

Appalachian Regional Commission



**Performance and Accountability Report
Fiscal Year 2003**



January 30, 2004

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Fiscal Year 2003**



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Cover Photo

*Little Hump Mountain, on the
North Carolina–Tennessee border.
Photo by Ken Murray.*

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Appalachian Regional Commission

1666 Connecticut Avenue, NW, Suite 700
Washington, DC 20009-1068
Telephone: 202-884-7799
email: info@arc.gov
Internet: www.arc.gov

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PART I: MANAGEMENT DISCUSSION AND ANALYSIS



Message from Federal Co-Chair Anne B. Pope and States' Co-Chair Mark R. Warner

We are pleased to submit the Appalachian Regional Commission's (ARC) Performance and Accountability Report for fiscal year (FY) 2003. This report is the second annual summary of ARC activities since the Commission was reauthorized in 2002. As ARC carries out its mission of creating opportunities for self-sustaining economic development and improved quality of life for the 23 million people of the Appalachian Region, this report serves as a record of our progress.

Overview

In FY 2003, the Appalachian Regional Commission invested \$73 million in 472 economic and community development projects and leveraged \$192 million in other public funds and over \$464 million in private investment in Appalachia, resulting in a leverage ratio of nearly 9 to 1. At least 23,000 jobs will have been created or retained in the process of implementing these projects. Projects in economically distressed counties and areas of the Region, as well as special initiatives in telecommunications and entrepreneurship, received dedicated funding. Over 60 percent of ARC's FY 2003 grant funds supported projects that primarily or substantially benefited distressed communities in the Region.

A great deal of progress has been made in the Region since ARC's inception in 1965. The regional poverty rate has been cut in half. The high-school graduation rate in Appalachia is on a par with the national average. Approximately 1.6 million jobs have been created. But these are challenging economic times. As the Appalachian Region continues to experience a fundamental restructuring of its economic base, employment levels in traditional sectors including manufacturing, mining, and steel have continued to decline. Significant health disparities remain between Appalachia and the rest of the United States. And while Appalachia has made important strides in educational achievement, there is a significant and growing gap between the Region and the nation in the number of adults who have completed college. That gap now stands at 6.7 percentage points, up from 6 percentage points in 1990.

To accommodate these changes in Appalachia's economic landscape, ARC has continued to follow a comprehensive development strategy focused on strengthening physical infrastructure, creating dynamic local economies, promoting an educated workforce, fostering a healthy population, and building civic capacity. Within these areas, key Commission initiatives focus on enhancing telecommunications access and use, and advancing entrepreneurship. ARC also continues to work to improve its services to the Region by conducting economic research and providing online assistance with commu-



*Federal Co-Chair
Anne B. Pope*



*States' Co-Chair
Mark R. Warner,
Governor of Virginia*

nity planning and development efforts. The common theme of all of ARC's programs and initiatives is economic diversification, which would help the Region enter the nation's economic mainstream and compete more effectively in the global economy.

In FY 2003, ARC continued to develop and foster partnerships with federal agencies to further leverage the resources available for economic development in Appalachia. These include partnerships with the Federal Communications Commission, the U.S. Department of Health and Human Services, and the Centers for Disease Control and Prevention. In addition, the Commission began laying the groundwork for the creation of the Interagency Coordinating Council on Appalachia, which was mandated by ARC's 2002 reauthorization legislation. The council's aim is to examine how the impact of federal programs and resources can be maximized in the Region and how greater coordination among federal agencies can yield better returns.

Following are highlights of Commission activities in FY 2003.

Strengthening Physical Infrastructure

With the completion and opening to traffic of 26.5 more miles of the Appalachian Development Highway System (ADHS) in FY 2003, the highway system continued to improve the Region's access to national and international markets and energize commerce in Appalachian communities. Designed to connect the Region to the national interstate system, the 3,025-mile highway system was 86 percent complete or under construction by September 30.

In addition, infrastructure projects supported by the Commission made it possible for over 23,000 Appalachian households to receive water and sewer services in FY 2003. Many of these projects provided first-time service for households in the Region's most economically distressed counties. ARC grants also made it possible for over 700 businesses in Appalachia to receive water and sewer services.

Enhancing Telecommunications Access and Use

ARC invested over \$9 million in telecommunications projects in the Region during the fiscal year, more than the \$8 million spending level set by Congress for telecommunications activities in ARC's appropriation legislation. In conjunction with partners in the nonprofit and private sectors, the Commission has begun working to reduce the isolation of rural Appalachian communities and enhance their business competitiveness by facilitating access to broadband Internet connections. Delhi, New York, and Glenville, West Virginia, are two initial sites that received assistance in FY 2003 with establishing high-speed Internet access. The Commission also began working to help establish a high-speed fiber-optic network to provide broadband Internet access in northeastern Mississippi and Haysi, Virginia. In addition, during the fiscal year ARC held ten workshops for business leaders and city and county officials in rural communities throughout the Region to heighten awareness of broadband's economic and social benefits.

Advancing Entrepreneurship and Creating Dynamic Local Economies

As of September 2003, the \$31.4 million invested by the Commission in its multi-year program to support entrepreneurial economies in the Region had leveraged \$45.3 million from other sources, for a total investment of \$76.7 million. This investment has resulted in the creation of over 1,200 new businesses and the creation or retention of more than 5,200 jobs. During the fiscal year ARC also helped establish the \$12.5 million Southern Appalachian Fund, which provides equity capital to emerging and growing businesses in Alabama, Georgia, Kentucky, Mississippi, and Tennessee. In addition, ARC partnered with the Federal Home Loan Bank of Atlanta and private banks in developing a \$2 million funding pool to support regional investments generated through the U.S. Department of the Treasury's New Markets Tax Credit Program.

Recognizing that the combined tourism and craft industries of the 13 Appalachian states hold great potential for generating economic growth in the Region, in FY 2003 a tourism advisory council convened by ARC completed an eight-month strategic planning process to assess ways in which the states can work collaboratively to maximize these industries' success. As a result, the council undertook its first major project to promote tourism in Appalachia, entering into a unique partnership with the National Geographic Society to produce and distribute a detailed promotional map showcasing up to 100 visitor attractions throughout the Region.

As another approach to supporting crafts- and cultural-heritage-based economic development in the Region, ARC has partnered with the National Endowment for the Arts to provide a series of workshops to help crafts and arts entrepreneurs grow more successful businesses. The Commission has also provided support for the Creative Economies Institute, based in Asheville, North Carolina, which will leverage philanthropic support to provide technical assistance and training to rural communities seeking to expand their crafts- and cultural-heritage-based development.

Additionally, ARC has funded the development of a heritage music trail in southwestern Virginia to help attract new visitors to the area by promoting local cultural and musical traditions. The heritage trail will include tourist attractions in seven counties and three cities. ARC funds are supporting the renovation and promotion of Clintwood, Virginia's Ralph Stanley Museum and Traditional Mountain Music Center, a future attraction on the trail.

Fostering a Healthy Population

Preliminary findings of an ARC-commissioned study on health disparities between the Region and the nation, completed in FY 2003, indicate that mortality rates for persons ages 35 to 64 for diseases including diabetes, cancer, and heart disease are higher in Appalachia than in the rest of the country. To help address such health disparities in the Region, in FY 2003 ARC invested \$3.4 million in projects bolstering health care, leveraging an additional \$2.9 million in federal, state, and local investments. Additionally, as a result of physician placements made through ARC's J-1 Visa Waiver Program

and an ARC-supported residency placement program at the Pikeville College School of Osteopathic Medicine, an additional 79 physicians are now providing care in rural areas of the Region that may otherwise lack sufficient health-care services.

ARC also continues building partnerships with other organizations to address chronic health issues in the Region. Working with Ohio University, the Commission has launched a pioneering and comprehensive initiative to further prevention and treatment of diabetes in Ohio's economically distressed counties. This year ARC also continued to collaborate with the Centers for Disease Control and Prevention on multi-state diabetes prevention and cervical cancer screening projects in economically distressed counties. In addition, the Commission has continued to support and expand the Coalition on Appalachian Substance Abuse Policy, a community-based group in Central Appalachia addressing the substance abuse and mental health problems of the Region. And it has also begun an effort with the U.S. Department of Health and Human Services to collaboratively address chronic health problems in Appalachia, including persistent prescription drug abuse in Central Appalachia.

Promoting an Educated Workforce

To increase college attendance rates in Appalachia, the Commission has supported the continued expansion of the Appalachian Higher Education Network, which provides funding, training, and assistance to high schools to encourage students to undertake post-secondary education. In FY 2003 the network established centers in two more Appalachian states, bringing the total number of participating states in the Region to eight: Ohio, West Virginia, Kentucky, Alabama, Mississippi, Tennessee, Virginia, and North Carolina. Schools participating in the network have increased their college attendance rates by an average of 20 to 30 percentage points in the first year of participation, and at several high schools over 90 percent of graduates are now continuing their education after graduation.

ARC has also continued to support the Math-Science-Technology Summer Institute at the Oak Ridge National Laboratory in Tennessee to help prepare students from the Region for careers in mathematics, science, and engineering. The Commission has collaborated with the U.S. Department of Energy since 1990 to offer this program, allowing students to conduct hands-on research projects on subjects including forest ecology, materials analysis, and hydropower.

Building Civic Capacity

The Commission invested over \$5 million in FY 2003 in programs to help Appalachian communities, particularly economically distressed areas, mobilize for change and build the civic capacity and leadership needed to promote social and economic development. Of this investment, \$1.5 million was designated for civic capacity initiatives in economically distressed counties. Over 5,000 participants, mostly from distressed counties, are now energizing civic society in their communities as a result. In addition, over 100 ARC-sponsored community programs are now being established to demonstrate new and traditional leadership and community-building models.

ARC's collaborations with a variety of national and community foundations, other nonprofit organizations, educational institutions, and the private sector continue to strengthen the Region's capacity to reinvent and reinvigorate its communities. Examples of partnerships that benefited Appalachian states in FY 2003 include initiatives with the Pew Partnership for Civic Change's LeadershipPlenty program, the Corporation for National and Community Service, the National Campus Compact Raise Your Voice campaign, and the Claude Worthington Benedum Foundation.

In its continuing support of Appalachia's local development districts (LDDs), which are multi-county planning and development organizations that provide a crucial link between their local communities and the state and federal governments, ARC provided the Region's 72 LDDs with \$5.4 million in administrative support in FY 2003. In addition, the Commission helped fund leadership, management, and administrative training for LDD staff and officials in all of Appalachia's 13 states.

Conducting Research and Providing Online Assistance

ARC compiles data and conducts research on key economic, demographic, and quality-of-life factors that affect the current and future development prospects of the Appalachian Region. ARC-commissioned research reports completed in FY 2003 include *Appalachia at the Millennium: An Overview of Results from Census 2000*, which provides a demographic, economic, and social portrait of the 410-county Region at the beginning of the twenty-first century; and *An Analysis of the Financial Conditions of Health Care Institutions in the Appalachian Region and Their Economic Impacts*, which describes the availability of health-care services in Appalachia, the financial stability of Appalachian health-care institutions, and the effect of hospital closures on Appalachian counties.

Also published in FY 2003 was *Evaluation of the Appalachian Regional Commission's Telecommunications Projects: 1994–2000*, which measured the extent to which ARC investments enhanced access to, and improved use of, telecommunications services in the Region.

The most frequently requested ARC research reports and data are available on the Commission's Online Resource Center (www.arc.gov/orc), which provides tools and information to help communities, particularly those in economically distressed areas, plan and develop projects for economic and community development. The site also includes information on sources of funding for community projects, examples of best practices in the Region, and an email-based assistance feature.

Looking to the Future

We are proud of ARC's accomplishments in the past fiscal year and of the continued strength of this partnership between the federal government and the 13 Appalachian states. As the Appalachian Region faces ongoing challenges and realizes new opportunities, the Commission is committed to working with its public, nonprofit, and private partners to serve as an advocate for the Region and, ultimately, to bring all of Appalachia's people into the nation's economic mainstream.

Preparation of the Performance and Accountability Report

This report includes information on the Appalachian Regional Commission's programmatic and financial activities during fiscal year 2003. It is based on data that is as reliable and comprehensive as possible. We are pleased to report that independent auditors have pronounced an unqualified opinion that the financial statements in this document fairly present the fiscal status of the Commission.

The Commission has made every effort to provide a complete and accurate report of its performance and stewardship of the public funds entrusted to it. We also want to assure Congress and the American people that the financial controls in place at the Commission reasonably meet the purposes of the Federal Managers' Financial Integrity Act of 1982. ARC's goal is nothing less than to achieve excellence in the management and disposition of its resources on behalf of the people of Appalachia.

Sincerely,



Anne B. Pope
Federal Co-Chair



Mark R. Warner
2004 States' Co-Chair
Governor of Virginia

January 30, 2004

APPALACHIAN REGIONAL COMMISSION STRUCTURE AND PROGRAMS

Mission

ARC's mission is to be an advocate for and partner with the people of Appalachia to create opportunities for self-sustaining economic development and improved quality of life.

ARC is a federal-state partnership with a governing board composed of a federal co-chair, who is appointed by the President and confirmed by the Senate, and the governors of the 13 member states. Congress established ARC in 1965 to address profound economic and social problems in the Appalachian Region that made it “a region apart” from the rest of the nation. The Appalachian Regional Development Act charges the Commission to

- Provide a forum for consideration of problems of the Region and proposed solutions; and establish and utilize citizens’ and special advisory councils and public conferences;
- Provide the infrastructure for economic and human resource development;
- Generate a diversified regional economy, develop the Region’s industry, and build entrepreneurial communities;
- Serve as a focal point and coordinating unit for Appalachian programs;
- Coordinate regional economic development activities and the use of federal agency economic development resources;
- Make the Region’s industrial and commercial resources more competitive in national and world markets;
- Improve the skills of the Region’s workforce;
- Adapt and apply new technologies for the Region’s businesses, including eco-industrial development technologies;
- Improve the access of the Region’s businesses to the technical and financial resources necessary to the development of business; and
- Coordinate the economic development activities of, and the use of economic development resources by, federal agencies in the Region.

The Commission strives to bring all of Appalachia into America’s economic mainstream. ARC is a unique forum for studying the problems and opportunities of the Region. It forges partnerships with federal, state, and local organizations, and leverages its investments by attracting private investment capital to the Region. ARC employs a “bottom-up” approach, involving multi-jurisdictional planning districts to help communities determine their economic development priorities and design and implement projects to accomplish regional strategic goals.

The Commission was reauthorized through fiscal year (FY) 2006 with the enactment of the Appalachian Regional Development Act Amendments of 2002, Public Law 107-149. ARC’s appropriation for FY 2003 nonhighway programs was \$70.8 million. Appendix C provides a history of appropriations to the Commission since its inception.

Historical Accomplishments

ARC has had a substantial impact throughout the Appalachian Region. Through its advocacy and its more than 23,000 grants over the years, it has helped

- Cut the Region’s poverty rate in half;
- Reduce the infant mortality rate by two-thirds;
- Double the percentage of adults age 25 and older with a high school diploma;
- Create over 400 rural health facilities;
- Construct over 2,400 miles of new highways;
- Provide water and sewer services to over 800,000 households;
- Create over 1.6 million new jobs in addition to 766,000 generated by the Appalachian development highways; and
- Cut the number of severely distressed counties from 223 in 1960 to 121 in FY 2003 and 91 in FY 2004.

The Commission has targeted special resources to the most severely distressed counties and areas in the Region since 1983, and has further increased funding dedicated to these areas in recent years. Public Law 107-149 requires that at least half of all ARC grant funds must benefit distressed counties or areas. ARC applies rigorous and conservative measures to identify the Region’s most severely distressed counties. (See map of distressed counties on page 18.)

Because of its partnership approach, ARC is able to identify and help fund innovative grassroots initiatives that might otherwise languish. In many cases, ARC functions as a predevelopment agency, providing modest initial funding that is unavailable from other sources. Successful initiatives, such as ARC’s Appalachian Higher Education Network program, can be replicated across the Region.

Through the years, ARC has effectively used its funds to help communities qualify for and make better use of limited resources from other federal agencies. These federal funds, combined with state, local, and private money, provide a broad program of assistance to the Region.

ARC is a performance-driven organization, evaluating progress and results on an ongoing basis and relying on clearly defined priorities and strategies for achieving them. Based on performance information, ARC promotes approaches that work to ensure maximum return for taxpayers.



Thomas Arledge



Ann Hawthorne



Ann Hawthorne

Organization: The ARC Partnership Model

The Appalachian Regional Commission has 14 members: the governors of the 13 Appalachian states and a federal co-chair, who is appointed by the President and confirmed by the Senate. Each year one governor is elected by his or her peers to serve as the states' co-chair. The partnership nature of ARC is evident in its policy making: the governors and the federal co-chair share responsibility for determining all policies and making spending decisions. The federal co-chair has one vote, and the 13 governors share one vote, on all Commission decisions. Accordingly, all program strategies, allocations, and other policy must be approved by both a majority of the governors and the federal co-chair. This consensus model ensures close collaboration between the federal and state partners in carrying out the mission of the agency. It also gives the Commission a non-federal character that distinguishes it from typical federal executive agencies and departments.

An alternate federal co-chair, who is also appointed by the President and confirmed by the Senate, has authority to act as the federal co-chair in his or her absence. Each governor appoints an alternate who oversees state ARC business and serves as the state-level point of contact for those seeking ARC assistance.

By law, there is an inspector general for the Commission who reports to the federal co-chair.

In all, there are only 11 federal employees of the Commission, including the federal co-chair's staff and the staff of the Office of Inspector General.

The Commission members appoint an executive director to serve as the chief executive, administrative, and fiscal officer. The executive director and staff are not federal employees. The 48 non-federal Commission staff are charged with serving both the federal and the state members impartially in carrying out ARC programs and activities, and they provide the legal support, technical program management, planning and research, and financial/administrative management necessary for ARC's programs.

Intergovernmental Cooperation

ARC's program authority encompasses a full range of federal domestic activities, including enterprise development, education and training, health care, export promotion, telecommunications, water and sewer infrastructure, and highway construction. Because of its limited appropriation, the Commission has always emphasized collaboration with public and private resources to accomplish its mission. ARC funding and technical assistance help communities leverage private and state funds, as well as other federal funds. ARC's highly flexible funds are often referred to as "glue money," which, although often a small part of projects, helps make them possible.

A special provision of the Appalachian Regional Development Act authorizes ARC to operate in part as a supplemental grant program. This authority allows ARC funds to be used to increase the allowable participation under federal grant programs, enabling grantees to participate in programs for which they would otherwise be ineligible. In addition, it involves appropriate federal entities to ensure not only program coordination but also compliance with all applicable laws, such as environmental and labor requirements. Accordingly, about half of past ARC grants have been administered under agreements with up to a dozen federal agencies, mainly the Economic Development Administration, Rural Development, the U.S. Department of Housing and Urban Development, and the Federal Highway Administration. Other agreements have involved such agencies as the Army Corps of Engineers and the U.S. Departments of Energy, Labor, and Health and Human Services.

ARC has also joined a range of national and regional foundations in special projects and initiatives over the years.

APPALACHIAN REGIONAL COMMISSION

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States' Co-Chair

Governor Mark R. Warner

Alternate Federal Co-Chair

Richard J. Peltz

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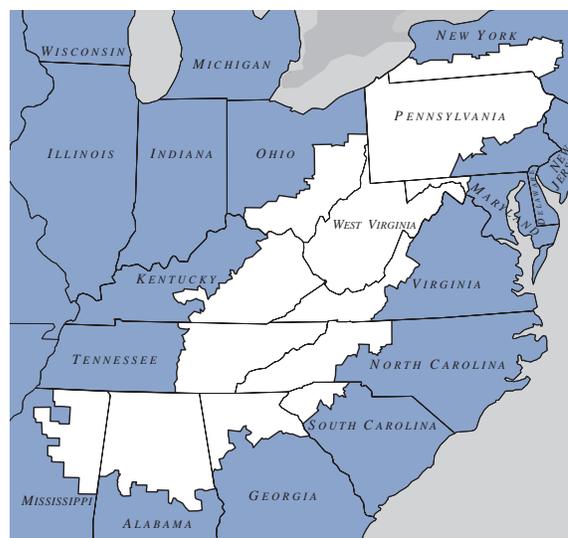
Governor Robert E. Wise Jr.
Bobby Lewis

States' Washington Representative

Cameron D. Whitman

The Appalachian Region

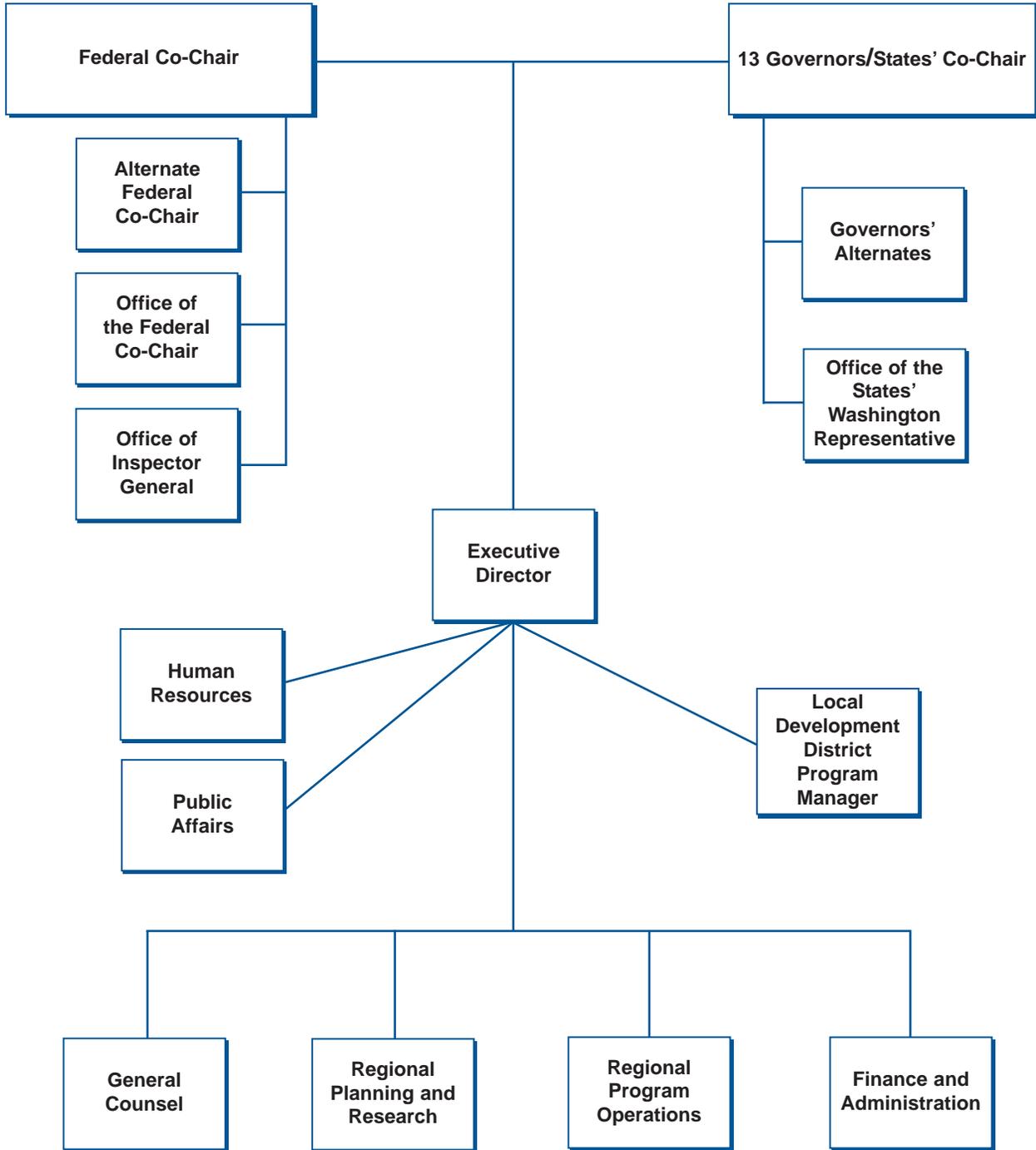
The Appalachian Region includes all of West Virginia and parts of Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia. The Region is home to nearly 23 million people and covers 410 counties and more than 200,000 square miles.



ARC Organization

Federal Representative = 1 VOTE

13 Appalachian Governors = 1 VOTE



Commission Programs: Getting the Job Done

While federal agencies are typically national in focus and categorical in scope, the Commission partnership is built to be regional in focus and comprehensive in scope. The Appalachian Regional Development Act gave the Commission very broad program discretion to address problems and opportunities in the Region. Accordingly, ARC has emphasized a wide-ranging set of priorities in its grant programs over time. Early programs included initiatives in environmental cleanup, hospital construction, vocational education, and rural health care. These were followed by various initiatives in business development, telecommunications infrastructure, and tourism development. Throughout the years, ARC has consistently maintained a focus on the construction of development highways and basic water and waste management facilities.

Area Development

Area development funds are largely allocated to the Appalachian states by formula to provide flexible assistance for individual community projects. The states have wide discretion in the use of these funds. Regional priorities for area development funding are set forth in the Commission's strategic plan, and state and community leaders work together to package funding from public and private organizations to implement those priorities. In addition, at least half of all ARC grant funds are required under Public Law 107-149 to benefit the counties ARC designates as severely distressed, as well as other distressed areas in the Region. The Commission had already been targeting funds to projects that benefit distressed counties at that level for several years prior to passage of the Act. In FY 2003, 121 counties were designated as distressed. (See map of distressed counties on page 18.)

During FY 2003, ARC's strategic plan set five goals for the Commission:

- Developing a knowledgeable and skilled population
- Strengthening the Region's physical infrastructure
- Building local and regional capacity
- Creating a dynamic economic base
- Fostering healthy people

ARC also targets a portion of area development funds for special regional projects and initiatives. In FY 2003, these included

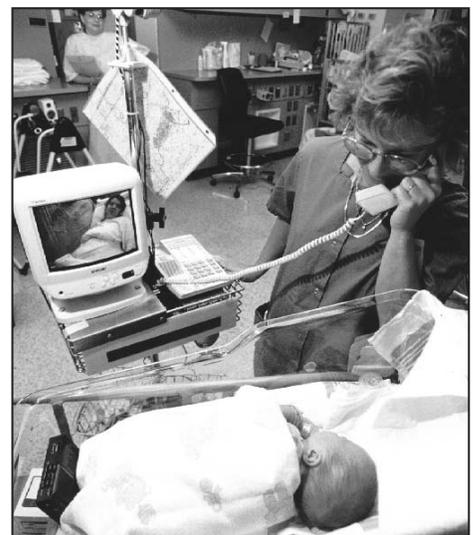
- A telecommunications and information technology program, which promotes the development of telecommunications in Appalachia, with a special focus on helping the Region's distressed counties.
- An entrepreneurship initiative, which seeks to provide communities with tools to assist entrepreneurs in starting and expanding local businesses.
- A mini-grant program to jumpstart community leadership activities in distressed counties.



Chuck Wyrostok



Ken Murray



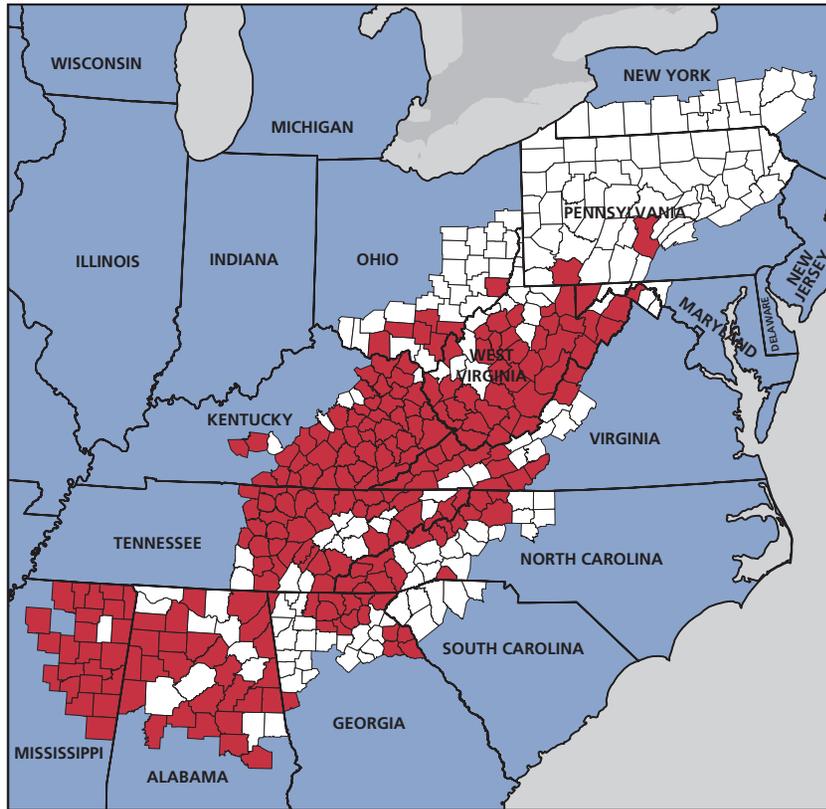
Ken Murray

(Continued on page 20)

Distressed Counties in the Appalachian Region

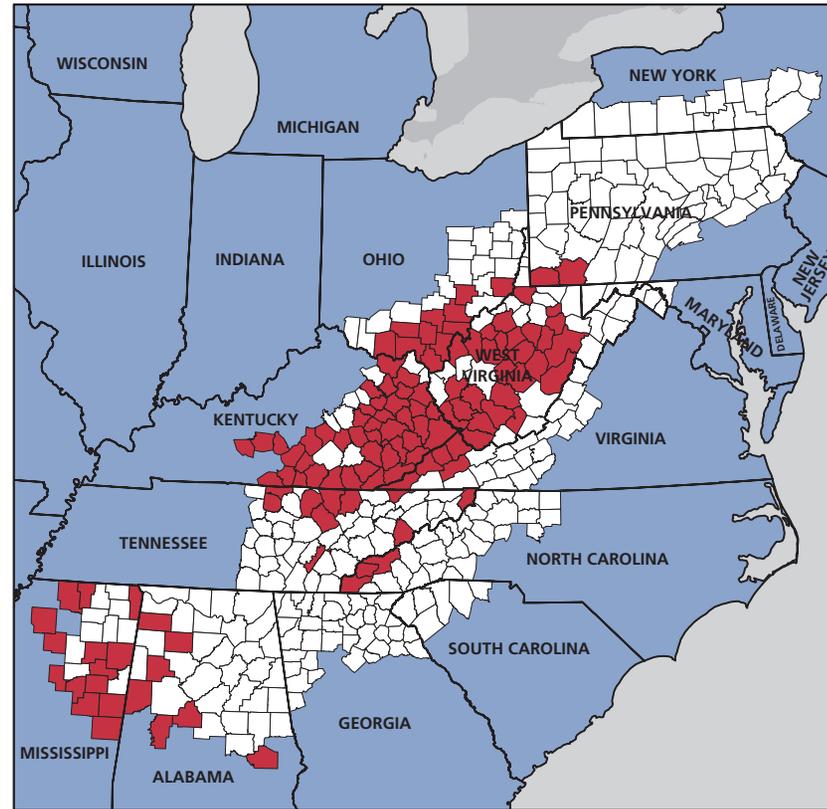
1960

223 Distressed Counties



FY 2003

121 Distressed Counties



Definition of Distress in 1960:
Distressed counties have an unemployment rate that is at least 1.5 times the U.S. average of 5.1 percent; a per capita market income that is two-thirds or less of the U.S. average of \$1,639; and a poverty rate that is at least 1.5 times the U.S. average of 22.1 percent; OR they have 2 times the U.S. poverty rate and qualify on the unemployment or income indicator.

Data Sources:
Unemployment: Census data from USDA, Economic Research Service (ERS), 1960;
Income: U.S. Department of Commerce, Census Bureau, 1960;
Poverty: Office of Economic Opportunity data from USDA, ERS, 1960.

Definition of Distress in Fiscal Year 2003:
Distressed counties have a three-year average unemployment rate that is at least 1.5 times the U.S. average of 4.2 percent; a per capita market income that is two-thirds or less of the U.S. average of \$24,819; and a poverty rate that is at least 1.5 times the U.S. average of 13.1 percent; OR they have 2 times the U.S. poverty rate and qualify on the unemployment or income indicator.

Data Sources:
Unemployment: U.S. Department of Labor, Bureau of Labor Statistics, 1998-2000;
Income: U.S. Department of Commerce, Bureau of Economic Analysis, 1999;
Poverty: U.S. Department of Commerce, Census Bureau, 1990 Census, STF3.

ARC-Designated Distressed Counties—Fiscal Year 2003

Alabama	Kentucky	Mississippi	North Carolina	Ohio	Pennsylvania	Tennessee	Virginia	West Virginia
Bibb	Adair	Benton	Cherokee	Adams	Fayette	Campbell	Buchanan	Barbour
Fayette	Bath	Chickasaw	Graham	Athens	Greene	Clay	Dickenson	Boone
Franklin	Bell	Choctaw	Swain	Gallia		Cocke	Lee	Braxton
Hale	Breathitt	Clay		Jackson		Fentress	Russell	Calhoun
Macon	Carter	Kemper		Lawrence		Hancock	Wise*	Clay
Pickens	Casey	Marshall		Meigs		Jackson		Fayette
Winston	Clay	Monroe		Monroe		Johnson		Gilmer
	Clinton	Montgomery		Morgan		Meigs		Jackson
	Cumberland	Noxubee		Pike		Morgan		Lewis
	Edmonson	Oktibbeha		Scioto		Scott		Lincoln
	Elliott	Panola		Vinton				Logan
	Estill	Tishomingo						Mason
	Floyd	Winston						McDowell
	Green	Yalobusha						Mingo
	Harlan							Nicholas
	Hart							Pocahontas
	Jackson							Raleigh
	Johnson							Randolph
	Knott							Ritchie
	Knox							Roane
	Lawrence							Summers
	Lee							Taylor
	Leslie							Upshur
	Letcher							Webster
	Lewis							Wetzel
	Lincoln							Wirt
	Magoffin							Wyoming
	Martin							
	McCreary							
	Menifee							
	Monroe							
	Morgan							
	Owsley							
	Perry							
	Pike							
	Powell							
	Rockcastle							
	Rowan							
	Russell							
	Wayne							
	Whitley							
	Wolfe							

* Includes the city of Norton.

The Message from Federal Co-Chair Anne B. Pope and States' Co-Chair Mark R. Warner provides a brief overview of major activities during FY 2003 (see page 6). Appendix A provides information on ARC funding by program type, both for FY 2003 and cumulative from FY 1965.

The Appalachian Development Highway System

When ARC was established, Congress realized that economic growth in Appalachia would not be possible until the Region's isolation had been overcome. Because of the high cost of building roads through mountainous terrain, adequate roads had not been built in much of Appalachia, leaving the Region with a network of winding two-lane roads that snaked through narrow valleys or over mountains. When the nation's interstate system was built, large areas of Appalachia were simply bypassed, compounding the problems of the Region's already troubled economy.

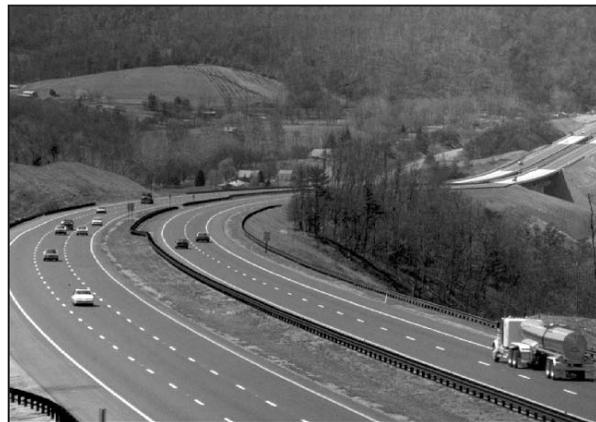


Ken Murray

To address these problems, the Appalachian Regional Development Act authorized ARC to build a modern highway system in the Region. The Appalachian Development Highway System (ADHS), authorized at 3,025 miles in FY 2003, links with the national interstate system and is the only highway system created by Congress explicitly to spur economic development. (See map on page 21.) In FY 2004, Congress added 65 miles to the ADHS through Public Law 108-199, for a new system total of 3,090 miles.

For many years, funds for construction of the ADHS were appropriated directly to the Commission. In FY 1999, for the first time, annual funding for the completion of the ADHS was provided from the federal Highway Trust Fund, in the Transportation Equity Act for the 21st Century (TEA-21). This change significantly increased funding for the system and accelerated the rate of completion.

TEA-21 provided annual authorizations of \$450 million for the ADHS for FY 1999 through FY 2003, for a total of \$2.25 billion. Funds authorized in TEA-21 were apportioned to states annually based on each state's proportional share of the cost to complete the ADHS as specified in the latest cost-to-complete estimate. Although the funds were authorized from the Highway Trust Fund, ARC continues to exercise policy control over the system and the allocation of funds to individual states. This ensures that the governors and the federal co-chair continue to determine where and how the money is used on ADHS highways.



Ann Hawthorne

Commission staff has worked closely with the Administration and Congress to ensure that ADHS program needs are adequately addressed in legislation that succeeds TEA-21.

Appendices B and C provide historical information on ADHS authorizations and funding history.

Appalachian Development Highway System



- Adequate or Complete—
September 30, 2003
- To be Completed
- Interstate System

Local Development Districts

ARC's statute underlines the importance of supporting local development districts (LDDs) in the Region. These multi-county planning and development organizations not only serve as the local presence of the ARC program across the Region, but also are essential contributors to the program.

Each LDD is governed by a board of directors composed of both local elected officials and non-elected individuals. Many of these state-chartered entities were originally created by state executive orders, but over half are now authorized in state legislation. Some also have 501(c)(3) nonprofit status, enabling them to access support from foundations and other non-public sources. The LDDs play four key roles in the development of the Region:

- Providing area-wide planning and program development, and coordination of federal and state funding sources;
- Assisting local governments in providing services, especially in poorer, more isolated communities;
- Promoting public-private partnerships and assisting in business development; and
- Helping communities assess, plan, and conduct a wide range of activities such as job training, business development, telecommunications planning and implementation, and municipal government support.

The Commission has also supported the training and technical assistance activities of the Development District Association of Appalachia (DDAA), an organization of the Region's LDDs. These activities improve member districts' organizational structure and operations, and their ability to effectively implement ARC's strategic plan and regional initiatives.

Appendix D provides a map and list of local development districts serving Appalachia.

Research and Technical Assistance

A fundamental concept of the Appalachian Regional Development Act is that of building regional strategies that enable consensus across jurisdictions based on knowledge of regional conditions. The Commission is uniquely positioned to provide such a focus on the problems and development opportunities of Appalachia, and on ways to address them collaboratively. For example, ARC's telecommunications strategy, Information Age Appalachia, grew directly from innovative research, expert consultations, and coordination with the states and the DDAA.

Research and technical assistance activities serve all ARC programs by maintaining performance measurement and program evaluation systems, assisting policy and program development, and providing information about the Region to the states, Congress, and the public.

Information for developing regional strategies comes from two principal areas of activity: ongoing regional socioeconomic analysis and research, and performance management and evaluation of programs and demonstrations.

Commission reports are typically distributed to stakeholders in the ARC program, and are also published in full on the Commission Web site to help ensure the widest possible use of study results.

Research started in FY 2003 includes:

- A study of the exposure of Appalachia to trade-related competition in such traditionally important industries as apparel and textiles, and identification of sectors with key opportunities;
- A study of workforce adjustment policies and practices in the Appalachian labor markets; and
- A study of water and sewer infrastructure needs and gaps in Appalachia.

Research completed or under way in FY 2003 includes:

- An overview of results for the 2000 Census: a demographic, economic, and social portrait of the Appalachian Region;
- An analysis of the financial conditions of health-care institutions and the availability of health-care services in the Region;
- An analysis of wage and employment dynamics of the Region's business establishments;
- An analysis of the global competitiveness of major industry groups in Appalachia, with a detailed analysis of seven key industry clusters;
- The development of an applied economic development evaluation and strategy "tool kit" for use by local development districts;
- A study of opportunities to improve transportation efficiencies in the Region through enhanced intermodal capabilities and increased use of the ADHS; and
- An analysis of disparities in health status and accessibility to health care in the Region.

Future Challenges

By virtually all socioeconomic measures, Appalachia has seen clear and substantial progress since the early days of the Commission's work. Yet the Region still does not enjoy the same economic vitality and living conditions that the rest of the country does. The Region continues to battle economic distress, concentrated areas of high poverty, unemployment, poor health, educational disparities, and population outmigration that are among the worst in the nation. Appalachia trails the rest of the nation by 18 percent in per capita income. Over one-fourth of the Region's 410 counties have poverty rates more than 150 percent of the national average. Most Appalachian counties have unemployment rates higher than the national average; 145 counties have unemployment rates that exceed the national average by 150 percent.

Structural changes in the economy and economic downturns can substantially and adversely impact the Region's capacity to address its developmental challenges. Downturns are felt earlier in the Appalachian Region, hit deeper, and last longer.

Addressing the long-standing problems of the Region's severely distressed areas continues to be a daunting challenge.

Water and Wastewater Systems

Most Americans don't realize that access to basic water and wastewater systems remains a critical issue in many smaller, poorer communities in Appalachia. Thirty percent of Appalachian households are not connected to a centralized wastewater treatment facility, and 15 percent of households in Central Appalachia lack both public water and wastewater services. According to preliminary estimates, an investment of \$10 billion would be required to provide adequate wastewater infrastructure, and \$8.4 billion would be required to provide safe drinking water systems throughout the Region. Without these basic pre-developmental requirements, business and industry simply are not likely to grow, and health is threatened.

Telecommunications

As local leaders assess the economic future of Appalachia, a clear message reverberates: Appalachia must have universal, affordable access to modern telecommunications and information technology. The technological innovations driving the most remarkable revolution in business, industry, and communications in a century present a new opportunity for Appalachia to participate fully in the nation’s economic mainstream. Yet 240 Appalachian counties, 59 percent of the total, are underserved by Internet services.

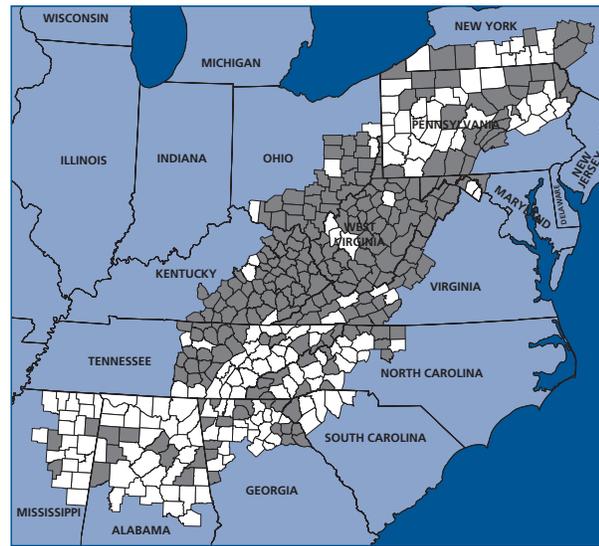
Education and Workforce Skills

Vigorous job growth will not occur in areas that lack a prepared workforce. Attracting knowledge-based jobs to the Region will require considerable investment in improving educational achievement. For example, in 2000 the gap between the Region’s and the nation’s share of adults age 25 and over with a college degree was 6.7 percentage points. Without improved levels of education and technical skills among its workforce, the Region will not be able to add the information technology workers it would require to close the job gap in telecommunications and information services industries between Appalachia and the rest of the nation.

Employment Losses in Traditional Industries

Increased global competition and technological changes have resulted in job losses and restructuring in many key Appalachian industries. Because of its dependence on traditional industries such as manufacturing and resource-based industries, employment losses in these industries have disproportionately impacted much of the Region. Over the last decade, one out of every five textile jobs and one out of every three apparel jobs lost nationally were in Appalachia. More than 24,000 jobs have been lost in Appalachian-based steel and other primary metals businesses over the last ten years. Appalachian coal-mining employment has fallen from 101,500 workers in 1987 to 58,600 in 1997. Some of these declines have been offset by employment growth in service sectors, but average wages in that sector are considerably lower than those in the goods-producing sectors.

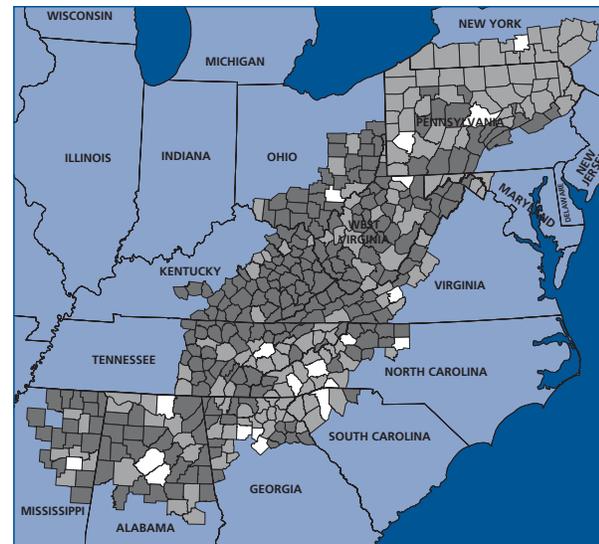
Appalachian Counties Underserved by Internet Services



Counties Lacking Significant High-Speed Internet Services

Data Source: Links to the Future: The Role of Information and Telecommunications Technology in Appalachian Economic Development. (2000 data.) Michael Oden and Sharon Strover, University of Texas, 2002.

Appalachian Counties with Low College Completion Rates

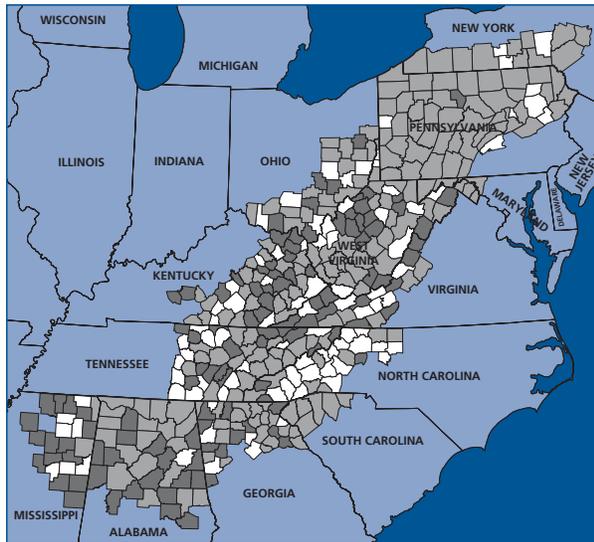


Percent of Adults Completing a Bachelor’s Degree or Higher

- Counties below 50 Percent of the U.S. Average
- Counties between 50 and 99 Percent of the U.S. Average
- Counties at or above the U.S. Average

Data Source: U.S. Department of Commerce, Census Bureau, Census 2000, Summary File 3.

Appalachian Counties Lacking Adequate Access to Health Care



Counties Designated as Health Professional Shortage Areas (HPSAs)

- Counties Fully Designated as HPSAs
- Counties Partially Designated as HPSAs
- Counties Not Designated as HPSAs

Data Source: U.S. Department of Health and Human Services, Health Resources and Services Administration, Bureau of Health Professions, March 2003.

Health Care

Health problems continue to impede the quality of life as well as the economic prospects of some areas in the Region. Over two-thirds of the Region’s counties are fully or partially designated by the U.S. Department of Health and Human Services as health professional shortage areas. Most Appalachian counties have had difficulty attracting or retaining basic services such as dentistry, outpatient alcohol treatment, outpatient drug treatment, and outpatient mental health services. In addition, Appalachia suffers from disproportionately high rates of chronic diseases such as cardiovascular disease, cancer, and diabetes.

Looking Ahead

The coming years are critical. As the Appalachian Development Highway System approaches completion, the Region must position itself to take advantage of the accessibility these highways create. The Region has important assets to build on: a rich cultural heritage, substantial natural resources, and a dedicated workforce. With its small appropriation, ARC cannot be the primary source of funds for addressing the Region’s challenges. The Commission will continue to rely on advocacy, strategic alliances, and regional and local partnerships to make the best of available public and private resources in working to achieve its goals for the Appalachian Region.

SUMMARY OF ACHIEVEMENTS

Detailed information on ARC’s performance goals and results is contained in the Fiscal Year 2003 Performance Report on page 32. ARC has planned to complete a new strategic plan in late FY 2004 that will require a reassessment of appropriate performance measures used for Commission programs.

Output and Outcome Results for FY 2003 Area Development Projects

INTERMEDIATE RESULTS

GOAL 1—*Appalachian residents will have the skills and knowledge necessary to compete in the world economy in the twenty-first century.*

Objective 1.1: Workforce Training—Outputs	13,605 Trainees	Exceeded Goal
Objective 1.1: Workforce Training—Outcomes	10,786 Trainees w/results	Exceeded Goal
Objective 1.2: Student Readiness—Outputs	51,201 Students	Exceeded Goal
Objective 1.2: Student Readiness—Outcomes	42,472 Students w/results	Exceeded Goal

GOAL 2—*Appalachian communities will have the physical infrastructure necessary for self-sustaining economic development and improved quality of life.*

Objective 2.2: Water, Sanitary Sewer and Waste-Disposal Systems		
Households Served—Outcomes	23,194 Households served	Met 93% of Goal
Jobs Created or Retained—Outcomes	23,358 Jobs	Met 78% of Goal

GOAL 3—*The people and organizations of Appalachia will have the vision and capacity to mobilize and work together for sustained economic progress and improvement of their communities.*

Objectives 3.1 and 3.2: Leadership Development and Capacity Building (Combined)—Outputs	5,714 Participants	Exceeded Goal
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GOAL 4—*Appalachian residents will have access to financial and technical resources to help build dynamic and self-sustaining local economies.*

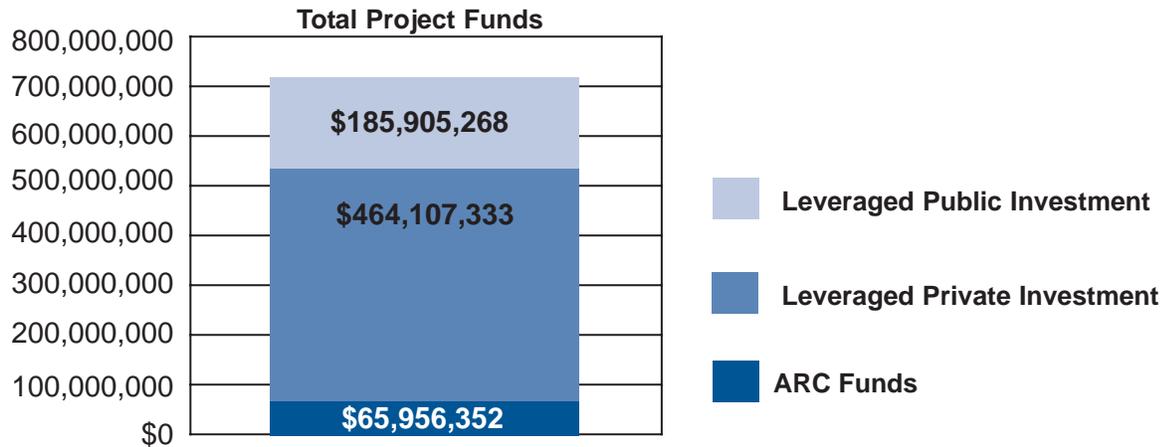
Objective 4.1: Entrepreneurial Education and Assistance—Outputs	9,198 Participants	Exceeded Goal
Objective 4.2: Entrepreneurial Job Creation—Outcomes	<i>At the time of publication, ARC is conducting further research to confirm intermediate estimates reported by grantee organizations.</i>	

GOAL 5—*Appalachian residents will have access to affordable, quality health care.*

Objective 5.1: Health-Care Providers—Outputs	79 Physicians placed	Exceeded Goal
Objective 5.2: Comprehensive Delivery Systems—Outcomes	363,400 Office visits	Exceeded Goal

Other Funds Leveraged in FY 2003

ARC spent a total of \$65,956,352* on area development projects in FY 2003. Those funds leveraged \$650,012,601 from both public and private revenue sources.



*This figure does not include funds for LDD support, the highway program, or research activities.

FINANCIAL MANAGEMENT

Financial Management System

The Appalachian Regional Commission uses a commercial off-the-shelf core accounting system, GLOWS, that is intended for government financial management. The GLOWS system incorporates capabilities to manage obligations, disbursements, the general ledger, and financial reporting and has been certified for government use by the Joint Financial Management Improvement Program through June 2003. Recertification is pending. ARC supplements this system with a historical project grant information system, ARC.net, that provides real-time funding, grant status, and performance measurement information, as well as grant-related financial data, in an intranet environment available to staff and key state officials. ARC.net applications are built using off-the-shelf software.

FMFIA Information

ARC implemented a process for providing audited financial statements in fiscal year 2002, following the guidance of the Accountability of Tax Dollars Act of 2002. ARC, strictly speaking, is not a federal agency as defined in Titles 5 and 31 of the U.S. Code; it is a 501(c)(3) organization with a quasi-federal character. While the Accountability of Tax Dollars Act applies only to executive branch agencies, the Commission has elected to comply with Office of Management and Budget (OMB) guidance because full disclosure of financial information is consistent with the governmental nature of ARC's mission and operations and its stewardship of public funds. ARC also follows OMB and Department of the Treasury financial reporting requirements as appropriate.

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 represents sound management practice for managing federal appropriations. FMFIA establishes specific requirements with regard to management controls. The agency must establish controls that reasonably ensure that: (1) obligations and costs comply with applicable law; (2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures are properly accounted for and recorded. In addition, the agency annually must evaluate and report on the control and financial systems that protect the integrity of federal programs. The FMFIA encompasses program, operational, and administrative areas as well as accounting and financial management. In addition, OMB Circular A-123 directs agencies to take systematic and pro-active measures to: (1) develop and implement appropriate, cost-effective management controls for results-oriented management; (2) assess the adequacy of management controls in federal programs and operations; (3) identify needed improvements; (4) take corresponding corrective action; and (5) report annually on management controls. Management controls are the organizational structures, policies, and procedures used to help program and financial managers achieve results and safeguard the integrity of their programs.

ARC maintains a written plan of internal control development and testing. The agency approach is to make management controls an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing. Testing procedures are based on a team approach and are designed to provide feedback to management on a continuing basis throughout the cycle. ARC recognizes that an appropriate balance of controls must exist in programs and operations. Managers should benefit from controls, not be encumbered by them. Too many controls, especially in an organization as small as the Commission, can result in inefficient and ineffective government. ARC strives to maintain an environment of accountability in which all employees help ensure that government resources are used efficiently and effectively to achieve intended program results with minimal potential for waste, fraud, and mismanagement.

The Commission conducts formal and informal meetings with division managers to identify vulnerable areas and potential control weaknesses. An internal management control committee is also in place to conduct reviews. The Office of Inspector General (OIG) conducts independent program reviews and audits. Weekly management team meetings provide an opportunity to address control issues. Finance staff conducts pre-payment examinations of approved payments, as well as oversight reviews of program account obligation and payment details. Finally, the annual financial audit of the agency provides independent assessments of the adequacy of internal controls. The internal control plan assigns responsibility within the organization for follow-up action on any deficiencies.

Fiscal year 2003 was the first year ARC was scheduled to produce an audited financial statement. The independent auditors issued an unqualified opinion on the fiscal year 2003 statement provided in this Performance and Accountability Report. A separate management report included a reportable condition affecting internal controls. While not a material weakness, the control condition calls for improved tracking of advance payments to grantees, based on advances outstanding more than 90 days to the grantees of 59 out of some 2,000 grants in force. ARC has implemented improved procedures and data management to eliminate the condition.

Management Follow-Up to Inspector General Recommendations

At the start of the fiscal year, all but one of the audit reports issued by the OIG in previous years had been addressed by ARC management. During fiscal year 2003, the OIG issued 16 reports covering ARC grants that totaled \$9.33 million. Five reports identified a total of \$390,998 in questioned or unsupported costs. Two reports recommended that grant funds totaling \$684,660 could be put to better use through management action to deobligate grant balances, encourage timely use of funds, or take similar steps. Commission management decisions were made with respect to all but four of the reports issued during fiscal year 2003. As a result of the 12 reports addressed by management, \$3,000 in unsupported costs were disallowed. In addition, the OIG referred one case for criminal investigation with support from another agency's OIG, and monitored two other investigations by state law enforcement or ethics organizations that may relate to ARC programs.

The OIG worked closely with ARC staff to prepare for the production of audited financial statements, and served as an important resource for workshops and meetings in the field to promote sound financial management on the part of ARC grantees. The semi-annual reports of the ARC inspector general, along with contact information, are available to the public on the Commission Web site.

SUMMARY OF FINANCIAL STATUS

Part III of this Performance and Accountability Report includes information about the financial status of the Commission. In the unqualified opinion of the independent auditors, M.D. Oppenheim and Company, P.C., the financial statements included in that section fairly represent the financial position of ARC in all material respects. The financial statements include details on ARC's assets, liabilities, and net position. They also include a statement of operations and changes in net position, and a statement of cash flows. The financial statements taken together include all the aspects of ARC, including the Office of the Federal Co-Chair, area development programs, and administrative/operational activities performed by ARC.

Assets on September 30, 2003, totaled \$85.2 million, and liabilities totaled \$4.1 million. Sixty percent of ARC's assets were in the United States Treasury. In addition, 31 percent, or \$26.5 million, represented Commission grants to intermediary organizations in Appalachia for the operation of revolving loan funds promoting business development. The federal government retains a residual interest in the loan funds. Remaining assets are accounts receivable, cash, and advances to grantees.

Liabilities included \$2.5 million in accounts payable, \$899,000 in accrued leave and pension liability, \$523,000 in grants from the Centers for Disease Control and Prevention, \$175,000 in accrued payroll, and \$40,000 in other accrued liabilities.

Total revenues for the year were \$48 million, and total expenses, including area development grants, were \$46.1 million. Revenues notably included \$3 million in state contributions for the operational expenses of the Commission, pursuant to ARC's legislation. The Commission must rely on congressionally appropriated funds to continue its operations, make grants, and meet its liabilities.

Notes are attached to the financial statements to describe and explain important disclosure information about line items in the statements and related financial policies and programs. Federal budgetary data are included as additional information, describing how the Commission's \$71.3 million of budgetary authority was applied.