The Arc™

of the Virginia Peninsula

FINANCIAL REPORT

JUNE 30, 2012 AND 2011

The Arc of the Virginia Peninsula, Inc.

FINANCIAL REPORT

JUNE 30, 2012 AND 2011

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PBMares

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
The Arc of the Virginia Peninsula, Inc.

We have audited the accompanying statements of financial position of The Arc of the Virginia Peninsula, Inc. ("The Arc"), a nonprofit organization, as of June 30, 2012 and 2011, and the related statements of activities, cash flows, and functional expenses for the years then ended. These financial statements are the responsibility of The Arc's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit provides 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 the Virginia Peninsula, Inc. as of June 30, 2012 and 2011, 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.

PBMares, LLP

Norfolk, Virginia
January 15, 2013

FINANCIAL STATEMENTS

THE ARC OF THE VIRGINIA PENINSULA, INC.

Statements of Financial Position

June 30, 2012 and 2011

	2012	2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	**$ 2,532,745**	$ 2,963,359
Accounts receivable, net	**3,666,640**	3,789,970
Account receivable - Medicaid	**566,033**	130,233
Pledges receivable, net	**273,829**	140,472
Advances to affiliates	**5,840**	4,635
Prepaid expenses	**121,691**	91,185
Total current assets	**7,166,778**	7,119,854
PROPERTY AND EQUIPMENT, NET	**6,604,337**	6,803,689
OTHER ASSETS		
Land held for sale	**97,313**	97,313
Pledges receivable, net of current portion	**15,100**	47,942
Deposits, insurance	**38,004**	63,634
Resident security deposits and custodial bank accounts	**34,607**	27,588
Total other assets	**185,024**	236,477
Total assets	**$ 13,956,139**	$ 14,160,020

THE ARC OF THE VIRGINIA PENINSULA, INC.

Statements of Financial Position

June 30, 2012 and 2011

	2012	2011
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	**$ 268,261**	$ 278,220
Accounts payable	**1,787,617**	812,946
Account payable - Medicaid	**31,583**	398,375
Accrued expenses	**1,199,525**	2,813,790
Total current liabilities	**3,286,986**	4,303,331
LONG-TERM LIABILITIES		
Long-term debt, less current maturities	**3,231,627**	3,515,585
Resident security deposits and custodial bank accounts	**34,607**	27,588
Total long-term liabilities	**3,266,234**	3,543,173
Total liabilities	**6,553,220**	7,846,504
NET ASSETS		
Unrestricted	**6,224,919**	5,139,541
Unrestricted, board designated	**1,000,000**	1,000,000
Temporarily restricted	**178,000**	173,975
Total net assets	**7,402,919**	6,313,516
Total liabilities and net assets	**$ 13,956,139**	$ 14,160,020

See accompanying notes.

THE ARC OF THE VIRGINIA PENINSULA, INC.

Statements of Activities

Year Ended June 30, 2012

	Unrestricted	Temporarily Restricted	Total
PUBLIC SUPPORT AND REVENUES			
Public support:			
Contributions	$ 55,115	$ 105,641	$ 160,756
United Way of the Virginia Peninsula	-	119,000	119,000
Net assets released from restriction			
Expiration of time restriction	220,616	(220,616)	-
Total public support	275,731	4,025	279,756
Revenues:			
State and local grants	206,071	-	206,071
Fee revenues	8,779,472	-	8,779,472
Contract sales and commissions	20,966,693	-	20,966,693
Other	601,432	-	601,432
Total revenues	30,553,668	-	30,553,668
Total public support and revenues	30,829,399	4,025	30,833,424
EXPENSES			
Program expenses:			
Work programs	21,937,397	-	21,937,397
Non-work programs	2,471,539	-	2,471,539
Intermediary Care Facility for the			
Mentally Retarded (ICF/ID)	5,156,992	-	5,156,992
Total program expenses	29,565,928	-	29,565,928
Supporting services:			
Management and general expenses	181,889	-	181,889
Total expenses	29,747,817	-	29,747,817
Change in net assets from operations	1,081,582	4,025	1,085,607
OTHER CHANGES			
Interest	3,317	-	3,317
Gain on disposal of fixed assets	479	-	479
Total other changes	3,796	-	3,796
Change in net assets	1,085,378	4,025	1,089,403
NET ASSETS			
Beginning	6,139,541	173,975	6,313,516
Ending	$ 7,224,919	$ 178,000	$ 7,402,919

See accompanying notes.

THE ARC OF THE VIRGINIA PENINSULA, INC.
Statements of Activities
Year Ended June 30, 2011

	Unrestricted	Temporarily Restricted	Total
PUBLIC SUPPORT AND REVENUES			
Public support:			
Contributions	$ 71,208	$ 114,665	$ 185,873
United Way of the Virginia Peninsula	-	99,000	99,000
Net assets released from restriction			
Expiration of time restriction	244,050	(244,050)	-
Total public support	315,258	(30,385)	284,873
Revenues:			
State and local grants	430,050	-	430,050
Fee revenues	7,838,907	-	7,838,907
Contract sales and commissions	18,979,093	-	18,979,093
Other	335,227	-	335,227
Total revenues	27,583,277	-	27,583,277
Total public support and revenues	27,898,535	(30,385)	27,868,150
EXPENSES			
Program expenses:			
Work programs	20,004,981	-	20,004,981
Non-work programs	2,912,275	-	2,912,275
Intermediary Care Facility for the			
Intellectually disabled (ICF/ID)	3,968,056	-	3,968,056
Total program expenses	26,885,312	-	26,885,312
Supporting services:			
Management and general expenses	173,413	-	173,413
Total expenses	27,058,725	-	27,058,725
Change in net assets from operations	839,810	(30,385)	809,425
OTHER CHANGES			
Interest	5,917	-	5,917
Loss on disposal of fixed assets	2,828	-	2,828
Total other changes	8,745	-	8,745
Change in net assets	848,555	(30,385)	818,170
NET ASSETS			
Beginning	5,290,986	204,360	5,495,346
Ending	$ 6,139,541	$ 173,975	$ 6,313,516

See accompanying notes.

THE ARC OF THE VIRGINIA PENINSULA, INC.

Statements of Cash Flows

Year Ended June 30, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	**$ 1,089,403**	$ 818,170
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	**403,822**	367,133
Provision for bad debts	**34,805**	90,489
Gain on disposal of fixed assets	**(479)**	(2,828)
In-kind donations of transportation equipment	**(79,346)**	-
Changes in assets and liabilities:		
Accounts receivable	**88,525**	(238,727)
Account receivable - Medicaid	**(435,800)**	(130,233)
Account payable - Medicaid	**(366,792)**	50,862
Pledges receivable, net	**(100,515)**	6,283
Advances to affiliates	**(1,205)**	31,746
Prepaid expenses	**(30,506)**	(33,706)
Deposits, insurance	**25,630**	(63,634)
Accounts payable	**974,671**	224,636
Accrued expenses	**(1,614,265)**	237,242
Net cash provided by (used in) operating activities	**(12,052)**	1,357,433
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	**(125,345)**	(176,171)
Proceeds on disposal of property and equipment	**700**	3,550
Net cash used in investing activities	**(124,645)**	(172,621)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on long-term debt	**(293,917)**	(610,420)
Net cash used in financing activities	**(293,917)**	(610,420)
Net increase (decrease) in cash and cash equivalents	**(430,614)**	574,392

(Continued)

See accompanying notes.

THE ARC OF THE VIRGINIA PENINSULA, INC.

Statements of Cash Flows

Years Ended June 30, 2012 and 2011

(Concluded)

	2012	2011
CASH AND CASH EQUIVALENTS		
Beginning	**$ 2,963,359**	$ 2,388,967
Ending	**$ 2,532,745**	$ 2,963,359
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash paid for interest	**$ 179,584**	$ 237,171
SUPPLEMENTAL DISCLOSURES OF NON-CASH ACTIVITIES		
Property and equipment purchased with debt	**$ -**	$ 224,000
Donated property and equipment	**$ 79,346**	$ -
Disposal of fully depreciated fixed assets	**$ 82,834**	$ 76,794

See accompanying notes.

THE ARC OF THE VIRGINIA PENINSULA, INC.
Statement of Functional Expenses
Year Ended June 30, 2012

	Work Programs	Non-Work Programs	ICF/ID	Management and General	Total
Direct costs					
Personnel costs	$ 10,783,678	$ 1,766,761	$ 3,135,700	$ 1,235,919	$ 16,922,058
Staff development	48,565	3,098	4,769	26,498	82,930
Subcontractors	8,744,388	-	-	-	8,744,388
Facility expenses	186,576	54,034	177,954	267,029	685,593
Equipment and supplies	501,365	176,517	332,927	160,709	1,171,518
Professional fees	213,572	1,879	180,776	104,498	500,725
Interest expense	11,232	13,860	59,977	93,785	178,854
Software licensing and support	6,198	1,102	420	89,816	97,536
ICF/ID assessment expense	-	-	244,291	-	244,291
Contract administration fees	646,659	-	-	-	646,659
Other	131,980	28,416	52,747	260,122	473,265
Total direct costs	21,274,213	2,045,667	4,189,561	2,238,376	29,747,817
Indirect costs					
Allocation of management and general expenses	663,184	425,872	967,431	(2,056,487)	-
Total costs	$ 21,937,397	$ 2,471,539	$ 5,156,992	$ 181,889	$ 29,747,817

See accompanying notes.

THE ARC OF THE VIRGINIA PENINSULA, INC.
Statement of Functional Expenses
Year Ended June 30, 2011

	Work Programs	Non-Work Programs	ICF/ID	Management and General	Total
Direct costs					
Personnel costs	$ 9,389,496	$ 2,005,576	$ 2,550,383	$ 1,043,094	$ 14,988,549
Staff development	49,417	3,052	4,344	18,071	74,884
Subcontractors	8,568,310	-	-	-	8,568,310
Facility expenses	123,189	117,839	126,411	275,369	642,808
Equipment and supplies	437,119	199,643	241,241	150,637	1,028,640
Professional fees	96,297	8,456	144,233	61,688	310,674
Interest expense	41,130	26,103	51,740	118,284	237,257
Software licensing and support	6,051	1,155	17	68,131	75,354
Contract administration fees	565,664	-	-	-	565,664
Other	126,010	42,577	45,114	352,884	566,585
Total direct costs	19,402,683	2,404,401	3,163,483	2,088,158	27,058,725
Indirect costs					
Allocation of management and general expenses	602,298	507,874	804,573	(1,914,745)	-
Total costs	$ 20,004,981	$ 2,912,275	$ 3,968,056	$ 173,413	$ 27,058,725

See accompanying notes.

NOTE 1. NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Organization

The Arc of the Virginia Peninsula, Inc. ("The Arc") is a non-profit, non-stock corporation. Founded in 1953 by a group of concerned families, The Arc has a proud history of service to people with developmental disabilities and their families. The Arc serves more than 1,600 individuals with developmental and related disabilities annually in employment, community living, day support and early childhood programs. Services range from providing developmental screenings for children to helping elderly caregivers plan for the future of their aging loved ones with disabilities. The Arc's service area includes Hampton, Newport News, Poquoson and York County, as well as the ten rural counties on the Middle Peninsula/Northern Neck of Virginia.

Basis of Presentation

Financial statement presentation follows the recommendations of FASB Accounting Standards Codification (ASC) 958, Not-for-Profit Entities. Under ASC 958, the organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of these financial statements, The Arc considers all highly liquid investments, purchased with a maturity of three months or less, to be cash equivalents.

Accounts Receivable

Accounts receivable represents revenues earned pursuant to various contracts or other agreements entered into by The Arc and are stated at the amount management expects to collect from outstanding balances. The organization does not accrue finance charges on outstanding accounts receivable. Most accounts receivable are due from governmental bodies, which pay The Arc interest at a variable rate if the account is not settled within 30 days of the invoice date. The Arc records this interest income as received.

(Continued)

NOTE 1. NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounts receivable are considered past due based on the payment terms of the various contracts and agreements. Receivables past due 90 or more days totaled $136,459 and $294,669 as of June 30, 2012 and 2011, respectively. Management provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. The allowance amount as of June 30, 2012 and 2011 was $240,754 and $205,949, respectively.

Pledges Receivable

Pledges are recognized when the donor makes a promise to give to The Arc that is, in substance, unconditional. Pledges that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire or are otherwise satisfied in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions.

The pledges receivable represent amounts due from the United Way expected to be received in the next fiscal year and amounts from capital campaigns. These amounts are temporarily restricted.

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets that range from three to forty years.

Maintenance and repairs, including replacement of minor items of physical properties, are charged to expense; major additions are capitalized. The Arc follows the practice of capitalizing all expenditures for equipment in excess of $5,000.

Land Held for Sale

The Arc holds a vacant parcel of land at its Hampton location that is being actively marketed.

Resident Security Deposits and Custodial Bank Accounts

The Arc holds security deposits for individuals living in residential homes as well as custodial bank accounts for participants in The Arc's programs.

(Continued)

NOTE 1. NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Functional Allocation of Expenses

Functional expenses have been allocated between program services and management and general expenses based on an analysis of personnel time, space, supplies and equipment utilized for the related activities.

Donated Materials and Services

Contributed property and equipment is recorded at fair value at date of donation. If donors stipulate how long the assets must be used, the contributions are recorded as restricted support. In the absence of such stipulations, contributions of property and equipment are recorded as unrestricted support.

The Arc recognizes the estimated fair value of contributed services that meet the following criteria:

- The services rendered either create or enhance non-financial assets.
- The services received require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by contribution.

Although a number of volunteers donate significant amounts of time to The Arc, no services meeting these criteria were donated.

Income Taxes

The Arc is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Furthermore, it is classified as a publicly supported charitable organization under Section 509(a)(l) of the Internal Revenue Code and qualifies for the maximum charitable contribution deduction for its donors. The Arc is subject to income taxes on profits, if any, from unrelated business activities.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Organization's management has evaluated the impact of this guidance on its financial statements. The Organization is not aware of any material uncertain tax positions, and has not accrued the effect of any uncertain tax positions as of June 30, 2012. With few exceptions, the Organization is no longer subject to income tax examinations by federal, state or local tax authorities for years before 2008.

The Organization's policy is to classify income tax related interest and penalties in interest expense and other expenses, respectively.

(Continued)

NOTE 1. NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Concluded)

Fee Revenues

Fee revenues include the estimated net realizable amounts from third party payers, patients and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are recorded on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Advertising

Advertising costs are expensed when incurred and totaled \$8,998 and \$20,534 for 2012 and 2011, respectively.

Contributions and Net Assets

The organization reports information regarding financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The financial statements report amounts separately by class of asset, when applicable, as follows:

Unrestricted amounts are those currently available for use at the discretion of the organization's Board of Directors and are used for operations. The Board of Directors has designated \$1,000,000 for operating reserves at June 30, 2012, and June 30, 2011.

Temporarily restricted amounts are those which are stipulated by donors for specific operating purposes or future years. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Temporarily restricted net assets consist of amounts restricted for future years and for use in connection with the Puller Center.

Permanently restricted amounts are restricted to investments in perpetuity, the income from which is expendable in accordance with the conditions of each specific donation. The organization has no permanently restricted net assets.

NOTE 2. PLEDGES RECEIVABLE

The pledges receivable are unconditional and are as follows:

	2012	2011
Receivable in less than one year	**$ 283,269**	$ 155,467
Receivable in one to five years	**15,100**	47,942
Total unconditional pledges	**298,369**	203,409
Less allowance for uncollectible pledges receivable	**(9,440)**	(14,995)
Net unconditional pledges receivable	**$ 288,929**	$ 188,414

NOTE 3. PROPERTY AND EQUIPMENT

As of June 30, 2012 and 2011, major classes of property and equipment consisted of the following:

	2012	2011
Land	**$ 779,575**	$ 779,575
Land and leasehold improvements	**176,967**	176,967
Buildings	**6,662,137**	6,617,394
Vehicles	**1,003,785**	902,354
Furniture and fixtures	**1,133,360**	1,157,898
	9,755,824	9,634,188
Less accumulated depreciation	**(3,151,487)**	(2,830,499)
	$ 6,604,337	$ 6,803,689

Depreciation expense for the years ended June 30, 2012 and 2011 was $403,822 and $367,133, respectively.

NOTE 4. ACCOUNTS RECEIVABLE/PAYABLE - MEDICAID

In accordance with their reimbursement agreement and as determined in their year-end cost report, The Arc has recorded $566,033 and $130,233 as a receivable from Medicaid at June 30, 2012 and June 30, 2011, respectively.

In 2011, The Arc entered into a payment agreement with the Department of Medical Assistance Services (DMAS) for settlement of the cost report for June 30, 2010. The Arc is paying the balance due in monthly installments of $29,625 which includes interest of 6%. The amount due to DMAS under this settlement plan totaled $15,734 and $203,289 for the years ended June 30, 2012 and June 30, 2011, respectively.

(Continued)

NOTE 4. ACCOUNTS RECEIVABLE/PAYABLE – MEDICAID (Concluded)

As of June 30, 2012, the total balance due to DMAS was $31,583, which includes $15,849 for the fiscal year 2011 retroactive cash adjustment and the above balance due for fiscal year 2011. As of June 30, 2011, the balance due to DMAS was $398,375, which included $195,086 for the fiscal year 2011 retroactive cash adjustment.

NOTE 5. LINE OF CREDIT

On March 31, 2011, The Arc obtained a line of credit of $350,000 with Wells Fargo Bank, N.A. Draws against the line are collateralized by a security interest and a lien on the organization’s equipment, deposit accounts and other personal property outlined in the security agreement with the financial institution. Interest accrues on the unpaid principal balance of each draw at a rate equal to the greater of 1-month LIBOR plus 3.50% or 5.00%.

On April 25, 2012, The Arc renewed its line of credit for $750,000. On June 19, 2012, the line of credit was increased to $1,000,000. This line of credit matures April 30, 2013.

The line of credit provides that the organization maintain a minimum tangible net worth of $4 million. The Arc was in compliance with this financial covenant at June 30, 2012 and 2011.

The Arc had no outstanding balances on the lines of credit at June 30, 2012 and 2011.

NOTE 6. LONG-TERM DEBT

Long-term debt at June 30, 2012 and 2011 is as follows:

	2012	2011
Chesapeake Bank, installment note, secured by deed of trust, due monthly at $1,362 including interest at 5.65%, maturing November 2028	**$ 171,636**	$ 207,258
SunTrust Bank, installment notes, secured by deed of trust or collateralized by furniture, fixtures, equipment and vehicles, due monthly at $5,267 including interest at 6.98%, maturing through August 2014	**124,421**	176,785

(Continued)

NOTE 6. LONG-TERM DEBT (Concluded)

	2012	2011
Old Point National Bank, installment notes, secured by deeds of trust, due monthly at $656 to $14,202 including interest at 4.125% to 6.000 %, interest rates are subject to a review every 60 months, maturing through July 2034	**$ 3,126,483**	$ 3,284,494
TowneBank, promissory notes, secured by vehicles and equipment, due monthly at $263 to $894 including interest at 5.6% to 8%, maturing through November 2016	**77,348**	125,268
	3,499,888	3,793,805
Less current maturities	**268,261**	278,220
	$ 3,231,627	$ 3,515,585

Future principal maturities of long-term debt are as follows:

2013	$ 268,261
2014	261,141
2015	206,639
2016	390,838
2017	200,175
Thereafter	2,172,834
	$ 3,499,888

Subsequent to year end the long-term debt with SunTrust Bank and Old Point National Bank was refinanced. After the refinancing, annual maturities of all the above debt for the next five years approximate the follows: $205,000 in 2013, $212,000 in 2014, $210,000 in 2015, $219,000 in 2016, $221,000 in 2017, and $2,433,000 thereafter.

NOTE 7. RETIREMENT PLAN

Up until November 30, 2009, The Arc had a group tax deferred annuity plan. Under this plan, The Arc contributed an amount equal to 5% of each eligible employee's gross salary. Eligible employees are "classified staff" (as defined in the Plan documents) who worked over 1,000 hours during the calendar year, have attained age twenty-one, and completed one year of service. Vesting in employer contributions occurred over a graduated six-year schedule. Employees were allowed to contribute additional amounts up to the maximum permitted under Internal Revenue Code regulations. In November, 2009, the Board of Directors voted to terminate the tax deferred annuity plan effective November 30, 2009.

On July 27, 2010, The Arc made a submission to the Internal Revenue Service under the Voluntary Correction with Service Approval Program to correct certain plan defects with the tax deferred annuity plan. The Arc received a favorable Compliance Statement dated June 15, 2011.

Effective September 1, 2009, The Arc established a 401(k) profit sharing plan that covers most employees. Eligible employees may elect to have their compensation deferred up to 100% of gross pay. The Arc contributes up to 5% of each eligible employee's gross salary.

Effective September 1, 2009, The Arc established a 457(b) deferred compensation plan that covers a select group of management.

Retirement expense under these retirement plans for the years ended June 30, 2012 and 2011 was $131,481 and $166,241, respectively.

The Arc also recorded contributions to separate 401(k) accounts for employees subject to a collective bargaining agreement, totaling $66,178 and $42,213 for the years ended June 30, 2012 and June 30, 2011, respectively. Contributions were made at a rate of $1.80 per hour worked for full-time employees and $0.75 per hour worked for part-time employees as of June 30, 2012. As of June 30, 2011, contributions were made at a rate of $0.75 per hour worked for all employees under the collective bargaining agreement.

NOTE 8. RELATED PARTY TRANSACTIONS

The Arc has management agreements for three homes for very low-income people with disabilities. These agreements provide for a management fee of 13.7% - 14.75% of rents collected to be paid to The Arc. Management fees for each of the years ended June 30, 2012 and 2011 were $10,270 and $8,347, respectively. Advances to affiliates represent operating advances to three affiliated corporations that were established with capital grants from the U. S. Department of Housing and Urban Development to operate these residential homes.

NOTE 9. FUNDRAISING

Management and general expenses include total fundraising expenses of $52,437 and $42,922 for the years ended June 30, 2012 and 2011, respectively.

NOTE 10. CONCENTRATIONS

Financial instruments that potentially subject The Arc to concentrations of credit risk include cash and cash equivalents, accounts receivable, Medicaid reimbursement receivable and pledges receivable.

All cash and cash equivalents are deposited with various financial institutions. Each bank's collected balances are insured in the aggregate by the Federal Deposit Insurance Corporation. The Arc had cash deposits in excess of insured amounts of $322,077 at June 30, 2012. The Arc had no amounts on deposit in excess of the insured amounts at June 30, 2011.

In the normal course of business, The Arc provides credit to customers under standard terms without collateral. Government contract revenue is a significant component of the revenues of certain employment programs of The Arc. Other program activities such as ICF/ID and supported and sheltered employment are dependent on third party reimbursement arrangements. The Arc is subject to review by the Department of Medical Assistance Services with regard to revenues in the ICF/ID programs. This has resulted in paybacks and reimbursements in the past and may result in subsequent revenue adjustments. The Arc does not believe these adjustments will be material to the organization.

During the year ended June 30, 2012 and 2011, 12% and 13%, respectively, of The Arc's employees were subject to a collective bargaining agreement (CBA) signed with the International Union of Operating Engineers (IUOE). The CBA expires September 30, 2012. Subsequent to year-end, the CBA was renewed, and will now expire on September 30, 2013.

NOTE 11. RENTAL REVENUE

The Organization leases warehouse and retail space to two unrelated businesses, under non-cancelable operating leases. Total rents received for the years ended June 30, 2012 and 2011 were $87,576 and $72,719, respectively.

Minimum future rentals on non-cancelable tenant operating leases at June 30, 2012 are as follows:

Years ending June 30

2013	$ 55,900
2014	23,341
	$ 79,241

NOTE 12. LEASE COMMITMENT

In June 2011, the Organization entered into an operating agreement to lease a facility for use in its operations. The lease is non-cancellable as long as the Organization has a valid government contract in force. The lease contains one three-year renewal option. If the option is exercised, the base rent will escalate 3% per year.

Rental expense totaled $42,450 and $5,238 for the years ended June 30, 2012 and June 30, 2011, respectively.

Minimum future rentals on non-cancelable operating lease payments at June 30, 2012 are as follows for each fiscal year:

2013	$ 48,000
2014	48,960
2015	50,421
2016	51,936
2017	17,483
	$ 216,800

NOTE 13. SUBSEQUENT EVENT

The Arc has evaluated all events subsequent to the statement of financial position date of June 30, 2012 through January 15, 2013, which is the date these financial statements were available to be issued. The Arc has determined that there are no subsequent events that require disclosure pursuant to the FASB Accounting Standards Codification except as disclosed below.

Service Agreement with Alcoa, Inc.

On September 28, 2012, The Arc entered into a procurement of services agreement with Alcoa, Inc. to oversee the digitization of X-rays onto Blu-Ray discs. These services are to be carried out by The Arc's employees at The Arc of the Virginia Peninsula, Inc. in Hampton, Virginia, and the Rochester Rehabilitation Center, Inc. in Rochester, New York. The agreement has a term of 2.5 years and is set to expire on March 27, 2015, but can be terminated by either party in the event of default. The terms of the agreement provide for the processing of 12 million X-rays with The Arc receiving $0.50 for each X-ray, resulting in total revenues of $6 million.

Pursuant to the agreement, The Arc purchased digitization equipment and a customized software suite needed to operate the equipment. In order to bring the digitizing equipment into service, total borrowings of $1,419,316 were authorized. A $519,316 loan agreement was entered into with Bank of America on November 15, 2012, under which The Arc will make 6 monthly payments of $1,363, followed by 30 monthly principal and interest payments of $18,024, with all due principal and interest payable on October 22, 2015. This loan has a stated rate of 3.15% and is secured by the software noted above and all rights attendant thereto. A $900,000 loan agreement was entered into with BB&T on November 15, 2012, under which The Arc will make 6 monthly interest-only payments of $2,063, followed by 24 principal and interest payment of $38,601, with all due principal and interest payable on May 5, 2015. This loan has a stated rate of 2.75% and is secured by the equipment noted above.

New Debt Agreements

On September 28, 2012, The Arc entered into a lease loan with Bank of America, the proceeds of which will be used to finance renovations made to its group homes, ICF/ID houses, vehicles, and administrative facilities. The debt agreement is in the amount of $900,015 and requires that all leases entered into under the terms of the agreement be converted into a term loan in February 2013, upon which date a payment schedule will be established based upon the payment structure of the leases that comprise the loan principal balance. This loan has a stated rate of 3.26%, and is secured by the improvements and vehicles noted above.

(Continued)

NOTE 13. SUBSEQUENT EVENT (Continued)

On December 18, 2012, The Arc entered into a debt agreement with Old Point National Bank in order to finance the purchase of land and construction of a new ICF/ID home in York County, Virginia. The debt agreement is comprised of two notes totaling $700,000 and requires The Arc to make 12 monthly interest-only payments of $2,403 followed by 84 principal and interest payment of $4,453, with all due principal and interest payable on December 18, 2020. These notes have a stated rate of 4.12% and are secured by The Arc's corporate facilities in Copeland Industrial Park.

On November 5, 2012, The Arc entered into a debt agreement with BB&T in order to finance the purchase of information technology equipment. The debt agreement is in the amount of $150,000 and requires The Arc to make 36 principal and interest payment of $4,348, with all due principal and interest payable on November 5, 2015. This loan has a stated rate of 2.75% and is secured by the equipment noted above.

Refinancing of Existing Long-Term Debt

Subsequent to year-end, The Arc transferred the debt agreement held by SunTrust to Old Point National Bank (OPNB), where it was refinanced in conjunction with the refinancing of three other debt agreements already held by OPNB. These four notes, totaling $2,408,807, now require monthly payments with interest at 4.12%. All of these refinanced notes are set to mature with all due principal and interest payable in either December 2019 or January 2020.

After refinancing its long-term debt and incurring new debt subsequent to year end, The Arc's future principal maturities of long-term debt as of the issuance of this report approximate the following:

2013	$ 366,000
2014	1,132,000
2015	1,064,000
2016	566,000
2017	462,000
Thereafter	3,118,000
	$ 6,708,000

(Continued)

NOTE 13. SUBSEQUENT EVENT (Concluded)

Federal Awards under the Department of Education

The Arc administers an Early Prevention and Intervention for Children (EPIC) program in order to provide assistance to infants and toddlers with developmental disabilities or delays and their parents. This program is funded by the United States Department of Education under the Individuals with Disabilities Education Act (IDEA) (Part C), Medicaid reimbursements for services rendered, and by matching funds from the Commonwealth of Virginia.

On July 9, 2012, subsequent to year-end, The Arc was notified that it would no longer receive Part C funds in support of the EPIC program unless the local Infant and Toddler Connection program receives additional funding. Federal funding ceased in October 2012. The Arc has continued to operate its EPIC program, but has changed the nature of the operations to only include children who qualify under Medicaid.

When preparing its budget for fiscal year 2013, The Arc had budgeted $281,300 of expected funding for the EPIC program. Operating expenses related to the EPIC program were expected to total $233,700, while overhead expenses allocated to the EPIC program were expected to total $44,485.

Lease Agreement for Adult Day Care Center

On August 15, 2012, The Arc entered into a 10-year operating lease with DF Fishing Point, LLC to rent commercial space to be used as an adult day care center. The lease is effective November 1, 2012 and requires monthly payments of $5,300, with a 2.0% escalation occurring annually at the lease anniversary date.

Renewal of the Collective Bargaining Agreement

On September 13, 2012, the collective bargaining agreement signed with the IUOE was renewed, as disclosed in Note 10.