

The Arc Of Baltimore, Inc.

Financial Report
June 30, 2008

McGladrey & Pullen
Certified Public Accountants

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McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

To the Board of Directors
The Arc of Baltimore, Inc.
Baltimore, Maryland

We have audited the accompanying statements of financial position of The Arc of Baltimore, Inc. (Arc) (a Maryland not-for-profit corporation) as of June 30, 2008 and 2007, and the related statements of activities, functional expenses 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 these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to the 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Arc of Baltimore, Inc. as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2008, on our consideration of Arc's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. 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 our audit.

As described in Note 3 to the financial statements effective July 1, 2006, Arc adopted Statement of Financial Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefits*.

McGladrey & Pullen, LLP

Baltimore, Maryland
October 28, 2008

The Arc Of Baltimore, Inc.

Statements Of Financial Position
June 30, 2008 And 2007

Assets	2008	2007
Current Assets		
Cash and cash equivalents	\$ 7,550,494	\$ 7,695,553
Accounts receivable, net (Note 6)	2,419,547	2,507,794
Receivables from government agencies (Note 11)	623,623	752,299
Other receivables	147,610	40,644
Residents' funds (Note 10)	293,177	165,783
Other current assets	211,852	74,614
Total current assets	11,246,303	11,236,687
Property and Equipment, net (Notes 2, 4 and 6)	13,319,935	12,703,888
Other Assets		
Certificate of deposit (Note 9)	400,099	383,714
Bond escrow funds (Notes 6 and 7)	1,445,768	1,410,656
Bond issuance costs, net (Note 7)	176,264	186,893
Prepaid pension (Note 3)	262,975	764,050
Board-designated investments (Note 5)	1,000,388	697,707
Total other assets	3,285,494	3,443,020
Total assets	\$ 27,851,732	\$ 27,383,595

See Notes To Financial Statements.

Liabilities And Net Assets	2008	2007
Current Liabilities		
Accounts payable and accrued expenses (Note 3)	3,277,488	\$ 2,963,406
Deferred revenue	9,267,180	9,166,241
Residents' funds payable (Note 10)	293,177	165,783
Current portion of long-term debt (Note 6)	647,723	616,961
Total current liabilities	13,485,568	12,912,391
Long-Term Liabilities (Note 6)		
Bond payable	4,810,000	4,965,000
Other long-term debt	2,492,110	2,579,056
Total long-term liabilities	7,302,110	7,544,056
Commitments and Contingencies (Notes 3, 4 and 9)		
Net Assets		
Unrestricted:		
Operating	5,585,193	5,850,968
Board-designated for investment	1,000,388	697,707
Total Unrestricted	6,585,581	6,548,675
Temporarily restricted (Note 12)	478,473	378,473
Total net assets	7,064,054	6,927,148
Total liabilities and net assets	\$ 27,851,732	\$ 27,383,595

The Arc Of Baltimore, Inc.

Statement Of Activities

Year Ended June 30, 2008

(with comparative totals for June 30, 2007)

	Unrestricted	Temporarily Restricted	2008 Total	2007 Total
Support and Revenue				
Government agencies	\$ 31,534,881	\$ -	\$ 31,534,881	\$ 31,342,838
Contracts and other revenue	10,306,582	100,000	10,406,582	9,092,336
Public support, direct	634,206	-	634,206	536,822
Public support, indirect	60,820	-	60,820	69,632
Gain on disposal of property	-	-	-	315,757
	<u>42,536,489</u>	<u>100,000</u>	<u>42,636,489</u>	<u>41,357,385</u>
Net assets released from restrictions	-	-	-	-
Total support and revenue	<u>42,536,489</u>	<u>100,000</u>	<u>42,636,489</u>	<u>41,357,385</u>
Expenses (Notes 2, 3 and 4)				
Program services	37,167,733	-	37,167,733	35,434,162
Supporting services				
Management and general	4,672,752	-	4,672,752	3,801,700
Fundraising	127,265	-	127,265	147,598
Total expenses	<u>41,967,750</u>	<u>-</u>	<u>41,967,750</u>	<u>39,383,460</u>
Change in net assets, from operating activities	568,739	100,000	668,739	1,973,925
Non operating activities				
Pension related changes other than net period pension costs and adoption of SFAS No. 158 in 2007 (Note 3)	(531,833)	-	(531,833)	(995,795)
Change in net assets	36,906	100,000	136,906	978,130
Net assets, beginning of year	6,548,675	378,473	6,927,148	5,949,018
Net assets, end of year	<u>\$ 6,585,581</u>	<u>\$ 478,473</u>	<u>\$ 7,064,054</u>	<u>\$ 6,927,148</u>

See Notes To Financial Statements.

The Arc Of Baltimore, Inc.

Statement Of Activities
Year Ended June 30, 2007

	Unrestricted	Temporarily Restricted	Total
Support and Revenue			
Government agencies	\$ 31,342,838	\$ -	\$ 31,342,838
Contracts and other revenue	9,092,336	-	9,092,336
Public support, direct	536,822	-	536,822
Public support, indirect	69,632	-	69,632
Gain on disposal of property	315,757	-	315,757
	<u>41,357,385</u>	<u>-</u>	<u>41,357,385</u>
Net assets released from restrictions	39,427	(39,427)	-
Total support and revenue	<u>41,396,812</u>	<u>(39,427)</u>	<u>41,357,385</u>
Expenses (Notes 2, 3 and 4)			
Program services	35,434,162	-	35,434,162
Supporting services			
Management and general	3,801,700	-	3,801,700
Fundraising	147,598	-	147,598
Total expenses	<u>39,383,460</u>	<u>-</u>	<u>39,383,460</u>
Change in net assets, before effect of adoption of SFAS No. 158	2,013,352	(39,427)	1,973,925
Pension related changes other than net periodic pension cost and adoption of SFAS No. 158 (Note 3)	(995,795)	-	(995,795)
Change in net assets	1,017,557	(39,427)	978,130
Net assets, beginning of year	5,531,118	417,900	5,949,018
Net assets, end of year	<u>\$ 6,548,675</u>	<u>\$ 378,473</u>	<u>\$ 6,927,148</u>

See Notes To Financial Statements.

The Arc Of Baltimore, Inc.

Statement Of Functional Expenses
Year Ended June 30, 2008

	Program Services	Management and General	Fundraising	Total
Staff salaries	\$ 17,285,497	\$ 2,110,011	\$ 61,290	\$ 19,456,798
Client salaries	3,061,904	36,523	-	3,098,427
Fringe benefits	3,816,908	432,401	13,297	4,262,606
Supplies, equipment and materials	2,123,374	474,880	16,440	2,614,694
Contract services	1,236,862	518,374	21,861	1,777,097
Assistance to individuals	3,101,332	277	78	3,101,687
Depreciation	1,070,715	311,502	2,969	1,385,186
Transportation of clients	1,318,273	-	-	1,318,273
Food	637,743	1,800	-	639,543
Dues, memberships and licenses	37,532	122,539	3,093	163,164
Interest	426,096	160,711	2,284	589,091
Insurance	589,009	73,122	-	662,131
Utilities and telephone	801,393	119,829	2,042	923,264
Rent and lease expense	875,089	51,969	3	927,061
Repairs and maintenance	450,048	72,813	1,017	523,878
Training and travel	265,541	140,332	1,866	407,739
Miscellaneous	70,417	45,669	1,025	117,111
Total functional expenses	\$ 37,167,733	\$ 4,672,752	\$ 127,265	\$ 41,967,750

See Notes To Financial Statements.

The Arc Of Baltimore, Inc.

Statement Of Functional Expenses
Year Ended June 30, 2007

	Program Services	Management and General	Fundraising	Total
Staff salaries	\$ 16,363,296	\$ 1,505,651	\$ 60,998	\$ 17,929,945
Client salaries	2,867,968	69,111	-	2,937,079
Fringe benefits	3,647,758	317,587	11,482	3,976,827
Supplies, equipment and materials	1,715,030	306,203	24,825	2,046,058
Contract services	1,205,454	493,294	36,198	1,734,946
Assistance to individuals	3,371,194	3,310	-	3,374,504
Depreciation	958,689	322,979	3,377	1,285,045
Transportation of clients	1,612,041	75	-	1,612,116
Food	552,564	13,790	138	566,492
Dues, memberships and licenses	57,714	129,770	1,080	188,564
Interest	385,733	166,705	2,321	554,759
Insurance	603,085	119,237	-	722,322
Utilities and telephone	681,887	104,139	2,662	788,688
Rent and lease expense	862,548	41,451	16	904,015
Repairs and maintenance	326,675	46,589	1,644	374,908
Training and travel	205,265	109,855	1,708	316,828
Miscellaneous	17,261	51,954	1,149	70,364
Total functional expenses	\$ 35,434,162	\$ 3,801,700	\$ 147,598	\$ 39,383,460

See Notes To Financial Statements.

The Arc Of Baltimore, Inc.

Statements Of Cash Flows
Years Ended June 30, 2008 And 2007

	2008	2007
Cash Flows From Operating Activities		
Change in net assets	\$ 136,906	\$ 978,130
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Effect of adoption of SFAS No. 158	-	813,631
Depreciation and amortization	1,385,186	1,285,045
Decrease in allowance for doubtful accounts	(8,499)	(17,241)
Unrealized loss (gain) on investments	71,715	(78,032)
Gain on disposal of property	-	(315,757)
Changes in assets and liabilities:		
Decrease (increase) in		
Accounts receivable, net	96,746	(629,124)
Receivables from governmental agencies	128,676	29,492
Other receivables	(106,966)	182,542
Other current assets	(137,238)	235,385
Prepaid pension	501,075	53,269
Increase (decrease) in		
Accounts payable and accrued expenses	314,082	(123,751)
Deferred revenue	100,939	542,313
Net cash provided by operating activities	2,482,622	2,955,902
Cash Flows From Investing Activities		
Acquisition of property and equipment	(1,552,973)	(789,698)
Net proceeds from sale of property	-	965,649
Purchase of investments	(374,396)	(81,005)
Increase in certificates of deposit	(16,385)	(19,444)
Increase in bond escrow funds	(35,112)	(726,938)
Net cash used in investing activities	(1,978,866)	(651,436)
Cash Flows From Financing Activities		
Principal payments on long-term debt	(648,815)	(492,118)
Net cash used in financing activities	(648,815)	(492,118)
Net (decrease) increase in cash and cash equivalents	(145,059)	1,812,348
Cash and cash equivalents, beginning of year	7,695,553	5,883,205
Cash and cash equivalents, end of year	\$ 7,550,494	\$ 7,695,553

(Continued)

The Arc Of Baltimore, Inc.

Statements Of Cash Flows (Continued)
Years Ended June 30, 2008 And 2007

	2008	2007
Supplemental Disclosure Of Cash Flow Information		
Cash paid during the year for interest	<u>\$ 592,676</u>	<u>\$ 563,018</u>
Supplemental Schedule Of Non-Cash Investing And Financing Activities		
Vehicles and equipment acquired through capital leases	<u>\$ -</u>	<u>\$ 249,606</u>
Vehicles acquired through notes payable	<u>\$ 437,631</u>	<u>\$ 635,509</u>

See Notes To Financial Statements.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 1. Nature Of Activities And Significant Accounting Policies

Nature of activities: The Arc of Baltimore, Inc. (Arc) organizes and operates programs that provide residential, vocational, employment, and other social services to mentally retarded citizens in order to develop and facilitate each individual's ability to function independently in the community. In addition, Arc operates a community day care facility.

For the years ended June 30, 2008 and 2007, approximately 74% and 76% of the Arc's revenue was received from the State of Maryland, respectively.

A summary of Arc's significant accounting policies follows:

Basis of accounting: The accompanying financial statements are presented in accordance with the accrual basis of accounting, whereby, revenue is recognized when earned and expenses are recognized when incurred.

Basis of presentation: The financial statement presentation follows the recommendations of the Financial Accounting Standards Board (FASB) in its Statement of Financial Accounting Standards (SFAS) Number 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, Arc is required to report information regarding its financial position and activities according to three classes of net assets: Unrestricted, temporarily restricted, and permanently restricted.

Unrestricted net assets – Unrestricted net assets are the net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations.

Temporarily restricted net assets – Temporarily restricted net assets result from contributions whose use is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of Arc pursuant to these stipulations. Net assets may be temporarily restricted for various purposes, such as use in future periods or use for specified purposes.

Permanently restricted net assets – Permanently restricted net assets result from contributions whose use is limited by donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by Arc's actions. As of June 30, 2008 and 2007, Arc had no permanently restricted net assets.

Credit risk: Arc has funds on deposit with a financial institution in excess of federally insured amounts. Arc has not experienced any losses on cash accounts and believes it is not exposed to significant credit risk on cash.

Accounts receivable: Accounts receivable consist of amounts due Arc from agencies and companies, related to Arc's programs providing services to developmentally disabled consumers.

Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual accounts receivable and considering a customer's financial condition, credit history and current economic conditions. The allowance for doubtful accounts was \$2,260 and \$10,759 at June 30, 2008 and 2007, respectively. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Board-designated investments: Board-designated investments consist of a separate investment account which is comprised of unrestricted gifts designated by the Board of Directors to be held for long-term investment, as well as an investment account to hold funds designated for use in a deferred compensation plan.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 1. Nature Of Activities And Significant Accounting Policies (Continued)

Investment risk and uncertainties: Arc invests in a professionally managed portfolio that contains common shares, bonds, and money market funds. Such investments are exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments it is at least reasonably possible that changes in risks in the near term would materially affect investment balances and the amounts reported in the financial statements.

Valuation of long-lived assets: Arc accounts for the valuation of long-lived assets under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Property and equipment and depreciation: Property and equipment purchased by Arc is recorded at cost. Depreciation is calculated over the estimated useful lives of the related assets using the straight-line method as follows:

	Estimated Useful Lives
Buildings and improvements	25 Years
Leasehold improvements	1 - 4 Years
Furniture, fixtures, and equipment	5 - 10 Years
Vehicles	5 Years

Land and buildings purchased with state funds are owned by Arc, subject to the provision that if the property is transferred within 20 years following the purchase, a pro rata share of the state funds must be returned to the granting state agency. It is the intent of management to hold the properties for at least 15 years.

Bond issuance costs: In 2000, the bond was refinanced and the new bond issue costs are being amortized over the life of the bond (25 years). Amortization expense was \$10,629 for each of the years ended June 30, 2008 and 2007. Accumulated amortization was \$89,461 and \$78,832 at June 30, 2008 and 2007, respectively.

Estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Revenue recognition: Arc's revenue is primarily derived from conditional grants and third-party reimbursements from various state and local government agencies and from services subcontracted to customers on a fee-for-service basis.

State and local grants are deemed to be earned and reported as revenues when Arc has incurred expenditures in compliance with the specific grant restrictions. Grant expenditures made, pending reimbursement, are recorded as accounts receivable. Grant funds received, but not spent, are recorded as deferred revenues. State and local grant amounts not expended in accordance with specific grant restrictions prior to the expiration of the grant period are refundable and recorded as deferred revenue.

Revenue from subcontract fees is recognized when the service is performed.

Notes To Financial Statements

Note 1. Nature Of Activities And Significant Accounting Policies (Continued)

Contributions: Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. Upon the expiration of a restriction, temporarily restricted net assets are reclassified to unrestricted net assets in the statement of activities.

Income taxes: Arc is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code. In addition, Arc qualifies for charitable contributions deductions under Section 170(b)(1)(A) and has been determined by the Internal Revenue Service not to be a "private foundation" within the meaning of Section 509(a) of the Internal Revenue Code. Income, which is not related to exempt purposes, less applicable deductions, is subject to federal and state corporate income taxes. There was no unrelated business income for 2008 and 2007.

In July 2006, the FASB released FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" an *Interpretation of SFAS 109, Accounting for Income Taxes* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006 and was implemented by Arc during the year ended June 30, 2008. The adoption of FIN 48 did not have a material effect on the financial statements.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority.

Allocation of expenses: The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities. General and administrative expenses include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of Arc.

Recent accounting pronouncements: In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and, expands disclosures about fair measurement. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS No. 157, fair value measurements are disclosed by level within that hierarchy. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis for which delayed application is permitted until fiscal years beginning after November 15, 2008. The adoption of SFAS No. 157 is not expected to have a material impact on Arc's financial position, results of operations or cash flows.

Reclassification: Certain 2007 amounts have been reclassified to conform to the 2008 presentation. These classifications had no effect on previously reported change in net assets.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 2. Property And Equipment

The following is a summary of land, buildings, and equipment at June 30, 2008 and 2007:

	2008	2007
Land	\$ 1,807,815	\$ 1,651,144
Buildings and improvements	16,472,250	15,525,455
Vehicles	1,577,423	954,548
Furniture, fixtures and equipment	4,453,231	4,188,964
Leasehold improvements	280,221	280,220
	<u>24,590,940</u>	<u>22,600,331</u>
Accumulated depreciation	<u>(11,271,005)</u>	<u>(9,896,443)</u>
	<u>\$ 13,319,935</u>	<u>\$ 12,703,888</u>

Depreciation and amortization expense was \$1,385,186 and \$1,285,045 for 2008 and 2007, respectively, of which \$1,374,557 and \$1,274,416 represents depreciation for 2008 and 2007, respectively.

Note 3. Pension Plans

Defined contribution plan: Arc participates in a contributory 403(b) Plan whereby all employees with 90 days of service are eligible to make employee contributions and employees with one year of service are eligible to receive employer contributions. Eligible employees may elect to make pre-tax contributions to the 403(b) Plan subject to the annual maximum amount allowed by the Internal Revenue Code. Arc makes an initial contribution of 2% to 5% of compensation to all eligible employees based on the years of service for each employee. In addition, Arc will match employee contributions as follows:

- a) 100% of the first 1% of employee contributions.
- b) 50% of any employee contribution greater than 1% with a total match not to exceed 3% of an employee's compensation during any 403(b) plan year.

Total expense under the 403(b) plan for the years ended June 30, 2008 and 2007 was \$480,518 and \$456,965, respectively.

Deferred compensation plan: Effective July 1, 2004, Arc adopted a deferred compensation plan for several members of management. Under the Plan, a separate account is established for each participant, and Arc is permitted, but not required, to make an annual contribution to each participant's account. Vesting occurs in accordance with the underlying plan document. Total contributions to the Plan were \$0 and \$35,000 for each of the years ended June 30, 2008 and 2007. Deferred compensation payable was \$56,702 and \$61,431 for the years ended June 30, 2008 and 2007, respectively.

Noncontributory defined benefit plan: Arc maintains a noncontributory defined benefit pension plan (the Pension Plan) for the benefit of substantially all employees. Arc's noncontributory defined benefit pension (benefit) expense was (\$30,758) and \$53,269 for the years ended June 30, 2008 and 2007, respectively. The Pension Plan was frozen during 2003. Pension related changes other than net periodic pension (benefit) cost were \$531,833 during the year ended June 30, 2008.

Notes To Financial Statements

Note 3. Pension Plans (Continued)

Under the provisions of the Pension Plan, Arc makes contributions as required to maintain the Pension Plan on a sound actuarial basis. The Arc of Baltimore, Inc.'s policy is to make annual contributions as determined through actuarial valuation. The overall rate of expected return on assets assumption was based on historical returns, with adjustments made to reflect expectations of future returns. The extent to which the future expectations were recognized included the target rates of return for the future, which has historically not changed.

Arc adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, effective June 30, 2007. This statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the statement of financial position and to recognize changes in that funded status in the year changes occur as a change in net assets in the statement of activities. Funded status is measured as the difference between plan assets at fair value and the projected benefit obligation. The effect on financial statements as a result of adopting SFAS No. 158 was a decrease in unrestricted net assets of \$813,631 for the year ended June 30, 2007.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 3. Pension Plans (Continued)

The funded status and amounts recognized on the accompanying Statements of Financial Position relating to the Pension Plan, as of the measurement dates, are as follows:

	2008	2007
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 4,980,269	\$ 5,008,938
Actuarial loss (gain)	23,811	92,298
Interest cost	282,357	299,276
Benefits paid	(5,809)	(3,873)
Settlements	(727,125)	(416,370)
Benefit obligation at end of year	4,553,503	4,980,269
Change in plan assets		
Fair value of plan assets at beginning of year	5,744,319	5,898,431
Actual return on plan assets	(109,346)	380,271
Benefits paid	(5,809)	(3,873)
Benefit settlements	(812,686)	(530,510)
Fair value of plan assets at end of year	4,816,478	5,744,319
Funded status		
Unrecognized net actuarial loss	-	813,631
Effect of SFAS No. 158	-	(813,631)
Prepaid pension	\$ 262,975	\$ 764,050
Components of net periodic benefit cost		
Interest cost	\$ 282,357	\$ 299,276
Return on assets	(333,048)	(440,806)
Net amortization and deferral	19,933	12,635
Net periodic benefit cost	\$ (30,758)	\$ (128,895)
Components of pension related changes other than net periodic benefit cost		
Change in unrecognized net actuarial loss	\$ 272,788	\$ -
Effect of settlement	259,045	182,164
Pension related changes other than net periodic benefit cost	\$ 531,833	\$ 182,164

Settlement losses of \$259,045 and \$182,164 for the years ended June 30, 2008 and 2007, respectively, resulted from the Plan's annuity purchases, as the total of the Plan's lump sum payments and the annuity purchases exceeded the sum of the Plan's service costs and interest costs for the respective years.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 3. Pension Plans (Continued)

Assumptions: Weighted average assumptions used to determine net periodic pension cost and benefit obligations are as follows:

	2008	2007
Discount rate	6.00%	6.00%
Average increase in future compensation levels	N/A	N/A
Expected long-term rate of return on assets	7.50%	7.50%

Arc determines the expected long-term rate of return on Pension Plan assets by taking into consideration the historical returns of various asset classes and the types of investments the Pension Plan is expected to hold. The chart below details ranges for the expected long-term returns for the asset classes in which the Pension Plan currently invests:

Asset Class	Range of Expected Returns
Stocks	7.9% -10.1%
Bonds	5.0% - 6.1%
Alternative investments	7.1% - 8.0%
Cash	4.5%

Plan assets: The Pension Plan's weighted-average asset allocations at June 30, 2008 and 2007, by asset category are as follows:

	2008	2007
Stocks	61%	62%
Bonds	24%	28%
Alternative investments	11%	5%
Cash	4%	5%

Assets of the Pension Plan are invested in a manner consistent with fiduciary standards of the Employees Retirement Income Security Act of 1974 (ERISA); namely, (a) the safeguards and diversity to which a prudent investor would adhere must be present, and (b) all transactions undertaken on behalf of the Pension Plan must be for the sole interest of plan participants and beneficiaries to provide benefits in a prudent manner. Investment objectives of the Pension Plan also include:

- Preserve the value of the Plan's assets.
- Provide sufficient liquidity to plan benefit payment outflows and meet the Plan's requirements.

Contributions: Arc does not expect to contribute to the Plan in the fiscal year ending June 30, 2009.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 3. Pension Plans (Continued)

Estimated future benefit payments: The following benefit payments are expected to be paid:

<u>Years Ending June 30,</u>	
2009	\$ 447,406
2010	328,460
2011	350,998
2012	280,875
2013	285,580
2014-2018	1,823,659
	<u>\$ 3,516,978</u>

Note 4. Lease Obligations

Operating leases: Arc leases a portion of its facilities, automobiles, and equipment which are treated as operating leases for reporting purposes. Facility lease terms generally expire between the years 2008 and 2011 with options to renew for additional periods. Under the terms of the facility leases, Arc is responsible for the payment of real estate taxes and other operating expenses. Additionally, Arc leases certain automobiles and equipment with minimum lease terms of one year with options to renew. At June 30, 2008, Arc is liable under terms of noncancelable leases for the following minimum annual lease payments:

<u>Years Ending June 30,</u>	
2009	\$ 341,719
2010	197,609
2011	201,904
2012	102,904
	<u>\$ 844,136</u>

Rent expense charged to operations amounted to \$647,416 and \$601,347 for facilities and \$279,645 and \$303,023 for equipment and automobiles for the years ended June 30, 2008 and 2007, respectively.

Capital leases: Arc is obligated under various capital leases for office and landscape equipment, which expire between the years 2009 and 2011. The following is a schedule, by years, of future minimum payments required under the lease, together with their present value as of June 30, 2008:

<u>Years Ending June 30,</u>	
2009	\$ 221,382
2010	194,568
2011	52,989
Total minimum lease payments	<u>468,939</u>
Less amount representing interest (at imputed rates ranging from 7% to 14%)	<u>(23,653)</u>
Present value of minimum lease payments	<u>\$ 445,286</u>

Amortization of assets held under capital leases is included with depreciation expense (see Note 6 for maturity schedule of capital lease obligations).

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 4. Lease Obligations (Continued)

The following is an analysis at June 30, 2008 and 2007 of the equipment acquired under capital leases, which is included in property and equipment on the statement of financial position:

	2008	2007
Cost	\$ 2,663,705	\$ 2,663,705
Less: accumulated depreciation	(2,253,956)	(1,946,184)
	<u>\$ 409,749</u>	<u>\$ 717,521</u>

Note 5. Board-Designated Investments

Board-designated investments as of June 30, 2008 and 2007 consisted of the following:

	2008		2007	
	Cost	Fair Value	Cost	Fair Value
Money market funds	\$ 195,871	\$ 195,871	\$ 15,461	\$ 15,461
Mutual funds	798,893	804,517	604,907	682,246
	<u>\$ 994,764</u>	<u>\$ 1,000,388</u>	<u>\$ 620,368</u>	<u>\$ 697,707</u>

Subsequent to year-end, the credit and liquidity crisis in the United States of America and throughout the global financial system has resulted in substantial volatility in financial markets and the banking system. These and other economic events have had a significant adverse impact on investment portfolios. As a result, Arc's investments have likely incurred a significant decline in fair value since June 30, 2008.

Note 6. Long-Term Obligations

Long-term obligations consisted of the following at June 30, 2008 and 2007:

	2008	2007
Bond payable, Series 2000A and 2000B	\$ 4,965,000	\$ 5,105,000
Various mortgages payable, collateralized by deeds of trust on the respective properties; interest at rates ranging between 2% and 8.25% payable monthly with various maturity dates through March 2034	1,588,557	1,658,621
Capital lease obligations (Note 4)	468,939	737,384
Various notes payable, collateralized by vehicles; interest at rates ranging between 0% and 9.25%; payable monthly with various maturity dates through June 2013	927,337	660,012
	<u>7,949,833</u>	<u>8,161,017</u>
Less: current portion	(647,723)	(616,961)
	<u>\$ 7,302,110</u>	<u>\$ 7,544,056</u>

Certain land, buildings and improvements, and automobiles and trucks are pledged as collateral for long-term debt.

Interest expense relating to long-term debt of \$589,091 and \$554,763 was charged to operations for 2008 and 2007, respectively.

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 6. Long-Term Obligations (Continued)

Principal maturities for all long-term obligations as of June 30, 2008 are due in future years as follows:

Years Ending June 30,	Bond Payable	Mortgages Payable	Capital Lease Obligations	Notes Payable	Total
2009	\$ 155,000	\$ 70,007	\$ 221,382	\$ 201,334	\$ 647,723
2010	165,000	75,206	194,568	217,548	652,322
2011	175,000	79,941	52,989	237,339	545,269
2012	190,000	77,360	-	217,791	485,151
2013	205,000	71,161	-	53,325	329,486
Thereafter	4,075,000	1,214,882	-	-	5,289,882
	<u>\$ 4,965,000</u>	<u>\$ 1,588,557</u>	<u>\$ 468,939</u>	<u>\$ 927,337</u>	<u>\$ 7,949,833</u>

Bonds payable – 2000: In February 2000, the Maryland Economic Development Corporation (through its Health and Mental Hygiene Providers Facilities Acquisition Program) issued \$5,750,000 Revenue Bonds, Series 2000A and \$155,000 Taxable Revenue Bonds, Series 2000B. The bond proceeds were allocated to Arc, who entered into financing agreements to repay the bonds through March 2025.

The terms of Arc's financing agreement are as follows:

Allocated Bond Proceeds: \$5,905,000

Purpose: To purchase and renovate property at 6151 Metro Drive, Baltimore City and to pay off mortgages on certain residential properties.

Maturity Date and Interest Rate:
 \$445,000 - 7.125% Term Tax-Exempt Bond (paid off in 2006)
 \$5,305,000 - 7.750% Term Tax-Exempt Bonds due March 1, 2025
 \$155,000 - 10.500% Term Taxable Bonds (paid off in 2002)

Security Interest: Accounts receivable and certain other property.

Payment Terms: The Bonds shall be subject to mandatory sinking fund redemption at a redemption price equal to the principal amount of the bonds to be redeemed plus accrued interest to the redemption date on March 1, 2001, through 2025.

Trustee: M&T Bank

Redemption Terms: Bonds can be redeemed at the option of the issuer on any interest payment date on or after March 1, 2010.

Note 7. Bond Escrow Funds

In connection with the 2000 bond issuance (see Note 5), the bond proceeds are in the following funds at June 30, 2008 and 2007:

	2008	2007
Reserve Fund	\$ 575,543	\$ 530,107
Bond Fund	870,225	880,549
	<u>\$ 1,445,768</u>	<u>\$ 1,410,656</u>

The Arc Of Baltimore, Inc.

Notes To Financial Statements

Note 8. Line Of Credit

Arc has a \$2,000,000 unsecured line of credit which bears interest at the bank's prime rate plus 0.5% and matures on March 31, 2009. Advances against the line of credit are to be used for working capital and must be repaid by the maturity date. There was no balance on this line of credit at June 30, 2008 and 2007. The loan is subject to certain financial and operating covenants.

Note 9. Letters Of Credit

Arc has available stand-by letters of credit totaling \$339,741 and \$344,966 at June 30, 2008 and 2007, in accordance with an agreement with the State of Maryland. The letters of credit can be used by the State if Arc fails to pay self-insured unemployment compensation claims. There are no outstanding borrowings at June 30, 2008 and 2007 related to the stand-by letters of credit. The letters of credit were collateralized by a certificate of deposit in the amount of \$400,099 and \$383,714 as of June 30, 2008 and 2007, respectively.

Note 10. Residents' Funds

Arc acts in an agency capacity regarding the holding of residents' cash funds.

Note 11. Government Agencies

Revenue is recognized from federal and state grants and reimbursement for services is provided by state agencies based on per diem rates. Subsequent to year-end, regulatory reports are submitted and final determinations are made regarding over or underpayments. As of June 30, 2008 and 2007, Arc had accrued a liability of approximately \$434,000 and \$330,000 for the potential adjustments. The state had requested approximately \$784,000 for prior year adjustments, based on audits through fiscal year 1998. This liability was settled in full for approximately \$260,000 during the year ended June 30, 2007, which was covered in full by the reserve with the remaining balance added to revenue.

Receivables from government agencies represent billings, grants, and reimbursements (overpayments) associated with various programs.

Note 12. Temporarily Restricted Net Assets

Temporarily restricted net assets consisted of the following at June 30, 2008 and 2007:

	2008	2007
Purchase of residences	\$ 378,473	\$ 378,473
Project search	100,000	-
	<u>\$ 478,473</u>	<u>\$ 378,473</u>

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report On The Supplementary Information

To the Board of Directors
The Arc of Baltimore, Inc.
Baltimore, Maryland

The accompanying schedule of expenditures of Federal Awards, on page 31, is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations*, and is not a required part of the basic supplemental financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic supplemental financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic supplemental financial statements taken as a whole.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The other supplementary information which follows is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

McGladrey & Pullen, LLP

Baltimore, Maryland
October 28, 2008

The Arc Of Baltimore, Inc.

Supplemental Schedule Of Revenue And Expenses
 Year Ended June 30, 2008
 (With Comparative Totals For 2007)

	Program Services			Total Program Services
	Employment And Day	Community Living	Family And Children	
Support and Revenue				
Government agencies	13,802,657	13,004,941	4,727,283	\$ 31,534,881
Contracts and other revenues	8,967,860	1,269,692	-	10,237,552
Public support - direct	67,687	13,847	175,677	257,211
Public support - indirect	-	-	60,820	60,820
Gain on disposal of property	-	-	-	-
Total support and revenue	22,838,204	14,288,480	4,963,780	42,090,464
Expenses				
Staff salaries	8,562,561	7,581,864	1,141,072	17,285,497
Client salaries	3,052,194	9,710	-	3,061,904
Fringe benefits	2,037,659	1,546,405	232,844	3,816,908
Supplies, equipment and materials	1,600,024	484,317	39,033	2,123,374
Contracted services	981,363	94,176	161,323	1,236,862
Assistance to individuals	77,042	539,106	2,485,184	3,101,332
Depreciation	694,309	339,121	37,285	1,070,715
Transportation of clients	1,295,355	466	22,452	1,318,273
Food	200,021	434,856	2,866	637,743
Dues, memberships and licenses	10,053	1,320	26,159	37,532
Interest	220,800	174,808	30,488	426,096
Insurance	416,363	170,978	1,668	589,009
Utilities and telephone	366,107	388,226	47,060	801,393
Rent and lease expense	340,134	534,562	393	875,089
Repairs and maintenance	255,316	181,145	13,587	450,048
Training and travel	113,914	111,186	40,441	265,541
Administration and support	2,325,988	1,448,032	497,849	4,271,869
Miscellaneous	14,184	6,467	49,766	70,417
Total expenses	22,563,387	14,046,745	4,829,470	41,439,602
Change in net assets	\$ 274,817	\$ 241,735	\$ 134,310	\$ 650,862

Support and Administration	2008 Totals	2007 Totals
-	\$ 31,534,881	\$ 31,342,838
169,030	10,406,582	9,092,336
376,995	634,206	536,822
-	60,820	69,632
-	-	315,757
546,025	42,636,489	41,357,385

2,171,301	19,456,798	17,929,945
36,523	3,098,427	2,937,079
445,698	4,262,606	3,976,827
491,320	2,614,694	2,046,058
540,235	1,777,097	1,734,946
355	3,101,687	3,374,504
314,471	1,385,186	1,285,045
-	1,318,273	1,612,116
1,800	639,543	566,492
125,632	163,164	188,564
162,995	589,091	554,759
73,122	662,131	722,322
121,871	923,264	788,688
51,972	927,061	904,015
73,830	523,878	374,908
142,198	407,739	316,828
(4,271,869)	-	-
46,694	117,111	70,364
528,148	41,967,750	39,383,460
\$ 17,877	\$ 668,739	\$ 1,973,925

The Arc Of Baltimore, Inc.

Supplemental Schedule Of Revenue And Expenses
Year Ended June 30, 2007

	Program Services			
	Employment And Day	Community Living	Family And Children	Total Program Services
Support and Revenue				
Government agencies	\$ 13,474,149	\$ 12,726,091	\$ 5,071,683	\$ 31,271,923
Contracts and other revenues	7,589,779	1,226,819	-	8,816,598
Public support - direct	45,780	508	142,613	188,901
Public support - indirect	-	-	80,504	80,504
Gain on disposal of property	-	-	-	-
Total support and revenue	21,109,708	13,953,418	5,294,800	40,357,926
Expenses				
Staff salaries	7,968,359	7,373,296	1,021,641	16,363,296
Client salaries	2,863,245	4,723	-	2,867,968
Fringe benefits	1,920,353	1,517,239	210,166	3,647,758
Supplies, equipment and materials	1,205,403	458,350	51,277	1,715,030
Contracted services	888,097	138,315	179,042	1,205,454
Assistance to individuals	52,641	535,953	2,782,600	3,371,194
Depreciation	582,868	333,828	41,993	958,689
Transportation of clients	1,586,433	355	25,253	1,612,041
Food	191,239	357,324	4,001	552,564
Dues, memberships and licenses	16,993	22,199	18,522	57,714
Interest	171,477	183,280	30,976	385,733
Insurance	402,949	191,081	9,055	603,085
Utilities and telephone	327,664	322,254	31,969	681,887
Rent and lease expense	356,072	504,255	2,221	862,548
Repairs and maintenance	220,078	96,586	10,011	326,675
Training and travel	91,370	72,958	40,937	205,265
Administration and support	1,737,031	1,116,175	412,390	3,265,596
Miscellaneous	2,565	32	14,664	17,261
Total expenses	20,584,837	13,228,203	4,886,718	38,699,758
Change in net assets	\$ 524,871	\$ 725,215	\$ 408,082	\$ 1,658,168

Support and Administration	Totals
\$ 70,915	\$ 31,342,838
275,738	9,092,336
347,921	536,822
(10,872)	69,632
315,757	315,757
999,459	41,357,385

1,566,649	17,929,945
69,111	2,937,079
329,069	3,976,827
331,028	2,046,058
529,492	1,734,946
3,310	3,374,504
326,356	1,285,045
75	1,612,116
13,928	566,492
130,850	188,564
169,026	554,759
119,237	722,322
106,801	788,688
41,467	904,015
48,233	374,908
111,563	316,828
(3,265,596)	-
53,103	70,364
683,702	39,383,460
\$ 315,757	\$ 1,973,925

The Arc Of Baltimore, Inc.

Schedule Of Foster Care And Treatment
 Foster Care Revenue And Expenses
 Year Ended June 30, 2008

	Treatment Foster Care	
	Actual	Budget (Unaudited)
Revenue		
Fee for service	\$ 3,485,752	\$ 4,281,000
Private Pay	25	-
	<u>3,485,777</u>	<u>4,281,000</u>
Expenses		
Employees salaries	866,285	1,138,969
Payroll Taxes	66,271	91,118
Fringe benefits	140,061	193,625
Staff Development Cost	7,979	17,674
Contracted services	632	-
TFC Difficulty of Care	998,514	1,320,300
TFC Board Payments	599,109	792,180
TFC Respite Care	48,157	76,000
Publicity	26,442	38,900
Rent	-	500
Utilities	10,641	7,500
Repairs and maintenance	11,047	8,000
Insurance and Taxes	3,532	5,000
Supplies	12,565	5,526
Depreciation	30,315	24,000
Equipment Rental/ Lease Repairs	74	-
Printing & Copying	12,800	5,700
Telephone	29,365	19,950
Memberships and Subscriptions	24,355	16,400
Conferences and Conventions	11,215	37,100
Travel and Transportation	26,855	27,700
	<u>336,679</u>	<u>454,858</u>
Total allowable expenses	<u>3,262,893</u>	<u>4,281,000</u>
Excess of revenue over allowable expenses	222,884	-
Interest	<u>24,788</u>	<u>24,911</u>
Excess of revenue over expenses	<u>\$ 198,096</u>	<u>\$ 24,911</u>
Contracted monthly fees	<u>\$ 3,568</u>	
Child care months	977	
Actual cost of care per month	<u>\$ 3,340</u>	

Independent Auditor's 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.

To the Board of Directors
The Arc of Baltimore, Inc.
Baltimore, Maryland

We have audited the financial statements of The Arc of Baltimore Inc. as of and for the year ended June 30, 2008, and have issued our report thereon dated October 28, 2008. 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 the Arc of Baltimore Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Arc of Baltimore Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Arc of Baltimore Inc.'s internal control over financial reporting

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether The Arc of Baltimore Inc.'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

McGladrey & Pullen, LLP

Baltimore, Maryland
October 28, 2008

Independent Auditor's Report On Compliance With Requirements Applicable To Each Major Program And Internal Control Over Compliance In Accordance With OMB Circular A-133

To the Board of Directors
The Arc of Baltimore, Inc.
Baltimore, Maryland

Compliance

We have audited the compliance of The Arc of Baltimore, Inc. with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Arc of Baltimore Inc.'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of The Arc of Baltimore Inc.'s management. Our responsibility is to express an opinion on The Arc of Baltimore Inc.'s compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about The Arc of Baltimore Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on The Arc of Baltimore Inc.'s compliance with those requirements.

As described in finding 08-01 in the accompanying schedule of findings and questioned costs, The Arc of Baltimore Inc. did not comply with requirements regarding compliance for medical and dental examinations for foster children and required certifications for foster parents. Compliance with such requirements is necessary, in our opinion, for The Arc of Baltimore, Inc. to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, The Arc of Baltimore, Inc. complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2008.

Internal Control Over Compliance

The management of The Arc of Baltimore Inc. is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered The Arc of Baltimore Inc.'s internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance but, not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of The Arc of Baltimore Inc.'s internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by any entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The Arc of Baltimore Inc.'s response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit The Arc of Baltimore Inc.'s response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

McGladrey & Pullen, LLP

Baltimore, Maryland
October 28, 2008

The Arc Of Baltimore, Inc.

Schedule Of Expenditures Of Federal Awards
Year Ended June 30, 2008

Federal Award Program	Federal Catalog Number	Pass-Through Grantor Program Title	Accrued (Deferred) Revenue as of June 30, 2008	Expenditures Recognized (Allowable)	Cash Received
U.S. Department of Health and Human Services: Pass-Through Maryland Department of Human Resources:					
Treatment Foster Care	93.658	Treatment Foster Care	\$ 303,939	\$ 3,262,893	\$ 3,589,686
U.S. Department of Housing and Urban Development: Pass-Through Baltimore County Department of Community Conservation: Commission on Disabilities Commission Development Block Grants Renovation Project					
	14.218	Commission on Disabilities Commission Development Block Grants Renovation Project	-	44,605	44,605
U.S. Department of Agriculture: Pass-Through Maryland State Department of Education: Child and Adult Care Food Program					
	10.558	Child and Adult Care Food Program	16,828	186,742	186,715
Totals			<u>\$ 320,767</u>	<u>\$ 3,494,240</u>	<u>\$ 3,821,006</u>

See Notes to Schedule of Expenditures of Federal Awards.

The Arc Of Baltimore, Inc.

**Notes To Schedule Of Expenditures Of Federal Awards
Year Ended June 30, 2008**

Note 1. Scope Of Audit Pursuant To OMB Circular A-133

All federal award programs operated by The Arc of Baltimore, Inc. (Arc) are included in the scope of the Office of Management and Budget (OMB) Circular A-133 audit (the Single Audit). The Single Audit was performed in accordance with the provisions of the OMB Circular A-133 Compliance Supplement (the Compliance Supplement). Arc is considered a low risk entity in accordance with OMB Circular A-133. Compliance testing of all requirements, as described in the Compliance Supplement, was performed for the major federal programs. These programs represent all federal award programs with fiscal year 2008 expenditures which were considered to be a major program and covered at least 25% of federally-granted funds.

Arc's other federal award programs were considered low-risk programs for the 2008 audit.

Note 2. Summary Of Significant Accounting Policies

Basis of presentation: The accompanying schedule of Expenditures of Federal Awards includes the federal grant activity of Arc and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Note 3. Subrecipients

Arc did not provide federal awards to any subrecipients.

The Arc Of Baltimore, Inc.

Schedule Of Findings And Questioned Costs
Year Ended June 30, 2008

I. Summary Of Independent Auditor's Results

Financial Statements

Type of auditor's report issued:

Unqualified

Internal control over financial reporting:

- Material weakness(es) identified?
- Significant deficiency(ies) identified that are not considered to be a material weakness(es)?

Yes No
 Yes None Reported

Noncompliance material to financial statements noted?

Yes No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified?
- Significant deficiency(ies) identified that are not considered to be a material weakness(es)?

Yes No
 Yes None Reported

Type of auditor's report issued on compliance for major programs:

Qualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?

Yes No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
93.658	Foster Care and Treatment Foster Care

Dollar threshold used to distinguish between type A and type B programs:

\$300,000

Auditee qualified as low risk auditee?

Yes No

Schedule Of Findings And Questioned Costs - Continued
Year Ended June 30, 2008

II. Financial Statement Findings

Compliance
None reported.

Internal Control
None reported.

III. Findings and Questioned Costs for Federal Awards

Compliance
Finding 08-01

Criteria or specific requirement: Files for foster care children and foster parents must be maintained. Files for foster care children must include annual medical and dental examinations. Files for foster parents must contain required first aid certifications, CPR certifications, a medical examination every two years, etc.

Condition: The foster care files lacked documentation that the required medical and dental examinations were being obtained for the children and that the required certifications were being obtained and updated for the parents. In our sample of 23 children, one child was missing the required dental examinations at the time of our testwork. Arc did follow up with this child subsequently and the required dental exam was performed. In our sample of 23 parents, including 11 households with multiple parents, three parents were missing CPS background checks. All three CPS background checks were performed after our testwork had been completed.

Effect: The failure to perform the examinations and update the certifications and maintain accurate records could result in the respective granting agency's determination that the programs are not in compliance with Federal guidelines and grant agreements. This could result in a denial of funding or termination.

Cause: Penalties on parents who fail to comply have not been enforced.

Recommendation: Management should enforce monetary penalties for parents who do not comply with Arc's guidelines established by the federal government.

Planned corrective actions: Effective July 1, 2008, management implemented penalty fees on households for late/missing documentation. These fees are deducted from the household's monthly stipend. As of December 1, 2008, families that comply will receive an increased stipend.

Internal Control
None reported

The Arc Of Baltimore, Inc.

Schedule of Prior Year Findings
Year Ended June 30, 2008

I. Schedule of Prior Year Audit Findings

Condition 07-01: The foster care files lacked documentation that the required medical and dental examinations were being obtained for the children and that the required certifications were being obtained and updated for the parents. In our sample of 23 children, four children were missing the required medical examinations, and eight children were missing the required dental examination. In our sample of 23 parents, five were missing the required CPR certification, five were missing the required first aid certification, and six had an expired two-year medical exam.

Corrective action taken: See Finding 08-01 on the Schedule of Findings and Questioned Costs