



November 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 September 30, 2016. During this fiscal period, we issued nineteen 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.

The report also contains significant issues impacting the OIG audit community that are not connected to the Appalachian Regional Commission operations.

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

Sincerely,

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 nineteen reports, including fifteen grant audits and four management evaluation reports. Follow-up on prior recommendations, including coordinating with ARC on a report follow-up process, and monitoring of contractor grant audits were also emphasized.

Overall there is a high degree of implementation of ARC policies and procedures. 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 \$150,000 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.

Management reports dealt with obtaining additional information with respect to actual accomplishment of performance measures and obtaining annual State Strategy Statements. Continued emphasis was placed on grant follow-up and agency action on recommendations including follow-up on older inactive grants.

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 identification and support of revised performance auditor qualifications, independent peer reviews of the efficiency and effectiveness of audit operations, reporting of actual monetary rather than primarily potential monetary benefits, and implementation of significant recommendations and inclusion of significant non-monetary program results in the OIG Annual Progress Report to the President.

**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	Page 8
Section 5(a)(2)	Recommendations with respect to problems, abuses, and deficiencies	Page 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 56 persons that includes 48 Commission employees responsible for program operations, and the office of the Federal Co-Chair that includes OIG staff. The Commissions' administrative expenses, including salaries, are jointly funded by Federal and State funds.

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

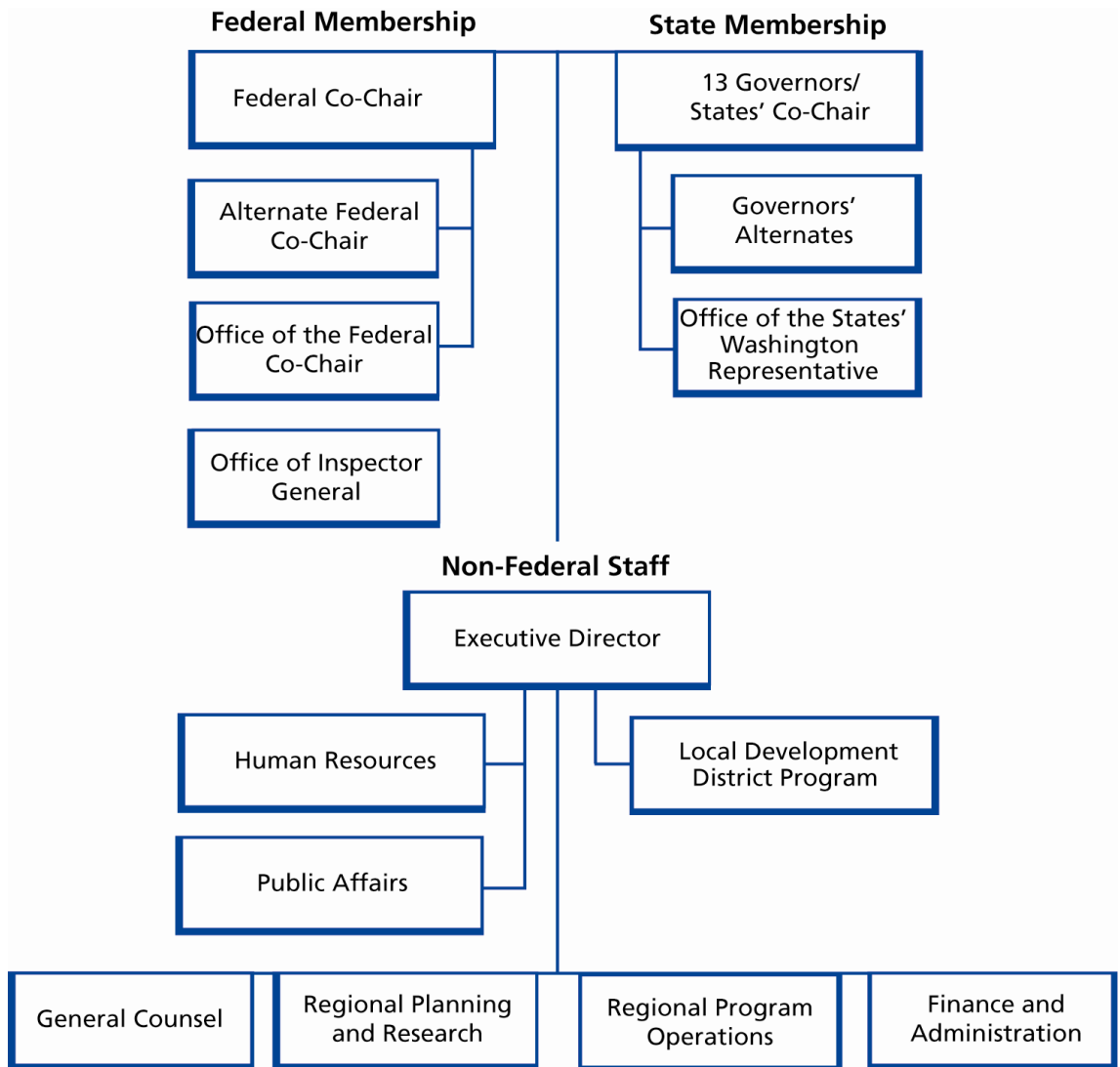
Although Congress changed the funding method for the Appalachian Development Highway System (ADHS) in July 2012, ARC continues to support and participate in completion of the ADHS including fulfilling planning and approval responsibilities.

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, working with State Departments of Transportation, ARC continues to actively monitor the status of construction in each State and disposition of any remaining ADHS.

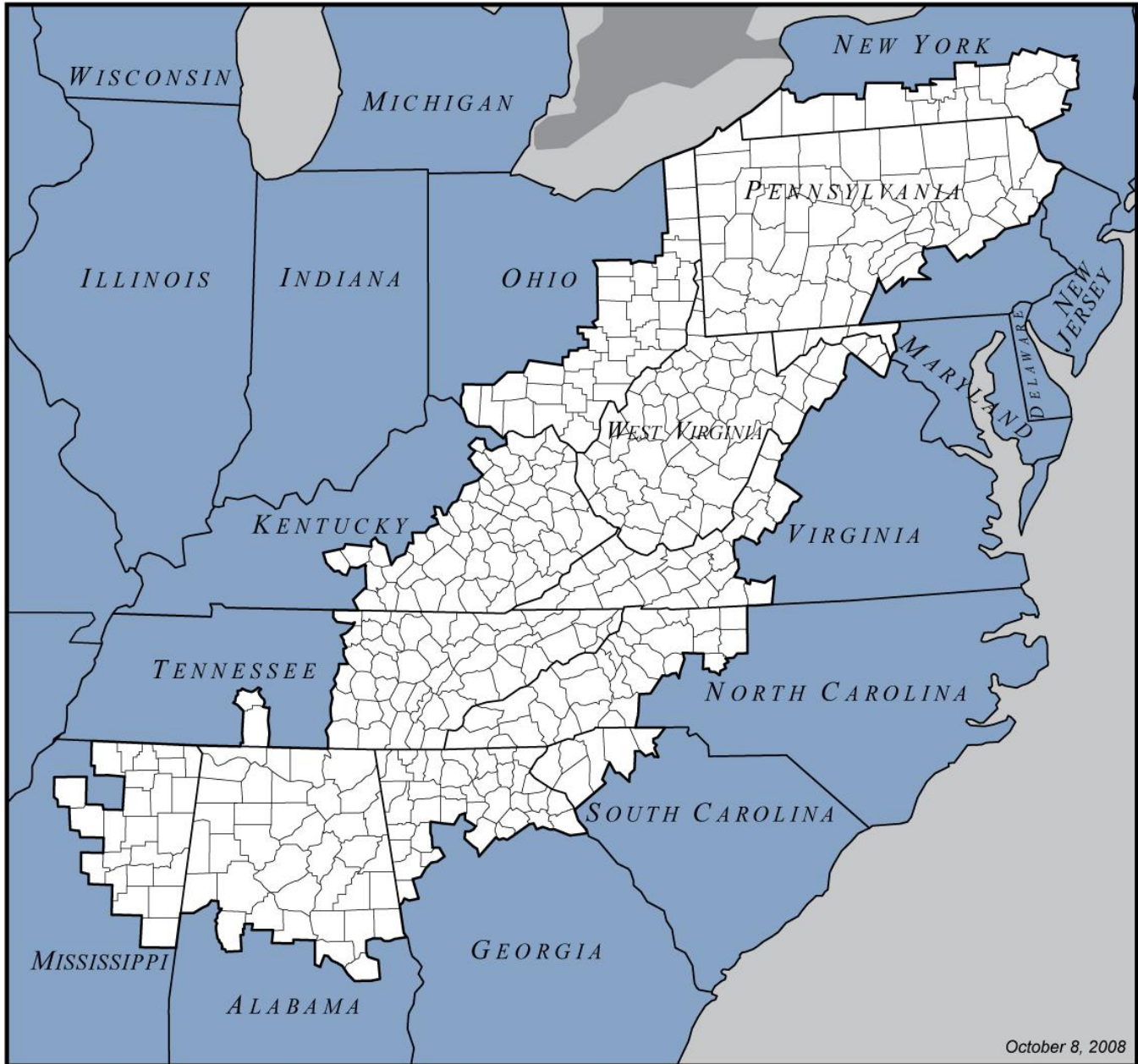
ARC relies on Child Agencies, including the Departments of Agriculture (USDA), Housing and Urban Development (HUD), and the Economic Development Administration (EDA) to administer construction related grants. Also utilization of State agencies to administer construction related grants is being emphasized.

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 was \$646,000. 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 fifteen grants audits and four management reports were issued. Follow-up on prior reports and recommendations identified approximately \$150,000 in de-obligations for which these funds became available for use on other needed Appalachia projects.

Audits of fifteen grants with total ARC funding of \$6,433,460 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. Emphasis was placed on grantee identification and support for performance measures included in grant applications and approvals.

Management reports dealt with obtaining additional information about actual performance measures results rather than reliance on projected results to satisfy requirements of the Government Performance and Accountability Act, obtaining annual State Strategy Statements that identify State goals and priority issues or projects for the coming fiscal year and follow-up on older inactive ARC and State administered grants to identify potential closing and deobligations of funds for use on other needed projects in Appalachia.

Agency actions on prior reports include implementation of controls to better identify grants needing follow-up. Actions have been initiated to improve and increase obtaining information about accomplishment of performance measures identified for approved grants.

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 prior OIG peer review in 2014 disclosed no significant findings and the next peer review of ARC 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.

Agency action based on ARC problem identification and OIG investigation confirmation resulted in a \$700,000 settlement and deobligations resulting from improper use of ARC funds.

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.

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 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. 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.

- There is a significant need to address the long standing issue of broader qualifications with respect to performance auditing that constitutes the majority of audit work at most OIGs. Currently the Office of Personnel Management (OPM) 0511 auditor series and classification requires 24 credits of accounting or an equivalent level of accounting credits and experience and the 0343 Management Analyst series is not used to any significant degree. Since 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.

The IG has unsuccessfully recommended that the CIGIE Audit Committee support a Performance Audit classification that identifies qualifications and competences more closely related to performance auditing. Such a classification would better assure the employment of professional staff that better meet the current and future OIG audit environment, increase audit effectiveness and reduce waste attributable to primary use of out of touch and out dated auditor qualifications.

Regardless of eventual OPM decisions primary need is OIG Audit to recognize and accept the need for significant qualification changes to address performance audits and emphasize recruiting and employing audit staff best suited to meet the OIG audit workload.

Other government and private sector audit organizations including the Government Accounting Office (GAO) have recognized and addressed this issue.

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

This issue remains under OPM consideration.

- 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. Such reviews should contribute to increased OIG audit efficiency and effectiveness such as addressing timely reporting that often surfaces as a criticism.

Some OIGs conduct internal assessments of key operational elements. These reviews are considered independent since they are conducted by staff from other units within the OIG. This reasoning conflicts with a major reason for establishment of OIGs being that agency internal audit units were not considered sufficiently independent even though audits were conducted by units not connected with the audited unit.

- 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 savings reported

annually based primarily on questioned and undocumented costs with low actual savings potential. OIG recommendations result in saving in excess of OIG operational costs. However, actual savings are not included in the OIG Annual Report to the President or in most OIG Semi-annual reports.

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. OMB circular A-50 states that the Agency follow-up official Semi-annually provide the head of the agency the amount of collections, offsets, write-offs, demands for payment and other monetary benefits resulting from audits.

Based on this available information and OIG Semi-annual reports that identify agreed with disallowance tracking of some actual savings over a multi-year period appears reasonable and would better support OIG credibility. Such reporting would also be in conformance with the intent of the Government Performance and Results Act (GPRA) that emphasizes reporting projected and actual results.

- 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 implementation plans, accepting agreement with the recommendation as sufficient to consider the recommendation implemented, or accepting the agency audit resolution officials decision. 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.

This overall issue is currently under review by the CIGIE Audit Committee.

- 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, especially since much of the noted potential monetary benefits does not result in identified actual benefits.

SCHEDULE OF AUDIT, INSPECTION, EVALUATION & REVIEW REPORTS
ISSUED APRIL 1, 2016 TO SEPTEMBER 30, 2016

Report No.	Report Title/Description	Program Dollars or Contract/Grant Amount*	Questioned/Unsupported Costs**	Funds to Better Use***
16-15	University of Pikeville KY College of Optometry	\$750,000	\$2,000	
16-16	Ohio Valley Regional Development Commission	\$209,000		
16-17	Tuppers Plains-Chester Water District	\$185,000		
16-18	Tuppers Plains-Chester Water District	\$225,000		
16-19	Morehead State University	\$900,000		
16-20	Southern Alleghenies Planning & Development Commission LDD Grant	\$102,055		
16-21	Southern Alleghenies Planning & Development Commission PREP Grant	\$400,000		
16-22	A+ Education Partnership	\$434,557		
16-23	Jobs for West Virginia's Graduates, Inc.	\$260,000		
16-24	Blue Ridge Crossroads Economic Development Authority	\$500,000	\$22,050	
16-25	NC Department of Commerce	\$1,018,848		
16-26	Southern Tier Central Regional Planning Development Board	\$289,000		
16-27	ARC Performance Measures			
16-28	State Strategy Statement			
16-29	Rutherford County Comprehensive Applied Sciences	\$600,000		
16-30	Tri County Council for Western MD	\$320,000		
16-31	ARC's J-1 Waiver Program			
16-32	VA Department of Housing and Community Development	\$240,000	\$13,207	
16-33	Open ARC/State Administered grants	\$2,504,833		
Total		\$8,938,293	\$37,257	

**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	\$ 37	\$ 37 ^{1/}
Subtotals (A + B)			
C. For which a management decision was made during the reporting period	3		
(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		\$ 13
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	\$2,000 ^{1/}
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	\$ 150 ^{1/}
--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:

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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