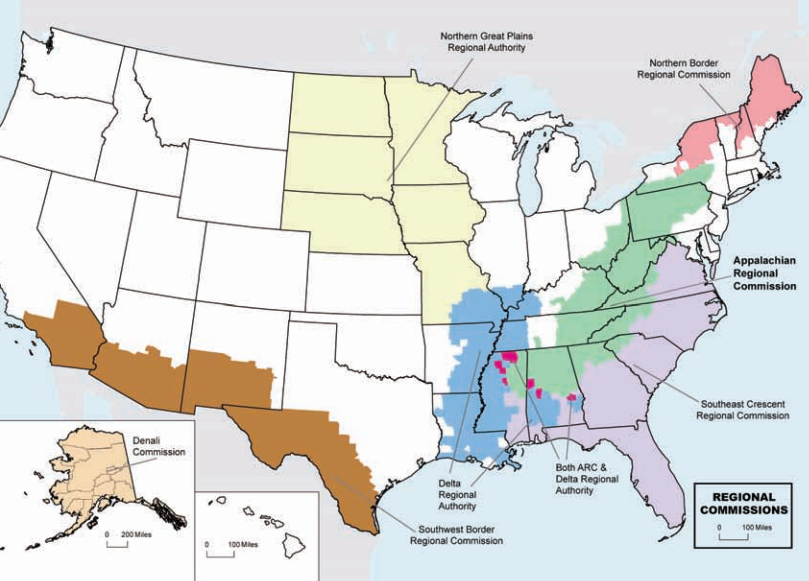




INSPECTOR GENERAL'S SEMIANNUAL REPORT TO CONGRESS

Appalachian Regional Commission

October 1, 2010–March 31, 2011





April 2011

MEMORANDUM FOR THE FEDERAL CO-CHAIR

SUBJECT: Semiannual Report to Congress

In accordance with the requirements of the Inspector General Act Amendments of 1988, Public Law 100-504, the Inspector General Reform Act of 2008, Public Law 110-409, and the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203. I am pleased to submit the Office of Inspector General's Semiannual Report to Congress.

This Semiannual Report to Congress summarizes the activities of our office for the 6-month period ending March 31, 2011. During this fiscal period, we issued three reports. Two other reports are in process, one was issued as a discussion draft and the other one should be issued as a discussion draft soon. During this period, the OIG passed a peer review required by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). Also during this period, the Inspector General and staff continued to serve as representatives on the Council of the Inspectors General on Integrity & Efficiency (CIGIE), the Federal Audit Executive Committee (FAEC), and the various Intergovernmental Audit Forums covering our jurisdictional region.

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

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

A handwritten signature in black ink, appearing to read 'C/H Jennings', written in a cursive style.

Clifford H. Jennings
Inspector General

Enclosure

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EXECUTIVE SUMMARY

ARC grant operations represent the most significant part of ARC's programs. In prior reporting periods, we issued two reports, one on ARC's grant system and the other on ARC's grant operations. To date, most of the recommendations related to the grant system remain unimplemented. However, just before the end of this reporting period, management issued a new grant policy memorandum that addressed approximately two-thirds of our grant operations recommendations; some additional recommendations may be closed pending further evaluation. For this reporting period our activities included: the issuance of three audits, and providing oversight for an audit and an inspection. The inspection was a resumption of work that was previously suspended in order to be brought current. It concerns ARC performance reporting. The audit being conducted is of a grant investment in a fund established under SBA's Rural Business Investment Program (RBIP), the only operating RBIP fund in the country.

The most recent financial statement audit report was issued without disclaimer or qualification; this makes the second consecutive report issued with a clean audit opinion since adopting federal financial reporting rules in 2007. Previous reports were issued over six months late but this report was issued more timely, yet was four months late. Financial reporting accuracy and timeliness appear to be improving, and some of the report's tardiness is probably attributable to new auditors becoming familiar with ARC's reporting operations.

The two performance audits we issued concern grants made to foster business growth in rural Appalachia. The purpose of the grants were to provide training and/or intensive technical assistance to businesses and to investigate, through trial, the establishment of a facility to house small business in need of continued technical support. The results of the audits found that generally the purposes of the grants were being met but did present recommendations concerning improper implementation of grant requirements, a recommendation requiring return of funds, and noted a conflict of terms in ARC requirements related to prior approvals.

As discussed in previous semiannuals, ARC continues to forego strict, if any, enforcement of the grant requirements, i.e., the return of funds. For a grant audited this time, ARC chose to issue a clarification to the grant documentation that generation of program revenue was expected and that it was not to be used to reduce the grant funds. We continue to urge management to enforce grant requirements as it is one of the best tools ARC has to ensure grant goals are met in a fair manner.

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

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

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

Reporting Requirements

Section 4(a)(2)	Review of legislation and regulations	Page 10
Section 5(a)(1)	Problems, abuses, and deficiencies	Pages 7-8
Section 5(a)(2)	Recommendations with respect to problems, abuses, and deficiencies	Pages 7-8
Section 5(a)(3)	Prior significant recommendations not yet implemented	**
Section 5(a)(4)	Matters referred to prosecutive authorities	Pages 8-9
Section 5(a)(5) and 6(b)(2)	Summary of instances where information was refused	*
Section 5(a)(6)	Listing of audit reports showing number of reports and dollar value of questioned costs	App A
Section 5(a)(7)	Summary of each particularly significant report	**
Section 5(a)(8)	Statistical table showing number of reports and dollar value of questioned costs	App B
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use and summary of management decisions	App C
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by end of the reporting period	*
Section 5(a)(11)	Significant revised management decisions	*

Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees	Pages 7-8
Section 5(a)(14)	Results of recent peer review	Page 8 & App. E
Section 5(a)(15)	Outstanding recommendations from any peer review	*
Section 5(a)(16)	List of peer reviews conducted and any outstanding recommendations	Page 8
Section 5(b)(3)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use and summary of management actions	App D
*	None.	
**	See references to Sections 5(a)(1) and 5(a)(2) for discussion of significant reports (including recommendations).	

I. INTRODUCTION

The Inspector General Act Amendments of 1988 (Pub. L. No. 100-504) provides for the establishment of an Office of Inspector General (OIG) at 30 designated Federal entities, including the ARC. The ARC OIG became operational on October 1, 1989, with the appointment of an IG and provision of budgetary authority for contracted audit and/or investigation activities.

II. BACKGROUND

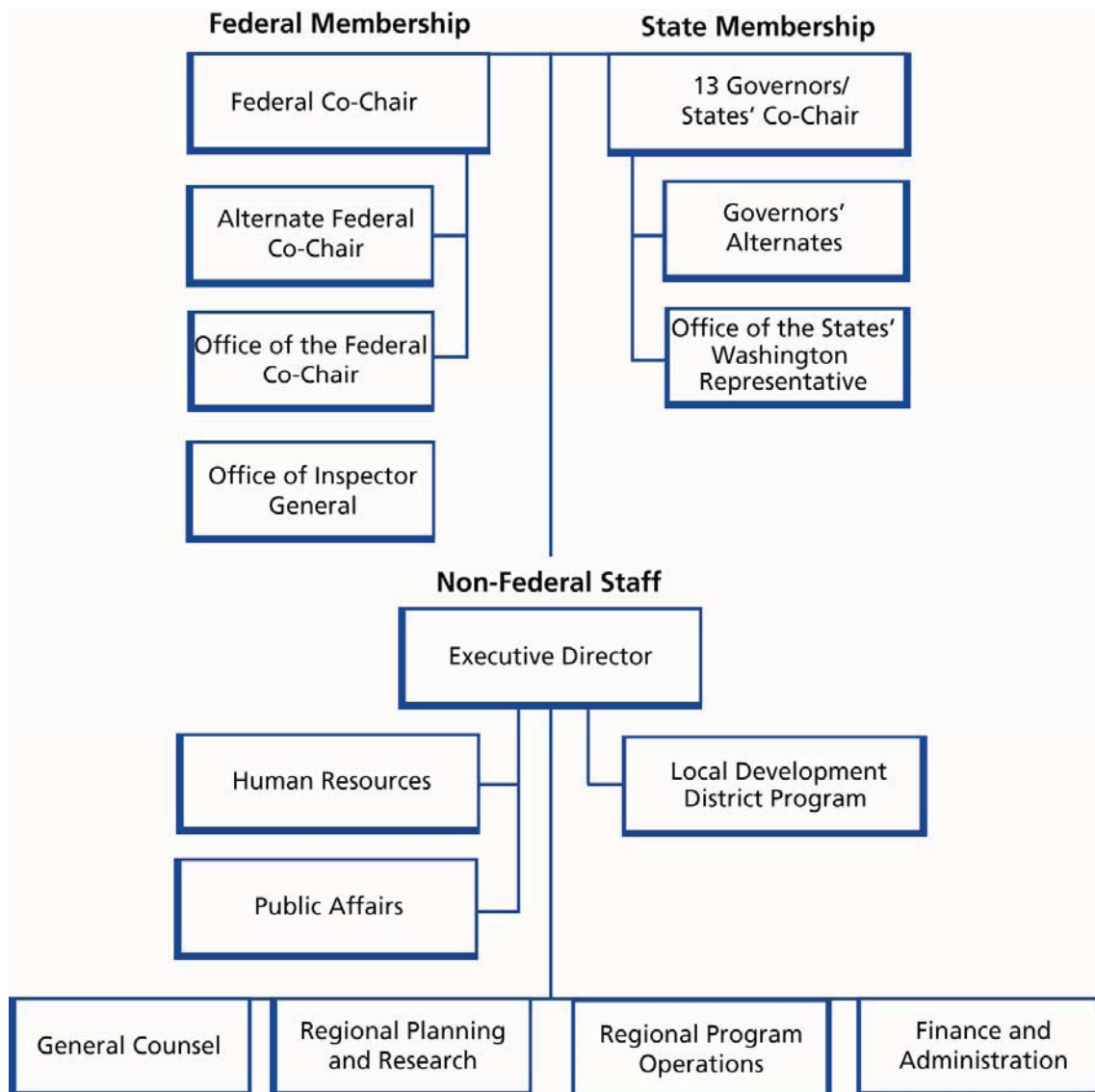
A. APPALACHIAN REGIONAL COMMISSION

The Appalachian Regional Development Act of 1965 (Pub.L. No. 89-4) established the Appalachian Regional Commission. The Act authorizes a Federal/State partnership designed to promote long-term economic development on a coordinated regional basis in the 13 Appalachian States. The Commission represents a unique experiment in partnership among the Federal, State, and local levels of Government and between the public and private sectors. It is composed of the Governors of the 13 Appalachian States and a Federal representative who is appointed by the President. The Federal representative serves as the Federal Co-Chair with the Governors electing one of their numbers to serve as the States' Co-Chair.

- Through joint planning and development of regional priorities, ARC funds are used to assist and encourage other public and private resources to address Appalachia's unique needs. Program direction and policy are established by the Commission (ARC Code) with the vote of a majority of the State members and the affirmative vote of the Federal Co-Chair. Emphasis has been placed on highways, infrastructure development, business enterprise, energy, and human resources programs.
- Administratively, the Office of the Federal Co-Chair, with a staff of 8 and the Commission, with a staff of 45, is responsible for ARC operations. The Office of Inspector General has a staff of 3. All personnel are located in Washington, DC. The Commission staff's administrative expenses, including salaries, are funded jointly by Federal and State funds. The Federal Office staff is funded entirely from Federal funds.
- The Commission's appropriation for FY 2010 was \$76 million. The office is currently operating under the government-wide continuing resolution. ARC was reauthorized in October 2008 through FY 2012 . In addition, in March 2010 the Highway Trust Fund, under Section 1101 of the Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) received short-term funding through the end of Fiscal Year 2011. The funding provides for construction of the Appalachian Development Highway System which is under ARC's programmatic jurisdiction; provided for under Section 201 of the 1965 Appalachian Regional Development Act.
- ARC's non-ADHS funds are distributed to state and local entities in accordance with an allocation formula intended to provide fair and reasonable distribution of available resources. ARC staff has responsibilities for program development, policy analysis and review, grant development, technical assistance to States, and management and oversight.

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

ARC ORGANIZATION CHART



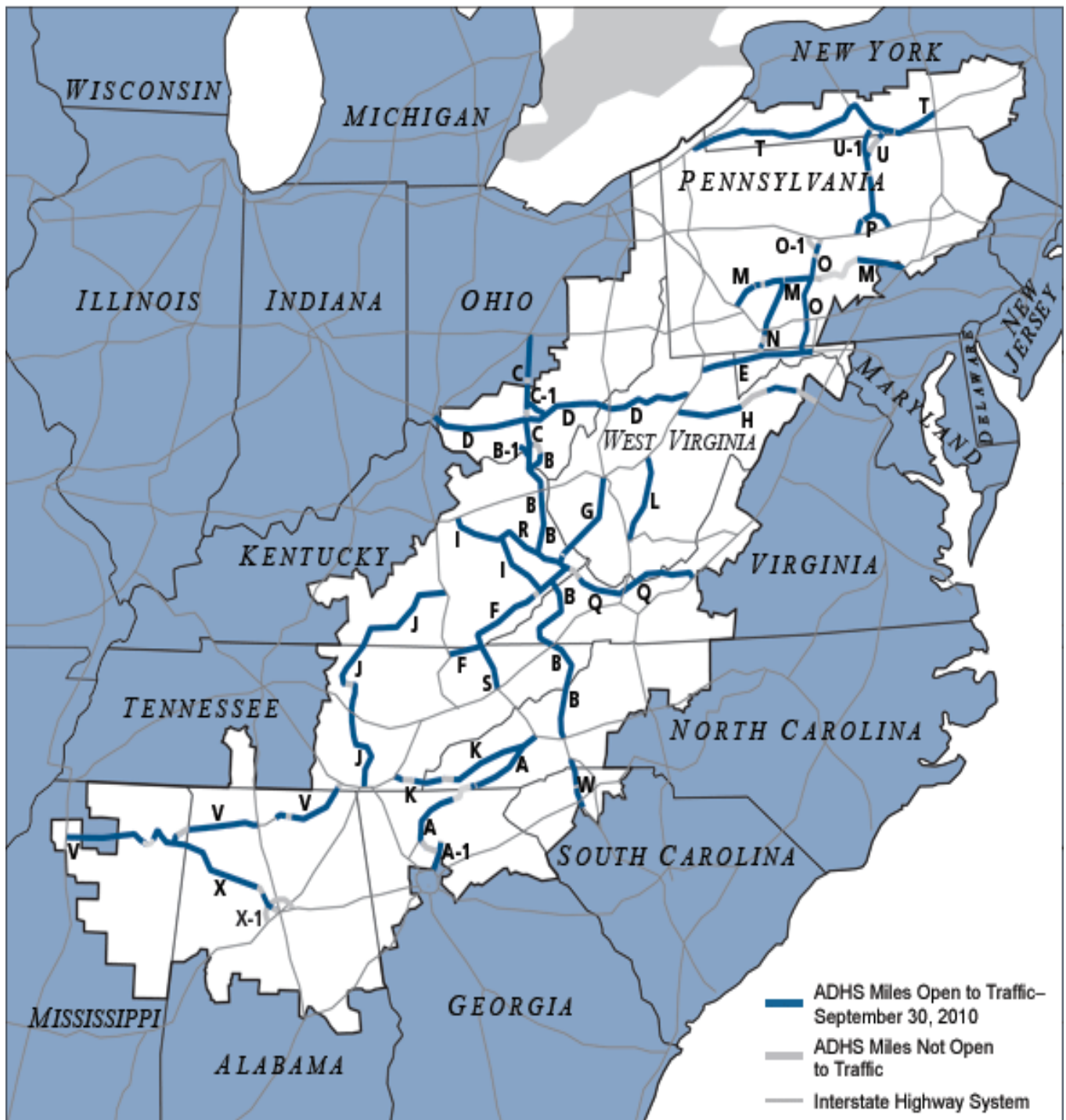


APPALACHIAN REGION



Appalachia, as defined in the legislation from which the Appalachian Regional Commission derives its authority, is a 205,000-square-mile region that follows the spine of the Appalachian Mountains from southern New York to northern Mississippi. It includes all of West Virginia and parts of 12 other states: Alabama, Georgia, Kentucky, Maryland, Mississippi, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, and Virginia.

Appalachian Development Highway System as of September 30, 2010



Source: Appalachian Regional Commission

B. OFFICE OF INSPECTOR GENERAL

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

Role and Authority

The Inspector General Act of 1978 (Pub.L. No. 95-452), as amended in 1988, states that the IG is responsible for (1) audits and investigations; (2) review of legislation; and (3) recommendation of policies for the purpose of promoting economy and efficiency in the administration of, or preventing and detecting fraud and abuse in, the program and operations of the establishment. In this regard, the IG is responsible for keeping the Federal Co-Chair and Congress fully informed about the problems and deficiencies in ARC programs and operations and the need for corrective action. The IG has authority to inquire into all ARC programs and activities that are federally funded. The inquiries may be in the form of audits, surveys, investigations, personnel security checks, or other appropriate methods. The two primary purposes of these inquiries are (1) to assist all levels of ARC management by identifying and reporting problem areas, weaknesses, or deficiencies in procedures, policies, program implementation, and employee conduct and (2) to recommend appropriate corrective actions.

Relationship to Other Principal ARC Offices

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

Funding and Staffing

The OIG funding level for FY 2011 is governed by the continuing budget resolutions. Our FY 2010 funding was \$612,000. Staffing consists of the Inspector General, an Assistant Inspector General for Audit, and a confidential assistant. Grant review activities continue to emphasize use of contracted services (e.g., independent public accounting firms or other OIG offices) supplemented by programmatic and performance reviews directed by OIG staff. Investigative assistance is provided by other OIG offices on an as-needed basis through memoranda of understanding. This approach is deemed the most appropriate to date in view of the nature of ARC operations and limited resources.

In order to comply with Pub.L. No. 110-409, the Inspector General Reform Act of 2008, the OIG included funding for FY 2011 that includes reimbursement of other IGs for counsel, audit and investigative services via Memorandums of Understanding. Currently, we use the Department of

Commerce OIG legal counsel and their audit staff to supplement our activities. We also use other OIG offices to provide investigative services.

Because of the small size of our OIG office, we have had to rely on the resources of other OIGs to complete some program activities. With the recent legislation enacted to form more regional commissions, we recommend consolidating regional commission OIG offices into one organization or moving regional commission OIG offices to larger agencies that already have similar agency programs. A full discussion immediately follows.

Support for Consolidation of OIG functions across Regional Commissions

In the 2008 Farm Bill, Congress created three new regional commissions, *the Southeast Crescent, the Southwest Border, and the Northern Border Regional Commissions*.¹ **Part of the bill states:**

*Appointment of Inspector General.—There shall be an Inspector General for the Commissions appointed in accordance with section 3(a) of the Inspector General Act of 1978 (5 U.S.C. App.). All of the Commissions shall be subject to a single Inspector General.*²

As can be seen on the map on the cover to this report, there are 7 regional commissions.³ As an office with only 3 FTE, there are times when more is needed. While the rest of the IG community has been more than forthcoming with assistance, there should not be a need for this. For example, in the past, we have received investigative assistance from the Department of Education OIG and from the Department of Homeland Security OIG, IT audit, technical, and investigative help. We currently have a Memorandum of Understanding with the Department of Commerce OIG to provide support. To date, the majority of this support has been in the form of legal advice and research.

Not having staff on board to cover the entire spectrum of skills needed to provide complete oversight tends to skew the work that is scheduled. While it is true that most skills can be contracted out (IT, audit, inspection), investigative work is an inherently governmental function. Additionally, there are occasions where technical assistance is needed, but the amount needed does not warrant contracting.

As can be seen on the map on the cover, there is certainly enough national coverage to warrant a full oversight capability. Our suggested approach is to put this responsibility under an agency that already has staff on board that deals with the major functions of these commissions. This would also further our independence as the reliance on the agency for support services could be transferred to the new organization.

In the Denali Commission's Semiannual report to the Congress for the first half of Fiscal Year 2010, the Inspector General recommended that the Denali Commission Office of Inspector General be included in the consolidation called for in the 2008 Farm Act. We would also support this consolidation of all regional commission OIGs into a separately functioning office or placement under another larger OIG with the appropriate and separate funding to properly oversight these regional commissions.

¹ Pub. L. No. 110-246, 122 Stat. 2231 (2008), 40 U.S.C. § 15301. The specific coverage of each commission is described at 40 U.S.C. §§ 15731-15733.

² Pub. L. No. 110-246, 122 Stat. 2242 (2008), 40 U.S.C. § 15704.

³ In addition to ARC and the three regional commissions created by the 2008 legislation, there are three other regional commissions: the Delta Regional Authority, 7 U.S.C. §§ 2009aa-2009aa-13; the Northern Great Plains Regional Authority, 7 U.S.C. §§ 2009bb-2009bb-13; and the Denali Commission, Pub. L. No. 105-277, 42 U.S.C. § 3121 note.

III. OIG ACTIVITY

A. AUDITS, INSPECTIONS, EVALUATIONS & REVIEWS

ARC grant operations represent the most significant part of ARC's programs. In prior reporting periods, we issued two reports, one on ARC's grant system and the other on ARC's grant operations. To date, most of the recommendations related to the grant system remain unimplemented and we provide a brief synopsis of that report below. However, just before the end of this reporting period, management issued a new grant policy memorandum that addressed approximately two-thirds of our grant operations recommendations; some additional recommendations may be closed pending further evaluation. During the current reporting cycle, we issued three other reports, two reports concern grants made to foster small businesses, and primarily have findings related to the grant requirements. The other report issued was a financial statement audit report. An inspection of ARC's performance measures and their reporting and an audit of an ARC's grant contribution to SBA's Rural Business Investment Program through a grantee are ongoing. A new auditor solicitation was in process but has been suspended pending the OIGs possible conversion to non-federal status.

All issued reports can be found on the OIG website <http://www.arc.gov/oig>

Audits of ARC's Grant Operations

We completed a comprehensive review of ARC's grant management system in April 2008. The audit revealed the system had data conversion, entry and internal processing errors. Additionally, inadequate resources had been allocated to ensure timely completion of the project/system and to provide for system documentation. System access and security features were not controlled appropriately and there was only a single person knowledgeable of the system internals. Ten recommendations to address these findings resulted from the audit. The implementation and completion of the recommendations has not been as prompt as envisioned and the project continues to languish. In addition, many of the recommendations are not being implemented in the sequence suggested by the report, which in all likelihood will result in increased costs and time to complete.

Audits of ARC's Grantees

The two performance audits we issued concern grants made to foster business growth in rural Appalachia. The purpose of the grants were to provide training and/or intensive technical assistance to businesses and to investigate, through trial, the establishment of a facility to house small businesses in need of continued technical support. The results of the audit found that generally the purposes of the grants were being met but did present recommendations concerning improper implementation of grant requirements, a recommendation requiring return of funds, and noted a conflict of terms in ARC requirements related to prior approvals.

As discussed in previous semiannuals, ARC continues to provide only lax enforcement of the grant requirements, i.e., the return of funds. For a grant audited this time, ARC issued a clarification to the grant documentation that generation of program revenue was expected and that it was not to be used to reduce the grant amount awarded. We continue to urge management to enforce grant requirements as it is one of the best tools ARC has to ensure grant goals are met in a fair and unbiased manner.

In addition, as we observed from previous audits, more underlies these issues than simple grantee compliance, but they concern management's attitudes towards enforcement of grant requirements. Also, as we noted in the last semiannual report, management has the appearance of enforcing grant requirements by writing/ informing grantees of requirements, but this is not the same as ensuring individual grantees live up to their grant obligations and taking action to require return of funds for violations. As stated in the previous semiannual, we will continue to monitor management's decisions concerning grant requirements.

ARC Financial Statement Audit

The most recent financial statement audit report was issued without disclaimer or qualification; this makes the second consecutive report issued with a clean audit opinion since adopting federal financial reporting rules in 2007. Previous reports were issued over six months late but this report was issued more timely, yet was four months late. Financial reporting accuracy and timeliness appear to be improving, and some of the report's tardiness is probably attributable to new auditors becoming familiar with ARC's reporting operations.

In-process Audits and Inspections

Currently, we are overseeing an inspection of ARC performance reporting. A discussion draft is expected shortly. We are also monitoring an audit being conducted by a contracted CPA. The audit concerns a grant investment in a fund established under SBA's Rural Business Investment Program.

Peer Review

Offices of the Inspectors General (OIGs) performing audits are required to perform (and undergo) reviews of other OIG offices every three years to ensure policies and/or procedural systems are in place that provide reasonable assurance of compliance with government auditing standards (GAS). ARC completed a peer review of the Federal Election Commission OIG and issued a report on its system of quality controls on March 28, 2008; there were no recommendations made to the Federal Elections Commission OIG. In 2009, CIGIE issued new guidance for peer reviews and we have implemented changes to help ensure conformity with them. However, we note that the Peer Review concerns itself almost exclusively with OIG internally generated audits conducted under GAS. The ARC OIG relies on contract auditors for its GAS audits; and for its internal review work relies on CIGIE's Inspection guidelines. Our peer review was completed in March 2011 and we received a pass rating with a scope limitation as there were no products germane to the review guidance. See Appendix E.

B. INVESTIGATIONS

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

We previously reported on our referral of a grant fraud investigation to the Tennessee Valley Authority OIG. The matter has been referred for prosecution. We will support any prosecution or further investigative activity and report the results when the matter is resolved.

C. OTHER

Requests for Information

Each year we receive and comply with requests for information from various governmental entities compiling statistics on OIG offices or their auditee agencies. CIGIE requests information for its annual OIG profile update and compilation of OIG statistics. The yearly compilation summarizes the results of audit and inspection activities for of all federal OIG offices. Information provided concerns the dollar value of management decisions related to *questioned costs* and *funds put to better use* and OIG recommendations related to *questioned costs*. The House Committee on Oversight and Government Reform, also with some regularity, requests information concerning the number and type or status of our recommendations. Lastly, we comply with information requests from other government regulatory bodies. For example, previously GAO requested us to provide survey information on governance and the role of the inspector general. Their requests involved our office's allocation of resources and the number of open recommendations.

Appalachian Development Highway System (ADHS) Audits

Since Fiscal Year 1999, ADHS has been funded by the Highway Trust Fund, which is administered in part by the U.S. Department of Transportation (DOT). ARC retains certain programmatic responsibilities, but the funding source is the Highway Trust Fund. Our office has reached an understanding with the DOT OIG regarding audit cognizance and has signed an MOU with the DOT OIG.

OIG Policy Manual

The OIG policy manual has been rewritten and re-issued to reflect the many changes within the OIG and audit standards community. Further, other changes were made to reflect the new peer review guidance. Continual updating of the manual will be required to improve the manual and keep it current.

Implementation of OIG Reform Act

The OIG has implemented all of the requirements of Pub.L. No. 110-409, The Inspector General Reform Act of 2008. We also completed an upgrade of our website and now have the ability to receive anonymous reports of fraud, waste, and abuse.

Recommendation Tracking Database

ARC-OIG has implemented a recommendation tracking database. The design of the database and some of the customization for ARC-OIG's use was provided by another OIG for which we are appreciative. The database is also available to selected ARC personnel, who can access the database at any time. The system provides:

- View access for all previously issued recommendations, both open and closed.
- An implementation status field for management updates (used by OIG to facilitate review activities and the closing of recommendations).
- An OIG response field/final management action field, which is used to communicate OIG views of management's implementation activities or to record management's final action.

Going Green

ARC management has implemented green measures within the organization's internal operations. For example, a document scanning system has been linked to ARC's e-mail system. Management, in a written response to our draft report on ARC's grant management system stated, "We have had preliminary discussion with our state partners about the need to move to a paperless application process, and will pursue this more vigorously within this fiscal year." Reduction in paper utilization can reduce cost, improve the timeliness of management decisions through better document storage and retrieval, and helps to reduce demands on our earth's ecological systems.

Our office, in alignment with management's initiative, is committed to "going green" and we continue to work toward that end. To date, our office has made substantial strides in working with contracted auditors and issuing reports electronically.

IV. REPORTING FRAUD, WASTE, AND ABUSE

A region wide toll-free hotline was previously established to enable direct and confidential contact with the ARC OIG, in line with governmental and longstanding OIG initiatives as identified in the IG Act of 1978; to afford opportunities for identification of areas subject to fraud, waste, or abuse. Also, in accordance with the Inspector General Reform Act of 2008, the ARC OIG implemented another communication channel allowing anonymous reporting of fraud, waste or abuse via a link on our website's home page. The web link is, <http://ig.arc.gov/>. However, with respect to the telephone hotline calls, contacts with the ARC OIG relative to public complaints or concerns continue to be primarily received through ARC staff, on regular OIG phone lines, or from other OIG offices.

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

V. LEGISLATIVE AND REGULATORY REVIEW

The OIG continues to review and provide comment on legislation germane to the OIG and the OIG community. Our comments are provided to the CIGIE for incorporation with comments from all other OIGs.

Reporting to Full Commission

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No.111-203) amended the Inspector General Act changing the entity head of ARC from the Federal Co-Chair to the Commission. Although the Office of Management & Budget (OMB) has not yet implemented these changes through the required notice and publication of the List of Designated Federal Entities and Federal Entities, which

they are required to publish annually under the IG Act, this amendment raises serious concerns. This amendment would place the Inspector General under the direct supervision of the 13 Appalachian state Governors, impinge upon OIG independence, and could pose significant administrative difficulties in implementing the new reporting structure. Based on our review of the legislation and discussions with certain congressional staff, we do not believe that legislators intended to have this amendment apply to agencies, such as ARC, where the Commission is composed primarily of non-federal, non-Presidentially appointed members. As a result of this unintended consequence, we have sought clarification from legislators and have suggested possible amendments to the Inspector General Act.

We believe that ARC and the other economic development commissions are alone in having non-presidentially appointed commission members. The other commissions affected by the Dodd-Frank act have presidentially-appointed commissioners.

In their attempt to comply with Dodd-Frank, ARC management responded with an effort to move the ARC OIG to become part of the Commission by way of a commission resolution. This would have the effect of making the IG and the employees of the OIG non-federal employees. At the most recent Commission meeting, a compromise resolution was passed requiring the Executive Director to investigate the options available to the Commission. The investigation is to be completed no later than the end of May 2011.

We reiterate our belief that having a non-federal OIG under the direction of the Commission will have a significant and negative impact on the OIG's abilities to perform its duties unobstructed and with independence, a central tenet of audit and investigational work.

In addition, we urge appropriate action be taken to amend the Inspector General Act, to prohibit non-presidentially appointed Commissions or Boards from being placed in charge of federal audit activities, which help to ensure proper expenditure of federal funds. We further urge the consolidation of all economic development commission OIG's under a cabinet level OIG (See discussion on page 6).

SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS
ISSUED OCTOBER 1, 2010 TO MARCH 31, 2011

Report No.	Report Title/Description	Program Dollars or Contract/Grant Amount*	Questioned/Unsupported Costs**	Funds to Better Use***
11-01	Compliance Audit of Kentucky Highlands Energy Business Boot Camp	\$75,000		
11-02	Compliance Audit of Kentucky Highlands Investment Corporation, Energy, Technology and Businesses Accelerator	199,000	\$16,501	
11-03	Appalachian Regional Commission Financial Statement Audit for Fiscal Year 2010			
TOTALS (3 Reports)		\$174,000	\$16,501	\$0

**SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS
OF QUESTIONED OR UNSUPPORTED COSTS**

	<u>No. of Reports</u>	<u>Questioned Costs</u>	<u>Unsupported Costs</u>
A. For which no management decision was made by the commencement of the reporting period	0	\$ 0	\$ 0
B. Which were issued during the reporting period	1	\$ 16,501	\$ 0
Subtotals (A + B)	1	\$ 16,501	\$ 0
C. For which a management decision was made during the reporting period			
(i) dollar value of disallowed costs	0	\$ 0	\$ 0
(ii) dollar value of costs not disallowed	1	\$ 16,501	\$ 0
D. For which no management decision has been made by the end of the reporting period	0	\$ 0	\$ 0
E. Reports for which no management decision was made within 6 months of issuance	0	\$ 0	\$ 0

**SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS WITH
RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE AND SUMMARY OF
MANAGEMENT DECISIONS**

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

**SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS WITH
RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE AND SUMMARY OF
MANAGEMENT ACTIONS** (\$ in thousands)

	<u>OIG Audit Reports</u>	<u>Number of Reports</u>	<u>Amounts Recommended by OIG</u>	<u>Amounts Agreed to by Management (Disallowed)</u>
A.	For which final action by management had not been taken by the commencement of the reporting period	0	\$ 0	\$ 0
B.	On which management decisions were made during the reporting period	0	\$ 0	\$ 0
C.	For which final action was taken by management during the reporting period			
(I)	Dollar value of recommendations that were actually completed	0	\$ 0	\$ 0
(ii)	the dollar value of recommendations that management has subsequently concluded should not or could not be implemented or completed	0	\$ 0	\$ 0
D.	For which no final action had been taken by the end of the reporting period	0	\$ 0	\$ 0

Peer Review Results

The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, amended the Inspector General Act to require reporting of OIG peer review results during the period of review, along with a listing of related and open recommendations, the status of open recommendations and why the recommendations had not been fully implemented, if applicable.

The ARC OIG peer review report was issued on March 18, 2011 by the National Archives (NARA) OIG who found that the ARC OIG's system of quality control for the audit organization through September 30, 2010 was suitably designed to provide reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. They assigned a pass rating with a scope limitation.

No recommendations were made by NARA.

NARA's peer review report is attached.



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INSPECTOR GENERAL

March 18, 2011

Clifford Jennings, Inspector General
Appalachian Regional Commission
1666 Connecticut Ave., NW, Suite 700
Washington, DC 20009

Subject: System Review Report on the Appalachian Regional Commission's Office
of Inspector General Audit Organization

Dear Mr. Jennings:

Attached is the final System Review Report on the Appalachian Regional Commission's Office of Inspector General audit organization conducted in accordance with *Government Auditing Standards* and Council of the Inspectors General on Integrity and Efficiency guidelines. ARC OIG reviewed the draft report and is in agreement with this report.

We thank you and all of your staff that we dealt with for your assistance and cooperation during the conduct of the review.

Paul Brachfeld
Inspector General

Attachment



NATIONAL
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INSPECTOR GENERAL

March 18, 2011

OIG Audit Report No. 11-11

To Cliff Jennings, Inspector General
Appalachian Regional Commission

We have reviewed the system of quality control for the Appalachian Regional Commission Office of Inspector General (ARC OIG) audit organization in effect for the two years ended September 30, 2010. A system of quality control encompasses ARC OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with *Government Auditing Standards*. The elements of quality control are described in *Government Auditing Standards*. ARC OIG is responsible for designing a system of quality control and complying with it to provide ARC OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and ARC OIG's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and guidelines established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During our review, we interviewed ARC OIG personnel and obtained an understanding of the nature of the ARC OIG audit organization, and the design of the ARC OIG's system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected administrative files to test for conformity with professional standards and compliance with the ARC OIG's system of quality control. Except as discussed below, the engagements selected represent a reasonable cross-section of the ARC OIG's audit organization, with emphasis on higher-risk engagements. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with ARC OIG management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for the ARC OIG's audit function. In addition, we tested compliance with the ARC OIG's quality control policies and procedures to the extent we considered appropriate. Our review was based

on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance.

There are inherent limitations in the effectiveness of any system of quality control and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

ARC OIG notified us that they did not perform any audits during the period under review but rather only inspections. It is ARC OIG's current policy not to perform audits or any other work under generally accepted government auditing standards (GAGAS) because of its staff size. ARC management and the ARC OIG contract with independent public accounting firms (IPAs) to conduct audits, attestation engagements, and certain other GAGAS engagements. As a result, we were unable to test compliance with certain GAGAS requirements in accordance with the peer review guidelines established by the CIGIE. Enclosure 1 to this report identifies the offices of the ARC OIG that we visited and the engagements that we reviewed.

In our opinion, except for the scope limitation cited above, the system of quality control for the audit organization of ARC OIG in effect for the two years ended September 30, 2010, has been suitably designed to provide ARC OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Therefore, based on our work, ARC OIG has received a peer review rating of pass with a scope limitation.



Paul Brachfeld
Inspector General

Enclosures

SCOPE AND METHODOLOGY (Enclosure 1)

Scope and Methodology

We tested compliance with the ARC OIG audit organization's system of quality control to the extent we considered appropriate. ARC OIG did not perform audit or attestation engagements but rather only inspections. It is ARC OIG's current policy not to perform audit or any other work under GAGAS. ARC management and the OIG contract with independent public accounting firms (IPAs) to conduct audits, attestation engagements, and certain other GAGAS engagements. Therefore we did not test compliance with certain ARC OIG's system of quality controls.

We reviewed the ARC OIG's monitoring of engagements performed by IPAs where the IPA served as the principal auditor during the period October 1, 2008, through September 30, 2010. During the period, ARC management contracted for the audit of its agency's Fiscal Year 2009 financial statements and ARC OIG monitored the IPA's work. ARC OIG also contracted for certain other engagements that were to be performed in accordance with *Government Auditing Standards*.

We visited the Washington, DC office of ARC OIG.

Reviewed Engagements Performed by ARC OIG

ARC OIG does not perform audits or attestation engagements. This scope limitation prevented us from testing compliance with certain ARC OIG's system of quality controls.

Reviewed Monitoring Files of ARC OIG for Contracted Engagements

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
10-05	June 8, 2010	Audit Report on ARCs Financial Statements for Fiscal Year 2008 and 2009
09-04	September 24, 2009	ARC Internal Control Performance Audit

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.

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

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Appalachian Regional Commission
1666 Connecticut Avenue, NW, Rm. 700
Washington, DC 20009-1068**

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Cover photos courtesy of the U.S. National Park Service

Appalachian Regional Commission

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