June 4, 2009

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 09-01
Fiscal Years 2007 and 2008 Financial Statement Audits

The enclosed report presents the results of the audit of the Commission's financial statements for the fiscal years ended September 30, 2007 and 2008. The report should be read in conjunction with the Commission's financial statements and notes to fully understand the context of the information contained therein.

The Appalachian Regional Commission (ARC) contracted with the independent certified public accounting firm of WithumSmith+Brown (WSB) to audit the financial statements of the Commission as of and for the fiscal years ended September 30, 2007 and 2008. The contracts required that the audits be conducted in accordance with U.S. generally accepted government auditing standards and OMB audit guidance. ARC's Office of Inspector General monitored audit activities to help ensure audit quality.

The following results were noted from WSB's audit of ARCs financial statements for the Fiscal Year Ended, September 30, 2008.

- WSB expressed a qualified opinion on ARC's financial statements and noted that except for its inability to satisfy itself as to the amounts reported in the financial statements related to the U.S. Department of Transportation (DOT) grants, the financial statements were properly stated in all material respects, in accordance with U.S. generally accepted accounting principles.

- WSB did not provide an opinion on the effectiveness of ARC's internal controls over financial reporting and did note improvements in meeting Parent-Child (agency funds allocated to other federal agencies for which the grantor agency has financial reporting responsibility) reporting requirements; however, as summarized in the paragraph above, because of problems related to verifying DOT's general ledger balances, the auditor continued to consider Parent-Child reporting a material weakness (discussed below). From errors occurring in Parent-Child reporting for FY 2007, ARC was forced restate its financial statements and are provided in this audit report.

- WSB identified, in addition to a material weakness, three other matters it considers to be significant deficiencies. Further discussion is provided below.

- WSB did not express an opinion on compliance with laws and regulations but did cite Anti-Deficiency Act (AD) violations occurring during the first quarter of FY 2007 and three other AD violations occurring during FY 2008.

For FY 2007, because of the implementation of OMB Circular A-136, which required Parent-Child reporting, and the related adoption of federal reporting requirements, which was more complex than ARC's previous financial statement presentation requirements, ARC was unable to issue timely financial statements and obtain an audit opinion. For FY 2008, many of the same problems inhibited timely completion of the financial statements and the reporting problem remains classified by the auditor as a material weakness. However, because of ARC's continuing efforts and improved data flow from child agencies, ARC was able to receive an opinion, although with a qualification for DOT grant amounts. The auditor continued to recommend vigilance to ensure timely financial information is received, identified issues resolved, and that ARC procedures enable management to make appropriate representations about child agencies' financial data.

In addition, ARC restated its 2007 financial statements, the balance sheet and the statement of changes in net position, because of errors recording ARC's child agency financial activity. The total cumulative change in the results of operations was approximately $8.9 million with no effect on net position. The effected financial statement line items were: cumulative results of operations, unexpended appropriations, appropriations used, and the change in accounting principles line item. The specific dollar amounts affecting each of these accounts are detailed in the Notes to Financial Statements (Note 11).

Aside from the material weakness in reporting for Parent-Child activities, three other issues, described below, were identified by the auditor as significant deficiencies impacting ARC's ability to present financial data reliably, in accordance with generally accepted accounting principles.

- Meeting federal reporting requirements.

  A required footnote disclosure, the "Reconciliation of Net Cost to Budget," formerly a part of the federal financial statements, could not be prepared for the FY 2007 financial statements, but for fiscal year 2008, the disclosure was completed but remains un-reconciled in the amount of $1.2 million. The problem resulted from ARC not processing budgetary accounting information properly and the financial system not requiring entry of budgetary data which should relate/equate to its proprietary counterpart. WSB recommended ongoing training in federal reporting requirements, the development and implementation of policies and procedures, and the adoption of an alternate financial system which will facilitate proper recording of proprietary and budgetary information.

  **Note:** Compliance with federal reporting requirements was a material weakness for FY 2007, but because ARC was able to prepare its Required Supplementary Stewardship Information the associated recommendation was closed and the classification changed to a significant deficiency.

- Properly accruing grant obligations.

  ARC has not developed an estimation methodology for accurately recognizing expenses incurred but not yet reported by its grantees as of September 30. The auditor recommended development of a system to obtain the necessary grant information and a methodology to properly record grant accruals.

- Properly managing the security of the financial and grant management systems.

  The auditor noted deficiencies in security management, access control, configuration/change management, segregation of duties, and contingency planning. WSB recommendations were for performance of a detailed risk assessment to be evaluated in terms of likelihood and magnitude of risk related to the deficiencies cited, and for an appropriate corrective action plan and rationale for not addressing identified risks. Continued implementation of corrective action for previously identified weaknesses and the replacement of ARC's unsupported financial accounting system were also recommended.

The FY 2007 recommendation relating to accounting for grant advances was closed and a material weakness in accounting for revenue exists only as a continuing recommendation under a WSB letter to management. The recommendation was for training and resources.

In connection with the contract, we reviewed WithumSmith+Brown's report and related documentation and inquired of its representatives. Our involvement in the audit process consisted of monitoring of audit activities, reviewing auditor independence and qualifications, attending meetings, participating in discussions, and reviewing audit planning and conclusion workpapers and reports. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on the Appalachian Regional Commission's financial statements, conclusions about the effectiveness of internal control, or conclusions about compliance with laws and regulations. WithumSmith+Brown is responsible for the attached auditor's report dated March 23, 2009 and the conclusions expressed in the report. However, our review disclosed no instances where WithumSmith+Brown did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Clifford H. Jennings
Inspector General

Attachment

cc: Director, Finance and Administration Division