 19,311,545</u>

ARC contributed \$220,326 and \$220,700 to the 401(k) plan for the years ended September 30, 2012 and 2011, respectively.

NOTE 8 – OPERATING LEASE

ARC's lease for its office commenced on January 1, 2007 and extends through December 31, 2016. The future minimum lease payments required under this lease are as follows:

Fiscal Year	Amount
2013	\$ 847,426
2014	864,375
2015	881,662
2016	899,325
2017	225,902
Total	<u>\$ 3,718,690</u>

Rent expense for the years ended September 30, 2012 and 2011 was \$837,308 and \$764,960, respectively.

NOTE 9 – EARMARKED FUND

Earmarked funds are funds that are financed by specifically identified revenues, 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 or purposes, and must be accounted for separately from the federal government's general revenues, per Statement of Federal Financial Accounting Standard (SFFAS) 27, *Identifying and Reporting Earmarked Funds*.

The source of earmarked funds is the federal contribution for half of the administrative costs of ARC except those of the Office of the Federal Co-Chair and the Office of the Inspector General, which are solely funded by the Federal Government. The funds are deposited into a Trust Fund (TAFS 46X8090), established by the U.S. Treasury under the authority of the Appalachian Regional Development Act of 1965, to receive, hold, invest, and disburse monies collected to cover the administrative expenses of ARC. The 13 member states also contribute for half of the administrative costs of ARC, which are recorded as earned revenues on the Statement of Net Cost, but not as an earmark.

Condensed financial information for the ARC trust fund for the years ended September 30, 2012 and 2011 is as follows:

	2012	2011
Balance Sheets		
ASSETS		
Fund Balance with Treasury	\$ 2,644,633	\$ 1,572,117
Cash in Commercial Institutions	67,799	60,136
Accounts Receivable	-	1,022,750
Other Assets	867,200	-
Total Assets	<u>\$ 3,579,631</u> *	<u>\$ 2,655,004</u> *
LIABILITIES AND NET POSITION		
Intragovernmental		
Other Liabilities	\$ 18,902	\$ 16,963
Total Intragovernmental	18,902	16,963
With the Public		
Accounts Payable	29,607	21,182
Other Liabilities	265,979	258,806
Benefits Due and Payable	448,666	1,110,659
Total With the Public	744,252	1,390,647
Total Liabilities	<u>763,154</u>	<u>1,407,610</u>
Cumulative Results of Operations	2,816,477	1,247,394
Total Net Position	2,816,477	1,247,394
Total Liabilities and Net Position	<u>\$ 3,579,631</u>	<u>\$ 2,655,004</u>
Statements of Net Cost		
Gross Program Costs	\$ 6,710,721	\$ 7,778,208
Less Earned Revenues	4,173,305	4,091,000
Net Program Costs	2,537,416	3,687,208
Net Cost of Operations	<u>\$ 2,537,416</u>	<u>\$ 3,687,208</u>
Statements of Changes in Net Position		
Net Position Beginning of Period	\$ 1,247,394	\$ 843,602
Transfers In/Out Without Reimbursement	4,106,500	4,091,000
Total Financing Sources	4,106,500	4,091,000
Net Cost of Operations	2,537,416	3,687,208
Net Change	1,569,084	403,792
Cumulative Results of Operations	2,816,477 *	1,247,394
Net Position End of Period	<u>\$ 2,816,477</u> *	<u>\$ 1,247,394</u>
*Rounding		

NOTE 10 – INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUE

Intragovernmental costs are those of goods/services purchased from a federal entity.

	<u>2012</u>	<u>2011</u>
Program A		
Intragovernmental costs	\$ 6,890,944	\$ 10,438,974
Public costs	76,249,310	72,488,408
Total Program A costs	<u>83,140,254</u>	<u>82,927,382</u>
Intragovernmental earned revenue	121,725	
Public earned revenue	4,173,305	4,137,540
Total Program A earned revenue	<u>4,295,030</u>	<u>4,137,540</u>
Total Program A Net Costs	<u>\$ 78,845,224</u>	<u>\$ 78,789,842</u>

NOTE 11 – CORRECTION TO BEGINNING BALANCES IN STATEMENTS OF CHANGES IN NET POSITION

There is a misstatement within Cumulative Results of Operations and Unexpended Appropriations. There is no impact on the ARC's overall Net Position in current or prior years.

NOTE 12 – STATUS OF BUDGETARY RESOURCES

A. Apportionment Categories of Obligations Incurred

Obligations incurred reported on the Statement of Budgetary Resources consist of the following:

	<u>2012</u>	<u>2011</u>
Direct Obligations		
Category A	\$ 2,000,412	\$ 2,119,580
Category B	70,638,430	75,502,549
Exempt	12,385,411	12,321,044
Total direct obligations	<u>85,024,253</u>	<u>89,943,174 *</u>
Reimbursable Obligations		
Category B	285,000	-
Total Obligations	<u>\$ 85,309,253</u>	<u>\$ 89,943,174</u>

*Rounding

Apportionment is a plan, approved by the U.S. Office of Management and Budget (OMB), to spend resources provided by one of the annual appropriations acts, a supplemental appropriations act, a continuing resolution, or a permanent law (mandatory appropriations). OMB Circular A-11 defines apportionment categories as follows:

- *Category A* apportionments distribute budgetary resources by fiscal quarters.
- *Category B* apportionments typically distribute budgetary resources by activities, projects, objects or a combination of these categories.
- *Exempt* – Exempt from apportionment (see OMB Circular A-11, paragraph 120.8 for details).

B. Permanent Indefinite Appropriations

The Commission's permanent indefinite appropriation includes the trust fund. These funds are described in Note 9.

C. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

Statement of Federal Financial Accounting Standards No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, calls for explanations of material differences between amounts reported in the Statement of Budgetary Resources (SBR) and the actual balances published in the Budget of the U.S. Government (President's Budget). The Budget of the U. S. Government, with the Actual column completed for 2012 and 2011, was reconciled to the Statement of Budgetary resources as follows:

(Dollars in Millions)	2012			
	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Statement of Budgetary Resources	\$ 108	\$ 85	\$ 4	\$ 88
<u>Reconciling Items</u>				
Offsetting collections and receipts	4	10	-	(4)
Budget of the U.S. Government	<u>\$ 112</u>	<u>\$ 95</u>	<u>\$ 4</u>	<u>\$ 84</u>

(Dollars in Millions)	2011			
	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Statement of Budgetary Resources	\$ 110	\$ 90	\$ 4	\$ 72
<u>Reconciling Items</u>				
Offsetting collections and receipts	(4)	(5)	(4)	-
Budget of the U.S. Government	<u>\$ 106</u>	<u>\$ 85</u>	<u>\$ -</u>	<u>\$ 72</u>

NOTE 13 – UNDELIVERED ORDERS AT THE END OF THE PERIOD

The amount of Unpaid Obligated Balance, Net, End of Period shown on the Statement of Budgetary Resources includes obligations relating to Undelivered Orders (goods and services contracted for but not yet received at the end of the year) and Delivered Orders, Unpaid (amounts owed at the end of the year by ARC for goods and services received). The amount of each is as follows:

	Undelivered Orders	Delivered Orders, Unpaid	Unpaid Obl. Balance, Net
2012	\$ 121,971,002	\$ 8,092,540	\$ 130,063,541 *
2011	\$ 140,697,902	\$ 6,908,917	\$ 147,606,819

*Rounding

NOTE 14 – RECONCILIATION OF NET COST OF OPERATIONS (PROPRIETARY) TO BUDGET (FORMERLY THE STATEMENT OF FINANCING)

A reconciliation between budgetary resources obligated and net cost of operations (i.e. providing an explanation between budgetary and financial (proprietary) accounting) is as follows:

	2012	2011
Budgetary Resources Obligated	\$ 85,309,253	\$ 89,943,174
Spending Authority from Recoveries and Offsetting Collections	(10,583,294)	(6,663,444)
Distributed Offsetting Receipts	(4,106,500)	(4,091,000)
Imputed Financing from Costs Absorbed by Others	21,831	72,740
Changes in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided	13,077,529	3,792,764
Other	(66,805)	
Resources that Do Not Affect Net Cost of Operations	(4,106,500)	(4,089,170)
Financing Sources Yet to be Provided	(700,291)	(175,222)
Net Cost of Operations	\$ 78,845,224 *	\$ 78,789,842

*Rounding

NOTE 15 – SUBSEQUENT EVENTS

ARC has evaluated subsequent events occurring after the balance sheet date and through the date of November 21, 2012, the date the financial statements were available for release. Based upon this evaluation, ARC has determined that no subsequent events have occurred which require disclosure in the financial statements.

APPENDIX A
COMMENTS ON DRAFT AUDIT REPORT



APPALACHIAN
REGIONAL
COMMISSION

*A Proud Past,
A New Vision*

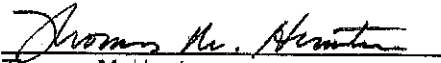
November 21, 2012


Martin & Wall, A Division of Chortek & Gottschalk
Mark E. Albrecht, CPA
Audit Partner
1633 Q Street, NW
Suite 230
Washington, DC 20009

Dear Mr. Albrecht:

We have reviewed the draft audit report provided to us relating to your audit of Appalachian Regional Commission for the fiscal years ended September 30, 2012 and 2011. We concur with the facts and conclusions in the draft report.

Sincerely,


Thomas M. Hunter
Executive Director


William Grant
Director, Finance and Administration

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