Final Report
Internal Control Performance Audit

APPALACHIAN REGIONAL COMMISSION

Washington, D.C.

Report No. 09-04

Prepared for
Office of Inspector General
Appalachian Regional Commission

Prepared by
Tichenor & Associates, LLP
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TABLE OF CONTENTS

Independent Auditors' Transmittal Letter i

Introduction 1

Objective, Scope, and Methodology 1

Executive Summary 3

- Audit Results 3
- Recommendations 4
- Management Response 4
- Auditor's Conclusion 5

Findings and Recommendations 7

1. Commercial Bank Accounts 7
2. Government Travel Charge Cards 10
3. Credit Card Purchases 12
4. Commuting Assistance Program 14
5. Property Management 16
6. External Reporting 18
7. Desktop Procedures Manual 20
8. Prior Audit Findings 22
9. Personally Identifiable Information 24

Appendix A – Management Response 25

TICHENOR & ASSOCIATES, LLP
CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

304 MIDDLETOWN PARK PLACE, SUITE C
LOUISVILLE, KY 40243

BUSINESS: (502) 245-0775
FAX: (502) 245-0725
E-MAIL: WTICHENOR@TICHENORASSOCIATES.COM

Inspector General
Office of Inspector General
Appalachian Regional Commission
1666 Connecticut Ave, NW
Washington, DC 20009

Independent Auditors' Transmittal Letter

Tichenor & Associates, LLP has conducted a performance audit of Appalachian Regional Commission's (ARC) internal controls. This performance audit was conducted at the request of the ARC Office of Inspector General (OIG).

The objective of this performance audit was to evaluate internal control procedures related to the financial management of the agency. This included policies and procedures in the areas of budget and accounts, program funds control, payroll, procurement, travel management, payments, collections, administrative services, accounting system, and audits and reports.

The scope of this performance audit included transactions occurring in fiscal year 2008 and policies and procedures in place at the time of the audit.

A draft report was provided to ARC on August 10, 2009. ARC concurred with our findings and stated that corrective actions were planned to address the report recommendations.

Sincerely,

Tichenor & Associates, LLP

Tichenor & Associates, LLP
June 24, 2009

INTRODUCTION

Tichenor & Associates, LLP performed an internal control performance audit of the Appalachian Regional Commission (ARC). This performance audit was conducted at the request of ARC's Office of Inspector General (OIG) as part of its oversight of the agency's financial management functions. In addition, the OIG specifically asked that we review personally identifiable information (PII) and provide comments in our findings.

ARC is a non-profit (501(c)(3)) government entity created by the Appalachian Regional Development Act (ARDA) with operating expenses jointly funded by state and federal appropriations. ARC follows federal guidance from the Government Accountability Office (GAO) and the Office of Management and Budget (OMB) in its financial management and its operation of a federally funded grant program. ARC is a designated federal entity subject to provisions of the Anti-Deficiency Act and the Inspector General Act. ARC also either voluntarily complies with or has implemented alternative mechanisms to attain the objectives of the following statutes: Accountability of Tax Dollars Act, Government Performance and Results Act, Federal Manager's Financial Integrity Act (FMFIA), and Federal Information Security Management Act.

ARC has established the Appalachian Regional Commission Code (ARC Code) as the overall statement of current ARC policy. The ARC Code requires the executive director to maintain a system of financial management sufficient to ensure the accountability of all funds appropriated to ARC or coming into the possession of ARC. The ARC Code further requires the executive director to maintain, in writing, financial management policies and procedures relating, at a minimum, to the following: payments, imprest funds, travel management, purchasing and procurement, and property management.

In accordance with the ARC Code, the executive director has established a set of Financial Management Guidelines (FMG), the purpose of which is to maintain a system of effective controls over accounting, and funds, and assets with reasonable safeguards against waste, fraud, and abuse. This includes full disclosure of results of activities, adequate financial information for agency management and reliable and conforming accounting information for preparation of budgets and reports to the federal government. The FMG addresses financial policies and procedures in the following areas: budget and accounts, program funds control, pay, leave and allowances, procurement, travel management, payments, collections, administrative services, accounting system, and audits and reports. ARC's Finance and Administration Division (FAD) is responsible for financial management and oversight.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of this performance audit was to evaluate internal control procedures in conformance with the ARC Code; the FMG, as referenced above; and federal statutes, which ARC is either subject to or voluntarily complies with; applicable federal guidance from the GAO and OMB; and generally recognized best practices. We also reviewed and

updated our findings from internal control reviews performed in 2007. The reports for those reviews, Internal Control Review of Disbursement Procedures (Report No. 07-02) and Follow-up Review on Internal Control Review of Administrative Functions (Report No. 07-03) were issued in March 2007. Additionally, at the request of the OIG, we reviewed ARC's handling of personally identifiable information (PII).

At the time of our performance audit, ARC was also undergoing a financial audit for the fiscal year 2008. We discussed with the financial auditors areas of internal control they were concentrating on and were given access to a preliminary report on their potential findings and recommendations. It was not our intent to duplicate work performed by the financial auditors and we have made no recommendations in those areas.

This performance audit was conducted at ARC's office in Washington, D.C. from October 2008 through December 2008; its scope was for transactions occurring in fiscal year 2008 and policies and procedures in place at the time of the audit.

We reviewed federal laws, and policies and guidelines, as described above. In addition, we reviewed ARC's 2006 and 2007 Performance and Accountability Reports (PAR), and OIG reports related to internal controls.

We interviewed the director of finance and administration, the financial manager, the network administrator, the financial program analyst, the financial services assistants, the personnel management specialist, the grants management specialist, the project control officer, and one of the program analysts.

We reviewed operating procedures and internal controls for each functional area addressed by the FMG, including: budgets, commercial bank accounts, program funds, payroll, procurement and credit card purchases, travel management, payments, collections, administrative services, accounting systems, and external reporting requirements.

We tested ARC's compliance with the FMG by reviewing and testing a representative sample of payroll transactions, procurement and credit card purchases, travel vouchers, vendor and grantee payments, and commuting assistance certifications. We judgmentally selected a sample of 10 payroll transactions for five employees representing nine percent of total employees; this covered two payroll periods of a 26 pay period year. For vendor transactions, we reviewed 29 of 1,471 vendor transactions (2%), and 15 credit card purchases from three monthly statements. For travel vouchers, we sampled and tested nine percent of 161 transactions, for grantee payments one percent of transactions (of 1024), and for employees' certifications of commuting assistance, 10 of 36, or 28% of employees' certifications.

For the five employees selected for payroll testing, we also compared authorized pay levels to actual pay level; and for the two payroll periods tested, we also reviewed time and attendance reconciliations to batch data submitted for processing.

We tested collections by reconciling one month's received checks log to the deposits log and reviewing the timeliness of deposits compared to when checks were received.

We made inquiries of the network administrator, director of finance and administration, and personnel management specialist concerning PII policies and observed procedures to protect PII in operation. At the request of the OIG, we have modified our reporting methodology. We normally only report findings when control weaknesses have been identified and recommendations made; however, with respect to PII we have included our results despite the lack of control weakness and recommendations.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

EXECUTIVE SUMMARY

Audit Results

During our performance audit we noted six areas where the FMG needs to be updated as described below:

- The FMG does not document procedures and controls for management of ARC's three commercial bank accounts;
- The use of government travel credit cards is not mandatory for all employees (federal and non-federal) who have been issued the card;
- The use of checks provided in conjunction with purchase credit cards is authorized in the FMG;
- Management controls and employee guidelines for Metro SmarTrip Cards are not documented in the FMG;
- Current property management policies are not documented in the FMG; and,
- The FMG does not document ARC's use of Federal Accounting Standards Advisory Board (FASAB) financial reporting standards.

We also noted that, during fiscal year 2008, monthly bank reconciliations were not performed on two of ARC's commercial bank accounts (health benefits and conference registration accounts), and that no documentation exists to support that ARC performed a review of the activity in its flexible benefits account, which is maintained by the plan administrator.

We further noted that ARC has no detailed desktop procedures manual.

Additionally, of sixteen recommendations made in our two previous reports from 2007, Internal Control Review of Disbursement Procedures (Report No. 07-02) and Follow-up

Review on Internal Control Review of Administrative Functions (Report No. 07-03), five of our recommendations, which ARC agreed to, had not been fully implemented.

During our review of ARC's handling of PII, we noted that PII is kept secure, accessible only to a limited number of employees and transmitted to outside agencies through secure encrypted protocols.

Recommendations

We recommend that ARC update the FMG to: (1) document procedures and controls for management of ARC's three commercial bank accounts; (2) make use of the government travel credit card mandatory for all employees (federal and non-federal) who have been issued the card; (3) discontinue the use of checks provided in conjunction with purchase credit cards; (4) document management controls and employee guidelines for Metro SmarTrip Cards; (5) document current property management policies; and, (6) document that ARC is currently using FASAB financial reporting standards, as required of federal government agencies, instead of Financial Accounting Standards Board (FASB) standards.

We also recommend that ARC require monthly bank reconciliations be performed in a timely manner on the two ARC maintained commercial bank accounts (health benefits and conference registration accounts), that the monthly bank reconciliations prepared by the flexible benefits account plan administrator be reviewed by someone independent of cash receipt and disbursement activities, and that a certification statement be prepared to provide evidence of ARC fulfilling its fiduciary responsibilities.

We further recommend that ARC develop a detailed desktop procedures manual.

Additionally, we recommend that ARC develop a system to track outstanding audit findings and follow-up within a set period of time to ensure full implementation of agreed-to recommendations.

Because PII is kept secure, accessible only to a limited number of employees and transmitted to outside agencies through secure, encrypted protocols, we have made no recommendation concerning ARC's handling of PII.

Management Response

Management responded that ARC plans to change its accounting system to the GSA's full service shared services accounting option, and has set a target date for revising the FMG of no later than 90 days after implementation of the new accounting system. ARC will revise the FMG to: (1) document procedures and controls for management of ARC's three commercial bank accounts; (2) reflect ARC's policy of mandatory use of government travel cards by federal and non-federal staff; (3) reflect ARC's policy of not issuing checks which are tied to the purchase credit card accounts; (4) document management controls and employee guidelines for Metro SmarTrip Cards; (5) document

current property management policies; and (6) reflect the use of FASAB financial reporting standards.

Management also responded that the FMG will also be revised to require reconciliations of ARC's health benefit and conference registration accounts, and to require documentary evidence of reviews of the flexible benefit account activity and plan administrator's bank account reconciliations.

Management further responded that once the FMG has been updated and the GSA shared services accounting is fully operational, staff will determine how the new accounting tasks are best executed and prepare desktop procedures documenting those procedures deemed necessary.

Additionally, management responded that ARC will track audit findings and set timelines for implementation of auditor recommendations.

For management's complete response, see **Appendix A – Management Response**.

Auditor's Conclusion

Management's comments were responsive to the findings and recommendations. Once ARC changes its accounting system to GSA's shared services accounting, the FMG will be revised within 90 days after implementation of the new system to:

- *document procedures and controls for management of ARC's three commercial bank accounts;*
- *require reconciliations of ARC's health benefit and conference registration commercial bank accounts;*
- *require documentary evidence of reviews of the flexible benefit account plan activity and administrator's bank account reconciliations;*
- *reflect ARC's policy of requiring the mandatory use of government travel cards by federal and non-federal staff;*
- *reflect ARC's policy of not issuing checks which are tied to the purchase credit card accounts;*
- *document management controls and employee guidelines for using Metro SmarTrip Cards;*
- *document current property management policies; and,*
- *reflect the use of FASAB financial reporting standards.*

Management will also prepare a desktop procedures manual, track audit findings, and set timelines for implementation of auditor recommendations.

As a result, the recommendations are considered closed.

FINDINGS AND RECOMMENDATIONS

1. Commercial Bank Accounts

ARC has three commercial bank accounts – a health benefit account, a conference registration account, and a flexible benefit account. The health benefit and conference registration accounts are maintained by ARC while the flexible benefit account is maintained by the plan administrator.

In our report, Internal Control Review of Disbursement Procedures (Report No. 07-02), we noted that the FMG (Section 2 – Budget and Accounts, page 2-1) states that the ARC executive director is authorized to establish commercial bank accounts, but does not include any information about the above referenced accounts. We recommended that the FMG be updated to document these accounts, including policies and procedures for management of the accounts. In 2007, ARC concurred with our recommendation and stated that policies and procedures for management of commercial bank accounts were being updated in the FMG; however, during our current audit we noted that the FMG had never been updated to document management of the three commercial bank accounts.

ARC maintains a health benefit account for payment of health benefit premiums to the State of Maryland (health benefits for non-federal ARC employees and retirees are provided through the state's insurance provider) and a registration account used for the receipt of conference registration fees and similar items. During our audit, we noted that monthly bank reconciliations were not being performed for these accounts.

ARC's flexible benefit account is maintained by the plan administrator. The plan administrator performs monthly bank reconciliations and forwards them to ARC's financial manager. During our audit, we noted that no documentation exists to support that ARC performs a review of the flexible benefit account activity.

Finding 1.1 The FMG has not been updated to document procedures and controls of commercial bank accounts.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that internal controls be clearly documented.

Condition: Procedures and controls for management of ARC's three commercial bank accounts are not documented in the FMG..

Cause: Management stated that they decided not to update the FMG at this time, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: The three commercial bank accounts are more susceptible to misuse and misappropriation of funds.

Recommendation: We recommend that ARC update the FMG to document procedures and controls for management of its three commercial bank accounts.

Management Response: Management accepted this recommendation and will update the FMG to document procedures and controls for management of its three commercial bank accounts. ARC plans to change its accounting system to GSA's shared services accounting, and has set a target date for the FMG revision of no later than 90 days after implementation of the new accounting system. (**See Appendix A – Management Response**)

Finding 1.2 Monthly bank reconciliations were not performed for the health benefit and conference registration commercial bank accounts.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that internal controls be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets.

Condition: Monthly bank reconciliations were not performed during fiscal year 2008 for the health benefit and conference registration commercial bank accounts maintained by ARC.

Cause: Management stated that they have not taken action to require monthly bank reconciliations for the health benefit and conference registration commercial bank because of other management priorities and limited employee time to address all issues.

Effect: Errors, misuse or misappropriation of funds can not be detected in a timely manner.

Recommendation: We recommend that ARC update the FMG to require that management perform monthly bank reconciliations in a timely manner on the health benefit and conference registration commercial bank accounts. We further recommend that the bank reconciliations be reviewed and approved by someone independent of cash receipt and disbursement activities.

Management Response: Management accepted this recommendation and, beginning with fiscal year 2010, will update the FMG to require reconciliations of its health benefit and conference registration commercial bank accounts, and that such reconciliations be reviewed and approved by someone independent of cash receipt and disbursement activities. (**See Appendix A – Management Response**)

Finding 1.3 No documentation exists to support that ARC performs a review of the flexible benefit account activity.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that internal controls be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets.

Condition: No documentation exists to support that ARC performs a review of the flexible benefit account activity.

Cause: Management stated that they have not taken action to require documentation supporting ARC's review of the flexible benefit account activity because of other management priorities and limited employee time to address all issues.

Effect: Errors, misuse or misappropriation of funds can not be detected in a timely manner.

Recommendation: We recommend that ARC require the monthly bank reconciliations prepared by the plan administrator of the flexible benefit account be reviewed by someone independent of cash receipt and disbursement activities. We further recommend that a certification statement be prepared to provide evidence of ARC fulfilling its fiduciary responsibilities, and that reconciliation policies/procedures be included in the FMG.

Management Response: Management accepted this recommendation and will update the FMG to require documentary evidence of reviews of the plan administrator's bank account reconciliations. (**See Appendix A – Management Response**)

Auditor's Comments - Section 1.1 through 1.3

ARC plans to change its accounting system to GSA's shared services accounting, and management will revise the FMG within 90 days after implementation of the new system to: (1) document procedures and controls for management of its three commercial bank accounts, (2) require reconciliations of its health benefit and conference registration commercial bank accounts, and that such reconciliations be reviewed and approved by someone independent of cash receipt and disbursement activities, and (3) require documentary evidence of reviews of the flexible benefit account plan activity and administrator's bank account reconciliations. As a result, the recommendations are considered closed.

2. Government Travel Charge Cards

ARC is a non-mandatory participant in the U.S. Government SmartPay travel charge card program. ARC federal employees are required to use the government travel charge card to cover travel expenses, but use is optional for non-federal employees. ARC designates employees who are frequent travelers and may use the government travel charge card for their individual use. Cards are authorized for employees who are expected by their supervisors to travel at least twice a year.

The FMG (Section 6 - Travel Management, page 6-6) states that the purposes of the program include enabling ARC to benefit from rebates provided by government credit card contractors.

In our report, Follow-up Review on Internal Control Review of Administrative Functions (Report No. 07-03), we noted that ARC does not benefit from rebates provided by government credit card contractors when employees don't use government travel charge cards for travel purchases. We recommended that ARC make use of the government travel charge cards mandatory for all ARC travelers who have been issued cards. In 2007, ARC concurred with our recommendation and stated that the FMG was being updated to mirror the policy for federal staff, i.e., if issued to an ARC employee, use of the government travel charge card is mandatory for travel-related purchases. However, during our current audit we noted that the FMG had never been updated to make the use of the government travel charge card mandatory for all ARC employees who have been issued the card.

Finding 2.1 The use of government travel charge cards is not mandatory for non-federal employees.

Criteria: Best practices in travel management, as indicated in, *The Federal Travel Card: Uses, Policies and Best Practices (AGA CPAG Research Series: Report No. 13), issued in June 2007*, include use of government travel charge cards to reduce the time and effort in processing travel reimbursements; to facilitate vendor discounts for employee airline tickets, hotels and rental cars; and to benefit from rebates provided by government credit card contractors.

Condition: The use of government travel charge cards is not mandatory for non-federal employees.

Cause: Management stated that they decided not to update the FMG government travel card policy at this time, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: ARC is losing out on potential rebates and other cost savings provided by government credit card contractors.

Recommendation: We recommend that ARC require the use of government travel cards for all employees (federal and non-federal) who have been issued the card, and that this policy be included in the FMG.

Management Response: Management stated that while ARC did require use of government travel cards by non-federal Commission staff, and this policy was communicated to staff, the FMG would be updated to reflect the mandatory use of government travel cards by federal and non-federal staff. (**See Appendix A – Management Response**)

Auditor's Comments

The FMG will be updated to reflect ARC's policy of requiring the mandatory use of government travel cards by federal and non-federal staff. As a result, this recommendation is considered closed.

3. Credit Card Purchases

ARC participates in the GSA credit card program and most small purchases are made using the purchase credit cards. There are five cardholders: three within the Finance and Administration Division, the director, the administrative officer, and one of the financial services assistants, and one each within the Office of the Federal Co-Chair and the Office of the State's Representative. Cardholder's must retain adequate documentation of all requisition requests for routine purchases. Written approval from division directors, or their designated managers is required for non-routine purchases of up to $2,500. The Director of Finance and Administration must approve all purchases of computers, software, or furniture, as well as non-routine purchases over $2,500.

Additionally, the FMG (Section 7 – Payments, page 7-3) authorizes the use of credit card checks on occasions when other means of payment are not acceptable. In our report, Internal Control Review of Disbursement Procedures (Report No. 07-02), we recommended that ARC discontinue the use of checks provided in conjunction with the purchase credit cards. In 2007, ARC concurred with our recommendation and stated that the use of credit card checks would be discontinued. During our current audit we did not note any instances of the credit card checks being used for purchases; however, we did note that the FMG still authorized their use.

Finding 3.1 The FMG authorizes use of credit card checks.

Criteria: The Federal Managers Financial Integrity Act (FMFIA) of 1982 requires that controls be established to reasonably ensure that "... funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation."

Condition: The FMG authorizes the use of credit card checks.

Cause: Management stated that they decided not to update the FMG at this time, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: The use of credit card checks increases the risk of misuse or misappropriation of funds.

Recommendation: We recommend that ARC discontinue the use of checks provided in conjunction with the purchase credit cards and that this policy be included in the FMG.

Management Response: Management stated that it suspended the use of credit card checks, during FY 08, communicated that policy to staff, and will update the FMG accordingly. (**See Appendix A – Management Response**)

Auditor's Comments

The FMG will be updated to reflect ARC's policy of issuing checks which are tied to the purchase credit card accounts. As a result, this recommendation is considered closed.

4. Commuting Assistance Program

ARC provides an employee benefit of either a mass transportation subsidy or parking assistance. Mass transit commuting assistance is provided up to an employee's actual costs, but no more than $100 per month (as of fiscal year 2008), with the Finance and Administration Division maintaining records of each employee's certified basis for claims. Parking assistance is a flat $30 per month for employees who park in the building garage. Parking in the building garage is solely by agreement between the building owner and the employee. The building's management directly bills ARC for its share of the cost of employee parking; employees pay their share directly to the building management.

Each employee who requests assistance must certify in writing every six months, or sooner if their commuting patterns change, that the commuting assistance requested will not exceed their actual expense for the period. No employee may receive both parking and mass transit benefits for any period. WMATA (Metro) SmarTrip Cards are used by most employees who receive mass transit assistance. The SmarTrip Cards allow employees to keep one fare card that can be replenished each month. ARC provides a monthly listing to Metro for the amount of subsidy for each employee's SmarTrip Card by number. In turn, employees are able to download the subsidies through the card readers available in all Metro stations. In addition, Metro provides ARC with monthly activity listings that show the amount of the monthly subsidy that has been downloaded to each employee's SmarTrip Card. Adjustments are made by Metro, crediting any portion of employees' subsidies that were not used during the prior month back to ARC.

The financial program analyst maintains copies of employee certifications and performs monthly mass transit assistance reconciliations. The division director pays Metro monthly for employees' SmarTrip Cards using his purchase credit card.

In our report, Follow-up Review on Internal Control Review of Administrative Functions (Report No. 07-03), we noted that the FMG (Section 9 – Administrative Services, page 9-2) did not address the procedures for using the Metro smartcards, instead, only detailing the use of monthly fare cards. We recommended that ARC update the FMG to reflect procedures for using the smartcards. In 2007, ARC concurred with our recommendation and stated that the FMG had been updated to include a description of the issuance process for mass transit subsidies using Metro smartcards; however, during our current audit we noted that the FMG had not been updated and still only detailed the process for distributing monthly fare cards.

Finding 4.1 The FMG does not address management controls and employee guidelines for using Metro SmartTrip Cards.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that internal controls be clearly documented.

Condition: The FMG does not address management controls or employee guidelines for using Metro SmarTrip Cards.

Cause: Management stated that they decided not to update the FMG at this time, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: The commuting assistance program is more susceptible to misuse or misappropriation of funds and unspent monies may not be returned to ARC.

Recommendation: We recommend that ARC update the FMG to document management controls and employee guidelines for using Metro SmarTrip Cards.

Management Response: Management accepted this recommendation and will update the FMG to address management controls and employee guidelines for using Metro SmarTrip Cards. (**See Appendix A – Management Response**)

Auditor's Comments

The FMG will be updated to address management controls and employee guidelines for using Metro SmarTrip Cards. As a result, this recommendation is considered closed.

5. Property Management

Individual equipment items with a cost of at least $15,000 are to be capitalized for accounting and reporting purposes. The financial services assistant maintains a schedule of capitalized property. Automatic Data Processing (ADP) equipment, including computers, printers, and other IT equipment, is designated high-risk property and is inventoried and tagged by the administrative officer. High-risk non-capitalized property is physically inspected semi-annually. The database administrator is responsible for maintenance of software licenses and storage of software media. Non-capitalized office furniture is considered of low value and low risk and is not inventoried.

In our report, Follow-up Review on Internal Control Review of Administrative Functions (Report No. 07-03), we noted that the then current policy was for the database administrator, who is responsible for procurement of IT equipment, to maintain the inventory of high-risk non-capitalized equipment and perform the semi-annual physical inspection. We recommended that ARC amend the FMG to require that an employee independent of the procurement function maintain the inventory and perform the semi-annual physical inspections. We also noted that the then current inventory of high-risk non-capitalized equipment was incomplete and we recommended that ARC require that all high-risk non-capitalized equipment be included in the inventory listing and verified during the semi-annual physical inspections. In 2007, ARC stated that property management responsibilities for high-risk non-capitalized equipment had been reassigned from the database administrator to the administrative officer, and that the FMG was being updated to reflect expanded property management procedures, describing the life cycle management of activities and responsibilities associated with procuring, managing, and disposing of high-risk non-capitalized equipment. ARC further stated that the FMG was also being updated to provide additional guidance about controls for equipment that contain sensitive or privacy-related data and to clarify its standing policy that all high-risk non-capitalized equipment be inventoried and physically inspected semi-annually.

During our current audit, ARC issued an official Internet Security Policy. We also noted that property management responsibilities for high-risk non-capitalized equipment, including semi-annual physical inspections, were reassigned to the administrative officer, who we determined to be independent of the procurement function, as recommended. However, the FMG has never been updated to reflect this new policy, nor has it been updated to reflect changed/expanded property management procedures.

Finding 5.1 The FMG has not been updated to require an employee independent of the procurement function maintain the inventory and perform the semi-annual inspections of high-risk non-capitalized equipment.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that internal controls be clearly documented.

Condition: An employee independent of the procurement function maintains the inventory and performs the semi-annual physical inspections of high-risk non-capitalized equipment; however, the FMG has not been updated to reflect this requirement.

Cause: Management stated that they decided not to update the FMG at this time, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: High-risk non-capitalized equipment is more susceptible to misuse or misappropriation.

Recommendation: We recommend that ARC update the FMG to require an employee independent of the procurement function, maintain the inventory and perform the semi-annual physical inspections of high-risk non-capitalized equipment.

Management Response: Management accepted this recommendation and will update the FMG to require an employee independent of the equipment procurement function to maintain the inventory and perform semi-annual inspections of high-risk non-capitalized equipment. (**See Appendix A – Management Response**)

Auditor's Comments

The FMG will be updated to require an employee independent of the equipment procurement function to maintain the inventory and perform semi-annual inspections of high-risk non-capitalized equipment. As a result, this recommendation is considered closed.

6. External Reporting

ARC began issuing audited financial statements for fiscal year 2003 and prepared its financial statements in accordance with generally accepted accounting principles (GAAP) as set by FASB. Beginning with fiscal year 2007, ARC began preparing its financial statements in accordance with GAAP as set by FASAB; however, during our audit we noted that the FMG had not been amended to reflect the adoption of FASAB financial reporting standards.

As stated in the FMG, ARC elects to voluntarily comply with the FMFIA because it represents sound management of federal appropriations and ARC also follows the guidance of OMB Circular No. A-123, Management Accountability and Control. OMB Circular No. A-123 encourages agencies and financial managers to take systematic and pro-active measures to develop and implement appropriate, cost effective management controls for results oriented management; to assess the adequacy of management controls in federal programs and operations; to identify needed improvements; to take corresponding corrective action; and report annually on management controls.

During our review of ARC's 2006 and 2007 PARs, we noted that the Federal Co-Chair's statement on financial controls did not meet the FMFIA's requirement that the agency head submit annually to the President and Congress the prescribed statement on whether there is reasonable assurance that the agency's controls are achieving their objectives and report on any material weaknesses in the agency's controls. We also noted that no FMFIA report was drafted and provided to the IG for review and supplementation, as required by the FMG. Because of past discussions with management concerning the FMFIA reporting requirements, and the related FMG policy, and because ARC has stated that it voluntarily complies with the FMFIA, we elected to forego making a formal recommendation at this time, but include these issues as a reminder to management that these policies need to be implemented beginning with the current financial reporting period.

Finding 6.1 The FMG needs to be updated to reflect ARC use of FASAB's financial reporting standards.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that key policies and procedures be clearly documented.

Condition: The FMG has not been amended to reflect that ARC began using FASAB financial reporting standards, rather than FASB standards, in fiscal year 2007.

Cause: Management stated that they decided not to update the FMG at this time, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: The FMG erroneously states that ARC policy is to use FASB financial reporting standards, even though ARC adopted FASAB financial reporting standards beginning in fiscal year 2007.

Recommendation: We recommend that ARC amend the FMG to reflect that ARC is currently using FASAB financial reporting standards instead of FASB standards.

Management Response: Management accepted our recommendation and will update the FMG to reflect the use of FASAB financial reporting standards. (**See Appendix A – Management Response**)

Auditor's Comments

The FMG will be updated to reflect the use of FASAB financial reporting standards instead of FASB standards. As a result, this recommendation is considered closed.

7. Desktop Procedures Manual

During the course of our review, we noted that in addition to the Financial Management Guidelines (FMG) and Personnel Manual, which primarily describe ARC's policies, there is little documentation of employees' day-to-day activities. ARC employees perform a wide variety of activities for which a written description of those activities, i.e., a desktop procedures manual, does not exist.

A desktop procedures manual detailing employee tasks and responsibilities would help to inform all employees of proper operating procedures, ensure consistency of task performance, aid in the training of new employees (or cross-training of employees), improve monitoring of employee performance, assist management in delegating and segregating duties, and would be an important tool to enhance management controls.

Finding 7.1 ARC has no detailed desktop procedures manual documenting employee tasks and responsibilities.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that internal controls be clearly documented.

Condition: ARC has no detailed desktop procedures manual documenting employee tasks and responsibilities.

Cause: Management stated that they have not taken action to develop a detailed desktop procedures manual documenting employee tasks and responsibilities because of other management priorities and limited employee time to address all issues.

Effect: ARC is less able to ensure consistency of task performance, train new employees, monitor existing employees, and document and evaluate internal control.

Recommendation: We recommend that ARC develop a detailed desktop procedures manual documenting employee tasks and responsibilities. We believe that ARC can accomplish this by having employees create documentation summarizing their activities over time, especially for complex activities or those involving multi-step processes.

Management Response: Management accepted this recommendation and, once the FMG has been updated and the GSA shared services accounting is fully operational, staff will determine how the new accounting tasks are best executed and prepare a desktop procedures manual. **(See Appendix A – Management Response)**

Auditor's Comments

Desktop procedures documentation will be prepared once the FMG has been updated, the GSA shared services accounting is fully operational, and staff have determined how the new accounting tasks are best executed. As a result, this recommendation is considered closed.

8. Prior Audit Findings

We noted during our audit that of sixteen recommendations made in our two reports from March 2007, Internal Control Review of Disbursement Procedures (Report No. 07-02) and Follow-up Review on Internal Control Review of Administrative Functions (Report No. 07-03), five of our recommendations, agreed to by ARC, had not been fully implemented. Those five recommendations are detailed in the following:

Finding 1.1 – The FMG had not been updated to document procedures and controls of commercial bank accounts

Finding 2.1 – The use of government travel charge cards was not made mandatory for non-federal employees

Finding 3.1 – The FMG continues to authorize the use of credit card checks

Finding 4.1 – The FMG still does not address management controls and employee guidelines for using Metro smartcards

Finding 5.1 – The FMG has not been updated to require an employee independent of the procurement function, maintain the inventory and perform the semi-annual inspections of high-risk non-capitalized equipment

Finding 8.1 Five of sixteen previous internal control recommendations have not been fully implemented.

Criteria: GAO/AIMD-00-21.3.1 – Standards for Internal Control in the Federal Government requires that monitoring of internal controls include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved.

Condition: Five of sixteen recommendations from in our two reports from 2007, Internal Control Review of Disbursement Procedures (Report No. 07-02) and Follow-up Review on Internal Control Review of Administrative Functions (Report No. 07-03), have not been fully implemented.

Cause: Management stated that they decided not to fully implement five of sixteen recommendations from our previous reports, and update the FMG accordingly, because of plans to implement a new accounting system, and to make a comprehensive update to the FMG at that time.

Effect: ARC's internal control is not as effective as it otherwise would be, possibly leading to waste, fraud, or abuse.

Recommendation: We recommend that ARC develop a system to track outstanding audit findings and establish a set period of time for follow-up to ensure implementation of agreed-to recommendations has been completed.

Management Response: Management stated that ARC implemented changes in its policies for two of the five prior internal control recommendations, Finding 2.1 and Finding 3.1 noted above, and these policies were communicated to staff and monitored, but the FMG was not revised because of the impending change in accounting systems. The implementation of the recommendations was not due to a lack of tracking or timelines, but the result of a considered and deliberate decision.

Management also agreed that tracking audit findings is a constructive recommendation and will track its audit findings and set timelines for implementation of auditor recommendations. (**See Appendix A – Management Response**)

Auditor's Comments

Management has agreed to track audit findings and set timelines for implementation of auditor recommendations. As a result, this recommendation is considered closed.

9. Personally Identifiable Information

At the request of the OIG, we reviewed ARC's handling of personally identifiable information (PII). We noted that there are two divisions/departments where PII is collected; the FAD collects information for vendor payments, such as payments to employees for travel vouchers, and in the HR Department for payroll processing.

Vendor information is entered into the GLOWS accounting system, which is not accessible via the internet. Payments are processed through the Treasury's Secure Payment System (SPS) using Treasury's prescribed and encrypted protocols. Access to PII is limited within FAD to those employees responsible for payment processing.

Payroll processing is performed by the National Finance Center (NFC) using NFC's prescribed and encrypted protocols. Access to payroll information is limited to the HR Department and employee information is kept in locked file cabinets.

Because PII is kept secure, accessible only to a limited number of employees and transmitted to outside agencies through secure, encrypted protocols, we make no finding or recommendation concerning ARC's handling of PII.

APPENDIX A

MANAGEMENT RESPONSE

APPALACHIAN
REGIONAL
COMMISSION

A Proud Past,
A New Vision

September 10, 2009

Jack Somerville, CPA, CGFM
Tichenor & Associates, LLP
304 Middletown Park Place, Suite C
Louisville, KY 40243

Dear Mr. Somerville:

Please find attached the responses to Tichenor & Associates 2008 Internal Control Review of the Appalachian Regional Commission.

Sincerely,

William T. Grant
Director, Finance and Administration

1666 CONNECTICUT AVENUE, NW, SUITE 700 WASHINGTON, DC 20009-1068 (202) 884-7799 FAX (202) 884-7691 www.arc.gov

Appalachian Regional Commission response to 2008 Internal Control Review

Finding 1.1

ARC began reviewing its options to update its accounting system in mid-FY2008. Early in fiscal 2009 ARC decided to move to a new accounting system and late in the second quarter approved the choice of GSA's full service shared services accounting option. ARC decided to revise its Financial Management Guidelines (FMG) after choosing its accounting solution so that all changes would be implemented at the same time. The target date for the FMG revision is within 90 days of the implementation of the GSA full service shared services accounting. Any changes in procedures were communicated to staff and implemented as if the FMG had been updated.

ARC accepts this recommendation and will update its FMG to document procedures and controls for management of its three commercial bank accounts.

Finding 1.2

ARC's Financial Manager has performed periodic reviews of the health and conference accounts, which is kept in an excel file. During fiscal 2009 ARC ceased writing any checks off of the conference account and in May 2009 transferred the balance on the account to its General Fund Treasury symbol. All future disbursements shall be from that Treasury symbol.

ARC accepts this recommendation and beginning with Fiscal 2010 ARC will update its FMG to require reconciliations of its health and conference commercial bank accounts and that such reconciliations be reviewed and approved by someone independent of cash receipt and disbursement activities.

Finding 1.3

ARC's flexible benefits plan administrator has performed monthly reconciliations of the account and the Financial Manager has reviewed these reconciliations. These reviews were not properly documented. ARC will document the reviews of the plan administrators account reconciliations.

ARC accepts this recommendation and will update its FMG to state its policy on requiring evidence of bank account reconciliations.

Finding 2.1

ARC began reviewing its options to update its accounting system in mid-FY2008. Early in fiscal 2009 ARC decided to move to a new accounting system and late in the second quarter approved the choice of GSA's full service shared services accounting option. ARC decided to revise its Financial Management Guidelines (FMG) after choosing its accounting solution so that all changes would be implemented at the same time. Any changes in procedures were communicated to staff and implemented as if the FMG had been updated.

ARC did require use of government travel cards by non-federal Commission staff and this was communicated to staff. The use was monitored by accounting staff with follow up on any non-

compliance of the policy. There were a limited number of instances of non-compliance with the policy, with some caused by credit card refusal at gas station pumps. ARC will update its FMG to reflect the mandatory use of government travel cards by federal and non-federal staff.

Finding 3.1

ARC began reviewing its options to update its accounting system in mid-FY2008. Early in fiscal 2009 ARC decided to move to a new accounting system and late in the second quarter approved the choice of GSA's full service shared services accounting option. ARC decided to revise its Financial Management Guidelines (FMG) after choosing its accounting solution so that all changes would be implemented at the same time. Any changes in procedures were communicated to staff and implemented as if the FMG had been updated.

ARC ceased using credit card checks during fiscal 2008, which was communicated to staff. ARC changed its credit card vendor beginning November 1, 2008 and that agreement does not allow for the use of credit card checks. ARC will update its FMG to reflect the non-use of credit card checks.

Finding 4.1

ARC began reviewing its options to update its accounting system in mid-FY2008. Early in fiscal 2009 ARC decided to move to a new accounting system and late in the second quarter approved the choice of GSA's full service shared services accounting option. ARC decided to revise its Financial Management Guidelines (FMG) after choosing its accounting solution so that all changes would be implemented at the same time. Any changes in procedures were communicated to staff and implemented as if the FMG had been updated.

ARC accepts this recommendation and will update the FMG and address management controls and employee guidelines for using Metro SmarTrip cards.

Finding 5.1

ARC began reviewing its options to update its accounting system in mid-FY2008. Early in fiscal 2009 ARC decided to move to a new accounting system and late in the second quarter approved the choice of GSA's full service shared services accounting option. ARC decided to revise its Financial Management Guidelines (FMG) after choosing its accounting solution so that all changes would be implemented at the same time. Any changes in procedures were communicated to staff and implemented as if the FMG had been updated.

ARC will update the FMG to require an employee independent of the equipment procurement function to maintain the inventory and perform semi-annual inspections of high-risk non-capitalized equipment.

Finding 6.1

ARC began reviewing its options to update its accounting system in mid-FY2008. Early in fiscal 2009 ARC decided to move to a new accounting system and late in the second quarter approved the choice of

GSA's full service shared services accounting option. ARC decided to revise its Financial Management Guidelines (FMG) after choosing its accounting solution so that all changes would be implemented at the same time. Any changes in procedures were communicated to staff and implemented as if the FMG had been updated.

ARC will update the FMG to reflect the use of FASAB financial reporting standards.

Finding 7.1

ARC will review and determine which of its tasks and responsibilities require a desktop procedure. During fiscal 2009 procedures were prepared for received checks. These procedures will be obsolete with the change to GSA shared accounting services. Once the FMG has been updated and the GSA shared services accounting is fully operational staff will determine how the new accounting tasks are best executed and document those procedures deemed necessary. ARC accepts this recommendation and will prepare desktop procedures for the selected tasks.

Finding 8.1

ARC implemented a change in its policy for two of the five prior internal control recommendations. These changes in policies were communicated to staff and monitored. The FMG was not revised because of the impending change in accounting systems, which will be outsourced. Frequent changes to guidelines leads to confusion about policies and procedures and directly affects compliance. The implementation of the recommendations was not due to a lack of tracking or timelines, but the result of a considered and deliberate decision.

ARC agrees that tracking audit findings is a constructive recommendation. Timelines are valuable in keeping staff focused on completing tasks. ARC accepts this recommendation and will track its audit findings. Timelines shall be set with flexibility that gives due consideration for ARC's size as a micro agency and the need to prioritize the continuing mandates implemented by the government for information technology and accounting.