



June 18, 2004

The Honorable Ken Mead
Inspector General
U.S. Department of Transportation
400 Seventh Street, S.W., Room 9210
Washington, DC 20590

Dear Mr. Mead: Ken

I am enclosing a copy of the performance audit on the Appalachian Development Highway System (ADHS) issued by my office. As you are aware, the ADHS is being build by the Federal Highway Administration (FHWA). We engaged an audit firm to review the ARC ADHS program focusing primarily on oversight issues. Given the complexities involved, there is audit coverage available from 4 distinct organizations, including the DOT OIG. The audit firm consulted with your audit staff in an effort to prevent any duplicative work imposed on FHWA and the states.

As can be seen on page 4 of the executive summary, the report includes a recommendation that a dedicated auditor be hired to work with the states to ensure that ADHS funds receive adequate oversight. This position would be funded with monies provided for the ADHS. The report also discloses on the first page of the executive summary that FHWA had incomplete reporting of the manpower utilization of the 16 full-time equivalents that are provided to FHWA for management of the ADHS.

The audit firm selected the Commonwealth of Pennsylvania to perform their audit work. Volume II of the audit includes a cycle memo, which delineates the process "from Congress to concrete".

I would like to thank you and your staff for their cooperation with the auditors. I also have both volumes of the audit report in electronic format and will provide it to your Office of Audit. If you have any questions, you or your staff can contact me on (202) 884-7675.

Sincerely,

[Handwritten signature of Clifford H. Jennings]

Clifford H. Jennings
Inspector General

Enclosures

Cc: Alexis Stefani (w/o enclosures)

VOL I

Mr. Clifford Jennings
Inspector General
Appalachian Regional Commission
1666 Connecticut Avenue NW
Washington, D.C. 20009

Dear Mr. Jennings:

M.D. Oppenheim & Company, P.C. is pleased to submit this performance audit report on the financial and compliance controls in place related to the Appalachian Development Highway System (ADHS) from appropriation to completion or from "Congress to Concrete." We are submitting the report in two volumes. Volume I presents the results of our audit with recommendations on areas where strengthened controls over compliance with program requirements would enhance program effectiveness.

Volume II provides additional reference information to document the ADHS program. It includes a cycle memorandum, flow charts, exhibits of the primary documents and agreements, and program responsibility tables applicable to the ADHS program.

We appreciate the opportunity to assist the Office of Inspector General by providing an independent assessment of the ADHS program. We want to thank ARC staff and the staff of the U.S. Department of Transportation Office of Inspector General, Federal Highway Administration (FHWA) Headquarters and Pennsylvania Division office, and Pennsylvania Department of Transportation (PennDOT) for their assistance with this engagement.

M.D. Oppenheim & Company, P.C.

December 15, 2003

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ACRONYMS

ADHS	Appalachian Development Highway System
ARC	Appalachian Regional Commission
ARDA	Appalachian Regional Development Act of 1965
CFDA	Catalog of Federal Domestic Assistance
FHWA	Federal Highway Administration
FTE	Full Time Equivalent
FY	Fiscal Year
HTF	Highway Trust Fund
MoU	Memorandum of Understanding
NHS	National Highway System
OIG	Office of Inspector General
OMB	Office of Management and Budget
PennDOT	Pennsylvania Department of Transportation
STA	State Transportation Agency
STP	Surface Transportation Program
TEA-21	Transportation Equity Act for the 21 st Century
USDOT	U.S. Department of Transportation

EXECUTIVE SUMMARY

Congress authorized construction of the Appalachian Development Highway System (ADHS) to generate economic development, supplement and connect Appalachia to the interstate system, and provide access to areas within the region. ARC has programmatic oversight over the ADHS program, as well as the responsibility for determining the corridor locations and termini. Individual Appalachian states take the lead in planning, designing, constructing, and maintaining ADHS projects. The U.S. Department of Transportation's Federal Highway Administration (FHWA) is charged with the day-to-day oversight of the ADHS program through each Appalachian state's Stewardship and Oversight Agreement ("Stewardship Agreement") with the FHWA under the Federal-aid Highway Program.

ADHS funding is only available for "eligible" highway projects on "participating" sections of Appalachian highway corridors. Those sections of highway that meet these criteria are detailed in cost-to-complete estimates prepared collaboratively by the states, FHWA, and the Appalachian Regional Commission (ARC) every five years. The most current estimates to complete the ADHS were published in 2002.

We were engaged by the ARC's Office of Inspector General (OIG) to perform a performance audit of the ADHS. Our audit work covered fiscal years 2002 and 2003 and was performed at ARC, the U.S. Department of Transportation and the Pennsylvania State Transportation Agency. As a result of our audit, we noted several weaknesses in the ADHS program.

Oversight vulnerability exists in both programmatic and administrative functions of the ADHS program. We found an increased risk that highway corridors not meeting ADHS eligibility criteria may be approved for ADHS funding. This is due to turnover of project-approval personnel, the amount of ADHS funding in relation to total state Federal-aid highway funding, and lack of inclusion in the Stewardship Agreements of ADHS program information or requirements. This vulnerability is enhanced as time passes since the preparation of the latest cost-to-complete estimates, especially within decentralized State Transportation Agencies.

Administratively, ARC cannot be assured that the ADHS program received adequate oversight and support in accordance with the program administrative budget. The FY 2003 budget approved funding for 16 full-time equivalent (FTE) staff in the FHWA Division offices in support of the ADHS program. However, payroll records indicated support was provided for only 6 FTE positions in 5 of the 13 FHWA Division offices. Inquiry of FHWA management revealed there was incomplete reporting of full-time equivalent (FTE) employment data between FHWA Headquarters and state Division offices. As a result, ARC cannot be assured that the ADHS program received adequate oversight and support from 16 FTEs as planned. The administrative funds were not audited during fiscal years 2002 and 2003.

Audit coverage of the ADHS program is provided by four audit organizations: (1) the U.S. Department of Transportation, Office of Inspector General (OIG); (2) the ARC OIG; (3) the State Transportation Agency (STA) internal and external auditors; and (4) the Single Audit auditors in each of the states receiving ADHS funds. The scope of the audit coverage for the Federal-aid Highway program, which includes the ADHS program, emphasizes Federal billing and state reimbursement processes related to highway construction projects. At the state level, performance audits of the transportation program are conducted. The audit approach at both Federal and state levels does not distinguish ADHS from non-ADHS projects within the Federal-aid Highway Program.

Compliance testing of program eligibility requirements is not required under the OMB A-133 Single Audit Compliance Supplement for the Federal-aid Highway program. Therefore, the Single Audit process does not provide audit coverage of ADHS project approval and eligibility requirements. In addition, we noted there were no ADHS expenditures reported in 7 of the 13 state FY 2001 Single Audit Reports. This indicates either no ADHS funds were expended by those states during the fiscal year, or the states failed to identify and properly report the expenditures in the Schedule of Expenditures of Federal Awards (SEFA). Consequently, there is no assurance that ADHS expenditures received adequate audit coverage under the Single Audit process.

Unobligated ADHS administrative funds, totaling \$91,638.50, that were appropriated prior to TEA-21 under the Energy and Water Development Appropriations Act were not returned timely to ARC by FHWA. We inquired as to the status of these outstanding funds during our audit and obtained documentation supporting a final reimbursement made to ARC during our audit period. Therefore, it appears this issue has been resolved.

ADHS' economic-development objectives, increasingly robust funding levels, its cost-to-complete concept, and unique eligibility criteria requires additional scrutiny by state and Federal personnel to ensure compliance with ADHS program requirements and achievement of program objectives. We believe reducing oversight vulnerabilities and developing an effective audit process is needed to strengthen the ADHS program.

We are making recommendations to the ARC and to FHWA, as applicable, to:

- request that Congress include language in the new multi-year surface transportation authorization act to designate the ADHS as a Federal oversight program;
- include a description of ADHS compliance "participating " and "eligibility" criteria, per the approved cost-to-complete estimate, within FHWA's Stewardship and Oversight Agreements with each Appalachian state;

-
- revise the ADHS Memorandum of Understanding (MoU) to include all administrative budget line items including FTE employment data and identify the individuals assigned as Appalachia FTEs in a table attached to the annual administrative expense allotment memo issued to the FHWA Division offices;
 - provide one auditor dedicated within the USDOT or ARC Offices of Inspector General to provide audit coverage for ADHS programmatic, financial, and administrative functions, which should be funded from the ADHS apportioned set-aside for administrative expenses;
 - request that the new dedicated ADHS auditor work with the 13 state auditors' offices to ensure that ADHS funding receives adequate audit coverage and is properly reported in the Schedule of Expenditures of Federal Awards as required under OMB Circular A-133; and
 - expand the ADHS information included in the OMB A-133 Compliance Supplement to provide better audit guidance to Single Audit auditors about the program.

Management 's Response

ARC stated it will meet with FHWA to determine the most effective approach to providing program oversight and for identifying individuals assigned to the ADHS program. ARC also stated it will follow FHWA's lead regarding a dedicated auditor for the ADHS program and ensuring adequate audit coverage and proper reporting. The Commission will request that FHWA take appropriate action regarding expanded ADHS coverage in the OMB A-133 Compliance Supplement. Commission staff will report to the Inspector General regarding the outcome of its meetings with FHWA.

Auditor's Conclusion

We concur with management's response and on its proposed action plan to report back to the Inspector General regarding the outcome of its meetings with FHWA on these issues.

BACKGROUND

In 1964 Congress authorized construction of the Appalachian Development Highway System (ADHS), consisting of 3,025 miles contained within 28 ADHS approved corridors. The ADHS is located throughout the Appalachian region which includes West Virginia and parts of Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia. The purpose of the ADHS is to generate economic development, supplement and connect Appalachia to the interstate system, and to provide access to areas within the region. Construction of the ADHS is considered a key component to accelerating regional economic growth.

Prior to 1999, Congress annually appropriated funding for the ADHS directly to ARC under the Appalachian Regional Development Act (ARDA). The construction of the ADHS is a joint Federal and state effort that involves ARC, the Federal Highway Administration (FHWA) within the U.S. Department of Transportation (USDOT) and the STAs in each of the 13 Appalachian states. From FY 1965 to FY 1999 ARC exercised programmatic and administrative control, as well as fiscal and audit responsibility for the ADHS program. Average annual funding for the five-year period prior to FY 1999 was \$132 million with cumulative funding during this period totaling \$660.5 million.

In 1998 Congress passed a multi-year surface transportation authorization act, the Transportation Equity Act for the 21st Century (TEA-21). Under this legislation, Section 201 of ARDA was amended to authorize continued ADHS appropriations from the Federal Highway Trust Fund (HTF). ARC continued to exercise programmatic and administrative control over the program but fiscal and audit responsibility for the program was transferred to USDOT. FHWA, which administers the HTF, retained responsibility for day-to-day oversight of the ADHS program, and the states have continued responsibility for planning, designing, construction and maintaining ADHS projects.

Under TEA-21 ADHS received a substantial increase in funding from \$132 million to \$450 million annually from FY 1999 through FY 2003. In addition, ADHS projects are eligible for other Federal-aid Highway funds, such as the National Highway System (NHS) and Surface Transportation Program (STP) funds. As a result, total ADHS funding has averaged \$583 million a year over the past five years. Funds for ADHS projects are provided at an 80 percent Federal / 20 percent state ratio and are available until expended.

The annual appropriation from the HTF is apportioned to the states based on an ARC formula for each state's proportional share of the cost to complete the ADHS. An estimate of the cost to complete the ADHS is prepared every five years to determine the additional funding needed to complete the ADHS and to establish the apportionment factor for distributing the funds to each state based on the construc-

tion needs. In addition to this cost estimate, design information and maps of the entire ADHS are also included which are used for identifying the highway corridor sections that are eligible for ADHS funding. These cost-to-complete estimates are prepared by each state under the supervision of FHWA and ARC and are subject to multiple levels of engineering and financial analysis before being accepted by FHWA and ARC. The resulting documents collectively provide the master plan for the program for a five-year period. The most recent cost-to-complete estimates were prepared in 2002.

In FY 2002, ARC issued the Appalachian Development Highway System 2002 Cost to Complete Report, which includes an overview of the individual states' cost estimates and is used in drafting continuing legislative support for the program. By the end of FY 2002, 2,571 miles or approximately 85 percent of the ADHS was complete or under construction, with the remaining 454 miles anticipated to be some of the most difficult and expensive to construct due to the terrain and other factors.

OBJECTIVES

We were engaged by ARC's Office of Inspector General to conduct a performance audit to identify the financial and compliance controls in place related to ADHS funding from appropriation to completion or from "Congress to Concrete" and to determine the effectiveness of those controls. Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States. A performance audit is an objective and systematic examination of evidence to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

The objectives of our audit were to:

1. Determine the impact TEA-21 legislation has had on the administration and oversight of the ADHS program.
2. Document the financial and compliance controls related to ADHS funding from "Congress to Concrete" and to determine the effectiveness of those controls.
3. Determine the adequacy of audit coverage related to ADHS funds both at the Federal and state levels.
4. Determine if ADHS allotments for administrative expenses are properly accounted for and spent in compliance with the ARC/FHWA Memorandum of Understanding (MoU) and applicable laws and regulations.
5. Provide an independent assessment of the status and proposed resolution of outstanding Energy & Water Development Appropriations Act funds.
6. Identify, based on audit results, program weaknesses to be recommended for expanded scope audits.

SCOPE AND METHODOLOGY

The audit scope involved fieldwork conducted in Washington, D.C. at ARC and USDOT related to fiscal years 2002 and 2003 ADHS activity. Interviews and testing were performed at the following offices:

- ARC's Office of Planning and Research;
- USDOT's Office of Inspector General;
- FHWA's Office of Program Administration; and
- FHWA's Finance Division.

In addition, we selected one state, Pennsylvania, from the 13 Appalachian states to conduct fieldwork at the state level. Based on the Appalachian Development Highway System 2002 Cost to Complete Report, Pennsylvania has approximately 15% of the remaining ADHS miles to be constructed in the system which represents approximately 29% of the total costs estimated to complete the ADHS. Fieldwork was performed in the following Pennsylvania offices:

- FHWA Division Office – Pennsylvania;
- Pennsylvania Department of Transportation (PennDOT) ; and
- Pennsylvania Department of the Auditor General.

We performed interviews and walk-throughs to obtain and document an understanding of the financial and compliance controls related to the ADHS program. To the extent possible, we relied on the audit work performed by USDOT's OIG and the Pennsylvania Department of the Auditor General. We reviewed Single Audit reports and OIG audit work papers to determine the adequacy of both the internal control work performed and the audit coverage related to ADHS funding at both the Federal and state levels. We prepared flow charts, as needed, to ensure the ADHS document flow was understood and documented.

Control testing was performed in three areas: 1) obligation and expenditure of ADHS funding, 2) program administrative expenses, and 3) program compliance. Internal control testing related to ADHS funding was performed using observation, inquiry, and inspection procedures. Two ADHS projects from a PennDOT May 2003 Federal billing were selected to test controls over expenditures and reimbursements. Two PennDOT Project Requests were tested for obligation controls associated with compliance with ADHS "participating" and "eligibility" criteria. Controls over administrative costs were tested in accordance with the ADHS Administrative Budget and the MoU between FHWA and ARC. No material errors were identified as a result of our testing.

In addition, we evaluated whether ADHS oversight responsibilities were being performed by management in the following areas:

- ARC ADHS oversight responsibilities;
- FHWA Headquarters ADHS Coordinator responsibilities; and
- FHWA Division office ADHS Coordinators responsibilities.

We also made inquiries and reviewed documentation to determine the disposition of final Energy and Water Development Appropriations Act funds in accordance with audit objectives.

OBSERVATIONS

Observation 1 Oversight Vulnerability

Oversight vulnerability exists within both programmatic and administrative functions of the ADHS program. There is a risk that highway projects or segments of projects will be approved for funding with ADHS funds that do not meet the “participating” and “eligibility” criteria in accordance with the approved cost-to-complete estimate. In addition, FHWA payroll records indicated only 6 FTE positions were utilized in 5 of the 13 FHWA Division offices in support of the ADHS program during FY 2003 instead of 16 FTEs in accordance with the ADHS Administrative Budget agreed to by ARC and FHWA.

Federal Compliance Requirements

In order to ensure that sections of highway that participate in the ADHS are also eligible for funding under ARDA, ADHS programmatic oversight requires added layers of scrutiny beyond those required for other (non-ADHS) Federal-aid Highway Programs. Cost-to-complete estimates provide detailed engineering and cost information concerning the highway corridors and sections that are approved as “participating” and “eligible” for ADHS funding. Because only a portion of an entire project may be eligible for ADHS funding, it is important that project requests are properly prepared and thoroughly reviewed by engineering and financial personnel with sufficient training and knowledge to ensure the proper use of ADHS funds.

We found several factors increase the vulnerability that ADHS funds may be spent on non-ADHS eligible highway projects. ADHS cost-to-complete estimates which contain detailed requirements on each participating highway section are developed every five years. The preparation of these estimates takes approximately eighteen months and involves engineering and financial people at the local, state, and Federal levels. The active involvement by individuals at all program levels increases the knowledge and understanding of ADHS requirements needed to ensure compliance with those requirements. However, as knowledgeable state officials involved in developing the cost-to-complete estimates turnover, the risk that ineligible projects may be funded by ADHS funds increases due to the lack of familiarity with program requirements by new personnel. We found that the monthly review of ADHS Project Status Reports by ARC’s Senior Transportation Advisor reduces but doesn’t eliminate this vulnerability.

In addition, while ADHS funding in Pennsylvania represented approximately 29% of total ADHS funds in FY 2003, it only represented about 7% of Pennsylvania’s total Federal highway funds available that year. This same relationship exists in all 13 Appalachian states. The control testing we performed in Pennsylvania did not identify any material errors in program compliance. However, because the ADHS program is such a small component of the states’ overall highway program, there is an increased risk that the states may overlook ADHS requirements.

OBSERVATIONS

The project request and approval process at the state level varies among the Appalachian states, but the relationship between FHWA and the STAs is defined by Stewardship Agreements between FHWA and each state in the Federal-aid Highway Program. These agreements assign project approval authority as either “Federal oversight” or “state oversight” based on categories of projects and dollar thresholds. This means that as a project request moves through the review and approval process, compliance with Federal requirements is primarily assumed by either the STA or the FHWA based on the designated highway system and cost. In the stewardship agreements, ADHS projects are included within the National Highway System so they may be approved by the STA or FHWA based on the designated oversight authority applicable. As a result, engineers and financial personnel at the local, state, and Federal levels must all be knowledgeable and adequately trained concerning ADHS requirements in order to ensure ADHS funding is used only for ADHS eligible projects.

Whenever a STA assumes FHWA oversight role and approval responsibilities, it includes responsibility for ensuring that their staff has appropriate training and knowledge to make sure that projects are developed and constructed in full conformance with Federal requirements. Training awareness may be degraded when Stewardship Agreements do not specifically identify ADHS eligibility criteria, which is unique within the Federal-aid Highway Program. This is especially true in decentralized STAs as more time passes since preparation of the last formal cost-to-complete estimate.

The designation of the ADHS as a Federal oversight program would strengthen controls needed to ensure project compliance with eligibility requirements by reducing the risk at the state level due to personnel turnover. In addition, Federal-aid Highway Stewardship Agreements should include a description of ADHS Cost-to-Complete “participating” and “eligibility” compliance criteria to increase awareness of the unique requirements applicable to ADHS projects.

Administrative Funds

Another area of program vulnerability relates to the administration of the ADHS program. Each fiscal year ARC and FHWA develop and agree on a budget for costs needed to implement the ADHS program. TEA-21 permits an administrative set-aside of one and a half percent of the funds appropriated for ADHS each fiscal year. Guidelines on appropriate expenses are included in the MoU between ARC and FHWA and the specific budget information by state is provided in a memo, *Allotments for Administrative Expenses for Appalachian Development Highway System*.

OBSERVATIONS

The administrative budget for FY 2003 was as follows:

Budget Line Item	FY 2003 Budget
FHWA Headquarters travel	\$ 50,000
Travel for 13 FHWA Division offices	230,000
Peer review	5,000
Software enhancement (used for Cost-to-Complete Estimate)	75,000
16 FTEs salaries & benefits (FHWA Division offices)	1,600,000
ARC administrative expenses	532,800
Total	\$ 2,488,800

However, we found that while the budget included amounts supporting 16 FTEs for oversight and administration of the program, payroll activity reports only reflected the allocation of 6 FTEs from 5 of the 13 Appalachian states. Each of 10 Appalachian states was assigned one FTE and two FTEs were assigned to Pennsylvania, Kentucky, and West Virginia. The intent of the allocation was for the FHWA Headquarters and Division Offices in each state to report 2,040 hours of ADHS-related activity for each FTE agreed-to in the Administrative Budget.

It appears the information concerning the FTE allocation was not adequately communicated to each of the FHWA Division offices. FHWA correspondence to the Division Administrators provided guidelines on appropriate expenses for implementing the ADHS program. Approved costs included:

- *Travel expenses specifically tied to ADHS program activities and ADHS conferences and workshops.*
- *Vehicle expenses associated with performing ADHS functions. We anticipate expenses would be charged on a pro-rata basis for days actually used for conducting ADHS business.*
- *Communications, printing supplies and materials to be charged accordingly again specifically for fulfilling ADHS functions.*
- *Furniture, duplicating equipment, and other equipment costs cannot be paid out of the ADHS administrative account.*

OBSERVATIONS

Neither the MoU between ARC and FHWA nor the FHWA Headquarters memo on administrative allotments sent to FHWA Division offices addressed the FTE issue. We found in our testing that while FHWA Division office in Pennsylvania indicated it did provide support for the ADHS program, time spent was not coded to ensure ADHS was properly charged for this payroll activity. This oversight was not identified by ARC or the FHWA Headquarters and Division offices. As a result, ARC cannot be assured that the ADHS program received adequate oversight and support from 16 FTEs as planned.

As a result of our discussions with FHWA's Accounting Policy and Procedures Team Leader and ARC's Senior Transportation Advisor, FHWA released a memorandum to the Appalachian State Division Administrators on September 26, 2003 to clarify the use of administrative funds for 16 FTEs in the FHWA Division offices.

Recommendations

1. We recommend that ARC and FHWA designate the ADHS as a Federal oversight program and work with FHWA to include a description of ADHS compliance criteria in the Federal-aid Highway Stewardship and Oversight Agreements between FHWA and each Appalachian state.

ARC Response

ARC will meet with FHWA and determine the most effective approach to providing program oversight. In addition ARC will encourage FHWA to implement new oversight measures as needed.

Auditor's Conclusion

Working with FHWA to discuss program oversight is an important step toward addressing the oversight vulnerabilities identified in this report. Agreement on an action plan for implementation of new oversight measures would also encourage a constructive result.

2. We recommend ARC and FHWA revise the ADHS MoU to include guidelines for all administrative budget line items, including FTE employment data, and identify the individuals assigned as ADHS FTEs in a table attached to the annual administrative expense allotment memo issued to the FHWA Division offices.

ARC Response

ARC will work with the FHWA to develop an approach for regularly identifying the individuals assigned to the ADHS program. The approach may involve the revision of the ADHS MOU.

Auditor's Conclusion

We agree that ARC working with FHWA to develop an approach that will effectively address this issue is needed. The approach must ensure that all FTEs allocated to ADHS are clearly identified each year by ARC, FHWA and the states.

OBSERVATIONS

Observation 2 Incomplete Audit Coverage

When TEA-21 was passed and fiscal responsibility for the ADHS program transferred to FHWA under the Highway Trust Fund, audit responsibility for ADHS funds also transferred. Four audit organizations provide audit coverage of Federal highway funds: the USDOT Office of Inspector General (OIG), the ARC OIG, STA internal and external auditors, and Single Audit auditors. We found the audit coverage at both the state and Federal levels was not adequate to address the unique requirements of the ADHS program. This is primarily because ADHS funding is small in relation to each states' total Federal highway funding. As a result, we found no evidence that the ADHS project-approval process and ADHS obligations are being audited for compliance with ADHS eligibility requirements.

USDOT OIG

The USDOT OIG conducts an audit of the HTF annually in conjunction with the agency's consolidated financial statement audit under the Chief Financial Officer's (CFO) Act. In FY 2002 four states (Colorado, Kentucky, Wisconsin, and Michigan) were selected for internal control testing at the state level, with Kentucky as the representative Appalachian state in the sample. The substantive expense sample selected for testing from all states consisted of 111 items including two ADHS projects, or 2 percent. Because ADHS funding is not material to the total HTF, audit coverage of ADHS funds and ADHS administrative funding may be limited in a CFO Act audit. To address this challenge, a systematic sampling approach is needed to ensure audit coverage of ADHS funds is adequate.

ARC OIG

The ARC OIG has responsibility for overseeing the ARC Transportation staff's programmatic oversight and/or financial responsibilities for the ADHS. In this capacity, the ARC OIG initiated the ADHS performance audit contained in this report.

STA Audit

In Pennsylvania we found that state internal and external auditors primarily conduct performance audits of the transportation program within the state. The audit coverage by external auditors may include audit areas such as highway consultants, contractors, engineering and design contracts, and special project requests. Transportation audit coverage by internal state auditors generally addresses controls and compliance with the state's procedures, processes, and policies in the District offices. The scope of the audits include both ADHS and non-ADHS projects and are not designed to focus specifically on unique ADHS program requirements.

OBSERVATIONS

Single Audit

The OMB Circular A-133 Compliance Supplement provides the guidance for auditing ADHS funds under the Single Audit Act. ADHS funding is assigned CFDA No. 23.003 in the Catalog of Federal Domestic Assistance and is included in a program cluster, the Highway Planning and Construction Cluster, in the Compliance Supplement. A cluster of programs is a grouping of closely related programs that have similar compliance requirements and may be treated as a single program for the purpose of meeting OMB A-133 Single Audit requirements. Clustered programs are frequently designated as major programs based on the combined total expenditures of the programs within each cluster and are subject to audit every one to two years. We reviewed the FY 2001 Single Audit Reports from all Appalachian states and found no Federal expenditures reported for CFDA No. 23.003 in 7 of the 13 reports. Even though a Federal award is included in a cluster, it is required that individual programs within a cluster must be reported separately in the Schedule of Expenditures of Federal Awards. The exclusion of ADHS expenditures in the 7 audit reports indicates that either no ADHS funds were expended by those states during the year or the states failed to properly identify and report ADHS expenditures. As a result, ARC has no assurance that the ADHS Federal expenditure and billing cycle is receiving audit coverage under the Single Audit process.

We also noted that compliance testing of program eligibility requirements is not a required audit procedure in the OMB Circular A-133 Compliance Supplement for the Highway Planning and Construction Cluster. This means that there is no audit coverage related to the ADHS project approval and eligibility requirements within the scope of the Single Audit process.

Because the ADHS funding is small in proportion to a states' total highway program funding, its unique "participating" and "eligibility" criteria did not receive adequate audit coverage to ensure compliance with its approved cost-to-complete estimate. ARC's Senior Transportation Advisor provides oversight of the ADHS program as a whole, but without an effective audit process, ARC lacks an important control to ensure that program is being properly carried out.

ARC's Senior Transportation Advisor forwarded proposed changes to the 2004 OMB Circular A-133 Compliance Supplement, in response to our discussion of the Single Audit process. A copy of the draft 2004 Compliance Supplement, Highway Planning and Construction cluster section, is included as Appendix E.

Recommendations

3. We recommend that one auditor be dedicated within the USDOT or ARC Offices of Inspector General to provide audit coverage related to ADHS

programmatic, financial and administrative functions. This position should be funded from the ADHS apportioned set-aside for administrative expenses.

ARC Response

ARC will review the audit finding regarding a dedicated auditor with the FHWA. Since the majority of ADHS funds are obligated and audited by the FHWA, ARC will follow the lead of FHWA on this item.

Auditor's Conclusion

While FHWA has audit responsibility for ADHS funds, ARC should be proactive to ensure that these funds are receiving adequate audit coverage. The decision to fund a dedicated auditor for the ADHS program should be made in coordination with the DOT-OIG and FHWA.

4. We recommend the dedicated ADHS auditor work with the 13 state auditors' offices to ensure that ADHS funding is receiving adequate audit coverage and is properly reported in the Schedule of Expenditures of Federal Awards as required under OMB Circular A-133.

ARC Response

ARC will review audit finding regarding ensuring adequate coverage and proper reporting with the FHWA. Since the majority of ADHS are obligated and audited by the FHWA, ARC will follow the lead of FHWA on this item.

Auditor's Conclusion

While FHWA has audit responsibility for ADHS funds, ARC should be proactive to ensure that these funds are receiving adequate audit coverage. The decision to fund a dedicated auditor for the ADHS program should be made in coordination with the DOT-OIG and FHWA.

5. We recommend that the ADHS information included in OMB A-133 Compliance Supplement be expanded concerning unique ADHS program requirements to provide better audit guidance to Single Audit auditors about the program.

ARC Response

ARC will meet with the FHWA and request that FHWA review this finding and take appropriate action regarding expanded ADHS coverage in the OMB A-133 Compliance Supplement.

Auditor's Conclusion

We agree that ARC should meet with FHWA to discuss the need for expanded coverage of the ADHS program in the OMB A-133 Compliance Supplement. ARC's Senior Transportation Advisor proposed revisions to the supplement that should also be considered in addressing the needed update.

CONCLUSION

The ADHS program requires additional layers of scrutiny beyond those required for other non-ADHS Federal-aid highway projects. Because ADHS funding is small in relation to the total Federal-aid Highway Program in each Appalachian state and personnel turnover occurs in the project approval process at the local, state, and Federal levels, an increased risk exists that projects will be approved for ADHS funding that are not in compliance with ADHS' unique eligibility requirements. In addition, existing audit coverage at the Federal and state levels which does not distinguish between ADHS and non-ADHS projects within the Federal-aid Highway Program, is not adequate to ensure ADHS program compliance.

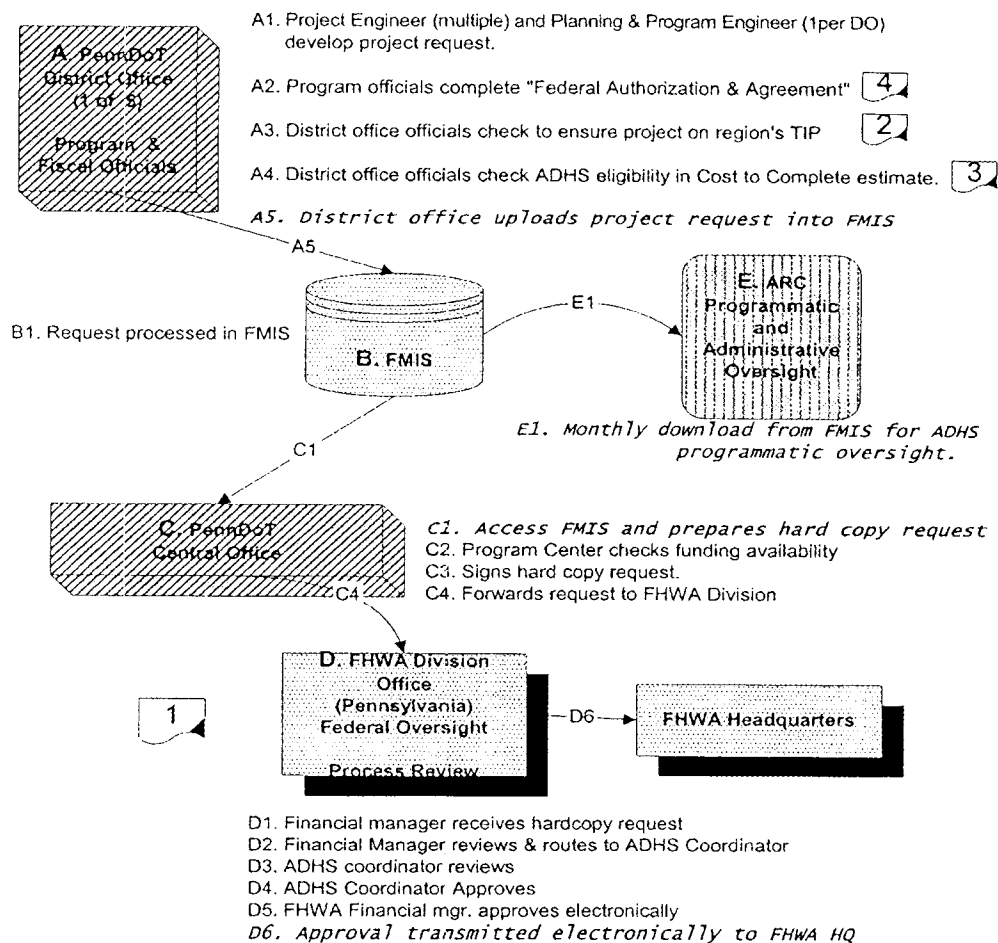
We recommend that ARC strengthen program controls by ensuring that the MoU between FHWA and ARC, the annual administrative allotment memo to the FHWA Division offices, and the Stewardship Agreements between FHWA and each Appalachian state include adequate information about program requirements. Designation of the ADHS as a Federal oversight program would also strengthen controls by placing responsibility for project approval with personnel with the greatest knowledge and training in the program.

The audit process at the Federal and state levels would be strengthened by providing one dedicated ADHS auditor who would provide audit coverage of the specific programmatic, financial and administrative functions of the ADHS. The costs of this position should be included in the ADHS Administrative Budget. In addition, we recommend the Single Audit process be strengthened by expanding ADHS program information included in the OMB A-133 Compliance Supplement and working with the state auditors' offices to ensure ADHS expenditures are properly audited and reported under the Single Audit Act.





TEA-21 legislation may be replaced by a new multi-year surface transportation act in FY 2004, the Safe, Accountable, Flexible, and Efficient, Transportation Equity Act (SAFETEA). The passage of this new legislation provides a good opportunity to update and expand ADHS information available in all program-related agreements. Oversight vulnerability is reduced as knowledge about the program effectively reaches the local, state, and Federal offices involved in the ADHS program from "Congress to Concrete." Improved program knowledge and a more effective audit process throughout the ADHS program will result in greater compliance with program requirements and more effective programmatic and administrative oversight by ARC.

APPENDIXES

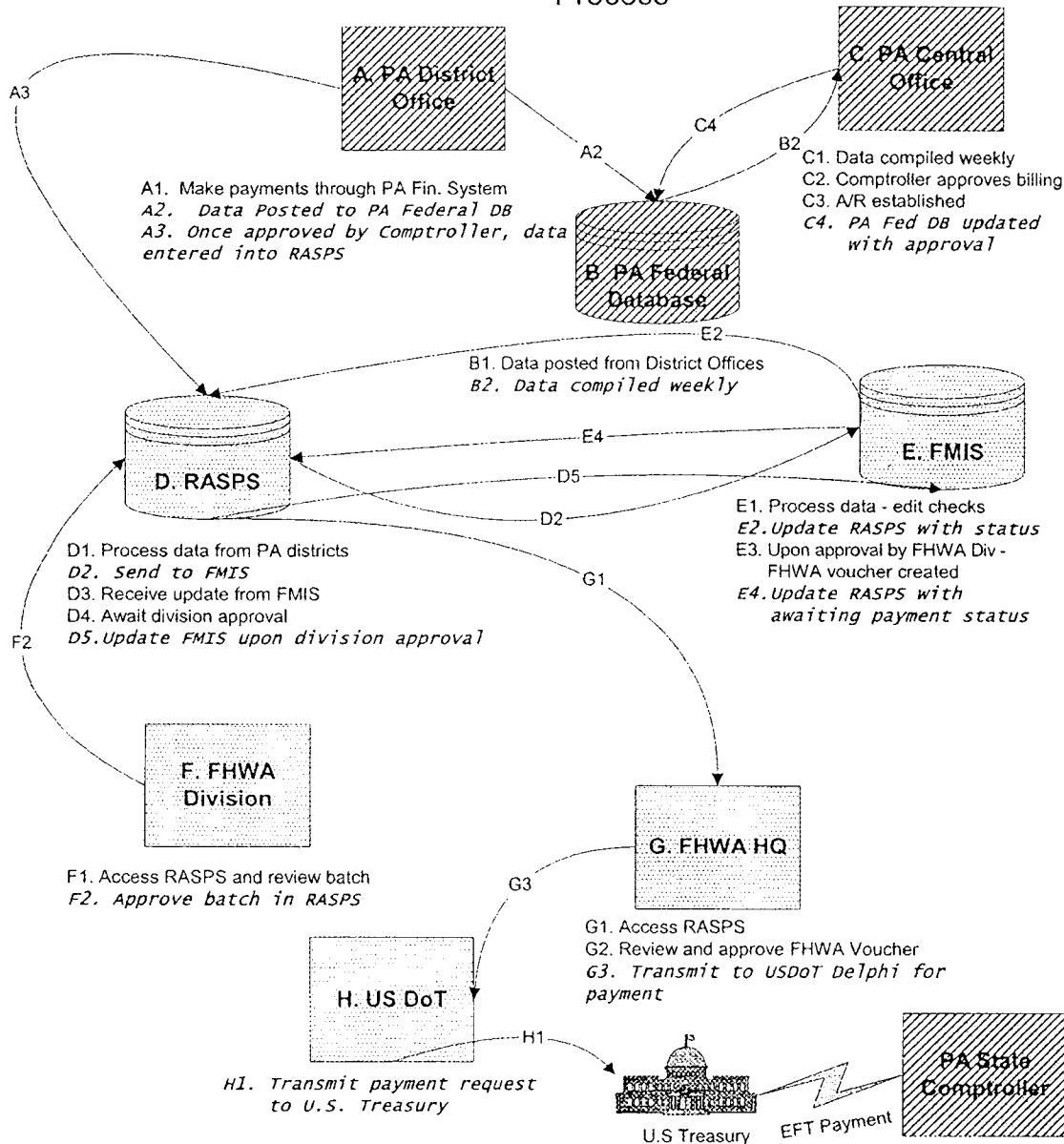
Pennsylvania Project Approval Process



KEY

-  Federal Agency/System
-  State Agency/System
-  Federal/State Entity
-  Data input/download
- FMIS - FHWA Financial Management Information System
- 1** Stewardship and Oversight Agreement - agreement between FHWA and PennDot determines oversight responsibilities
- 2** Transportation Improvement Plan (TIP) - first 4 years of 12 year master plan for State of PA
- 3** ADHS Cost to Complete Estimate - 5 year plan includes Participating and Eligible Criteria
- 4** "Federal Authorization & Agreement" - project request prepared by District offices (PA Form 4232)

Pennsylvania Federal Billing and Reimbursement Process



KEY

Federal Agency/System

State Agency/System

Data input/download

RASPS - U.S. DoT Rapid Approval and State Payment System

FMIS - FHWA Financial Management Information System

Pennsylvania Corridor O

An exception to the Federal highway oversight responsibilities, as defined in the Federal-aid Highway Program Stewardship Agreement between FHWA and the state of Pennsylvania, relates to Corridor O. Statutory language contained in TEA-21 Section 1212(u), as amended by the TEA-21 Restoration Act, designates state oversight and approval of all Corridor O projects, including participating ADHS sections.

The provision of TEA-21 Section 1212(u), as amended by the TEA-21 Restoration Act states:

*Notwithstanding any other provision of law, **the Secretary shall approve, and** the Commonwealth of Pennsylvania is authorized to proceed with, engineering, final design, and construction of the Corridor of the Appalachian Development Highway system between Bald Eagle and Interstate 80 (as redefined by the Act). All records of decision relating to Corridor O issued prior to the date of enactment of this Act shall remain in effect.*

The amendment added the phrase “...the secretary shall approve, and...” which directs FHWA to approve the final design, plans, specifications, estimates, and construction for Corridor O projects as submitted by PennDOT. FHWA will also approve obligation of Federal-aid funds for each stage at PennDOT’s request. All prior FHWA approvals to comply with the National Environmental Policy Act of 1969 (NEPA) remain in effect. However, FHWA has no authority or responsibility to comply with any Federal laws as a condition for approving Federal-aid participation in Corridor O projects. Its involvement in coordination with other Federal, state, and local officials is limited to technical assistance as the Federal transportation expert.

Energy and Water Development Appropriations Act Funds

Prior to TEA-21, funding was authorized from the Energy and Water Development Appropriations Act of 1995 (PL 103-316) "...for necessary expenses for the Federal Co-Chairman and alternate on the Appalachian Regional Commission and for payment of the Federal share of the administrative expenses of the Commission..." ARC transferred some of the Energy and Water Development funding to FHWA for use in the preparation of the cost-to-complete estimate in 1997.

In order to complete a final accounting of any remaining unobligated funds, ARC requested FHWA to reconcile any outstanding amounts and reimburse remaining funds, as applicable. As of the beginning of our audit period, FHWA had not completed this request, and we were engaged by the OIG to determine the status and proposed resolution of these outstanding monies.

We obtained copies of documentation of the final reimbursement of \$91,638.50 requested in August 2002 and summarized below. The matter has been resolved to ARC's satisfaction.

State	FMIS Report as of 8/26/02
Alabama	\$ 2,297.78
Georgia	41.64
Kentucky	18,181.31
Maryland	3,982.00
Mississippi	3,875.00
New York	0
North Carolina	13,976.00
Ohio	979.15
Pennsylvania	10,000.00
South Carolina	10,000.00
Tennessee	0
Virginia	0
West Virginia	27,145.00
State sub-total	90,477.88
Headquarters 79G	1,061.00
Headquarters 795	99.62
Grand Total	\$ <u>91,638.50</u>

Extract from OMB Circular A-133 Compliance Supplement

Draft March 2004

Highway Planning and Construction Cluster

DOT

DEPARTMENT OF TRANSPORTATION

CFDA 20.205 **HIGHWAY PLANNING AND CONSTRUCTION (Federal-Aid Highway Program)**
 CFDA 23.003 **APPALACHIAN DEVELOPMENT HIGHWAY SYSTEM**

I. PROGRAM OBJECTIVES

The objectives of the Highway Planning and Construction Cluster are to: (1) assist States in the planning and development of an integrated, interconnected transportation system important to interstate commerce and travel by constructing and rehabilitating the National Highway System (NHS), including Interstate highways and most other public roads; (2) provide aid for the repair of Federal-aid highways following disasters; (3) foster safe highway design, and replace or rehabilitate structurally deficient or functionally obsolete bridges; and (4) to provide for other special purposes. This cluster also provides for the improvement of roads in Puerto Rico, Guam, the Virgin Islands, American Samoa, the Northern Mariana Islands, the Alaskan Highway, and the Appalachian Development Highway System (ADHS). The objective of the ADHS program is to provide a highway system which, in conjunction with other federally aided highways, will open up areas with development potential within the Appalachian region where commerce and communication have been inhibited by lack of adequate access.

II. PROGRAM PROCEDURES

Federal-aid highway funds are generally apportioned by statutory formulas to the States and generally restricted to use on Federal-aid highways (i.e., roads open to the public and not functionally classified as local). Exceptions to the use on Federal-aid highways include planning and research activities, bridge and safety improvements which may be on any public road, and the Federal Lands Highway Program. Some categories of funds may be granted directly to Local Public Agencies (LPAs), such as cities, counties, tribal governments, Metropolitan Planning Organizations (MPOs), and other political subdivisions. States also may pass apportioned funds through to such agencies. Federal-aid funds may be used for: surveying; engineering; right-of-way acquisition; and relocation assistance; for capital improvement projects classified as new construction, reconstruction, improvements for functional, geometric, or safety reasons; and 4R projects (restoration, rehabilitation, resurfacing, and reconstruction); planning; research, development, and technology transfer; intelligent transportation systems projects; roadside beautification; wetland and natural habitat mitigation; traffic management and control improvements; improvements necessary to accommodate other transportation modes; development and establishment of transportation management systems; billboard removal; construction of bicycle facilities and pedestrian facilities; fringe and corridor parking; car pool and van pool projects; and transportation enhancements, such as scenic and historic highway improvements. These funds generally cannot be used for routine highway operational activities, such as police patrols, mowing, snow plowing, or maintenance, unless it is preventative maintenance. Also, certain authorizations for the (e.g., Surface Transportation Program (STP) and Congestion Mitigation and Air Quality (CMAQ) Improvement Program), may be used for capital improvements to mass transit; CMAQ funds are for projects and programs in air quality, non-attainment and maintenance areas for ozone, carbon monoxide, and small particulate matter, which reduce transportation related emissions. ADHS projects

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are subject to the same standards, specifications, policies, and procedures as other Federal-aid highway projects.

Eligibility criteria for the programs differ, so program guidance should be consulted. Projects in urban areas of 50,000 or more population must be based on a transportation planning process carried out by the MPOs in cooperation with the State and transit operators, and be included in metropolitan plans and programs. Projects in nonmetropolitan areas of a State must be consistent with the State's Transportation Plan. All projects must also be included in the approved Statewide transportation improvement program (STIP) and are developed as part of the required Statewide transportation planning process. In the case of the ADHS program, the Appalachian Regional Commission determines if the State-approved project is eligible within an approved Appalachian Highway Plan and notifies FHWA of centerline approval. The FHWA determines if the project satisfies all Federal requirements, administers the grants, and disburses the funds.

The ADHS is a cost-to-complete program (i.e., sufficient funding is to be provided over time to complete the approved initial construction/upgrading of the system) authorized by Section 201 of the Appalachian Regional Development Act of 1965. The Appalachian Regional Commission (ARC) has programmatic oversight responsibilities, which include approval of the location of the corridors and of State-generated estimates of the cost to complete the ADHS. FHWA has project-level oversight responsibilities for the ADHS program. If the location, scope, and character of proposed ADHS projects are in agreement with the latest approved cost-to-complete estimate and all Federal requirements have been satisfied, FHWA authorizes the work and disburses the ADHS funds. FHWA oversees the construction and accepts the ADHS projects upon satisfactory completion of the work.

Source of Governing Requirements

The primary sources of program requirements are 23 USC (Highways). Implementing regulations are found in 23 CFR (Highways) and 49 CFR (Transportation).

Availability of Other Program Information

The Federal Highway Administration maintains a Website that provides program laws, regulations, and other general information (www.fhwa.dot.gov).

III. COMPLIANCE REQUIREMENTS

In developing the audit procedures to test compliance with the requirements for a Federal program, the auditor should first look to Part 2, Matrix of Compliance Requirements, to identify which of the 14 types of compliance requirements described in Part 3 are applicable and then look to Parts 3 and 4 for the details of the requirements.

A. Activities Allowed or Unallowed

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1. Federal funds can be used only to reimburse costs that are: (1) incurred subsequent to the date of authorization to proceed, except for certain property acquisition costs permitted under 23 USC 108; (2) in accordance with the conditions contained in the project agreement and the plans, specifications, and estimates (PS&E); (3) allocable to a specific project; and, (4) claimed for reimbursement subsequent to the date of the project agreement (23 CFR sections 1.9, 630.106, ~~and 630.205, and 630.303~~).
2. Federal funds can be used to reimburse for administrative settlement costs incurred in defending contract claim proceedings before arbitration boards or State courts only if approved by FHWA for Federal-aid projects. If special counsel is used, it must be recommended by the State Attorney or State DOT legal counsel and approved in advance by FHWA (23 CFR section 140.505).
3. Costs incurred by the State DOT or MPO for highway planning and research work are subject to prior approval by FHWA (23 CFR section 420.111).
4. STP funds may be used by the State for the cost of tuition and direct educational expenses (excluding salaries) of State and local transportation agency employees (23 USC 504(a)(4)).
5. ~~ADHS funds may be used only for work included in the ADHS cost estimate approved by the ARC.~~

F. Equipment and Real Property Management

The State shall charge, at a minimum, a fair market value for the sale, lease, or use of real property acquired with Federal assistance from the Highway Trust Fund (other than the Mass Transit Account) for the non-transportation purposes and shall use such income for projects eligible under 23 USC. Exceptions may be granted when the property is used for social, environmental or economic purposes (23 USC 156).

G. Matching, Level of Effort, Earmarking Requirements**1. Matching**

- a. The State is generally required to pay a portion of the project costs. Portions vary according to the type of funds authorized and are stated in project agreements.
- b. A State's matching share for a project may be credited by certain toll revenues used to build or improve highways, bridges and tunnels (23 USC 120(j)).
- c. Donations of funds, materials, and services may be credited towards a State's matching share. Donated materials and services must meet the eligibility

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requirements of the project. However, donations of services by units of local government cannot be credited against the State share of the project (23 USC 323(c) and (e)).

- d. The fair market value of land provided by State or local governments for highway purposes is eligible for matching share on a project. The fair market value of donated land shall not include any increase or decrease in value of donated land caused by the project. The fair market value of donated land shall be established as of the earlier of (1) the date on which the donation becomes effective or (2) the date on which equitable title to the land vests in the State (23 USC 323(b)).
- e. For transportation enhancement (TE) projects, funds from Federal agencies (except U.S. DOT) may be used for the non-Federal share of the project. Credit for the value of donations of funds, materials, land, or services (including the value of local and State government services, materials and land applied to the project and the cost of preliminary engineering prior to project approval) may be credited toward the non-Federal share (23 USC 133(e)(5)(C)).
- f. Funds appropriated to any Federal land management agency may be used to pay the non-Federal share of any Federal-aid highway project funded under 23 USC 104 (23 USC 120(k)).
- g. Federal Lands Highway Program funds may be used to pay the non-Federal share of Federal-aid highway projects which provide access to or within Federal or Indian lands (23 USC 120(l)).

2. **Level of Effort** - Not Applicable

3. **Earmarking** - Not Applicable

J. Program Income

State and local governments may only use the Federal share of net income from the sale, use, or lease of real property previously acquired with Federal funds if the income is used for projects eligible under 23 USC (23 USC 156).

L. Reporting

1. Financial Reporting

- a. SF-269, *Financial Status Report* - Not Applicable
- b. SF-270, *Request for Advance or Reimbursement* - Not Applicable

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- c. SF-271, *Outlay Report and Request for Reimbursement for Construction Program* - Not Applicable
- d. SF-272, *Federal Cash Transactions Report* - Not Applicable
- e. PR-20, *Voucher for Work Under Provisions of the Federal-Aid and Federal Highway Acts, as Amended (OMB No. 2125-0507)*

2. **Performance Reporting** - Not Applicable

3. **Special Reporting** - Not Applicable

N. Special Tests and Provisions

1. Use of Other State or Local Government Agencies

Compliance Requirement - A State may use other public land acquisition organizations or private consultants to carry out the State's authorities under 23 CFR section 710.201(b) in accordance with a written agreement (23 CFR section 710.201(h)).

Audit Objective - Determine whether other public land acquisition organizations or private consultants are carrying out the State's authorities under 23 CFR section 710.201(b) in accordance with their agreements with the State.

Suggested Audit Procedures

- a. Examine records and ascertain if other agencies were used for right-of-way activities on Federal-aid projects.
- b. Review a sample of right-of-way agreements with other agencies.
- c. Perform tests of selected right-of-way activities to other agencies to verify that they comply with the written agreement.

2. Replacement of Publicly Owned Real Property

Compliance Requirement - Federal funds may be used to reimburse the reasonable costs actually incurred for the functional replacement of publicly-owned and publicly-used real property provided that FHWA concurs that it is in the public interest. The cost of increases in capacity and other betterments are not eligible except: (1) if necessary to replace utilities; (2) to meet legal, regulatory, or similar requirements; or (3) to meet reasonable prevailing standards for the type of facility being replaced (23 CFR section 710.509).

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Audit Objective - Determine whether the functional replacement of real property was accomplished within FHWA requirements.

Suggested Audit Procedures

- a. Ascertain if there were any functional replacements of publicly-owned real property.
- b. Verify that FHWA concurred in the State's determination that the functional replacement is in the public interest.
- c. Review a sample of transactions involving functional replacements and verify that the transactions were consistent with the FHWA requirements.

3. Project Extensions

Compliance Requirement - FHWA must approve extensions affecting project costs or the amount of liquidated damages, except those for projects administered by the State DOT under 23 USC 106(c) which allow the State DOT to assume the responsibilities for design, plans, specifications, estimates, contract awards and inspection of progress (23 USC 106(c); 23 CFR section 635.121).

Audit Objective - Determine whether proper FHWA approvals were obtained for contract extensions affecting project costs and the amount of liquidated damages assessed.

Suggested Audit Procedures

- a. Review the systems for monitoring and controlling contract time and review project files to determine if there were project extensions.
- b. Verify that FHWA approval was obtained for time extensions affecting project cost and, where applicable, the amount of liquidated damages assessed.

4. Sampling Program

Compliance Requirement - A State DOT or LPA must have a sampling and testing program for construction projects to ensure that materials and workmanship generally conform to approved plans and specifications (23 CFR section 637.205).

Audit Objective - Determine whether the State is following a quality assurance program that meets FHWA's requirements.

Suggested Audit Procedures

- a. Obtain an understanding of the recipient's sampling and testing program.

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- b. Review documentation of test results on a sample basis to verify that the proper number of tests are being taken in accordance with the program.

5. Contractor Recoveries

Compliance Requirement - When a State recovers funds from highway contractors for project overcharges due to bid-rigging, fraud, or anti-trust violations or otherwise recovers compensatory damages, the Federal-aid project involved shall be credited with the Federal share of such recoveries (Tennessee v. Dole 749 F.2d 331 (6th Cir. 1984); 57 Comp. Gen. 577 (1978); 47 Comp. Gen. 309 (1967)).

Audit Objective - Determine whether the proper credit was made to the Federal share of a project when recoveries of funds are made.

Suggested Audit Procedures

- a. Determine the extent to which the State has recovered overcharges and other compensatory damages on Federal-aid projects through appropriate interviews and a review of legal, claim, and cash receipt records.
- b. Review a sample of cash receipts and verify that appropriate credit is reflected in billings to the Federal Government.

6. Project Approvals

Compliance Requirement - FHWA project approval and authorization to proceed is required before costs are incurred for all construction projects other than those administered by the State DOT under 23 USC 106(c). Construction projects administered under standard procedures cannot be advertised nor force account work commenced until FHWA: (1) approves the plans, specifications, and estimates; and (2) authorizes the State DOT to advertise for bids or approves the force account work (23 CFR sections 630.205(c), 635.112(a), 635.204, and 635.309). Construction cannot begin until after FHWA concurs in the contract award (23 CFR section 635.114). This requirement does not apply to construction projects administered by the State DOT under 23 USC 106(c) which allow the State DOT to assume the responsibilities for design, plans, specifications, estimates, contract awards, and inspection of progress (23 USC 106(c)).

Audit Objective - Determine whether project activities are started with required Federal approvals.

Suggested Audit Procedures

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- a. Review a sample of projects and identify dates of the necessary approvals, authorizations, and concurrences.
- b. Identify dates that projects were advertised and contract or force account work was initiated and compare to FHWA's approval dates.

MANAGEMENT'S RESPONSE



Date: May 3, 2004
Subject: Draft Audit Report
Performance Audit of the
Appalachian Development Highway System (ADHS)
To: Clifford Jennings, ARC Inspector General

After a review of the draft audit report on the ADHS, I am in agreement that ARC should pursue a number of steps to reduce the oversight vulnerability of the programmatic and administrative functions of the ADHS program. Regarding the 5 recommendations included in the audit report ARC staff will take the following actions.

Audit Recommendation # 1

We recommend that ARC and FHWA designate the ADHS as a Federal oversight program and work with FHWA to include a description of ADHS compliance criteria in the Federal-aid Highway Stewardship and Oversight Agreements between FHWA and each Appalachian state.

ARC Response

ARC will meet with FHWA and determine the most effective approach to providing program oversight. In addition ARC will encourage FHWA to implement new oversight measures as needed.

Audit Recommendation # 2

We recommend ARC and FHWA revise the ADHS MOU to include guidelines for all administrative budget line items, including FTE employment data, and identify the individuals assigned as ADHS FTE's in a table attached to the annual administrative expense allotment memo issued to the FHWA Division offices.

ARC Response

ARC will work with the FHWA to develop an approach for regularly identifying the individuals assigned to the ADHS program. The approach may involve the revision of the ADHS MOU.

Audit Recommendation # 3

We recommend that one auditor be dedicated within the USDOT or the ARC Offices of Inspector General to provide audit coverage related to ADHS programmatic, financial, and administrative functions. This position should be funded from the ADHS apportioned set-aside for administrative expenses.

ARC Response

ARC will review the audit finding regarding a dedicated auditor with the FHWA. Since the majority of ADHS funds are obligated and audited by the FHWA, ARC will follow the lead of FHWA on this item.

Audit Recommendation # 4

We recommend the dedicated auditor work with the 13 state auditor offices to ensure that the ADHS funding is receiving adequate audit coverage and is properly reported in the Schedule of Expenditures of Federal Awards as required under OMB Circular A-133.

ARC Response

ARC will review the audit finding regarding ensuring adequate coverage and proper reporting with the FHWA. Since the majority of ADHS funds are obligated and audited by the FHWA, ARC will follow the lead of FHWA on this item.

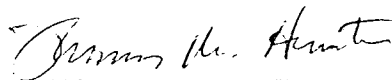
Audit Recommendation # 5

We recommend that the ADHS information included in the OMB A-133 Compliance Supplement be expanded concerning unique ADHS program requirements to provide better audit guidance to Single Audit auditors about the program.

ARC Response

ARC will meet with the FHWA and request that FHWA review this finding and take appropriate action regarding expanded ADHS coverage in the OMB A-133 Compliance Supplement.

The ARC staff will report to the Inspector General regarding the outcome of our meetings with FHWA regarding this audit. In the meantime, if you have any questions or need additional information, please contact Regional Planning and Research Division Director John Cartwright.


THOMAS M. HUNTER
Executive Director