



April 1, 2016

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, 2016. During this fiscal period, we issued fourteen reports, followed-up on open recommendations and monitored contractor performance.

During this period, the Inspector General continued to serve as an active member of the Council of the Inspectors General on Integrity & Efficiency (CIGIE), its Audit and Inspections and Evaluations Committees and small OIG group.

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.

Sincerely,

A handwritten signature in cursive script that reads "Hubert Sparks".

Hubert Sparks  
Inspector General

Enclosure

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## EXECUTIVE SUMMARY

ARC grant operations, including grant management and grant projects represent the most significant aspect of ARC programs and OIG reviews. For this reporting period OIG activity included issuance of fourteen reports, including nine grant audits, four management evaluation reports and the FY 2015 Financial Statement audit. Follow-up on prior recommendations, including coordinating with ARC on a report follow-up process, and monitoring of contractor grant audits were also emphasized.

Individual grant audits disclosed that grants were generally implemented in accordance with applicable regulations and project objectives. Findings and recommendations pertained to matching funds, progress reports, financial systems, internal controls, and un-supported or questioned costs and expired end dates that could result in ineligible payments.

Agency action included grant follow-up and pro-active efforts to address recommendations, including older grants identified for follow-up and potential deobligations. Follow-up on prior recommendations disclosed de-obligations of approximately \$880,000 with respect to grants identified for follow-up in prior reports which involved funds for better use in connection with needed projects in the Appalachian Region.

Based on evaluations of grant management continued emphasis and actions was recommended with respect to timely grant applications, approvals and obligations, Basic Agency Monitoring Reports (BAMR), progress reports, supportable extensions of grant periods, and follow-up on older inactive grants. The application, approval and obligation process resulted in a large majority of annual approvals and obligations in the last quarter of the fiscal year, particularly in September. The condition also results in an unbalanced workload for program staff.

An IT Security Evaluation disclosed overall implementation of information security measures and the recommendations are being addressed by ARC.

The FY 2015 Financial Statement Audit contained a clean opinion similar to the prior opinions received since ARC adopted Federal Financial Reporting rules in 2007.

In December 2013 OMB issued an updated Designated Federal Entity (DFE) list that identified the Federal Co-Chair and the Governors of the thirteen Appalachian States as the ARC Agency Head. The applicable Dodd-Frank legislation provides that the Agency Head can terminate the Inspector General with a two thirds vote. No problems have resulted from the implementation of this provision.

Within the OIG community and the Council of Inspectors General on Integrity and Efficiency (CIGIE) the IG continues to emphasize issues impacting efficiency, effectiveness and credibility of OIG-wide audit operations. These issues include independent peer reviews of the efficiency and effectiveness of audit operations, identification and support of performance auditor qualifications and reporting of actual monetary rather than primarily potential monetary benefits.

**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 12
Section 5(a)(1)	Problems, abuses, and deficiencies	Pages 8
Section 5(a)(2)	Recommendations with respect to problems, abuses, and deficiencies	Pages 8
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 - OIG**

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 - ARC**

### **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 programs.

- Administratively, the Commission has a staff of 53 persons that includes 45 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.

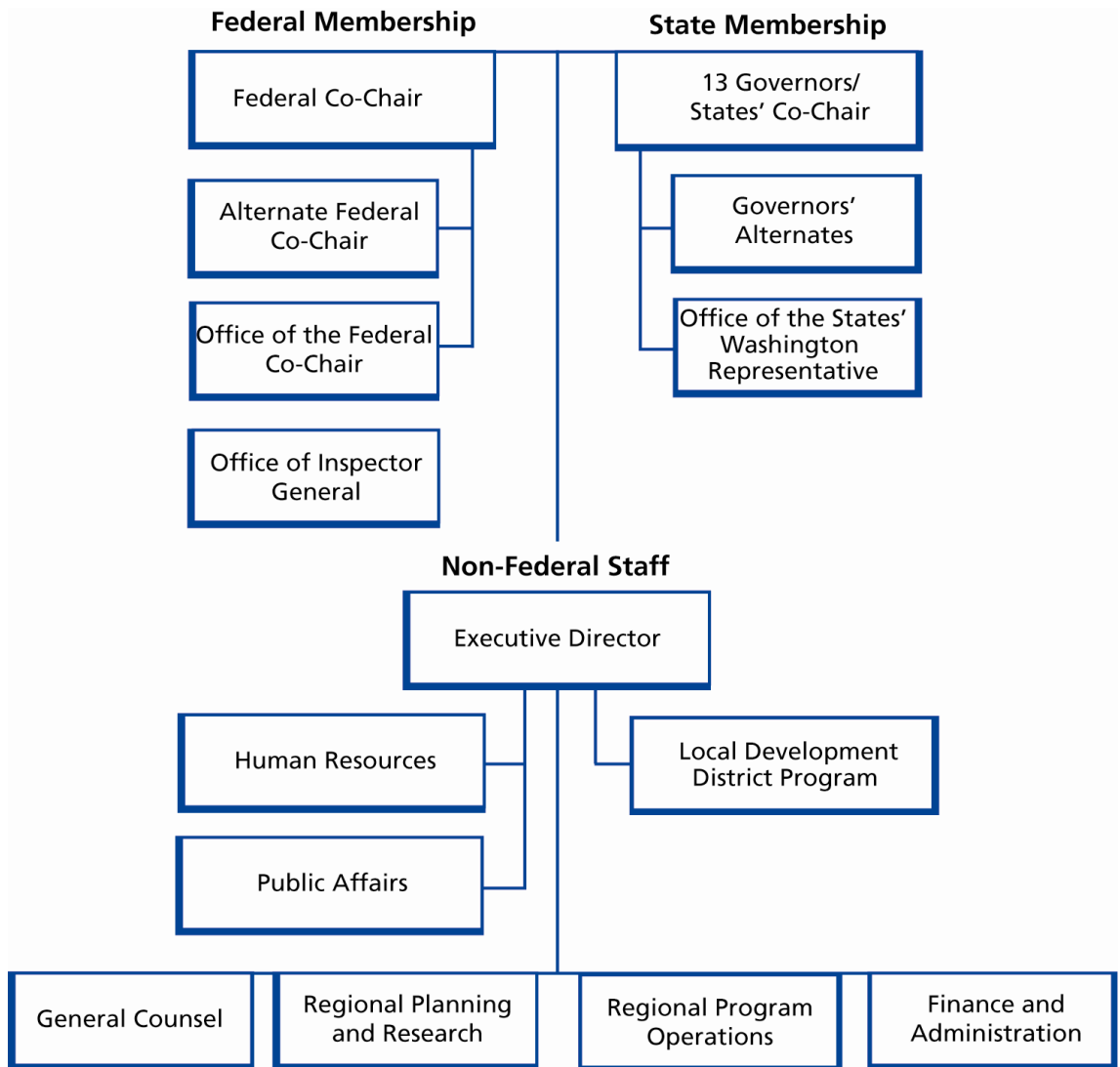
- The Commission's appropriation for FY 2016 is \$96 million.

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

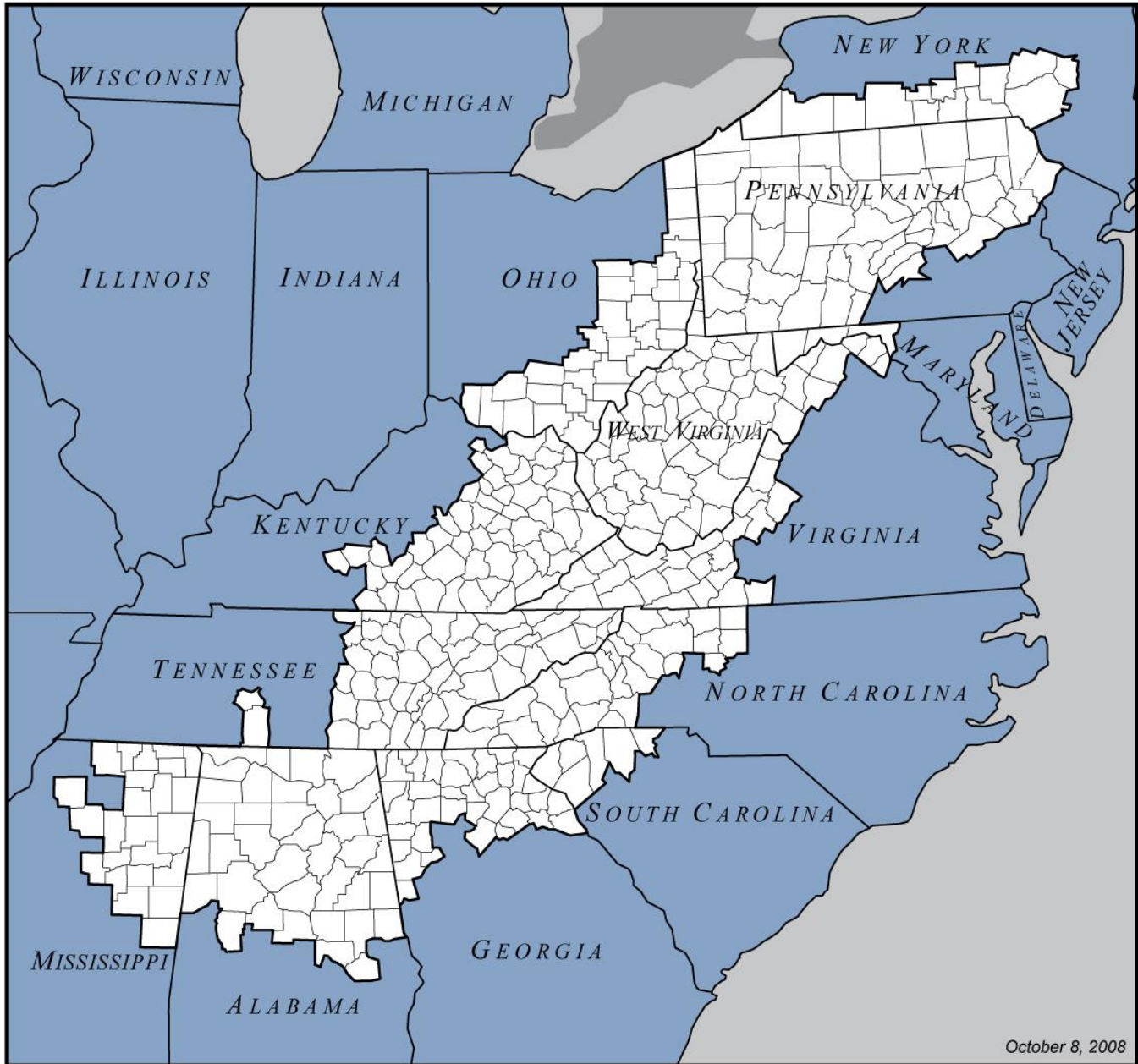
and administrative capability in certain areas, ARC often relies on other departments and agencies for program administration, especially with respect to highways and infrastructure projects. For example, the Appalachian Regional Development Act authorizes the Secretary of Transportation to administer 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 (USDA), Housing and Urban Development (HUD), and the Economic Development Administration (EDA) to administer construction related grants. Also utilization of State agencies to administer construction related grants is being emphasized.

# 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 OIG.

### **Funding and Staffing**

The OIG funding level for FY 2016 is \$642,000. 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 conducted 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 2016 included reimbursement of other IGs for counsel and investigative services via Memorandums of Understanding.

### 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. During the reporting period nine grants audits, four management reports and the FY 2015 Financial Statement Audit were issued. Follow-up on prior reports and recommendations identified approximately \$880,000 in de-obligations for which these funds became available for use on other needed Appalachia projects.

Audits of nine grants with total ARC funding of about \$4,191,119 million reported overall implementation of grants in accordance with policies, procedures and regulations. Findings and recommendations were related to financial systems and internal controls, untimely progress reports, documentation and support for matching funds, indirect costs and identification of performance results.

Follow-up reports identified additional older open ARC grants with no or limited disbursements for which additional follow-up was recommended. ARC actions on prior reports included additional follow-up based on information available in Basic Agency Monitoring Reports (BAMR) and implementation of controls that enable project coordinators to better track grant status.

Additional recommendations included increased emphasis on grant expenditures within the grant period to avoid ineligible payments, supportable requests for extension of performance periods, receipt of BAMRs from basic agencies and closing of grants with zero balances.

Continued ARC emphasis and action with respect to timely grant applications, approvals and obligations was recommended. The follow-up reports noted that the FY 2015 patterns were basically similar to the FY 2014 patterns with respect to applications received and resulted in a large majority of approvals (71 percent) and obligations (83 percent) in the last quarter, including 58 percent of obligations in September. This pattern also contributes to an unbalance annual workload for project coordinators responsible for reviewing applications, obtaining additional information as required and recommending actions.

An IT Security Evaluation disclosed overall implementation of information security measures and the recommendations are being implemented by ARC.

ARC and OIG coordinated on finalizing a report follow-up policy and procedures that will better assure attention to and resolution of recommendations on a more timely basis.

#### **ARC Financial Statement Audit**

The financial statement audit for FY 2016 is in process. The prior six years reports have 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 audit policies and/or procedural systems are in place that provide reasonable assurance of compliance with government auditing standards (GAS). The next peer review of ARC OIG is scheduled for FY 2017.

## **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 and utilizes other OIGs to perform needed investigations. Also, the results of investigations may be referred to the appropriate Federal, State, or local prospective authorities for action.

## **C. OTHER**

### **OIG Working 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 is an active member of the small working group that meets periodically to discuss such issues and recommends actions/best practices to facilitate smaller OIG operations.

### **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 current 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.

## **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 LEGISLATION – 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. No problems have been experienced with respect to implementation of the legislation.

## VII. **OIGs Audit Community Wide Issues**

OIG 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 the IG continues to emphasize various areas where OIG-wide audit performance and credibility can be significantly improved by addressing the following issues.

- Develop and implement peer review guides to independently 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 these key operational elements that determine OIG efficiency and effectiveness. OIGs that conduct internal assessments of operational elements consider these as independent since they are conducted by staff from other units within that OIG.

- There is a significant need to broaden the qualifications with respect to the classification of "auditor". Currently the 0511 auditor series and classification that requires 24 credits of accounting or an equivalent level of accounting credits or experience is out of date and out of touch with the OIG audit workload. The large majority of OIG audits are performance, not financial, related for which skills, attributes and competencies such as analysis, evaluation, oral and written communications, analytics, problem solving, interpersonal relationships, and critical thinking are far more important than accounting for effective performance auditing.

This issue is being considered by the Office of Personnel Management (OPM) and the IG has emphasized and recommended a "Performance Auditor" classification. Such a classification would identify broader educational and/or experience requirements that would be consistent with competencies identified as more closely related to performance. Such a classification would better assure the employment of professional staff that better meet the current and future OIG audit environment.

Regardless of OPM action a primary need is OIG Audit recognizing and accepting current audit requirements and recruiting and employing audit staff best suited to meet these requirements. Other government and private sector audit organizations including the Government Accountability Office have recognized and addressed this issue.

An option is significantly increased use of a management analyst series such as GAO implemented to address skills gap issues related to performance auditing.

- Identify outcome based performance measures that, over a multi-year period, provide for reporting of actual savings in relation to the multi billions of potential audit related (\$250 billion over prior 5 years) 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 primary argument presented against including some actual rather than only potential monetary benefits over a multi-year period in OIG Semi-annual reports (SAR) and the CIGIE Annual Report to the President is the difficulty in obtaining this information. However, the IG Act and OMB Circular A-50, Audit Follow-up specifically require the agency head to identify actual monetary related benefits resulting from OIG reports when transmitting the OIG SAR to Congress. Section 5(b)(2)(c)(i) & (ii) of the IG Act specifies that the agency head will include the disallowed costs that were recovered by management through collection, offset, property in lieu of cash or otherwise and the dollar of disallowed costs that were written off by management as part of the agency head transmittal of the OIG SAR to Congress.

- Develop CIGIE guidance to ensure consistent identification of implemented recommendations. OIGs use different criteria regarding implemented recommendations, ranging from confirming the recommendation was implemented, obtaining implantation plans, or accepting agreement with the recommendation as sufficient to consider the recommendation implemented. Emphasis should be placed on validation of implementation actions with respect to significant program or monetary benefits recommendations. In order to address non-implementation of significant practical recommendations and the constraints imposed by OMB A-50 with respect to the agency follow-up official having the final decision on audit recommendations increased use of section 5(a)(12) of the IG Act that provides for including in the semi-annual report information concerning any significant management decision with which the IG is in disagreement is an available action.

- Expand the Council of Inspectors General Annual Report to the President to include a few significant programmatic and improved service non-monetary recommendations. Currently the audit sections of this report only identifies the extent of questioned costs and funds to better use and significantly understates the benefits of OIG audit work.

**SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS**  
**ISSUED OCTOBER 15 2015 TO MARCH 31, 2016**

Report No.	Report Title/Description	Program Dollars or Contract/Grant Amount*	Questioned/Unsupported Costs**	Funds to Better Use***
16-01	Northern Tier LDD	\$103,136	\$95,713	
16-02	Northern Tier Prep	\$285,000	\$116,965	
16-03	KY Oral Health	\$1,046,932		
16-04	Financial Statement Audit			
16-05	Upgraded Water System	\$300,000		
16-06	Training Facility	\$500,00		
16-07	PA Technical Assistance	\$700,000		
16-08	MS High Performance Leadership	\$259,000		
16-09	MS Appalachian Community Learning	\$697,051	\$166,256	
16-10	Chautauqua Trail	\$300,000		
16-11	IT Security Evaluation			
16-12	ARC/State Admin. Grants	\$1,726,883		\$242,458
16-13	Basic Agency Admin Grants	\$8,230,349		\$639,801
16-14	Applications, Approvals and Obligations			
Total		\$14,148,351	\$377,934 1/	\$882,259

1/ Most questions costs are undocumented costs.

2/ Deobligations based on grants noted in prior report.

**SCHEDULE OF AUDIT, INSPECTION AND EVALUATION REPORTS  
WITH QUESTIONED OR UNSUPPORTED COSTS (THOUSANDS)**

	<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	3	\$ 375	\$ 377 <sup>1/</sup>
Subtotals (A + B)			
C. For which a management decision was made during the reporting period	2		
(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	1		\$ 166
E. Reports for which no management decision was made within 6 months of issuance			

**1/ Costs that are questioned in audit reports primarily relate to unsupported costs for which support is provided subsequent to the audit Report. Thus amounts noted are similar.**

SCHEDULE OF AUDIT, INSPECTION AND EVALUATION REPORTS WITH  
RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE AND SUMMARY OF  
MANAGEMENT DECISIONS (THOUSANDS)

	<u>No. of Reports</u>	<u>Dollar Value</u>
A. For which no management decision was made by the commencement of the reporting period		
B. Which were issued during the reporting period	2	
Subtotals (A + B)	2	\$12,000 <sup>1/</sup>
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	2	\$ 880 <sup>1/</sup>
--based on proposed legislative action		
(ii) dollar value of recommendations that were not agreed to by management		
D. For which no management decision has been made by the end of the reporting period		
E. Reports for which no final management decision was made within 6 months of issuance	0	0

**1. Based on value of grants recommended for follow-up. Management agrees to follow-up on identified grant and the value noted in c(i) is actual deobligations during the reporting period.**



**DEFINITIONS OF TERMS USED**

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

<b>Questioned Cost</b>	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.
<b>Unsupported Cost</b>	A cost which the OIG questioned because the cost was not supported by adequate documentation at the time of the audit.
<b>Disallowed Cost</b>	A questioned cost that management, in a management decision, has sustained or agreed should not be charged to the Commission.
<b>Funds Be Put To Better Use</b>	A recommendation made by the OIG that funds could be used more efficiently if management took actions to implement and complete the recommendation.
<b>Management Decision</b>	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.
<b>Final Action</b>	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**

Office of Inspector General  
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