



June 29, 2005

Memorandum for: The Federal Co-Chair
ARC Executive Director

Subject: OIG Report 05-16
Internal Control Review of Administrative Functions

Attached are copies of the subject report. The objectives of the audit were to determine if internal controls over administrative functions were adequate to ensure that: (1) resources are used in accordance with laws, regulations, and ARC policies, (2) resources are safeguarded against fraud, waste, and unauthorized use, and (3) reported data is reliable and fairly presented.

The audit work relied heavily on the work of the internal ARC internal control review team. The report makes four recommendations. Management's response to the recommendations are included in the report and are considered responsive to the recommendations. The audit is considered closed.

A handwritten signature in black ink, appearing to read 'CHJ/H', followed by a long, sweeping horizontal line that ends in a small loop.

Clifford H. Jennings
Inspector General

Attachment

cc: Director for Program Operations
Director for Finance and Administration

Final Report
Internal Control Review Of Administrative Functions

APPALACHIAN REGIONAL COMMISSION

Washington, DC

Report No. 05-16

Prepared for
Office of Inspector General
Appalachian Regional Commission

Prepared by
Leon Snead & Company
June 2005



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June 22, 2005

Inspector General
Appalachian Regional Commission
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Leon Snead & Company, P.C. has conducted a review of Appalachian Regional Commission's (ARC) internal controls over its administrative functions. The review was conducted at the request of the ARC Office of the Inspector General (OIG).

The objectives of the review were to determine if the agency's internal controls over its administrative functions were adequate to ensure that: (1) resources are used in accordance with laws, regulations and ARC policies, (2) resources are safeguarded against fraud, waste and unauthorized use, and (3) reported data is reliable and fairly presented.

The ARC internal control review (ICR) team was in the process of conducting a review of the agency's internal controls at the start of our review. As a result, we curtailed our testing and relied on the work performed by the ICR team. The ICR team issued its report on July 20, 2004. The results of our review and that of the ICR team indicated that agency's programs and operations were in compliance with applicable laws, regulations and policy and that controls were adequate to safeguard against fraud, waste and unauthorized use for those items tested. However, the review indicated that improvements are needed in certain areas of ARC's internal control system. These areas are discussed in the Findings and Recommendations section of the report.

A draft report was provided to ARC on April 20, 2005. The Director of Finance and Administration concurred with our audit findings and stated that corrective actions have been taken or planned to address the report recommendations.

Sincerely,

Leon Snead & Company, P.C.
Leon Snead & Company, P. C.

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Introduction

Leon Snead & Company, P.C. completed a review of the Appalachian Regional Commission (ARC) internal controls over its administrative functions. The review was performed at the request of ARC's Office of the Inspector General (OIG) to assist the OIG in its oversight of the agency's administrative activities and functions.

The ARC Management Control Plan provides that management controls should be in place to reasonably ensure that ARC's stewardship of Federal and State resources are maintained consistent with applicable laws, regulations and policies. ARC established an internal control review (ICR) team to assess the effectiveness of its management controls. The team issued a report dated July 20, 2004, on the results of its examination of 93 items selected from 13 functional areas managed by the headquarters units. This review was in process at the start of our review and as a result, we curtailed our work and relied on the testing of the ICR team.

Objectives, Scope, and Methodology

The review objectives were to determine if ARC's internal control procedures over its administrative functions were adequate to ensure that: (1) resources are used in accordance with laws, regulations and ARC policies, (2) resources are safeguarded against fraud, waste and unauthorized use, and (3) reported data is reliable and fairly presented. Our review was completed in January 2005.

We reviewed ARC policies and operating procedures and interviewed the ICR coordinator to gain an understanding of the agency's internal control system. Also, we evaluated the work performed by the ICR team. This included a review of their report, and supporting working papers developed during the review, and interviews of team members to assist in the evaluation of the reported results. In addition, we performed tests of selected administrative, grant and other files to assess the validity of the work performed by the ICR team.

The review was performed in accordance with *Government Auditing Standards*, and included appropriate tests necessary to achieve the review objectives.

Summary of Review

The ICR team found that the agency's programs and operations were generally in compliance with appropriate laws, regulations and policies and that controls were in place to safeguard against waste, fraud and unauthorized use. Based on our evaluation of the review results and limited independent testing, we concluded that the controls are adequate in those areas tested. The ARC team found that 5 of the 93 items tested were not in compliance with the control procedures. We agreed with the conclusions drawn by the review team concerning these five reviews. We identified eight items in the areas of financial management, grant management, property management and travel that need improvement to fully comply with applicable laws, regulations and policies. These areas are discussed in the Findings and Recommendations section of this report.

FINDINGS AND RECOMMENDATIONS

1. Financial Management

The ARC did not have sufficient controls in place to ensure that (a) unliquidated obligations were reviewed by the Finance and Administration staff at the end of each fiscal year, (b) remittances were properly safeguarded, processed and deposited in accordance with ARC guidelines, (c) payments were authorized by an ARC designated approving official, and (d) certifications were obtained every six months from employees that receive commuting assistance.

Unliquidated Obligations - The ARC Financial Management Guidelines (Red Book) states that the Finance and Administration staff should review unliquidated obligations at the end of each year. The ICR team concluded that ARC complied with the requirements concerning unliquidated obligations by making a final payment or deobligation of unused funds. However, the team found that grant coordinators did not pursue grantee inactivity for 3 of the 17 sampled grants. While the ARC Code does not require that grants be closed if there is no activity over a period of time, the internal review team found that three grants had been inactive from 1 to 4 years. For example:

One grant for a proposed Venture Capital Fund had been inactive for about 4 years. At the time of our review, \$530,673 obligated for the fund in May 2000 remained unpaid. The two other grants had a total balance of \$76,927 in unliquidated obligations. The grantees were sent letters of inquiry dated March 26, 2003 and September 29, 2003. The two grantees had not responded by the end of the ARC review.

ARC needs to establish controls to ensure that unliquidated obligations are reviewed annually and that all grants are reviewed to ensure that inactive grants are closed and any remaining funds are deobligated.

Remittances - The Red Book requires that checks received from outside sources be properly processed, safeguarded, and deposited to a designated depository promptly. The ICR team concluded that ARC complied with these requirements. However, we determined that there were material weaknesses in cash collection and safekeeping. Specifically, we found that there was no fixed responsibility in the mailroom for opening all mail, searching for checks and making a record of checks received at ARC. Currently, the Financial Services Assistant relies on other employees, such as grant coordinators, to bring checks to his attention. In addition, since there was no logbook to record the date of receipt, there was no assurance that all checks were deposited promptly and in accordance with ARC guidelines.

ARC needs to establish procedures to ensure that (1) all mail is systematically opened in the mailroom, (2) checks received are recorded in a logbook, and (3) checks are deposited in a timely manner.

Payments - The Red Book requires that an approving official be designated on the purchase document and that each payment made to vendors and grantees be made on the basis of

approval by that individual of the accuracy and appropriateness of the invoice. The internal review team found that 3 of the 14 invoices sampled were either not signed by the person designated in the procurement document, or no designation had been made in the document. The ICR team stated in its report that "The compliance criteria were barely met. Several purchase orders in the sample did not designate a person to approve the receipt of goods or services. If not for technicalities, this item would not be complied with." We believe that ARC needs to establish controls that will ensure that all purchase documents include a designated approving official.

Commuting Assistance - The Red Book requires employees receiving commuting assistance to certify in writing every 6 months to their commuting pattern and cost. The ICR team concluded that 13 of the 17 sampled ARC employees did not comply with this requirement. As a result, the reviewer expanded his review to cover all of the employees receiving subsidies for the current period (March 31, 2004) and found that 47 of the 60 employees involved had submitted certificates and that only one of the 13 non-compliers was receiving a METRO subsidy. The team member concluded that the improvement in compliance was from increased pressure from the Coordinator for compliance. We believe ARC should improve its procedure for monitoring employee certifications and deny commuting assistance immediately to employees not in compliance with the requirements.

Recommendations

We recommend that the ARC Executive Director:

1. Develop control procedures to identify grants that have been inactive for an extended period of time and closeout those that are expired or no longer valid.
2. Establish responsibilities within the mailroom for: (a) opening and distributing mail, (b) maintaining a logbook for recording the receipt of all checks, and (c) ensuring that the checks are deposited within required timeframes.
3. Establish controls to ensure that all purchase documents include a designated approving official and that said officials approve invoices related to those documents.
4. Emphasize to all employees receiving commuting assistance the requirement to submit semi-annual certifications. Discontinue assistance to those employees who are not in compliance with the certification requirement.

Management Response

The Director of Finance and Administration responded to each of the four recommendations. The Director's responses were as follows.

Recommendation 1 – two of the three grants that had unliquidated obligations have been closed, and the third grant was restructured to carry out six additional projects. This grant

will remain open. ARC will continue to use the report of unliquidated obligations to identify inactive grants.

Recommendation 2 – on April 27, 2005, the ARC staff was reminded to bring any mail remittances to a designated employee in Finance and Administration. This employee will log in all checks, and the checks will then be provided to the Financial Services Assistant for deposit. The Assistant will record the receipt of each check, ensure the funds are deposited in a timely manner, and keep a record of the bank confirmation.

Recommendation 3 – ARC management has reemphasized to the staff the importance of designating persons to approve the receipt of goods and services, and to approve payments on the basis on vendor invoices for each purchase order or contract.

Recommendation 4 – ARC management has reemphasized to the staff that all employees requesting commuting assistance must certify their commuting costs semiannually. Any employee not providing the required certification by March 31 and September 30 of each year will have their commuting assistance terminated on April 1 and October 1 as appropriate.

Auditor's Comments

ARC comments were responsive to the findings and recommendations. Actions have been taken to eliminate or revise inactive grants; establish responsibilities for handling remittances, designating persons to approve payments; and terminating commuting assistance if certifications are not submitted timely. As a result, the recommendations are considered closed.

2. Grant Management

The ICR team concluded that ARC's grant project approval did not have sufficient controls in place to ensure that each approved grant included a State approved strategy statement, as required by Section 7.3-c.2 of the ARC Code. The team sampled 23 grants and found that 9 grants did not include the required statement. Since funds are allotted based on how well the project meets the State's strategy, ARC should develop a checklist to use in certifying that this requirement, along with all the other requirements, has been met.

The ICR team provided comments on the ARC Project Guidelines requirement that each grant contain detailed outcome measures. The team concluded that, "The proposition is barely complied with," and "Projects are being recommended and approved without outcome measures recorded." The Project Guidelines state that outcome measures are indicators that measure actual impact of public benefit of the actions of an agency such as loans awarded, jobs created, or the amount of technical assistance provided, as the means to judge grant performance and without a measurement, the grant coordinators could not provide performance results to management. We concluded that while only 5 of the 23 grants reviewed lacked outcome measures, ARC needs to establish controls to ensure that all grants awarded include this requirement.

We believe that management should ensure that all ARC Project Guideline requirements are met before a grant is awarded to any grantee.

Recommendation

We recommend that the ARC Executive Director establish controls to ensure all ARC Project Guideline requirements are met before the grant is awarded, including a State approved strategy statement and outcome measurements.

Management Response

The Director of Finance and Administration responded that ARC's Program Operations Division has revised the ARC Application Format and Checklist to address strategy statements and outcome measures. The Director further stated that, "No projects will be forwarded to the Federal Co-Chair for signature without an ARC goal and corresponding State Strategy identified." In addition, ARC has awarded a consulting contract to assist the agency in developing meaningful performance measures for difficult to assess grants.

Auditor's Comments

ARC comments were responsive to the finding and recommendation. The ARC Application Format and Checklist has been revised, and no grant will be forwarded for signature without an ARC goal and corresponding State Strategy. Consequently, the recommendation is considered closed.

3. Travel

The ICR team concluded that the agency did not have sufficient controls in place to ensure that the agency's travelers were using the Government credit card for required expenses, such as car rental and other travel expenses. In addition, the team concluded that travelers were not submitting travel vouchers for payment within five business days as required by the Red Book.

The reviewer found that 5 of 13 employees in its travel sample that rented cars in did not use the government credit cards as required by the Red Book. Four of the employees used personal credit cards and the fifth employee used a centrally billed credit card whose use had been terminated years ago. The Red Book states that non-Federal employees are required to use the government credit card for vehicle rentals, hotels and other uses are optional.

Also, the ICR team found that 7 of the 23 travel vouchers sampled were not submitted to ARC by the employee within 5 business days as required by ARC guidelines. The team found that vouchers were submitted from 6 to 46 days, and averaged 20 days, after the completion of travel. We agree with the results reported by the team.

Recommendation

We recommend that the ARC Executive Director, ensure that all:

1. Employees use the government credit cards in accordance with the requirement of the Red Book.
2. Travel vouchers are submitted within 5 business days after completion travel, unless there are extenuating circumstances.

Agency Response

Director of Finance and Administration responded that ARC staff has been reminded of the requirement to use the Government Travel Card for all official business rental of vehicles as well as a mandatory use of the Government Travel Card for all travel costs. Regarding the submission of travel vouchers, the Director stated that ARC considers that there are sufficient incentives to submit vouchers in a timely manner to drop the 5 day requirement. The Financial Management Guidelines will be revised accordingly.

Auditor's Comments

ARC's comments were response to the finding and recommendations. The ARC has reemphasized the requirement to use the Government Travel Card for all official travel costs, and the Red Book will be revised to eliminate the requirement to submit travel vouchers within 5 business days. The recommendations, therefore, are considered closed.

4. Property Management

The IRC team concluded that ARC did not have sufficient controls in place to maintain an up-to-date inventory of capitalized equipment and high-risk non-capitalized personal property. The ICR team concluded, "...Network Administrator does not separately identify capitalized or high value equipment. The high value equipment is limited essentially to laptop computers. Only three are on the inventory of approximately twelve on hand." In addition, the review team found that 3 of the 22 personal property items tested could not be located and two of those items were computer-processing units.

The Red Book states that the local area network administrator is responsible for keeping a perpetual inventory of the equipment as to its location and use. An ICR team member stated that, "...the Administrator maintains a perpetual inventory that is not updated on a regular basis and locations are not current. He should be recording all new additions as well as deletions."

We believe controls are needed to ensure that the property inventory is current and accurate.

Recommendation

We recommend that the ARC Executive Director require that an independent party conduct a periodic physical inventory, to ensure that the automated inventory of capitalized and high risk non-capitalized property is accurate.

Agency's Response

The Director of Finance and Administration responded that the ARC Financial Management Guidelines will be amended to assign staff responsibility for high risk non-capitalized personal property. The Director further stated that the Management Officer will: (1) be responsible for maintaining a perpetual inventory of all non-capitalized high risk equipment; (2) coordinate with the Systems Administrator to assure that any new equipment receives an asset control tag and is properly entered into the inventory database; and (3) perform a physical check of the location of all equipment in the database semi-annually.

Auditor's Comments

ARC's comments were responsive to the finding and recommendation. The ARC will revise its Financial Management Guidelines to assign responsibility for high risk non-capitalized equipment and require a semi-annual physical check of the location of all equipment in the database. As a result, the recommendation is closed.

**APPENDIX A
MANAGEMENT RESPONSE**



May 31, 2005

Leon Snead, President
Leon Snead & Company, P.C.
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Subject: Management Response to the ARC Inspector General review of ARC's internal controls over administrative functions, performed by Leon Snead & Company, P.C.

Dear Mr. Snead:

Thank you for your review of ARC internal controls over administrative functions. The assistance provided by this review will enhance ARC's oversight over the agency's programs. The following is provided as comment on the draft report.

Unliquidated Obligations

The Internal Control Review (ICR) team Report on the Test of Adequacy and Effectiveness of ARC Management Controls identifies that the source used to identify the grants used in the sample was a report of unliquidated obligations. This was being used as a source by Finance & Administration and Program Operations to liquidate grant obligations. Two of the three grants, CO-13082L and AL-13615, addressed by the auditor review have been closed. The third grant, NC-13503, is being proposed for restructure to carry out six projects in Western North Carolina. This item should remain open until the use of the funds proposed for this grant is proven viable.

Remittances

The ARC staff was reminded on April 27, 2005 to bring any mail remittances they discover to a designated employee in Finance and Administration who will log in all checks in the log book located in Finance. Checks will be transferred to the Financial Services Assistant for deposit. The Financial Services Assistant will receipt in the log book for each check received for deposit. The ICR team found that the Financial Services Assistant was the central point for processing checks, did endorse them, provided safe custody, deposited them IAW the schedule prescribed by the Financial Management Guidelines (Red Book) and kept a record of the bank confirmation.

Payments

The ICR team that there was a sufficient level of compliance with the ARC Financial Management Guidelines to consider this item complied with. ARC management has reemphasized to the staff the importance of designating persons to approve the receipt of goods and services and approve payments on the basis of vendor invoices for each purchase order/contract.

Commuting Assistance

As a result of the ICR teams preliminary findings ARC management reemphasized the requirement for each employee requesting commuting assistance to certify semi-annually their commuting costs. Any employee not providing the required certification by March 31 and September 30 each year will have their commuting assistance terminated on April 1 and October 1 as appropriate.

Grants Management

The Program Operations Division has revised the ARC Application Format and Checklist to address this issue. No projects will be forwarded to the Federal Co-Chair for signature without an ARC goal and corresponding State Strategy identified. ARC has awarded a consulting contract to assist the agency in developing meaningful performance measures for difficult to assess grants. Four of the five grants identified by the ICR team fit that category. The fifth grant had outcome measures identified in the grant approval. The ICR report was in error in that regard.


Travel

The ARC staff has again been reminded of the requirement to use the Government Travel Card for official business rental of vehicles. Federal office staff has been reminded that they are a mandatory user of the Government Travel Card for all travel costs. ARC has reviewed the "Red Book" requirement for employees to submit travel vouchers within 5 business days. ARC considers that sufficient incentive exists with all travel costs included on the Government Credit Card, billed monthly, to drop the 5 day requirement. Financial Management Guidelines will be revised accordingly.

Property Management

The ARC Financial Management guidelines will be amended to assign staff responsibility for high risk non-capitalized personal property. The Management Officer is responsible for maintaining a perpetual inventory of all non-capitalized high risk equipment. This officer will coordinate with the Systems Administrator to assure that any new equipment receives an asset control tag and is properly entered into the inventory database. The Management Officer will be responsible for removing obsolete equipment to surplus and updating the inventory. The Management Officer will perform a physical check of the location of all equipment in the database semi-annually.

Sincerely,



Robert M. Decker, Director
Finance and Administration