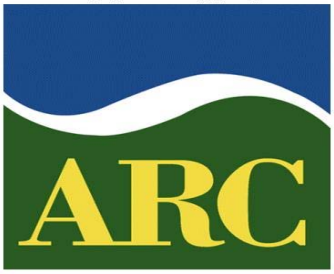
Office of Inspector General

Grant Management Compliance

The Appalachian Regional Commission



July 2, 2010

Inspection Report 10-06

Why We Did This Inspection

The results of grantee audits demonstrated prior weaknesses in ARC's oversight of grantee activities and enforcement of grant requirements. Accordingly, we wanted to know what specific ARC oversight policies and processes were in use. We also wanted to understand the full range of grant requirements that needed to be monitored and to assess grantee oversight activities. For this review, our scope was limited to 5 grants dealing with compliance concerns.

This inspection report presents the second part of our results on the topic of grants management. The findings in this report were separated out from the first report, report 09-03, because of time considerations related to the securing of a general counsel, whose input was needed for proper evaluation of these findings.

Summary of Recommendations

Our office makes the following recommendations.

1) ARC should immediately comply with the ARC Code's construction limitations and if appropriate seek to have the Code revised.

2) We recommend that ARC develop a policy to define what constitutes administrative oversight responsibility, so that administrative agencies are properly listed in ARC approvals and in ARC's grant management system.

What We Found

Our inspection presents two findings regarding ARC's oversight of construction grants. Specifically, we found three grants each raising at least one of the following concerns:

A. ARC Code's Construction Provisions

ARC recognizes that it does not have personnel with adequate skill sets to provide administrative oversight for most types of construction grants. ARC Code Section 8.1 appears to address this shortcoming by limiting the administration of certain construction grants to federal agencies, and by excluding ARC from their administration. However, a review of a sample of grants found 10% involving significant construction that were either administered by ARC or a state agency (a non-federal agency) in seeming conflict with the ARC Code construction limitation provision.

In discussions with the ARC General Counsel (GC), we were advised that the limitations on construction grants in the Code are intended to prevent ARC from directly managing construction site daily activities. According to the GC, this provision was never intended to prevent non-federal agencies or ARC from administering construction grants. After further discussions with our office, the GC agreed that there appear to be differences in the way this code section was understood and implemented versus the way an outsider might read and understand it. Accordingly, we recommend that management update this section of the Code to reflect the current business practices of ARC with respect to the administration of construction grants. Code changes and other improvements to policies demonstrate, by example, ARC's commitment to the appropriateness and transparency of its activities.

B. Recognition of Administrative Responsibilities

We also found problems with the naming of administrative agencies in the Federal Co-chair's grant approval memoranda and in ARC's grant management system. We believe the division of responsibility for managing construction grant activities among different agencies contributed to the naming inconsistencies between the approval memoranda and ARC's grant management system. Also, the agencies named were not always reflective of the underlying grant documentation. For instance, the approval memorandum would list a federal agency (not ARC) as the administrator when, in fact, ARC or the state agency was administering the grant. Ultimately, it is important for only one agency to be accountable for oversight of grant activities.

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Background

ARC is an entity created by Congress, a partnership of the federal government and 13 state governments charged with improving the lives of Appalachian residents and improving the economic vitality of the Appalachian region, as defined in the Appalachian Regional Development Act of 1965, as amended. Primarily, ARC achieves these goals by making grants to state and local government entities that provide needed programs. Aside from the legislation governing ARC's activities, ARC has adopted a code which was developed to address ARC's unique needs and is the "definitive statement of current ARC policy."[1] The Code is an important regulatory tool, providing the framework for a significant part of ARC's operations, and reflects the operating ideologies of both the state and federal components of ARC.[2]

Results of Inspection

We found that ARC was issuing construction grants in seeming conflict with the ARC Code's restrictions on the administration of construction grants by ARC and non-federal agencies.[3] ARC Code section 8.1 (B)(1) states:

> **Construction Grants Ineligible**. No projects under the Area Development Program involving significant construction, except housing projects, may be administered by the Commission. A basic federal agency must be responsible for the administration…

In discussions with ARC's General Counsel (GC), he informed us that the provision limiting the administration of construction grants to federal agencies was only intended to prevent the direct administration of construction site work by ARC.[4] The GC went on to state that no one associated with the program has any misunderstanding about what is permitted under this Code section. Our appraisal of this Code section was that it prohibits non-federal agencies (including state agencies) and ARC from having any administrative responsibilities for most types of construction grants. After further discussions with our office, the GC agreed that there appear to be differences in the way this Code section was understood and implemented versus the way we interpreted it or how a non affiliated party might understand it.

Another concern was related to ARC's difficulty in defining who has ultimate responsibility for construction grant oversight. We believe the division of responsibilities among different agencies contributed to the naming difficulties/inconsistencies between the approval memoranda and ARC's grant management system. Also, the agencies named were not always reflective of the underlying grant documentation. For instance, the approval memorandum would list a federal

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[1] The ARC Code, Section 1.1, Revised 2008.

[2] Section 1.1 of the ARC Code states, "The Code reflects Commission decisions adopted through resolutions and motions." and "…no decision involving any modification or revision in the Code can be made without a quorum of governors present."

[3] Except that ARC is permitted to administer construction for housing projects.

[4] The ARC General Counsel explained in an opinion to our office that ARC did not employ personnel with the necessary skill sets to oversee construction grants, and that it had met the intended purpose of the Code's provisions by using state agencies. An excerpt from ARC's explanation states, "The extension of the definition of federal agency administration … to the state agencies in the projects you cite is consistent with the purpose of that provision."

agency (not ARC) as the administrator when, in fact, ARC or the state agency was administering the grant.

Confirming what we were told by the GC, that a significant number of grants were issued for construction, we found that 10% of our sample of 30 grants (3 of 30) were issued with ARC or state agency administration, which was contrary to our interpretation of ARC's construction code provision, but consistent with the GC's statements to our office. All of the construction grants reviewed also had issues in the naming of the administrative agency. The next few paragraphs describe three construction grants which were administered by state agencies or ARC.

1. A County Water System Grant

A grant was provided to a county government for construction of a water system supplying homes, businesses and a school. ARC construction funding was provided in conjunction with funding from the U.S. Environmental Protection Agency (EPA). ARC's approval memo lists the U.S. EPA as the Basic Agency (a federal agency charged with grant administration). However, neither the U.S. EPA nor any other federal agency is administering the grant. The grant contract states that the state EPA is responsible for construction project review and oversight[5] and mentions a Memorandum of Understanding (MOU) made between ARC and the federal and state EPA. Under the MOU, the state EPA is responsible for following specific procedures for contract administration. However, ARC is listed as the administrative agency in ARC's grant management system. It appears that the state EPA and ARC had administrative responsibilities for this grant.

2. A Grant for Infrastructure

Another grant was provided a governor's office for infrastructure rebuilding following a flood. The funds were primarily used to repair roads, a retaining wall, and an embankment. This grant was not administered by a federal agency and it is unclear how ARC intended to manage the grant—ARC's approval memo does not list a grant administrator, the contract documents provide for the grant's joint administration by two state offices, and ARC's grant management system lists ARC as the administrative agency.

3. A Grant Made to Improve a City and Town's Water Systems

A third grant for construction, administered by ARC, was made to a state administrative agency. The purposes of the grant were to improve the water storage capacity and a water distribution system for a city and town. The state agency was the grantee and provided construction project management (per the grant agreement). A letter from the U.S. EPA to ARC noted the existence of an operating agreement between the state agency and themselves. The operating agreement established operating procedures and required an annual compliance review for other matters, but did not provide for grant administration. However, ARC's approval memo listed the EPA as the Basic Agency.[6] As above, this grant is reported by ARC's grant management system as being self-administered.

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[5] The state EPA, under an agreement with the US EPA and ARC, is supposed to follow a contract provision for the proper administration of the grant.

[6] The memo also conflicts with itself as later in the document it states that the grant will be administered by the state with oversight by the EPA.

Because the Code reflects the operating direction that the Commission, as a whole, has established, we believe it is important that ARC personnel adhere to the Code's provisions. As we discussed, the Code provision relating to construction grants appears to limit its administration to federal agencies (and it excludes ARC administration). Accordingly, our recommendation is that the Code be implemented as written, and if this implementation process is not appropriate for operations, then operating management should seek to have it changed. This will help to improve the appropriateness and transparency of ARC's operations. In addition, it is important to know who has ultimate oversight responsibility for ARC's construction projects. ARC needs to develop procedures to ensure the proper naming of administrative agencies.

Recommendations

We recommend that ARC's Executive Director:

1) a) Immediately implement procedures to comply with the ARC Code's construction grant provisions, and discontinue making any future construction grants where ARC administers or a non federal agency administers the grant, and

b) at management's option, modify the Code to allow for ARC or non federal agencies (or other entities) to administer construction grants.

2) Develop a policy to define what constitutes administrative oversight responsibility, so that administrative agencies are properly listed in ARC approvals and in ARC's grant management system.

Management Response

Management agreed with our assessment of ARC Code Section 8.1 (B)(1), that the Code's language should be modified to reflect ARC's practice of assigning qualified agencies, both federal and state, responsibility for construction grants. Further, management stated that ARC has never been staffed to provide construction site management and recognized that the Code is appropriate in prohibiting ARC from directly administering grants. In conclusion, management will propose to the Commission in August (just over a month from now) an amendment to the Code which will align the Code with management's assignment of administrative responsibilities for construction projects, but in the meantime they will continue their current method of operation.

In concurrence with our second recommendation, management agreed to rectify the naming of construction grant administrative agencies in its approvals and in its grant management system.

The entire text of management's response in provided Appendix B.

Office of Inspector General Comments

Management's response addresses our concerns and we will consider the recommendations resolved once the promised actions take place later in the year. However, if the Commission chooses not to pass an amendment allowing for both federal and state agency administration of construction grants during its August 2010 meeting, the part of the recommendation dealing with an immediate moratorium on the issuance of construction grants would come into play. We do not expect that this will be the case.

Appendix A

Objectives, Scope, and Methodology

The objectives of this inspection were to identify ARC oversight policies and processes in use, to understand the grant requirements and to assess and evaluate grantee oversight. In particular, we identified grant requirements and practices in use by ARC's grant managers to provide oversight of grantee activities and compared that to the universe of applicable grant requirements. Then, we assessed compliance with the requirements and evaluated the effectiveness of grant oversight. Also, in conjunction with this inspection; we reviewed ARC grant files, discussed concerns with ARC grant personnel and researched issues of concern.

The scope of this inspection was limited to the five grant findings which were developed during our earlier inspection work and were unresolved. With respect to those findings, we did the following:

- obtained a written explanation and/or held discussions with ARC's General Counsel (OGC) to acquire information regarding certain items related to ARC's grant management activities and guidance;
- drafted our assessments and evaluations to provide this report while taking into account information and opinions received from the OGC and the OIG Counsels.

Our inspection was conducted at ARC's offices in Washington, DC from April 2008 to April 2010 in accordance with the Quality Standards for Inspections adopted by the Council of Inspectors General on Integrity and Efficiency.

Note: This inspection report presents the second part of our results on the topic of grants management. The findings in this report were separated out from the first report, report 09-03, because of time considerations related to the securing of a general counsel, whose input was needed for proper evaluation of these findings.

Appendix B

APPALACHIAN REGIONAL COMMISSION

A Proud Past, A New Vision

Date: June 28, 2010

To: Clifford Jennings, ARC Inspector General

From: Thomas Hunter, ARC Executive Director

Subject: Grant Management Compliance Report (10-XX)

This memorandum is the agency response to the above-referenced Office of Inspector General Report. Essentially, the Report highlights the lack of complete congruence between a provision of the ARC Code and the Commission's intention in adopting that provision.

Section 8.1.b.1 of the ARC Code prohibits ARC from "directly administering" certain construction grants and requires a federal agency to be responsible for the administration of these grants. The provision, which has been a part of the ARC Code for more than twenty years, was intended to ensure that major ARC construction grants will be managed by experts in construction project management located in proximity to the project sites. The provision was included in the Code in recognition of the fact that ARC has never been staffed to provide the expertise or field office presence that management of grants of this type requires.

The provision has always been understood in practice to include grants that are managed by state agencies that are statutorily recognized as the appropriate administering agencies of federal programs working under operating agreements with federal agencies. (These include the two noted in your report: the state Community Development Block Grant (CDBG) offices that operate under agreements with the federal Department of Housing and Development and the state environmental agencies operating under agreements with the federal Environmental Protection Agency.) Accordingly, we will continue to implement this section of the Code in accordance with the Commission's consistent understanding that it should be read broadly enough to include grants of the type noted in your report.

We agree with your assessment, however, that the Code language should be clarified to exactly correspond to the Commission's intentions and practices in this regard. In particular, as you have noted, a more rigorous distinction between "grants administration" and "project management" might be usefully introduced. Accordingly, we will propose a clarifying amendment to this Code provision for consideration by the Commission at the earliest opportunity (which should occur in North Carolina in August.) We will also rectify the listing of administrative agencies in ARC approvals and in its grants management system in accordance with the Commission's decision regarding administrative responsibilities for ARC grants.

In closing, we wish to express our appreciation of the helpful efforts you and your staff have made to focus this important issue for Commission attention.

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