APPALACHIAN REGIONAL COMMISSION
A Proud Past, A New Vision
Office of Inspector General

July 24, 2008

Memorandum for The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 08-14
FY 2007 Financial Statement Audit and Accompanying Documents

The enclosed report presents the results of the audit of the Commission's financial statements for the fiscal year ended September 30, 2007. 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 to audit the financial statements of the Commission as of and for the year ended September 30, 2007. The contract required that the audit 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 are noted from the audit of ARC:

- WithumSmith+Brown was unable to express an opinion as to whether the financial statements were properly stated in accordance with U.S. generally accepted accounting principles in use by the federal government due to a scope limitation.

- WithumSmith+Brown did not provide an opinion on the effectiveness of ARC's internal controls over financial reporting but did note material weaknesses in meeting Parent-Child reporting requirements, preparing certain disclosures, and properly accounting for grant advances, revenue and equity transactions in compliance with federal accounting standards.

- WithumSmith+Brown did not express an opinion on compliance with laws and regulations but did note a deficiency addressed in an earlier audit issued by us on information system security.

The Accountability of Tax Dollars Act of 2002 requires ARC to prepare and submit audited financial statements and to consolidate the audited financial statements and other financial and performance reports into a combined Performance and Accountability Report in accordance with OMB Circular A-136, *Financial Reporting Requirements.* Prior to FY 2007, ARC had not presented federal financial statements; instead utilizing generally accepted accounting principles promulgated by the Financial Accounting Standards Board for the presentation of its financial information. In 2007, OMB Circular A-136 required that agencies report financial information for funds allocated to other agencies (Child Agencies or Children) regardless of the control and/or oversight exercised by the allocating "Parent"

agency. The Parent-Child reporting requirement necessitated that ARC present its financial statements in accordance with federal standards of reporting. ARC management, foreseeing difficulties in complying with the new standards of A-136 requested both an exemption from the reporting requirements and later an extension for completion of the financial statements. Both requests were denied but ARC was unable to comply.

ARC, like most agencies presenting federal financial statements for the first time, found it difficult to successfully implement federal reporting requirements in the first year and obtain a "clean" audit opinion. However, unlike other agencies' first experiences with federal reporting requirements, ARC's difficulties were exacerbated by the new Parent-Child reporting requirements and the departure of ARC's CFO. ARC, a small Parent agency with seven Child agencies, was challenged in obtaining timely, complete, usable data from the other agencies and subsequently to verify its integrity. As a result, Management could not make required representations concerning this financial information included in its financial statements.

Other requirements impacting the issuance of auditable financial statements are the following:

- ARC must record transactional data properly, not only to proprietary accounts, but to budgetary accounts and reconcile this activity.

- Recorded activity must be sufficiently detailed to allow reconciliation.

  As part of the new requirements currently being developed for ARC's Grant Management System (GMS) ARCNet, it is imperative that that these two systems be in concert and that the GMS acts as a subsidiary to the general ledger. This will also serve to bring the systems into compliance with OMB Circular A-127 which requires integration of the financial management systems. This is also referenced in the Audit of ARC's Grant Management System (OIG report 08-09).

- Data from grant programs must be readily accessible to permit five year reporting (initially, only the first year of activity must be reported if data is unavailable) of supplementary stewardship information for non-federal property, human capital, and research and development.

WithumSmith+Brown recommended that management:

- Ensure that timely, complete financial information is received from its Child agencies and appropriate controls and other procedures are implemented to enable management to make required representations concerning its Child financial information.

- Ensure that finance staff receive training in federal accounting standards and federal reporting requirements.

- Ensure written policies and procedures are developed to address the need to review and properly account for contractual relationships between ARC and other entities.

For the 2006 audit, ARC was provided written comments recommending that management strengthen internal controls to ensure liabilities reflect accruals for grant payment requests. Additionally, the auditor recommended that ARC ensure policies and procedures be developed so that funds received and expended from other agencies are properly recorded. For the 2007 audit, these issues remain unresolved, although in the first instance some improvement was noted for the accrual of liabilities.

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, internal controls, or compliance with laws or regulations. WithumSmith+Brown is responsible for the attached auditor's report dated June 24, 2008 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