PART III:
FISCAL YEAR 2006 FINANCIAL REPORT

Financial Report

Message from the Executive Director

The executive director of the Appalachian Regional Commission is appointed by the federal co-chair and the governors of the 13 member states to be the chief executive officer of the organization, a responsibility that includes financial management. ARC recognizes its responsibility to demonstrate to the American public that it exercises proper stewardship of the public resources entrusted to it. The financial statement in this Performance and Accountability Report fairly presents the financial position of ARC.

I am very pleased to report that M.D. Oppenheim and Company, the independent auditor of ARC's financial statement for 2006, has rendered an unqualified opinion about the adequacy of the statement. The independent audit was performed in cooperation with the Office of Inspector General (OIG). This is the fourth consecutive year with an unqualified opinion.

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

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

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

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

Thomas M. Hunter
Executive Director

November 15, 2006

Report of Independent Audit

Office of Inspector General

November 14, 2006

Memorandum for The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 07-01
FY 2006 Financial Statement Audit
and Accompanying Documents

The enclosed report presents the results of the audits of the Commission's financial statements for the fiscal years ended September 30, 2006 and 2005. The report should be read in conjunction with the Commission's financial statements and notes to fully understand the context of the information contained therein.

The Appalachian Regional Commission contracted with the independent certified public accounting firm of M.D. Oppenheim & Company, P.C. to audit the financial statements of the Commission as of and for the years ended September 30, 2006 and 2005. In its audit, M.D. Oppenheim & Company, P.C found the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles.

The Accountability of Tax Dollars Act of 2002 requires ARC to prepare and submit audited financial statements and to consolidate the audited financial statements and other financial and performance reports into a combined Performance and Accountability Report in accordance with OMB Circular A-136, Financial Reporting Requirements.

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

The audit was conducted in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States.

The results of the audit were discussed with Commission officials and the OIG throughout the audit. The auditors' reported that the recommendation made during FY 2005 has yet to be satisfied as their sample testing showed that 50% of the grant progress reports were not submitted timely. This prior year finding and recommendation on compliance will remain open, pending full implementation of the corrective action plan.

M.D. Oppenheim & Company, P.C., also identified two additional matters presenting opportunities for strengthening internal controls and operating efficiency. They are communicated in a separate letter dated November 6, 2006 for management's consideration and is attached under separate cover.

M.D. Oppenheim & Company, P.C is responsible for the attached auditors' report dated November 6, 2006 and the conclusions expressed in the report. We do not express opinions on the Appalachian Regional Commission's financial statements or internal controls.

In connection with the contract, we reviewed M.D. Oppenheim & Company's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted auditing standards, was not intended to enable us to express, and we do not express, opinions on the Appalachian Regional Commission's financial statements or internal control. M.D. Oppenheim & Company, P.C is responsible for the attached auditors' report dated November 6, 2006 and the conclusions expressed in the report. However, our review disclosed no instances where M.D. Oppenheim & Company, P.C did not comply, in all material respects, with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States.

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

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

Clifford H. Jennings
Inspector General

Attachments

cc: Director, Finance and Administration Division

Appalachian Regional Commission

Financial Statements and Independent Auditors' Report

September 30, 2006 and 2005

APPALACHIAN REGIONAL COMMISSION

September 30, 2006 and 2005

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M.D. OPPENHEIM & COMPANY, P.C.
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To the Commission Members
Appalachian Regional Commission
Washington, DC

Independent Auditors' Report

We have audited the accompanying balance sheets of the Appalachian Regional Commission ("ARC") as of September 30, 2006 and 2005, and the related statements of operations and changes in net position and cash flows for the years then ended. These financial statements are the responsibility of ARC's management. Our responsibility is to express an opinion on the financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Appalachian Regional Commission as of September 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2006 on our consideration of ARC's internal controls

The Commission Members
Appalachian Regional Commission
Washington, DC

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

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

Silver Spring, Maryland
November 6, 2006

APPALACHIAN REGIONAL COMMISSION
Balance Sheets
September 30, 2006 and 2005

		2006		2005
ASSETS				
Current assets				
Fund balance with U.S. Treasury	$	60,655,435	$	61,537,066
Cash in commercial institutions		95,898		71,117
Total cash		60,751,333		61,608,183
Accounts receivable		4,219		-
Advances to grantees		61,828		-
Total current assets		60,817,380		61,608,183
Business development revolving loan funds		30,235,390		28,942,787
TOTAL ASSETS	**$**	**91,052,770**	**$**	**90,550,970**
LIABILITIES AND NET POSITION				
Current liabilities				
Accounts payable	$	1,148,389	$	1,177,477
Center for Disease Control and Prevention grants		398,078		750,000
Accrued pension liability		1,934,715		1,683,124
Accrued leave		370,046		386,370
Accrued payroll and taxes payable		249,596		241,706
Other accrued liabilities		165,684		75,754
Total current liabilities		4,266,508		4,314,431
Net position		86,786,262		86,236,539
TOTAL LIABILITIES AND NET POSITION	**$**	**91,052,770**	**$**	**90,550,970**

See accompanying notes and Independent Auditors' Report.

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APPALACHIAN REGIONAL COMMISSION
Statements of Operations and Changes in Net Position
Years Ended September 30, 2006 and 2005

	2006	2005
REVENUES		
Appropriations	$ 64,817,280	$ 65,472,000
Less: Grant transfers to other agencies	(25,937,110)	(26,160,682)
Appropriations (net)	38,880,170	39,311,318
Appalachian Development Highway System administrative revenue	616,558	1,064,200
State contributions	3,293,000	3,164,000
Other revenue	460,447	273,833
Total revenues	**43,250,175**	**43,813,351**
EXPENSES		
Area development grants	33,038,339	32,170,267
Office of the Federal Co-Chair and Inspector General	1,776,601	1,724,265
Commission management and administration	7,885,512	7,501,639
Total expenses	**42,700,452**	**41,396,171**
NET INCOME	**549,723**	**2,417,180**
Net position, beginning of period	**86,236,539**	**83,819,359**
NET POSITION, END OF PERIOD	**$ 86,786,262**	**$ 86,236,539**

See accompanying notes and Independent Auditors' Report.

APPALACHIAN REGIONAL COMMISSION
Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Net income	$ 549,723	$ 2,417,180
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation	-	13,394
Changes in assets and liabilities:		
Accounts receivable	(4,219)	-
Advances to grantees	(61,828)	864,383
Business development revolving loan funds	(1,292,603)	(2,400,996)
Accounts payable	(29,088)	(771,943)
Center for Disease Control and Prevention grants	(351,922)	750,000
Accrued pension liability	251,591	697,557
Accrued leave	(16,324)	32,781
Accrued payroll and taxes payable	7,890	30,351
Other accrued liabilities	89,930	(16,715)
Net cash provided by operating activities	**(856,850)**	**1,615,992**
Net (decrease)/increase in cash	**(856,850)**	**1,615,992**
Cash at beginning of year	**61,608,183**	**59,992,191**
CASH AT END OF YEAR	**$ 60,751,333**	**$ 61,608,183**

Supplemental disclosures:

No amounts were paid for Interest and Taxes in 2006 or 2005.

See accompanying notes and Independent Auditors' Report.

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APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

Note A – Organization and Mission

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

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

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

Note B – Summary of Significant Accounting Policies

1. **Major Programs** – ARC is authorized to fund area and other development programs including education, workforce training, water and sewer construction, housing, leadership development, small business start-ups and expansions and development of health care resources. In executing its programs, local communities and Federal agencies provide administrative and technical services. ARC utilizes approximately 10 Federal departments and agencies to administer, disburse funds, and account for its infrastructure and other programs. ARC is responsible for allocating funds to the projects and for the management and administration of all projects.

2. **Basis of Accounting** – The accompanying financial statements have been prepared using the accrual method of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred. Appropriations are recognized as revenue when appropriated and available.

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

Note B – Summary of Significant Accounting Policies (continued)

3. **Financing Sources** – ARC receives annual no-year Federal appropriations to provide grants to the entities within the Appalachian Region and to fund its operations. The state members also contribute funds to ARC operations. Funds are allocated to thirteen states and are available until expended. States can generally decide how their allocations will be used for ARC programs.

4. **Fund Balance with U.S. Treasury** – Cash receipts and disbursements for operations and the area development programs are processed by the U.S. Department of Treasury. Funds held by the Department of Treasury represent funds available for operations.

5. **Cash in Commercial Institutions** – ARC uses commercial bank accounts to accommodate collections and payments that cannot be processed by the U.S. Department of Treasury.

6. **Advances to Grantees** – Unexpended grant funds in the hands of grantees at the end of the fiscal year are reclassified as advances.

7. **Equipment and Software** – Capital assets are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of three to five years. All assets are fully depreciated as of September 30, 2006. Depreciation expense for the years ended September 30, 2006 and 2005 is $0 and $13,394, respectively.

8. **Retirement Plans** – ARC Federal employees participate in Federal retirement plans. ARC non-Federal employees participate in the ARC Pension and 401(k) plan.

9. **Accrued Pension Liability** – ARC recognizes and records a liability for post-retirement benefits other than pension in accordance with the Statement of Financial Accounting Standards (SFAS) No. 106, *Employer's Accounting for Post-retirement Benefits Other Than Pensions*.

10. **Accrued Leave** – Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year the balance in the accrued annual leave account is adjusted to reflect current accrual at current pay rates.

11. **Use of Estimates** – The preparation of the accompanying financial statements requires management to make estimates and assumptions about certain estimates included in the financial statements. Actual results will invariably differ from those estimates.

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

Note B – Summary of Significant Accounting Policies (continued)

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

Note C – Business Development Revolving Loan Funds

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

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

The following summarizes the RLF balances at September 30:

	2006	2005
RLF Funds Obligated	$ 34,543,851	$ 33,435,470
RLF Funds Advanced	30,235,390	28,942,787
RLF Loans Outstanding	34,848,640	34,261,278

Note D – Grant Transfers to Other Federal Agencies

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

	2006	2005
Department of Transportation	$ 210,000	$ 688,000
US Army Corps of Engineers	3,960,000	(493,000)
Economic Development Administration	2,538,000	2,323,298
Environmental Protection Agency	(746,710)	
Department of Agriculture	13,900,000	12,325,976
Department of Housing and Urban Development	6,075,820	11,316,408
	$ 25,937,110	$ 26,160,682

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APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

Note E – Retirement and Other Post-Employment Benefit Plans

Federal

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

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

Contributions to these plans for FY 2006 were $43,055 and $72,154 for CSRS and FERS, respectively, and contributions for FY 2005 were $44,099 and $69,879 for CSRS and FERS, respectively.

Several employees also participate in the Federal Employees Health Benefit plan (FEHB) and the Federal Employees Group Life Insurance program (FEGLI), also administered by OPM. ARC pays the cost of current employees. Post-retirement benefits are paid by OPM. No amounts have been recognized in the financial statements for these imputed costs as they are not deemed material. Contributions to these plans for FY 2006 were $58,846 and $2,161 and for FY 2005 $56,862 and $2,234 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 $27,236 and $25,894 to the Federal Thrift Savings plan for all eligible employees for the years ended September 30, 2006 and 2005, respectively.

Non-Federal

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

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

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

		2006		2005
Benefit obligation	$	(11,133,361)	$	(11,415,578)
Fair value of plan assets		4,415,875		3,313,848
Funded status	$	(6,717,486)	$	(8,101,730)
Accrued benefit cost recognized in the balance sheet	$	1,934,715	$	1,683,124

		2006		2005
Employer contribution	$	1,212,108	$	467,777
Participant contribution		20,565		25,815
Benefits paid		345,831		121,609
Net periodic benefit costs		1,441,506		1,165,334

The accumulated benefit obligation was $9,783,577 and $9,070,903 at September 30, 2006 and 2005, respectively.

Additional Information

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

	2006	2005
Discount rate	5.75%	4.75%
Rate of compensation increase	3.00	4.51

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

	2006	2005
Discount rate	4.75%	5.75%
Expected return on plan assets	7.25	7.50
Rate of compensation increase	4.51	4.08

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

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

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

Plan Assets

Pension plan weighted-average asset allocations at September 30, 2006 and 2005 are as follows:

Asset Category	2006	2005
Equity securities	34.00%	30.00%
Debt securities	61.00	65.00
Real estate	5.00	5.00
Total assets	100.00%	100.00%

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

The Commission expects to contribute $1,271,329 to the plan in FY2007.

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

	Pension Benefits
2007	$ 3,952,404
2008	1,022,268
2009	466,351
2010	71,724
2011	1,689,832
Years 2011 – 2016	7,190,877

ARC also maintains a 401(k) plan covering substantially all non-Federal employees. ARC contributed $152,806 and $146,018 for the years ended September 30, 2006 and 2005, respectively.

Note F – Lease

ARC's lease for its office space provides for increases in annual base rent based on consumer price index increases, and payment of a portion of the increases in building operating expenses and real estate taxes. The old lease commenced on April 30, 1996 and extends through December 31, 2006. The new lease commences on January 1, 2007 and extends through December 31, 2016. Future minimum lease payments required under these non-cancelable leases are as follows:

APPALACHIAN REGIONAL COMMISSION
Notes to Financial Statements
Years Ended September 30, 2006 and 2005

Note F – Lease (continued)

Year Ended September 30,		Amount
2007	$	705,414
2008		740,154
2009		754,957
2010		770,056
2011		785.458
Thereafter		4,542,200
Total	$	8,298,239

Rent expense for the years ended September 30, 2006 and 2005 was $598,605 and $667,188, respectively.

Additional Information

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APPALACHIAN REGIONAL COMMISSION
Additional Information (Unaudited)
Years Ended September 30, 2006 and 2005

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

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

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

The following is a summary of the balances and activity related to the ADHS for FY 2006:

	Unexpended Authority as of 10/1/2005	FY 2006 Authorizations	FY 2006 Expenditures	Unexpended Authority as of 9/30/2006
DOT Appropriations	$ 207,640,713	$ 99,160,000	$ (62,554,752)	$ 244,245,961
Highway Trust Fund Obligation Ceiling	1,372,242,485	395,295,735	(661,262,398)	1,106,275,822
Total	$ 1,579,883,198	$ 494,455,735	$ (723,817,150)	$ 1,350,521,783

Status of budgetary resources as of September 30, 2006:

	Obligated Balance	Unobligated Balance	Total
DOT Appropriations	$ 136,008,694	$ 108,237,267	$ 244,245,961
Highway Trust Fund Obligation Ceiling	440,547,887	665,727,935	1,106,275,822
	$ 576,556,581	$ 773,965,202	$ 1,350,521,783

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APPALACHIAN REGIONAL COMMISSION
Additional Information (Unaudited)
Years Ended September 30, 2006 and 2005

Federal Budgetary Data

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

BUDGETARY RESOURCES		2006		2005
Budget authority – appropriation	$	65,472,000	$	66,000,000
Net transfers		(25,937,110)		(26,160,682)
Unobligated balance brought forward October 1		5,891,302		8,565,932
Spending authority from offsetting collections		1,213,540		1,027,169
Recoveries of prior year obligations		4,177,838		3,189,101
Permanently not available		(654,720)		(528,000)
Total budgetary resources		50,162,850		52,093,520
STATUS OF BUDGETARY RESOURCES				
Obligations incurred		39,725,374		46,202,218
Unobligated balance		10,437,476		5,891,302
Total budgetary resources	$	50,162,850	$	52,093,520

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To the Commission Members
Appalachian Regional Commission
Washington, DC

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the Appalachian Regional Commission as of and for the year ended September 30, 2006, and have issued our report thereon dated November 6, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Compliance

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

The Commission Members
Appalachian Regional Commission
Washington, DC

We noted other matters involving the internal control over financial reporting, which we have reported to the management of ARC in a separate letter dated November 6, 2006.

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

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

November 6, 2006

APPALACHIAN REGIONAL COMMISSION
Follow-up on Prior Audit Finding

Grant Reporting

Condition: During the prior year audit of ARC's grant files, we noted a lack of timely submission of grant progress and final reports. Our FY 2005 testing found that out of the 44 grant files sampled, 7 of the files where the grant period had expired, the final reports were not submitted timely which caused a delay in closing of the grants.

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

Current Status: During our current year audit, we found that in 5 out of 10 (50%) of the files, the progress reports were not submitted timely per ARC policy. Due to the continued late filing of progress report submissions, this finding will remain open pending full implementation of the corrective action plan.