



# INSPECTOR GENERAL'S SEMIANNUAL REPORT TO CONGRESS

*Appalachian Regional Commission*

*October 1, 2007–March 31, 2008*



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***On the cover:*** (Clockwise, from top) ARC Governors Quorum Meeting; Governor Haley Barber and ARC Federal Co-Chair Anne B. Pope; Governor Tim Kaine and Governor Phil Bredesen; Governor Steve Beshear, Governor Sonny Perdue, and Governor Bob Riley; Governor Joe Manchin and Governor Tim Kaine. Photographs by Ann Hawthorne.



April 2008

MEMORANDUM FOR THE FEDERAL CO-CHAIR

SUBJECT: Semiannual Report to Congress

In accordance with the requirements of the Inspector General Act Amendments of 1988, Public Law 100-504, I am pleased to submit the Office of Inspector General Semiannual Report to Congress.

This Semiannual Report to Congress summarizes the activities of our office for the 6-month period ending March 31, 2008. During this semiannual period we issued six reports to the Appalachian Regional Commission. During this period, the Inspector General continued to serve as representative of the Executive Council on Integrity and Efficiency.

The Inspector General Act of 1978, as amended by the Inspector General Act Amendments of 1988, provides that this report be forward to appropriate Congressional committees within 30 days and that you provide whatever additional comments you consider appropriate.

I appreciate the Commission's and your cooperation with the Office of Inspector General in the conduct of our operations.

Clifford H. Jennings  
Inspector General

Enclosure

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## **EXECUTIVE SUMMARY**

During the reporting period, six final reports were issued dealing with the J-1 Visa Waiver program. Draft reports for nine grants are currently out for agency comment. Additionally, a peer review was completed of the Federal Election Commission's OIG office.

Three soon to be issued audits are evaluating issues of grant compliance with grant terms, federal regulations and internal controls. Another upcoming audit report deals with ARC's grant management system. Current work will include a review of ARC's grants management. We will be analyzing the completeness and effectiveness of ARC's grant policies and procedures in controlling the activities of ARC administered grants.

During the reporting period, the IG served on the Executive Council on Integrity and Efficiency.

## **PURPOSE AND REQUIREMENTS OF THE OFFICE OF INSPECTOR GENERAL SEMIANNUAL REPORT**

The Inspector General Act of 1978 requires the IG to keep the Federal Co-Chair and Congress fully and currently informed about problems and deficiencies in the Commission's operations and the necessity for corrective action. In addition, the Act specifies that semiannual reports will be provided to the Federal Co-Chair by April 30 and October 31 and to Congress 30 days later.

The Federal Co-Chair may transmit comments to Congress along with the report but may not change any part of the report. The specific requirements prescribed in the Act, as amended (Public Law 100-504), are listed below.

### Reporting Requirements

Section 4(a)(2)	Review of legislation and regulations	Page 8
Section 5(a)(1)	Problems, abuses, and deficiencies	Page 6-7
Section 5(a)(2)	Recommendations with respect to problems, abuses, and deficiencies	Page 6-7
Section 5(a)(3)	Prior significant recommendations not yet implemented	*
Section 5(a)(4)	Matters referred to prospective authorities	*
Section 5(a)(5) and Summary of instances where information was refused 6(b)(2)		*
Section 5(a)(6)	Listing of audit reports showing number of reports and dollar value of questioned costs	App A
Section 5(a)(7)	Summary of each particularly significant report	**
Section 5(a)(8)	Statistical table showing number of reports and dollar value of questioned costs	App B
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use	App C
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by end of the reporting period	*
Section 5(a)(11)	Significant revised management decisions	*
Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees	*
* None.		
** See references to Sections 5(a)(1) and 5(a)(2) for discussion of significant reports.		

## **I. INTRODUCTION**

The Inspector General Act Amendments of 1988 (P.L. 100-504) provides for the establishment of an Office of Inspector General (OIG) at 30 designated Federal entities, including the ARC. The ARC OIG became operational on October 1, 1989, with the appointment of an IG and provision of budgetary authority for contracted audit and/or investigation activities.

## **II. BACKGROUND**

### **A. APPALACHIAN REGIONAL COMMISSION**

The Appalachian Regional Development Act of 1965 (P.L. 89-4) established the Appalachian Regional Commission. The Act authorizes a Federal/State partnership designed to promote long-term economic development on a coordinated regional basis in the 13 Appalachian States. The Commission represents a unique experiment in partnership among the Federal, State, and local levels of Government and between the public and private sectors. It is composed of the Governors of the 13 Appalachian States and a Federal representative who is appointed by the President. The Federal representative serves as the Federal Co-Chair with the Governors electing one of their numbers to serve as the States' Co-Chair.

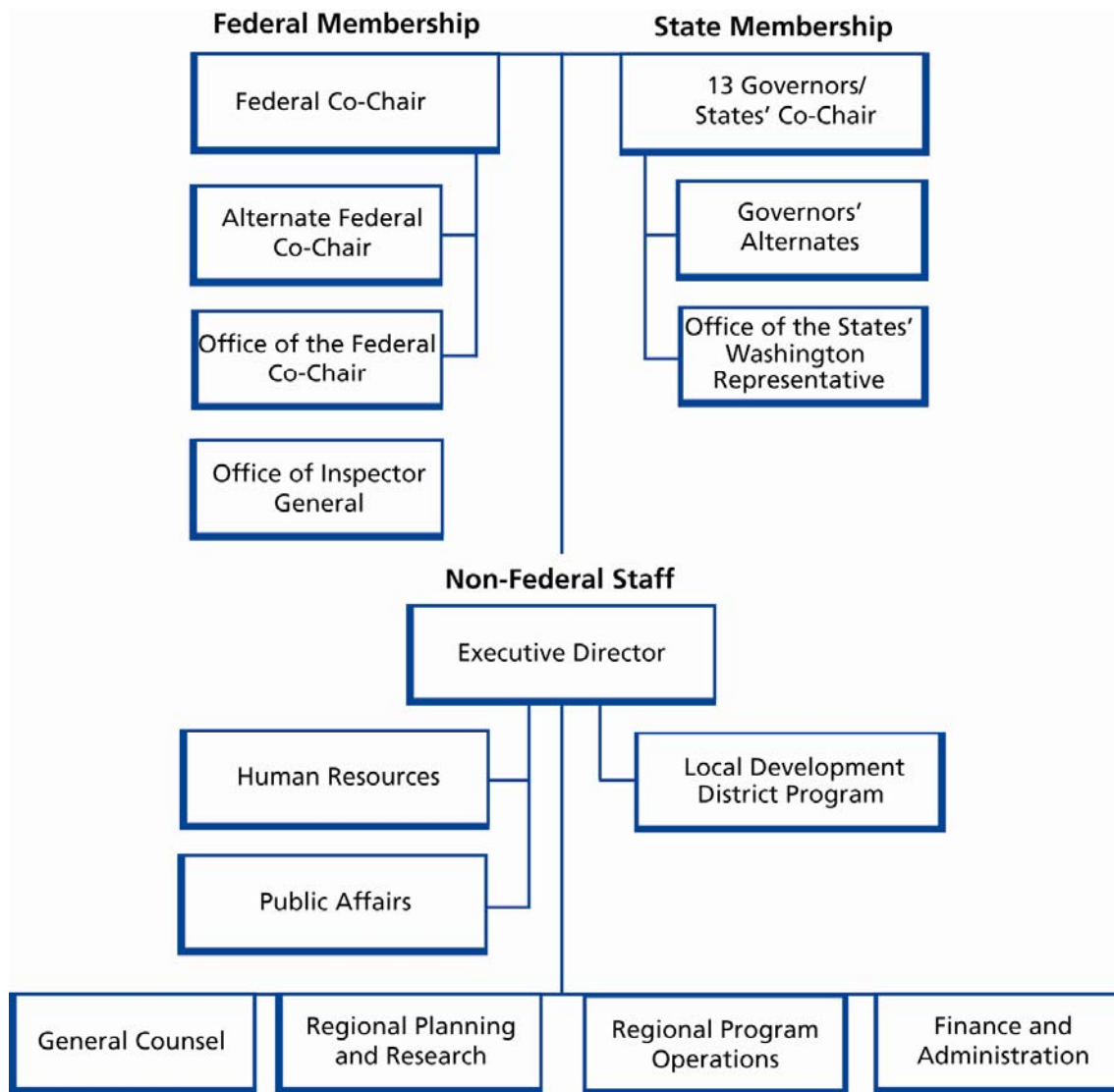
- Through joint planning and development of regional priorities, ARC funds are used to assist and encourage other public and private resources to address Appalachia's unique needs. Program direction and policy are established by the Commission (ARC Code) with the vote of a majority of the State members and the affirmative vote of the Federal Co-Chair. Emphasis has been placed on highways, infrastructure development, business enterprise, and human resources programs.
- Administratively, the Office of the Federal Co-Chair, with a staff of 11, and the Commission, with a staff of 45, is responsible for ARC operations. The States maintain an Office of States' Representative (2 persons) that has primarily liaison responsibilities. All personnel are located in Washington, DC. The Commission staff's administrative expenses, including salaries, are funded jointly by Federal and State funds; the States' Representative staff is funded entirely by the States; and the Federal Office staff is funded entirely from Federal funds.
- The Commission's appropriation for FY 2008 is \$ 73.032 million. ARC was reauthorized in March 2002. In addition, Section 1101 of the Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) provides annual authorizations of \$470 million for construction of the Appalachian Development Highway System (ADHS), under Section 201 of the 1965 Appalachian Regional Development Act, for a total of \$2.35 billion over the five-year period, FY 2005 through FY 2009, from the Highway Trust Fund. Although these funds are derived from the Highway Trust Fund they remain under ARC's programmatic jurisdiction.



Program funds are distributed to state and local entities in accordance with an allocation formula intended to provide fair and reasonable distribution of available resources. ARC staff has responsibilities for program development, policy analysis and review, grant development, technical assistance to States, and management and oversight.

- In order to avail itself of federal agency expertise and administrative capability in certain areas, ARC often relies on other departments and agencies for program administration, especially with respect to highways and infrastructure projects. For example, the Appalachian Regional Development Act authorizes the Secretary of Transportation to administer the Commission's highway programs with the Commission retaining responsibility for priorities, highway locations, and fund allocations.

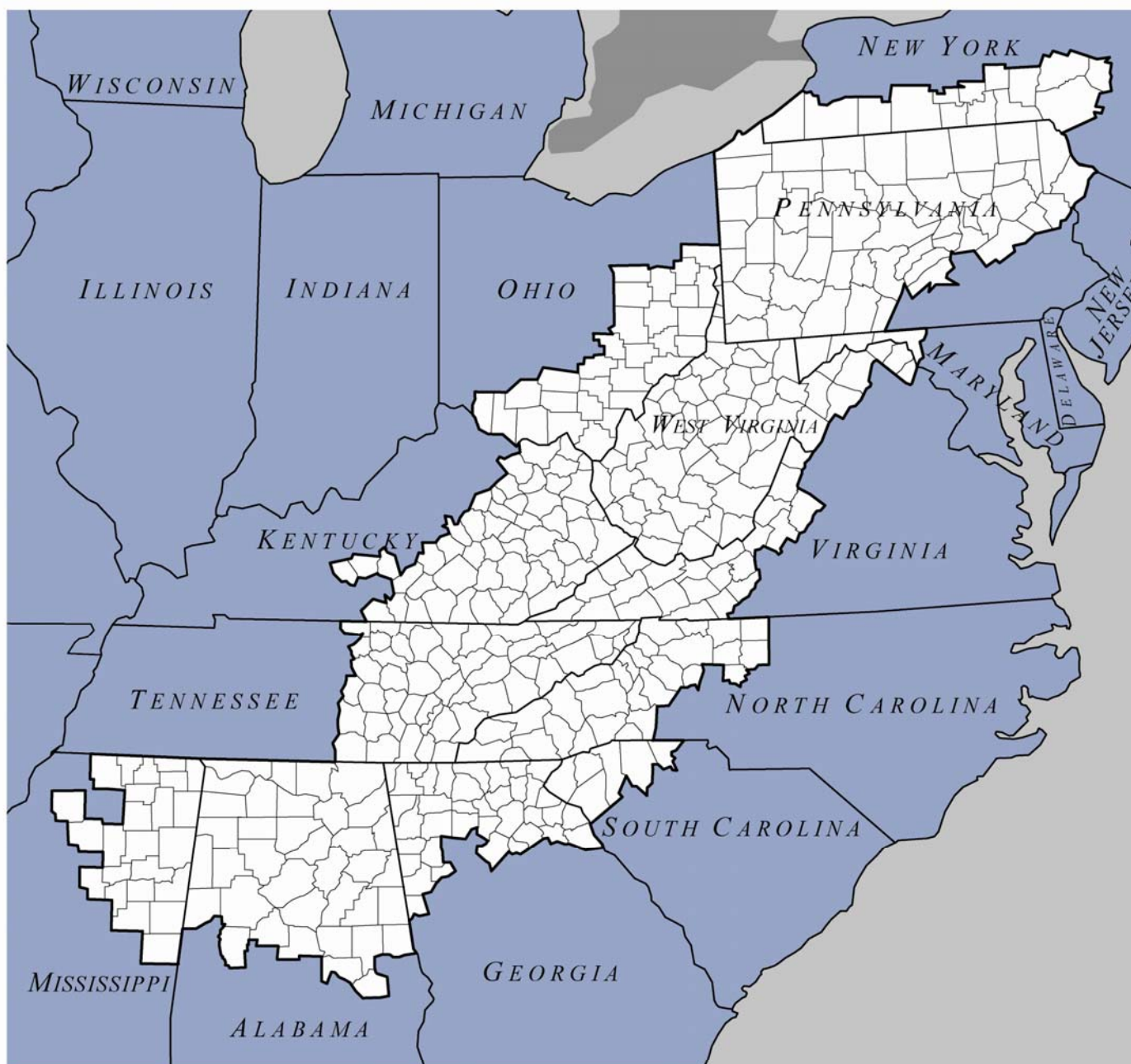
## ARC ORGANIZATION CHART







## APPALACHIAN REGION

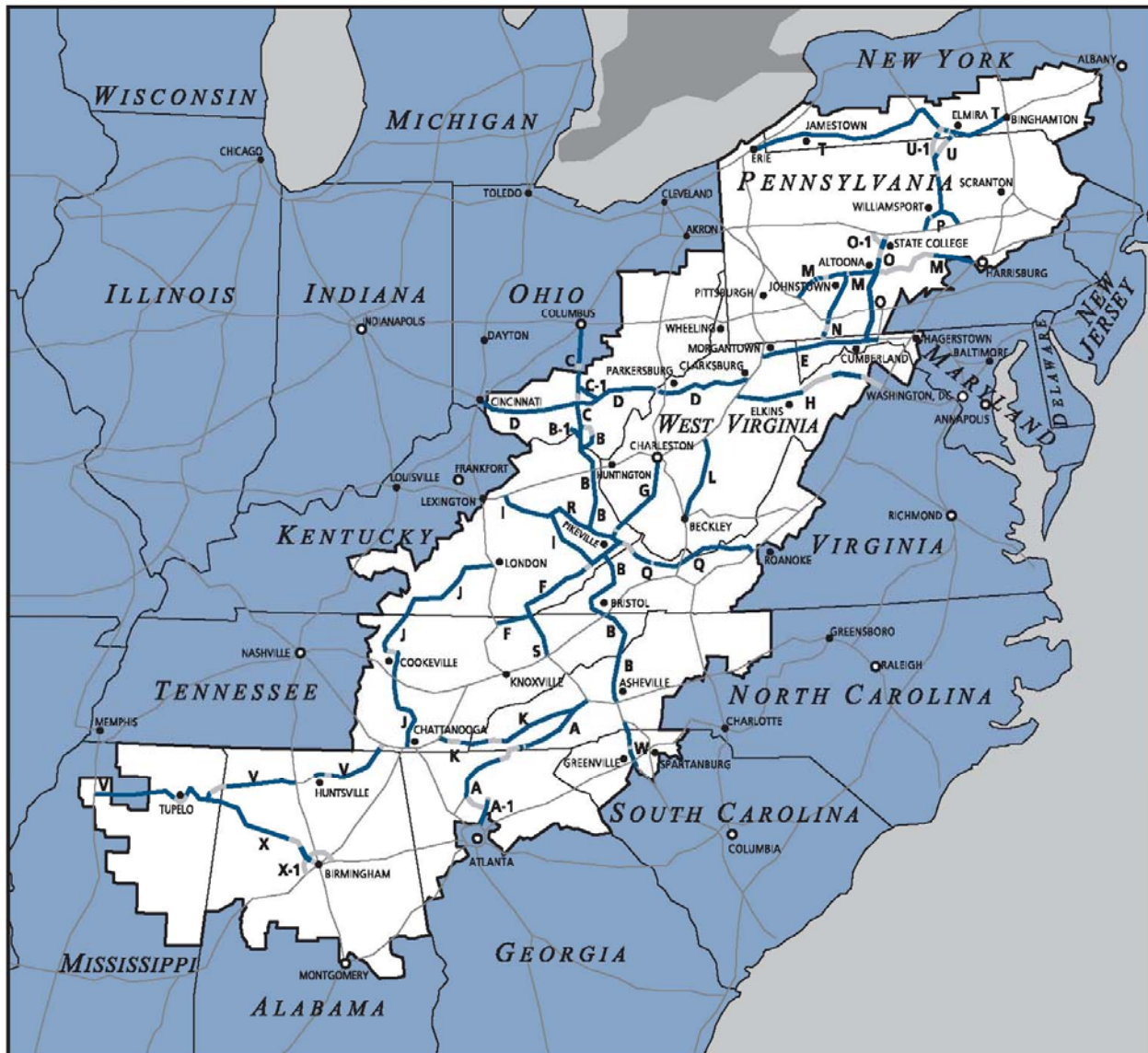


Appalachia, as defined in the legislation, from which the Appalachian Regional Commission derives its authority, is a 200,000-square-mile region that follows the spine of the Appalachian Mountains from southern New York to northern Mississippi. It includes all of West Virginia and parts of twelve other states: Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia.



# APPALACHIAN DEVELOPMENT HIGHWAY SYSTEM

September 30, 2007



- ADHS Miles Open to Traffic—  
September 30, 2007
- ADHS Miles Not Open to Traffic
- Interstate Highway System

## **B. OFFICE OF INSPECTOR GENERAL**

The ARC OIG is an independent audit and investigative unit. An independent Inspector General who reports directly to the Federal Co-Chair heads the OIG.

### **Role and Authority**

The Inspector General Act of 1978 (P.L. 95-452), as amended in 1988, states that the IG is responsible for (1) audits and investigations; (2) review of legislation; and (3) recommendation of policies for the purpose of promoting economy and efficiency in the administration of, or preventing and detecting fraud and abuse in, the program and operations of the establishment. In this regard, the IG is responsible for keeping the Federal Co-Chair and Congress fully informed about the problems and deficiencies in ARC programs and operations and the need for corrective action. The IG has authority to inquire into all ARC programs and activities that are federally funded. The inquiries may be in the form of audits, surveys, investigations, personnel security checks, or other appropriate methods. The two primary purposes of these inquiries are (1) to assist all levels of ARC management by identifying and reporting problem areas, weaknesses, or deficiencies in procedures, policies, program implementation, and employee conduct and (2) to recommend appropriate corrective actions.

### **Relationship to Other Principal ARC Offices**

The States' and Federal Co-Chairs, acting together as the Commission, establish policies for ARC's programs and its administration. These policies are codified in the ARC Code and implemented by the Commission staff, which is responsible for monitoring project performance and providing technical assistance as needed. The Federal Co-Chair, as the Federal fiscal officer, is responsible for the proper use and protection of Federal funds, for ensuring compliance with applicable Federal laws and regulations, and for taking appropriate action on conditions needing improvement, including those reported by the OIG. The operations of the OIG neither replace established lines of operating authority nor eliminate the need for the Commission offices to take reasonable measures to protect and enhance the integrity and effectiveness of their operations. All Commission offices are responsible for monitoring and evaluating the programs entrusted to them and reporting information or incidences needing further audit and/or investigation to the IG.

### **Funding and Staffing**

The OIG funding level for FY 2008 is \$486,000. For FY 2008, approximately 44 percent was used for contract audit services, 46 percent for salaries and benefits, 2 percent for travel, and 8 percent for all other activities (training, equipment, space, supplies, etc.).

Staffing consists of the Inspector General, an Assistant Inspector General for Audit, and a confidential assistant. Grant review activities continue to emphasize use of contracted services (e.g., independent public accounting firms or other OIG offices) supplemented by programmatic and performance reviews directed by OIG staff. Investigative assistance is provided by other OIG offices on an as-needed basis through memoranda of understanding. This approach is deemed the most appropriate to date in view of the nature of ARC operations and limited resources. During the most recently passed reporting period, the Department of Homeland Security (DHS) OIG conducted a computer security review of ARC operations at our request.

### **III. OIG ACTIVITY**

#### **A. AUDITS & REVIEWS**

During the reporting period, six reports were issued dealing with the J-1 Visa Waiver program. Three audits soon to be issued are investigating grant compliance with the terms of the grant and internal controls. Another audit soon to be completed concerns ARC's grant management system. All issued reports can be found on the OIG website <http://www.arc.gov/index.do?nodeId=2060>.

#### **J-1 Visa Waiver (Physicians) Program**

During the reporting period, six reports were issued dealing with compliance requirements of the J-1 Visa Waiver Program. The program includes requirements that J-1 physicians provide primary care services in an Appalachian Health Profession Shortage Area for 40 hours per week, regardless of the physician's specialty. Audit findings include insufficient time provided by the doctor and/or practice in the location approved; lack of required notices stating that Medicare, Medicaid and indigent patient care will be provided; and other issues. In all cases, the issues were resolved.

#### **Audit of ARC's Grant Management System**

Our office initiated an audit of ARC's grant management guidance. During the course of the audit, we became interested in how grant data was processed by ARC's grant management system, ARC.net. Accordingly, a second audit was undertaken dealing with how the system was established, how data was (and is) recorded and summarized, and how information is accessed and utilized. The results of the audit were not finalized as of March 31, 2008- report issuance is planned for April 2008.

#### **2007 Financial Statement Audit**

The Appalachian Regional Commission's financial statements are audited by an outside independent auditor. The OIG monitors the activities of the auditor to help ensure compliance with applicable statutes, OMB guidelines, and auditing standards. Performance and Accountability Report submissions to OMB, to include the financial statement audit, were required by November 15<sup>th</sup> for 2007. However, because of a change in OMB reporting requirements and ARC's unique relationship with other agencies, obtaining an audit opinion became unachievable.

Effective for fiscal years beginning in 2007, the parent agency (ARC in this situation) is required to report on the use and status of funds transferred to the child agencies. This created two problems for ARC which were not resolved (despite managements concerted efforts), getting activity and balance reports from the child agency, and obtaining an understanding and then confidence in the internal controls of the child agency, especially when the amount of funds transferred to the child is insignificant to the child (and below levels of audit materiality) but is significant to the parent. For FY 2007, ARC's auditor has informed management that it plans to disclaim an opinion on the financial statements, and management has made plans to issue the financial statements, "as is." The auditability of FY 2008 financial statements remains in question.

#### **Peer Review**

Offices of Inspectors General (OIGs) are required to perform (and undergo) reviews of other OIG offices every three years to ensure policies and/or procedural systems are in place that provide reasonable assurance of compliance with auditing standards and policies. ARC completed a peer review of the Federal Election Commission OIG and issued a report on its system of quality controls on March 28, 2008.

## **Telecommunications Audits**

Draft reports on telecommunications issues are awaiting agency comment. These reports are on grants to Connect Kentucky, Pickens County (Alabama) Board of Education, Hancock County (Tennessee) and Mission West Virginia, Inc.

## **B. INVESTIGATIONS**

The Inspector General Act of 1978, as amended, provides that the IG may receive and investigate complaints or information concerning the possible existence of an activity constituting a violation of law, rules, or regulations; mismanagement; gross waste of funds; or abuse of authority. The OIG does not employ criminal investigators. When the need has arisen, the matter would be referred to the Federal Bureau of Investigation or assistance would be contracted with another Federal OIG. Also, the results of investigations may be referred to the appropriate Federal, State, or local prospective authorities for action.

As a result of the computer security review performed by the DHS OIG, an investigation was opened and certain personnel actions taken. The investigation is still awaiting the resolution of a referral to another law enforcement agency. ARC itself has taken all necessary actions resulting from the audit and subsequent investigation.

In 2006, the OIG referred a case involving \$500,000 in ARC funding and potential contracting violations and kickbacks to the Tennessee Valley Authority's OIG for investigation. The investigation is still ongoing.

## **C. OTHER**

### **OIG Policy Manual**

During this period and for the next several months, ARC OIG will be involved in re-writing its policy manual. The manual is being updated to reflect changes made to generally accepted governmental auditing standards and other issues affecting our operating environment. Of special consideration are recent changes related to internal controls, fraud considerations, ethical issues, and computerization of audit processes.

### **Electronic Audit Work papers**

ARC-OIG is aware of the benefits of electronic work papers for improving audit efficiency. In particular, we believe that an improved indexing, and numbering system, together with an improved supervisory review structure could be beneficial. We have recently reviewed some electronic work papers systems and are continuing to gather information in anticipation of the purchase of the most effective system for our use.



## **Going Green**

ARC management has implemented green measures within the organization's internal operations. For example, a new document scanning system has been linked to ARC's e-mail system. Management, in a written response to our draft report on ARC's grant management system stated, "We have had preliminary discussion with our state partners about the need to move to a paperless application process, and will pursue this more vigorously within this fiscal year."

Reduction in paper utilization can reduce cost, improve the timeliness of management decisions through better document storage and retrieval, and helps to reduce demands on our earth's ecological systems.

Our office, in alignment with ARC's management's initiative, is committed to "going green" and we will attempt in future periods to issue our communications, and perform and transmit more work electronically, e.g., reports, including semiannual reports, audit reports from contracted auditors, and audit workpapers will be issued or maintained electronically, to the extent possible.

## **IV. OIG HOTLINE**

A region wide toll-free hotline was previously established to enable direct and confidential contact with the ARC OIG in line with governmental and longstanding OIG initiatives as identified in the IG Act of 1978; to afford opportunities for identification of areas subject to fraud, waste, or abuse. However, contacts with the ARC OIG relative to public complaints or concerns continue to be primarily received through ARC staff, on regular OIG phone lines, or from other OIG offices.

Also, numerous hotline calls were received with respect to matters for which other agencies have jurisdiction. This resulted primarily from the ARC OIG hotline apparently being the first such OIG listing in some telephone directories, resulting in ARC OIG being contacted by citizens who did not know the appropriate agency for handling their concerns. The ARC OIG facilitated the complaint process by identifying the applicable agency based on complainant information and providing the correct OIG hotline number.

## **V. LEGISLATIVE AND REGULATORY REVIEW**

Primary efforts in this area continued to be related to potential legislative initiatives with respect to OIG operations. The ARC OIG continues to support legislation that would provide improved protections for IGs, including appointee and career IGs, by consideration of alternatives such as removal for cause criteria and term limits as well as the prohibition of acceptance of bonuses. The majority of legislative review is performed by the PCIE/ECIE legislation committee which forwards the consensus remarks to the appropriate bodies.

## APPENDIX A

### SCHEDULE OF AUDIT REPORTS ISSUED OCTOBER 1, 2007 TO MARCH 31, 2008

Report No.	Entity and Title	Program Dollars or Contract/Grant Amount*	Questioned/Unsupported Costs**	Funds to Better Use***
08-01	Review of Selected Health Providers and J-1 Visa Waiver Physicians in Kentucky			
08-02	Review of Selected Health Providers and J-1 Visa Waiver Physicians in Ohio			
08-03	Review of Selected Health Providers and J-1 Visa Waiver Physicians in Tennessee			
08-04	Review of Selected Health Providers and J-1 Visa Waiver Physicians in New York			
08-05	Review of Selected Health Providers and J-1 Visa Waiver Physicians in Mississippi			
08-06	Review of Selected Health Providers and J-1 Visa Waiver Physicians in Alabama			
TOTALS	(note: all audits this period were of a non-monetary program.)	\$ 0.00	\$ 0.00	\$ 0.00

\* Grant amounts reported are for ARC grant amounts and do not include matching funds.

\*\* A cost the Office of Inspector General has questioned because of an alleged violation of law, regulation, contract, or other agreements governing the expenditure of funds; such cost is not supported by adequate documentation; or the expenditure of funds for the intended purpose is unnecessary or unreasonable. Includes required matching contributions.

\*\*\* Funds the Office of Inspector General has identified in an audit recommendation that could be used more efficiently by reducing outlays, deobligating program or operational funds, avoiding unnecessary expenditures, or taking other efficiency measures, such as timely use of funds.



**SCHEDULE OF AUDIT REPORTS WITH  
QUESTIONED OR UNSUPPORTED COSTS**

(\$ in thousands)

		<u>No. of Reports</u>	<u>Questioned Costs</u>	<u>Unsupported Costs</u>
A.	For which no management decision was made by the commencement of the reporting period	3	\$ 440	\$ 88
B.	Which were issued during the reporting period	0	\$ 0	\$ 0
	Subtotals (A + B)	3	\$ 440	\$ 88
C.	For which a management decision was made during the reporting period			
	(i) dollar value of disallowed costs	0	\$ 0	\$ 0
	(ii) dollar value of costs not disallowed	0	\$ 0	\$ 0
D.	For which no management decision has been made by the end of the reporting period	3	\$ 440	\$ 88
E.	Reports for which no management decision was made within 6 months of issuance	3	\$ 440	\$ 88

**SCHEDULE OF AUDIT REPORTS WITH  
RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE**

		<u>No. of Reports</u>	<u>Dollar Value (\$ in thousands)</u>
A.	For which no management decision was made by the commencement of the reporting period	0	\$ 0
B.	Which were issued during the reporting period	0	\$ 0
	Subtotals (A + B)	0	\$ 0
C.	For which a management decision was made during the reporting period		
	(i) dollar value of recommendations that were agreed to by management		
	--based on proposed management action	0	\$ 0
	--based on proposed legislative action	0	\$ 0
	(ii) dollar value of recommendations that were not agreed to by management	0	\$ 0
D.	For which no management decision has been made by the end of the reporting period	0	\$ 0
E.	Reports for which no final management decision was made within 6 months of issuance	0	\$ 0

**DEFINITIONS OF TERMS USED**

The following definitions apply to terms used in reporting audit statistics:

<b>Questioned Cost</b>	A cost which the Office of Inspector General (OIG) questioned because of an alleged violation of a provision of a law, regulation, contract, or other agreement or document governing the expenditure of funds; such cost is not supported by adequate documentation; or the expenditure of funds for the intended purpose is unnecessary or unreasonable.
<b>Unsupported Cost</b>	A cost which the OIG questioned because the cost was not supported by adequate documentation at the time of the audit.
<b>Disallowed Cost</b>	A questioned cost that management, in a management decision, has sustained or agreed should not be charged to the Commission.
<b>Funds Be Put To Better Use</b>	A recommendation made by the OIG that funds could be used more efficiently if management took actions to implement and complete the recommendation.
<b>Management Decision</b>	Management's evaluation of the findings and recommendations included in the audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary. Interim decisions and actions are not considered final management decisions for the purpose of the tables in this report.
<b>Final Action</b>	The completion of all management actions that are described in a management decision with respect to audit findings and recommendations. If management concluded that no actions were necessary, final action occurs when a management decision is issued.

**THE OFFICE OF INSPECTOR GENERAL  
APPALACHIAN REGIONAL COMMISSION**

**serves American taxpayers  
by investigating reports of waste, fraud, or abuse  
involving Federal funds.**

**If you believe an activity is  
wasteful, fraudulent, or abusive of Federal funds,  
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or (202) 884-7667 in the Washington metropolitan area**

**or write to:**

**Office of Inspector General  
Appalachian Regional Commission  
1666 Connecticut Avenue, NW, Rm 215  
Washington, DC 20009-1068**

**Information can be provided anonymously.  
Federal Government employees are protected from reprisal,  
and anyone may have his or her identity held in confidence.**

**Appalachian Regional Commission**

Office of Inspector General  
1666 Connecticut Avenue, NW, Suite 700  
Washington, DC 20009-1068

