



April 30, 2014

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, 2014. During this fiscal period, we issued eighteen reports, followed-up on open recommendations and monitored contractor performance.

During this period, the Inspector General continued to serve as a member of the Council of the Inspectors General on Integrity & Efficiency (CIGIE), its Audit and Inspections and Evaluations Committees and participate in Intergovernmental Audit Forums. The Inspector General chaired a smaller OIG group in order to address issues directly impacting these offices.

The Inspector General Act of 1978, as amended by the Inspector General Act Amendments of 1988, provides that this report be forwarded 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.

Inspector General

Enclosure

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EXECUTIVE SUMMARY

ARC grant operations represent the most significant part of ARC's programs. For this reporting period our activities included the issuance of eighteen reports, follow-up on significant recommendations in prior reports, and monitoring contractor performance of grant reviews. This included 13 grant audits issued during the reporting period, four reports dealing with management issues, and the FY 2013 Financial Statement Audit.

Agency action to improve grant follow-up including use of the Basic Agency Management Report (BAMR) provides additional information about grant status and permits an improved assessment of grants needing follow-up.

Follow-up on older Basic Agency grants without any disbursements that were noted in our prior report disclosed de-obligations of \$699,560 in seven cases. Continued emphasis is appropriate for older open grants for which no disbursements have been made, grants with no additional disbursements for lengthy periods, open grants with expired performance periods and grants for which the BAMR reports noted additional potential de-obligations for \$2.6 million.

For older ARC administered grants no disbursements were noted in 9 of 14 cases included in prior reports and de-obligations of \$36,722 were reported in three cases.

Twenty-three HUD old administered grants with balances totaling \$904,124 that should be de-obligated remained open and continued emphasis is needed to assure HUD de-obligates these funds so that the funds can be used for other projects.

Individual grant reviews disclosed that grants were generally implemented in accordance with applicable regulations and project objectives. Finding and recommendations pertained to matching funds, Davis-Bacon monitoring, progress reports and questionable costs.

We noted the Tennessee Valley Authority (TVA) that administers ARC infrastructure grants under a Memorandum of Understanding has advised they will no longer administer such grants which can have a significant impact on ARC projects in the southern states unless alternative actions are identified, including administration and monitoring of about 80 open grants.

OMB issued the updated Designated Federal Entity (DFE) in December 2013 that confirmed Dodd-Frank legislation that established entire Commission/Boards, as the Agency Head. The legislation provides that Agency Heads can terminate the IG with a two thirds vote of the Agency Head.

The IG, until February 2014 chaired a group of smaller OIGs to address issues that have particular impact on these offices. The IG is also an active member of the Council of Inspectors General and its Audit and Inspections and Evaluations Committees and actively participated with respect to OMB's major grant reform initiative and Congressional initiatives with respect to small OIGs including testimony about independent oversight of smaller entities.

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

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

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

Reporting Requirements

Section 4(a)(2)	Review of legislation and regulations	Page 8
Section 5(a)(1)	Problems, abuses, and deficiencies	Pages 6-9
Section 5(a)(2)	Recommendations with respect to problems, abuses, and deficiencies	Pages 6-9
Section 5(a)(3)	Prior significant recommendations not yet implemented	*
Section 5(a)(4)	Matters referred to prosecutive authorities	*
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)(8)	Statistical table showing number of reports and dollar value of questioned costs	App B
Section 5(a)(8)	Statistical table showing number of reports and dollar value of recommendations that fund be put to better use	App C

* None.

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 Designated Federal Entities (DFEs), 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, human resources, and health and education programs.

- To ensure that funds are used effectively and efficiently, and to strengthen local participation, ARC works with the Appalachian states to support a network of multicounty planning and development organizations, or local development districts (LDDs), throughout the Region. The 73 LDDs cover all 420 counties in Appalachia. The LDDs' roles include identification of priority needs of local communities and assisting with participation in ARC progress.

- Administratively, the Commission has a staff of 56 persons that includes 49 Commission employees responsible for program operations, and the office of the Federal Co-Chair that includes the three person OIG staff. The Commissions' administrative expenses, including salaries, are jointly funded by Federal and State funds.

- The Commission's appropriation for FY 2014 was \$64.8 million.

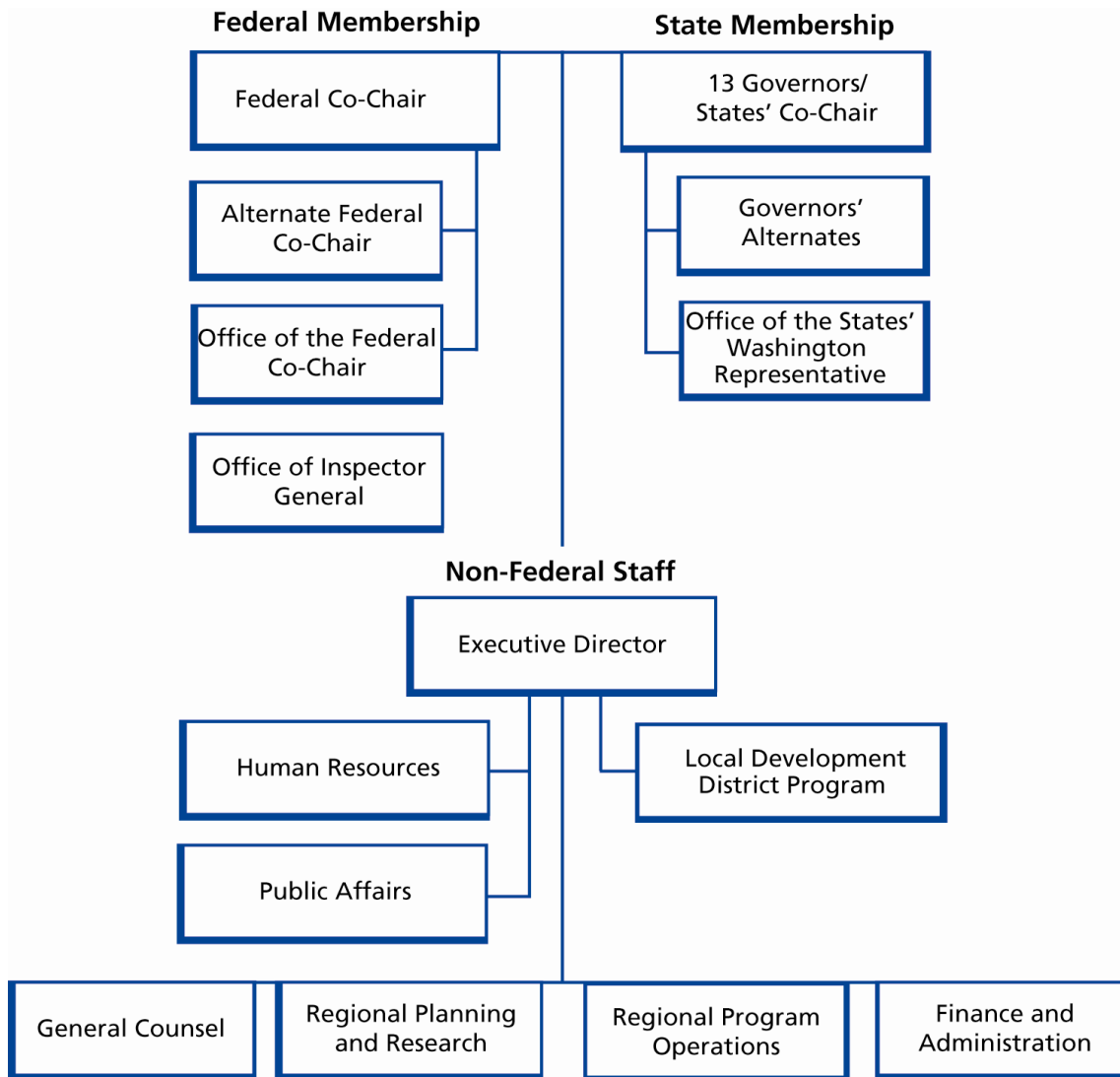
Although Congress changed the funding method for the Appalachian Development Highway System (ADHS) in July 2012, ARC continues to support and participate in completion of the ADHS including fulfilling planning and approval responsibilities.

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 monitoring. 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 relies on Child Agencies, including the Departments of Agriculture, Commerce and Economic Development Administration and the Tennessee Valley Authority (TVA), to administer and monitor construction related grants.

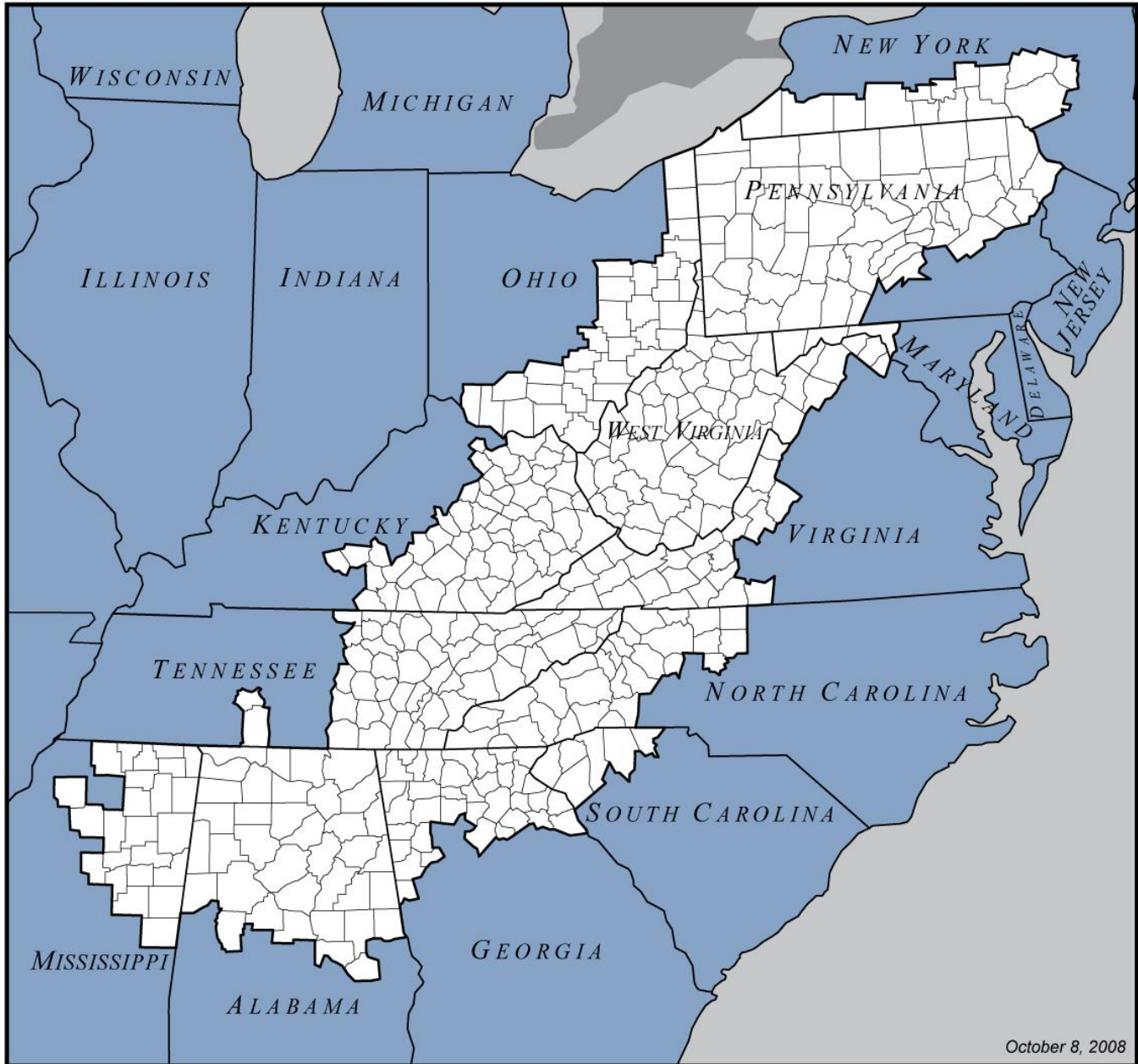
The TVA currently administers, under the terms of a Memorandum of Understanding with the Commission that provides for reimbursement of services, about 80 open ARC grants, primarily in the southern states of the Region. TVA has recently indicated that they intend to curtail or reduce their administration services after this fiscal year, which will put additional pressure on the management of ARC's grant program. We encourage ARC to continue current discussions with TVA aimed at assuring effective monitoring of active grants and the acceptance of administrative responsibility by TVA at least for pending grants that would be difficult to place with another agency. Also, we recommend ARC explore other alternatives to assure administration of future infrastructure grants in the impacted states.

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.

B. OFFICE OF INSPECTOR GENERAL

The ARC OIG is an independent Federal audit and investigative unit that reports directly to the Agency Head.

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 Agency Head 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, inspections, evaluations, 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 2013 was \$609,000 after sequestration and \$658,000 for FY 14. 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.

In order to comply with Pub.L. No. 110-409, the Inspector General Reform Act of 2008, the OIG funding for FY 2013 included reimbursement of other IGs for counsel, audit and investigative services via Memorandums of Understanding. We use Treasury OIG for Tax Administration for legal services, and the Interior OIG for investigation services.

III. OIG ACTIVITY

A. Audits, Inspections, Evaluations and Reviews

Grant reviews focused on grant implementation and administration in line with ARC and OMB policies and procedures. Management reviews focused on headquarters program and grant management activities.

ARC has continued its emphasis on grant follow-up including identification of inactive grants with potential for termination and de-obligations. For example, follow-up on prior reports identifying old open grants administered by basic agencies disclosed that ARC's initiation of an annual Basic Agency Monitoring Report (BAMR) resulted in better identification of project status and initiation of follow-up action. Consequently the number of grants previously identified as having no activity for lengthy periods was substantially reduced. Available reports identified seven instances where grants balances totaling \$699,560 in our prior report were de-obligated. BAMR reports also noted seven additional grants where de-obligations of about \$2.6 million could result and 20 additional grants where follow-up was appropriate due to potential problems that could impact project completion.

In seven other instances of open basic agency grants totaling \$255,892, no additional ARC disbursements were noted for 21 to 78 months.

Continued follow-up on old open ARC open grants is appropriate. Nine of fourteen grants identified in our prior report remained without any disbursements from 30 to 77 months since approved. Grant funds totaled \$994,819. Also, there were no additional disbursements noted in 3 of 4 cases in our prior report. Balances of these grants totaled \$285,741 and periods between disbursements ranged from 28 to 70 months. In three cases de-obligations of \$36,722 were noted.

ARC follow-up has achieved limited success with respect to obtaining necessary information from HUD in order to de-obligate funds for use on other needed projects. For example, de-obligations of \$151,763 applicable to two of 22 grants in our prior semi-annual report were noted. The remaining 20 open grants and two additional grants for which construction was reported completed between 2005 and 2011 have balances of \$904,124 that are subject to de-obligation.

Twenty open grants with balances had expired performance periods that could result in ineligible costs if expenditures are made after the expired performance periods.

Audits of 13 grants with values totaling about \$4.3 million dollars reported overall implementation of grants in accordance with policies, procedures and regulations. Findings and recommendations included accounting system improvements, documentations and support for matching funds, monitoring of Davis-Bacon, performance measures reporting, eligibility of some costs and viability of one project.

ARC Financial Statement Audit

The financial statement audit for FY 2013 was issued with a clean opinion. The prior five reports have also been issued with a clean audit opinion since ARC adopted federal financial reporting rules in 2007.

Peer Review

Offices of the Inspectors General (OIGs) are required to perform (and undergo) reviews of other OIG offices every three years to ensure policies and/or procedural systems are in place that provide reasonable assurance of compliance with government auditing standards (GAS). The next audit peer review of ARC OIG is scheduled for FY 2014.

The current audit peer review process, as legislatively mandated, assesses compliance with auditing standards but does not address issues impacting the efficiency and effectiveness of audit operations which comprises the largest segment of OIG offices.

The IG continues to recommend to the Council of Inspector General and Legislative Staff that OIG peer reviews be revised to incorporate assessments of key OIG operational elements such as: planning; timely reporting; staff development, including training, utilization and supervision; audit follow-up and inclusion of actual monetary results in Semi-Annual and Annual OIG reports based on implementation of recommendations

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.

C. OTHER

Smaller OIG Groups

Smaller OIG offices have some significantly different operational concerns than larger OIG offices in trying to maintain effective and efficient oversight of agency programs. One challenge involves the significant human and capital resources being allocated to the ever growing number of mandated reviews.

The IG was the coordinator/chair of this group that meets periodically to discuss such issues and recommends actions/best practices to facilitate smaller OIG operations. The IG testified with respect to potential legislation dealing with small OIGs and entities not included in the IG Act.

Requests for Information

Each year we receive and comply with requests for information from various governmental entities compiling statistics on OIG offices or their audited 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.

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. Under new legislation the ADHS is a part of a larger Surface Transportation Program grant to Appalachian states, with the states using the funding at their own discretion.

Implementation of OIG Reform Act

The OIG has implemented the requirements of Pub.L. No. 110-409 the Inspector General Reform Act of 2008. A Memorandum of Agreement for Counsel services is in place with the Treasury Inspector General for Tax Administration and for investigative services is in place with the Interior Inspector General.

Going Green

ARC management has implemented green measures within the organization's internal operations. Examples include a document scanning system that has been linked to ARC's e-mail system and an expansion of ARC net to include operational elements. ARC continues to encourage state partners to move to a paperless application process. 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.

IV. REPORTING FRAUD, WASTE, AND ABUSE

A region wide toll-free hotline is maintained 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/>.

V. LEGISLATIVE AND REGULATORY REVIEW

The OIG reviews legislation germane to ARC, OIG and the OIG community. Our comments are provided, as appropriate to agency officials, and/or to the CIGIE for incorporation with comments from all other OIGs.

VI. DODD-FRANK LEGLISATION – Reporting to Full Commission

OMB issued an updated list of Designated Federal Entity (DFE) Agency Head in December 2013 that confirmed legislation identifying the 13 Appalachian Governors as part of the Appalachian Regional Commission (ARC) Agency Head (Commissioners) designations.

VII. OIGs Audit Performance and Credibility Issues

OIGs audit units have provided very valuable services to the taxpayers including significant monetary benefits and major program improvements. However, as with any organization, improvements are possible and within the OIG community there are various areas where OIG audit performance and credibility can be significantly improved by addressing the following issues.

- Develop peer review guides to assess OIG audit efficiency and effectiveness that highlights key operational elements, such as planning field work, report timeliness, staff utilization and training, supervision, audit follow-up and actual results. The required peer review of compliance with audit standards does not address the key operational elements that determine OIG efficiency and effectiveness.
- Identify outcome based performance measures that, over a multi-year period, identify actual savings in relation to the multi billions of potential savings reported annually based primarily on questioned and undocumented costs with low actual savings potential. OIG Semi-Annual reports identify agreed with disallowances and tracking and reporting agency actions such as establishment of claims and recoveries appears practical and reasonable. A recent OIG survey of OIG metrics noted that 13 of 14 respondents to a question as to how they measured return on investment responded the basis was agreed with recommendations. A better basis for identifying the return on investment appears appropriate, such as implemented recommendations and actual rather than potential savings.
- Develop CIGIE guidance to ensure consistent identification of implemented recommendations. OIGs appear to use different criteria regarding implemented recommendations, ranging from actually confirming the recommendation was implemented, to obtaining implantation plans, to accepting agreement with the recommendation as sufficient to consider the recommendation implemented.
- There is a significant need to broaden the core competencies with respect to the classification of “auditor”. Currently the GS-511 auditor classification requires 24 credits of accounting or an equivalent level of accounting credits or experience. However, the large majority of OIG audits performed by OIG audit staff are performance, not financial, related for which attributes such as evaluation, analysis, oral and written communications and critical thinking skills are far more important than accounting for effective performance auditing.

The last issue is currently being studied by the OIG community and OIG support for the addition of a “performance auditor” classification identifying educational and experience attributes most applicable to performance auditing would better assure the employment of professional staff with backgrounds suited to the current and future audit environment.

SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS
ISSUED OCTOBER 1, 2013 TO MARCH 31, 2014

Report No.	Report Title/Description	Program Dollars or Contract/Grant Amount*	Questioned/Unsupported Costs**	Funds to Better Use***
14-01	Kentucky Housing Program	\$500,000		
14-02	Appalachian Rural Dental Program	\$500,000		
14-03	Ft. Payne Infrastructure	\$400,000	\$3,876	
14-04	Winber Medical Center	\$250,000	\$221,000	
14-05	KY Department of Local Government	\$151,723		
14-06	Energy Efficiency in small Alabama Cities	\$200,000	\$30,981	
14-07	Northern Tier Career Center Expansion	\$300,000	\$153,935	
14-08	Glade Center Renovation	\$226,600	\$9,245	
14-09	Financial Statement Audit			
14-10	Edwina-Bridgeport Water Improvement	\$500,000	\$47,200	
14-12	Competitive Improvement Program	\$450,000		
14-13	Cumberland Plateau LDD	\$180,000		
14-14	Jasper Water Storage Tank	\$300,000		

14-15	Open HUD Administered Grants with Potential De-obligations	\$1,055,763		\$904,124
14-16	Older Basic Agency Administered Grants	\$19,000,000		\$699,560 ^{1/2}
14-17	Older ARC Administrative Grants	\$1,000,000		\$36,722 ^{1/ 2}
14-18	Administrative Review	\$14,000		
14-19	Pontotoc County Site Improvement	\$436,000		
Total		\$25,464,086	\$466,237	\$1,640,406

¹ Value of grants reviewed for project status

² De-obligations based on prior follow-up recommendations

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		
B. Which were issued during the reporting period	6		
Subtotals (A + B)	6	\$299	\$167
C. For which a management decision was made during the reporting period			
(i) dollar value of disallowed costs			
(ii) dollar value of costs not disallowed			
D. For which no management decision has been made by the end of the reporting period	6	\$299	\$167
E. Reports for which no management decision was made within 6 months of issuance	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</u>
A. For which no management decision was made by the commencement of the reporting period	2	\$161
B. Which were issued during the reporting period	3	\$1,974
Subtotals (A + B)	5	\$2,135
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	5	\$2,135 ¹
--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

1. Based on management decisions to follow-up on older open grants. Also \$851,413 in de-obligations resulted from grants identified for follow-up in prior SAR.

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**

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

**If you believe an activity is
wasteful, fraudulent, or abusive of Federal funds,
please call
toll free 1-800-532-4611
or (202) 884-7667 in the Washington metropolitan area**

or write to:

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

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

Appalachian Regional Commission

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