



**APPALACHIAN REGIONAL COMMISSION**

**INSPECTOR GENERAL'S  
SEMIANNUAL REPORT  
TO CONGRESS**

APRIL 1 - SEPTEMBER 30, 1991



## APPALACHIAN REGIONAL COMMISSION

OFFICE OF  
INSPECTOR GENERAL  
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### MEMORANDUM FOR THE FEDERAL CO-CHAIRMAN

SUBJECT: Semiannual Report to Congress

In accordance with the requirements of the Inspector General Act Amendments of 1988, Public Law 100-504, I submit the semiannual report of the Office of Inspector General for the period April 1 through September 30, 1991.

During this reporting period, operational activities included initiation of 16 individual grant audits and issuance of 9 individual grant audit reports and 4 headquarters survey or update reports, including Business Development RLFs and Appalachian Housing Programs. Recommendations highlighted the potential for more timely use of funds and system/control improvements with respect to grantee operations. Of particular note was ARC's initiation of an audit followup system in line with OMB Circular A-50, Audit Followup. Emphasis was also placed on contracting for audit services; guidance and/or monitoring of contract audit services; coordination with Federal, State, and ARC officials; strategic audit planning; and development of fraud or abuse audit tests.

During the reporting period, we established liaison with a State OIG, commented about increased ARC involvement in the Federal Managers' Financial Integrity Act (FMFIA) process, coordinated with ARC staff on audit followup issues, and reviewed and analyzed actions in response to OIG recommendations. Also, audit and investigation work with respect to several entities partially funded by ARC grants was initiated and/or completed by other OIG offices.

A senior auditor was employed to assist the Inspector General in day to day operations, conduct audits, and monitor contract audit staff.

We noted various ARC actions to address OIG recommendations, including deobligation of unused funds, improved followup on old and/or inactive grants, initiation of programmatic assessments, and development of an audit followup system.

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## EXECUTIVE SUMMARY

During this reporting period, nine grant audits and four headquarters surveys and followup reviews were completed that contained recommendations for grantee and/or ARC actions. Additionally, two matters were referred for investigation, six audit survey programs were prepared, and recommendations with respect to the establishment of an ARC audit followup system were implemented.

Emphasis was also placed on contracting for audit services; contract monitoring; participating in PCIE study of single audit work; coordination with Federal, State, and ARC officials; and addressing staffing issues.

Examples include:

- o A summary report of 20 Appalachian Housing Fund grants identified nine cases with limited activity and loan balances of about \$356,000 that could be put to better use if the inactive balances were deobligated. Action was initiated to effect interim or final deobligations.
- o An updated report on business development revolving loan funds disclosed at least eleven cases with RLF balances approximating \$4 million where we believe substantial deobligations are appropriate and possible. Action was initiated to address the largest cases noted.
- o Nine grant audits conducted by contract staff contained recommendations with respect to eligibility and documentation of costs incurred approximating \$494,000 and identified needed control and program improvements with respect to project reporting, audits, and accounting for expenditures on ARC activities.
- o ARC implemented recommendations for an audit followup system in line with OMB Circular A-50, Audit Followup.
- o ARC initiated action with respect to recommendations concerning program evaluation and grant close-outs, including initiation of program assessments of infrastructure projects and controls to ensure timely identification of close-out potential.
- o Emphasis was placed on identifying and testing audit methodologies and procedures to more effectively detect and prevent fraud and abuse.
- o The Inspector General continues to participate on a PCIE evaluation of single audit, and work to date includes finalization of questionnaires to persons performing single audits. Continued emphasis was placed on encouraging revision and redirection of single audit

## **I. INTRODUCTION**

The Inspector General Act Amendments of 1988 (P.L. 100-504) provided for the establishment of an Office of Inspector General at 33 designated Federal entities, including the Appalachian Regional Commission (ARC). The ARC Office of Inspector General became operational on October 1, 1989, with the appointment of an Inspector General and provision of budgetary authority for contracted audit and/or investigation activities. Prior to the establishment of an Office of Inspector General, audit and investigation activity was carried out primarily by ARC staff, supplemented by financial and compliance audits required of State and local agencies receiving Federal funds and contracts with independent public accounting firms.

## **II. BACKGROUND**

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

The Appalachian Regional Commission (ARC) was established as an independent agency by the Appalachian Regional Development Act of 1965 (P.L. 89-4). 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-Chairman with the Governors electing one of their number to serve as the States' Co-Chairman.

- o 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 is established by the Commission (Appalachian Regional Commission Code) by the vote of a majority of the State members and the affirmative vote of the Federal Co-Chairman. Emphasis has been placed on highways, infrastructure development, business enterprise, and human resources programs.
- o Administratively, the Commission consists of three distinct, but interrelated components: the Office of the Federal Co-Chairman with a staff of 11, the Commission staff (56), and the Office of the States' Washington Representative (4). 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.

### Relationship to Other Principal ARC Offices

The ARC staff have full responsibility for establishing, executing, and ensuring compliance with policies, plans, and procedures; for proper protection and use of Commission resources; and for 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 Inspector General.

### Funding and Staffing

FY 1991 funding for OIG operations was \$350,000. Approximately 57 percent was budgeted for contract audit or investigative services; 34 percent, for salaries and benefits; 6 percent, for travel; and 3 percent, for all other activities (training, equipment, supplies, etc.). The OIG funding level represents about 35 percent of the total funds available to the Office of the Federal Co-Chairman. The FY 1992 funding for OIG is also \$350,000.

Initial OIG operations included authorization for an Inspector General and a Confidential Assistant. A senior auditor was employed in the latter half of FY 1991. Grant review activities will 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. Ongoing evaluations and determinations will continue with respect to the practicality and efficiency of this approach.

### III. OIG ACTIVITY

#### A. AUDITS

During the reporting period, emphasis was placed on surveys of ARC operations and programs; completion of grant audits by contractors; audit planning and guidance with respect to performance oriented reviews; audit resolution and followup; participation in a PCIE study of single audit; and continued liaison and communications with ARC, State, and other OIG officials about matters of mutual interest.

The division of OIG resources requires that audit work be conducted by a combination of permanent and contractor staff. During the reporting period, 9 grant audits were completed by contractor staff and 16 grant audits were initiated, including 7 that remain in process. The OIG office was directly responsible for 4 headquarters survey reports, including the status of Appalachian Housing fund grants and an update on the status. The OIG provided information and recommendation with respect to establishment of an agency audit followup system, implementation of procedures with

use of funds that were noted in prior reports and the need for additional and continuing action to address general issues and specific cases.

We noted 11 cases with RLF balances approximating \$4 million where we believe deobligations should be considered. This included 5 cases with fund balances approximating \$2.8 million where no disbursement of ARC funds was noted during the prior year. In one case, involving a \$1.5 million grant approved in October 1989, no disbursements were noted as of July 1, 1991.

In response to our prior report, ARC initiated action to limit initial capitalizations to \$500,000 and provide for deobligation of ARC capitalizations not disbursed within 36 months of grant approval. These actions, which became effective April 1, 1991, were included in the revised ARC Code during this reporting period. However, ARC disagreed with recommendations to include an implementation schedule that would require disbursement of initial capitalizations throughout the grant period.

We reiterated our recommendation to provide a schedule for implementation in order to (1) provide incentive for aggressive program implementation, (2) use funds on a more timely basis to assist other priority projects, and (3) complement other RLF provisions. Other recommendations included increased cooperative efforts between ARC and States to timely identify excess balances and achieve voluntary deobligations prior to expiration of established time frames, revision of restrictive grantee loan policies and deobligation of funds, to the extent practical based on analysis of near-term needs, in the cases noted.

We noted the ARC had initiated action to notify the grantee with the \$1.5 million unused balance of its intention to deobligate this money.

- o Nine grant audits were completed, involving ARC funds approximating \$19 million. These reports noted questioned or unsupported costs approximating \$474,000, with the primary issues being the eligibility of or documentation for claimed costs. Grantee officials are in the process of resolving the audit conclusions and recommendations with ARC. Additionally, we noted one housing fund with excess and/or unused balances of about \$2 million, resulting from termination of two projects and delays in converting the loan program to a grant program. Actions are in process to resolve these conditions and obligate funds for eligible projects.
- o Grant audits identified needed programmatic or control improvements with respect to submission of required reports; improved reporting to reflect project

methodologies. The primary recommendation relates to ARC expansion of FMFIA assessments to include Section 2, Internal Accounting and Administrative Controls, in addition to the annual assessments currently made of accounting systems.

- o Followup work with respect to an initial survey of ARC grant close-out activity identified a need for additional controls to ensure that management information is effectively used as a tool for identifying, tracking, and ensuring timely closing action with respect to older grants. ARC management initiated action to require documentation of problems holding up grant closeouts, with special attention to those that have gone beyond 6 months of the termination date.
- o An initial survey of ARC operations included recommendations for increased Commission program evaluation activity. Among the actions noted by ARC was initiation of programmatic followup on approved infrastructure projects. This activity will include assessments as to whether projects are achieving objectives and identification of problem areas that need to be considered in the grant review and approval process.
- o Survey programs were prepared in conjunction with several planned reviews and to emphasize audit tests with respect to potential fraud and abuse. These included:
  - Project Coordinator activity
  - Grant close-out
  - Audit report processing and followup
  - Fund redistributions
  - Business incubators
  - Fraud indicators and questions
- o Emphasis continued to be placed on ascertaining the extent and effectiveness of single audit coverage provided ARC programs, including participation in a quality control review of a statewide single audit. Grant audit work included the review of available audit reports to avoid duplicative efforts. It was noted that most grants were subject to financial audits, either under single audit or in line with ARC, State, or local requirements. However, limited compliance testing of ARC activity was noted. Consequently, action remains necessary with respect to single audit compliance and transaction testing of non-major program activity in order to provide program managers with sufficient

## **B. INVESTIGATIONS**

Two referrals for investigation resulting from audit testing of contracting practices were referred to the applicable State Office of Inspector General. An investigation of the misuse of Government, including ARC, funds was completed by another OIG office and resulted in a criminal conviction of a local development district employee and required restitution of more than \$100,000.

## **IV. AUDIT PLANNING**

FY 1992 audit work continues to include additional grant compliance reviews; but increased emphasis is being placed on efficiency, economy, and performance reviews in accordance with requirements of the Inspector General Act to test the efficiency and economy in the administration of programs and operations. A combination of individual grant audits in all of the 13 Appalachian States, functional across-the-board subject specific audits, and headquarters surveys in several areas are planned.

With respect to functional/expanded scope audits, emphasis is being placed on Commission administered grants for (1) similar type activities in disbursed geographic areas or (2) concentrated efforts on a multi-county basis in a particular State. These audits should afford an initial opportunity to assess the efficiency and effectiveness of ARC and grantee operations and to provide input with respect to the success of programs and projects in meeting goals and objectives.

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

The ARC Office of General Counsel (OGC) was requested to provide comment with respect to statewide projects and the related costing of such projects where substantial portions of applicable States are not in Appalachia. Also OGC was requested to comment on several other issues, such as: (1) the applicability of OMB Circulars to ARC, including updated comments on ARC's status as Federal or non-Federal agency; (2) the basis for ARC Code language that permits the Commission to proactively or retroactively waive any Commission policy or interpretation thereof; and (3) the applicability and/or implementation of Federal guidelines with respect to lobbying restrictions and procurement activities.

Additionally, our prior recommendation with respect to an implementation schedule for RLF grants, that was included in our prior review of proposed regulations was reiterated in connection with a followup report on RLF fund balances.

## **VI. OTHER**

The Inspector General continues to serve on the PCIE Task Force on Single Audit and participated in the development of questionnaires intended to obtain feedback from Federal, State, and local officials, including auditors, and public accounting firms about

**SCHEDULE OF AUDIT REPORTS COMPLETED APRIL 1 TO SEPTEMBER 30, 1991**

Audit Report No.	Title	Program Dollars or Contract/Grant Amount	Questioned Costs*	Unsupported Costs**	Funds to Better Use***
91-14(G)	New York Consolidated Technical Assistance Grants	\$ 759,731	\$ 10,627		
91-15(G)	Alabama Consolidated Technical Assistance Grants	330,000			
91-16(G)	Georgia Consolidated Technical Assistance Grants	773,325	8,621		
91-18(G)	Pennsylvania Consolidated Technical Assistance Grants	920,744	90,117		
91-19(G)	Kemper County Small Business Incubator	250,000			
91-20(G)	South Carolina Work Force Excellence Initiative	200,000		\$14,025 <sup>1/</sup>	
91-21(G)	Georgia Appalachian Housing Program	3,106,072	289,558		
91-22(G)	Ohio Appalachian Housing Program	2,617,923	62,000		\$ 25,890
91-23(G)	Maryland Appalachian Housing Program	4,624,053			390,500
91-5(H)	Appalachian Housing Fund Status	5,728,333			356,000
91-9(H)	Update on RLF Status	4,000,000			2,800,000 <sup>2/</sup>
91-10(H)	Intergovernmental Assignment				
91-12(H)	Grant Close-Out Procedures				
TOTALS		\$19,310,181	\$460,923	\$14,025	\$3,572,390

\* 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.

\*\* A cost the Office of Inspector General has questioned because of a lack of adequate documentation at the time of the audit.

\*\*\* 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.

1/ Unexpended funds for deobligation.

2/ Potential funds available for better use also noted in prior reports.

# APPENDIX B

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

	No. of Reports*	Dollar Value (\$ in thousands)
A. For which no management decision has been made by the commencement of the reporting period	1	\$2,900
B. Which were issued during the reporting period	<u>4</u>	\$ 772 <sup>1/</sup>
Subtotals (A + B)	5	\$3,672
C. For which a management decision was made during the reporting period	1	\$2,900
(i) dollar value of recommendations that were agreed to by management	1	\$1,600
--based on proposed management action	1	\$1,600
--based on proposed legislative action	0	0
(ii) dollar value of recommendations that were not agreed to by management	1	\$1,300 <sup>2/</sup>
D. For which no management decision has been made by the end of the reporting period	4	\$ 772 <sup>3/</sup>
E. Reports for which no management decision was made within 6 months of issuance	0	0

1/ Pertains primarily to inactive fund balances in the Appalachian Housing Fund Program. Also, additional potential deobligations in Revolving Loan Fund balances were noted; but the initial report noting \$2.9 million in excess balances is considered to include maximum overall RLF deobligation potential.,

2/ Management agreed with recommendations and revised the ARC Code to require deobligations if funds not used timely. In some cases, grantees were permitted to retain funds based on potential use rather than deobligation actions being initiated.

3/ Actions in process to deobligate funds with about \$270,000 deobligated during audit period.

## APPENDIX C

**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 has been made by the commencement of the reporting period	2	\$ 34	\$260
B. Which were issued during the reporting period	<u>6</u>	<u>\$461</u>	<u>\$ 14</u>
Subtotals (A + B)	8	\$495	\$274
C. For which a management decision was made during the reporting period	5	\$ 53	\$274
(i) dollar value of disallowed costs	3	\$ 41	\$ 14
(ii) dollar value of costs not disallowed	2	\$ 12	\$260
D. For which no management decision has been made by the end of the reporting period	3	\$442	0 <sup>1/</sup>
E. Reports for which no management decision was made within 6 months of issuance	0	0	0

1/ Reports issued at end of reporting period.

DEFINITIONS OF TERMS USED

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

**Questioned Cost**

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.

**Unsupported Cost**

A cost which the OIG questioned because the cost was not supported by adequate documentation at the time of the audit.

**Disallowed Cost**

A questioned cost that management, in a management decision, has sustained or agreed should not be charged to the Commission.

**Funds Be Put To Better Use**

A recommendation made by the OIG that funds could be used more efficiently if management took actions to implement and complete the recommendation.

**Management Decision**

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.

**Final Action**

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.