

APPALACHIAN REGIONAL COMMISSION

INSPECTOR GENERAL'S

SEMIANNUAL REPORT

TO CONGRESS

OCTOBER 1, 1991 - MARCH 31, 1992



APPALACHIAN REGIONAL COMMISSION

OFFICE OF
INSPECTOR GENERAL
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May 15, 1992

MEMORANDUM FOR THE FEDERAL CO-CHAIRMAN

SUBJECT: Semiannual Report to Congress

In accordance with the requirements of the Inspector General Act Amendments of 1988, Public Law 100-504, I submit the semiannual report of the Office of Inspector General for the period October 1, 1991, through March 31, 1992.

During this period, operational activities included issuance of seven individual grant audit reports and two headquarters survey reports. Additionally, field testing was conducted at nine Local Development Districts (LDDs) with respect to administrative expenditures. The results of this work was presented to the annual LDD Conference, and a summary report is being finalized. Recommendations highlighted system and control improvements for grantee operations, including adherence to applicable travel and related expense provisions, timely use of funds, use of funds for the purpose intended, and improved planning to ensure efficient use of grant funds. With respect to timely use of funds for business development and Appalachian housing revolving loan funds, approximately \$2 million of inactive balances were deobligated by ARC and made available for other projects. ARC management continued its aggressive action to identify, follow up, and close inactive projects.

Emphasis continued to be placed on implementation of the Federal Managers' Financial Integrity Act (FMFLA) and ARC initiated vulnerability assessments of key operating divisions. Survey questionnaires for use during field audits were prepared for internal controls and fraud attitudes, including management attitudes toward prevention detection, and reporting of fraud. The Inspector General actively participated on the PCIE Single Audit Task Force and assisted in the development and issuance of questionnaires to affected parties in order to obtain input about the effectiveness of single audit.

The continued support of the Office of Inspector General by ARC management and utilization of OIG reports and recommendations have contributed to improved controls and operations. This support was further demonstrated by the inclusion of Inspector General issues at the annual LDD Conference and the establishment of an ARC ad hoc committee by the Federal Co-Chairman to focus on issues raised by the Inspector General.

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.

Sincerely,


Hubert N. Sparks
Inspector General

Enclosure

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EXECUTIVE SUMMARY

During this reporting period, seven grant reviews and two headquarters surveys were completed. Primary recommendations were directed at better use of funds based on deobligation of old and/or inactive grant balances, closing of old grants, improved adherence to OMB cost principles and applicable travel regulations, and improved procedures to ensure grant funds are used effectively and efficiently. Two matters referred for investigation were resolved; and emphasis was placed on coordination with other OIG offices, development and implementation of internal control and fraud questionnaires, and continuation of a PCIE study of single audit coverage and effectiveness.

Examples include:

- o Two audits of Appalachian housing fund grants identified the potential for substantial deobligations and/or fund recoveries based on grant inactivity and use of funds for investment purposes rather than for loans to achieve project objectives. Consequently, actual and potential fund returns to ARC for use on other projects approximated \$500,000.
- o A review of three grants totaling \$300,000 for a welfare reform demonstration project identified deficiencies in the contracting and training module review process and untimely use of available loan funds that reduced the efficiency and effectiveness of program operations and resulted in a referral for further review by a State Office of Inspector General.
- o Based on identification of questioned costs at one entity resulting from grantee not fully implementing ARC travel regulations or OMB cost principles, a seven entity survey of Local Development District (LDD) administrative grant expenditures was initiated. The reviews, which will be included in the next reporting period, were the basis for a half-day seminar conducted by the Inspector General at the March 1992 LDD annual conference dealing with OMB cost principles and allowable travel expenditures.
- o The Inspector General was an active participant in the finalization and issuance of questionnaires to Federal, state, and local government auditors and program managers and to public accounting firms in connection with on-going PCIE single audit study.

ARC management continues to exhibit a positive attitude with respect to OIG operations and has utilized OIG reports and recommendations to improve program operations.

I. INTRODUCTION

The Inspector General Act Amendments of 1988 (P.L. 100-504) provided for the establishment of an Office of Inspector General at 33 designated Federal entities, including the Appalachian Regional Commission (ARC). The ARC Office of Inspector General became operational on October 1, 1989, with the appointment of an Inspector General and provision of budgetary authority for contracted audit and/or investigation activities.

II. BACKGROUND

A. APPALACHIAN REGIONAL COMMISSION

The Appalachian Regional Commission (ARC) was established as an independent agency by the Appalachian Regional Development Act of 1965 (P.L. 89-4). The Act authorizes a Federal/State partnership designed to promote long-term economic development on a coordinated regional basis in the 13 Appalachian States. The Commission represents a unique experiment in partnership among the Federal, State, and local levels of Government and between the public and private sectors. It is composed of the Governors of the 13 Appalachian States and a Federal representative who is appointed by the President. The Federal representative serves as the Federal Co-Chairman with the Governors electing one of their number to serve as the States' Co-Chairman.

- o Through joint planning and development of regional priorities, ARC funds are used to assist and encourage other public and private resources to address Appalachia's unique needs. Program direction and policy is established by the Commission (Appalachian Regional Commission Code) by the vote of a majority of the State members and the affirmative vote of the Federal Co-Chairman. Emphasis has been placed on highways, infrastructure development, business enterprise, and human resources programs.
- o Administratively, the Office of the Federal Co-Chairman, with a staff of 11, and the Commission, with a staff of 55, are responsible for ARC operations. The States maintain an Office of States' Representative (4 persons) that has primarily liaison responsibilities. All personnel are located in Washington, DC. The Commission staff's administrative expenses, including salaries, are funded jointly by Federal and State funds; the States' Representative staff is funded entirely by the States; and the Federal Office staff is funded entirely from Federal funds.
- o The Commission's appropriation for FY 1992 is \$190 million, which is divided approximately \$143.57 million for highway projects, \$43.14 million for non-highway projects, and \$3.284 million for administrative expenses. ARC is authorized through a current appropriation.
- o Program funds are distributed to State and local entities in line with an allocation formula intended to provide fair and reasonable distribution of available resources. ARC staff have responsibilities for program development, policy analysis and

review, grant development, technical assistance to States, and management and oversight.

- o In order to avail itself of Federal agency expertise and administrative capability in certain areas, the 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. Under this arrangement, the Commission retains responsibility for priorities, highway locations, and fund allocations.

B. OFFICE OF INSPECTOR GENERAL

The ARC Office of Inspector General is an independent audit and investigation unit. The OIG is headed by an Inspector General who reports directly to the Federal Co-Chairman.

Role and Authority

The Inspector General Act of 1978 (P.L. 95-452), as amended in 1988, states that the Inspector General 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 Inspector General is responsible for keeping the Federal Co-Chairman and Congress fully informed about the problems and deficiencies in ARC programs and operations and the need for corrective action. The Inspector General has authority to inquire into all ARC programs and activities that are Federally funded. The inquiries may be in the form of audits, surveys, investigations, personnel security checks, or other appropriate methods. The two primary purposes of these inquiries are (1) to assist all levels of ARC management by identifying and reporting problem areas, weaknesses, or deficiencies in procedures, policies, program implementation, and employee conduct and (2) to recommend appropriate corrective actions.

Relationship to Other Principal ARC Offices

The States and the Federal Co-Chairman, acting together as the Commission, establish policies for ARC's programs and its administration. These policies are codified in 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-Chairman, 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 operations of the OIG neither replace established lines of operating authority nor eliminate the need for the commission offices to take reasonable measures to protect and enhance the integrity and effectiveness of their operations. All Commission offices are responsible for monitoring and evaluating the programs entrusted to them and reporting information or incidences needing further audit and/or investigation to the Inspector General.

Funding and Staffing

The OIG Funding level has been \$350,000 for FYs 1990, 1991, and 1992. Approximately 48 percent has been budgeted for contract audit or investigative services; 40 percent, for salaries and benefits; 7 percent, for travel; and 5 percent, for all other activities (training, equipment, supplies, etc.). The OIG funding level represents about 35 percent of the total funds available to the Office of the Federal Co-Chairman. The FY 1993 funding for OIG is projected as \$380,000.

Initial OIG operations included authorization for an Inspector General and a Confidential Assistant. A senior auditor was employed in the latter half of FY 1991. Grant review activities will continue to emphasize use of contracted services (e.g., independent public accounting firms or other OIG offices) supplemented by programmatic and performance reviews directed by OIG staff. Ongoing evaluations and determinations will continue with respect to the practicality and efficiency of this approach.

III. OIG ACTIVITY

A. AUDITS

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

The division of OIG resources requires that audit work be conducted by a combination of permanent and contractor staff. During the reporting period, 6 grant audits were completed by contractor staff and 7 additional reviews of administrative grants to LDDs were initiated. The OIG office was directly responsible for 2 headquarters surveys, dealing with lobbying restrictions and certifications and implementation of drug-free work place requirements. The OIG provided information and recommendations with respect to resolution of open grants, eligibility of administrative grant expenses, and implementation of an agency audit followup system. During this reporting period, continued emphasis was placed on contract monitoring, training, coordination with other OIG offices, development and/or implementation of internal control and fraud questionnaires, followup on prior audit recommendations, and a PCIE study of single audit coverage and effectiveness.

- o Two audits were performed of Appalachian Housing Fund grants. In one instance, audit followup work based on prior identification of inactive loan balances disclosed that the bulk of \$250,000 in funds advanced had been invested rather than expended for the intended purposes of rehabilitating rental properties. Additionally, we noted that the grantee had not maintained records necessary to clearly identify project status and allowable costs. The grantee returned the \$250,000 advanced by ARC and agreed with deobligation of an additional \$50,000

that had never been advanced. These funds will be utilized for other eligible ARC projects.

The second audit addressed three old grants with remaining unused obligations of approximately \$206,000 and for which the last request for funds were 1979 and 1982. The audit also disclosed questionable or undocumented costs approximating \$223,000. The grantee and ARC responded that they are presently engaged in the close-out or amendment of all ARC contracts and the deobligation and/or return of unspent, authorized funds is integral to and consistent with the close-out process. Also, the grantee reduced its administrative expense claim by about \$78,000 by the exclusion of ineligible indirect costs.

- o Our review of three ARC grants totaling \$300,000 for the purpose of investigating through a demonstration process the effectiveness of self-employment training as an alternative to welfare assistance disclosed several conditions that adversely affected achievement of grant objectives. Although subgrantees initiated substantial actions toward accomplishment of project goals and objectives to assist welfare recipients and disadvantaged women develop self-employment opportunities, factors inhibiting additional success and efficient use of available funds included:

- applicability of the training model selected for the target audience,
- necessity for subgrantee tailoring, adjusting, and/or revising the training model,
- limited pre-award evaluation of the training model selected, and
- limited follow through with respect to loans to start up businesses.

We also raised questions about the contractor (training model) selection process and requested the assistance of the applicable State Inspector General to obtain additional information about the propriety of the contractor selection process. The State IG concluded that the contracting process was not adequately documented nor fully in accord with state requirements and that full benefit was not obtained with respect to the \$130,000 spent for the training models.

The grantee concurred with recommendations to improve grant review and approval procedures.

- o Audits of the revolving loan funds provided to the two subgrantees participating in the ARC portion of the above-noted self-employment training project disclosed limited loan activity and the potential for fund deobligations in order to permit better use of limited ARC funds on other projects. In one instance, the grantee had disbursed \$15,539 of the \$100,000 obligation for four loans over a 21-month period since project approval and two additional loans of \$10,000 had been approved. In the other case, the grantee had approved \$14,600 for two loans and

one loan guarantee during the 21-month period since project approval. In both cases, grantees responded to audit recommendations for deobligation of funds that they were exploring alternative methods to enhance fund utilization.

- o We initiated a series of reviews of LDD administrative grants, including an audit at one entity and surveys at seven additional entities. The audit was completed and the surveys were in process at the end of the reporting period. The audit questioned about \$100,000 in claims including approximately \$10,000 in travel and related expenditures and \$90,000 in matching funds. Recommendations regarding the noted costs and applicable travel regulations and cost principles are being resolved between ARC and the grantee.
- o During our LDD surveys, we noted one entity that was substantially delinquent with respect to posting of records, paying expenses, and funding obligations and appeared substantially overextended by over \$100,000 in relation to receivables, including available and potential grants. Additionally, we noted inadequate separation of duties and accumulation of the noted conditions over a multi-year period. Consequently, we suspended our review and recommended ARC provide the necessary assistance to determine the financial viability of the entity, including current financial status, testing of internal controls, and historical summary of the entity's fiscal decline, which appeared to result from staff and office expenses in excess of grant and other receipts for a 4- to 6-year period. ARC contracted for a financial audit of the entity.
- o Surveys of ARC compliance with the Federal Anti-Lobbying Act, as respects lobbying restrictions and certification, and the Drug-Free Work Place Act, as respects contractor certifications that they provide a drug-free work place, disclosed that ARC was in compliance with applicable provisions.
- o ARC had previously identified an audit followup official in accordance with OMB Circular A-50; and coordination with ARC staff on establishing a Commission audit followup system, including identifying OIG and Commission responsibilities, was continued during this period. Procedures identifying respective roles and responsibilities will be finalized in accordance with revised Circular OMB-50 when issued.
- o We previously recommended that ARC expand its Federal Managers' Financial Integrity Act reviews and certifications to include internal risk assessments of the key operating divisions. ARC initiated action and FY 1991 internal control and accounting system reviews included risk assessments of three major ARC operating units.
- o In line with prior OIG recommendations about closing and/or settling of old active grants, we assisted ARC management in obtaining and analyzing information, including coordination with other Federal entities, about an open 1983 grant involving \$600,000 in undisbursed ARC funds. Recommendations and

observations about resolution of the issues and fund disbursement were provided to ARC.

- o Questionnaires were developed and implemented with respect to grantee internal controls and grantee management attitudes toward prevention, detection, and reporting of potential fraud. These questionnaires are intended to help assess these areas and to alert grantees about fraud and control issues.
- o The US Department of Commerce Office of Inspector General finalized its audit of a Kentucky LDD that identified \$110,475 in questioned costs, including at least \$16,845 identified as ARC funds. These questioned costs resulted primarily from an employee embezzlement, which resulted in conviction and incarceration of the employee who pleaded guilty to embezzling \$109,216 based on the DOC OIG joint audit and investigation.

B. INVESTIGATIONS

Action was completed with respect to two referrals previously made to a state OIG as a result of audit testing of ARC grants. Although no criminal violations were noted, the report confirmed audit questions with respect to the reduced benefits received by grantees for the funds expended for training models, the absence of documentation supporting contractor selection, and inconsistencies in the selection process.

IV. AUDIT PLANNING

FY 1992 audit work includes completion of a functional review of costs charged by LDDs against ARC administrative grants at eight entities. Such a review provides expanded and overall information with respect to this area but limits the number of individual grant audits that can be performed with available resources. However, the benefits of this type activity are deemed sufficient to justify the resource use since the results provide management with broader based information, conclusions, and recommendations about overall operations in a specific program area. This work provided the basis for a half-day seminar wherein preliminary results were discussed with LDD directors and finance staff during an annual meeting.

During the second half of FY 1992, audit work will include individual grant audits in about six states; headquarters survey and followup testing in areas such as staff monitoring and followup on open grants with completed budget periods, grant extensions, file documentation, etc.; and random field tests of physician compliance with requirements of an ARC-assisted program to increase health service providers in Appalachia.

V. LEGISLATIVE AND REGULATORY REVIEW

During the reporting period, the ARC Office of General Counsel provided comment with respect to several issues noted in our prior semiannual report, including (1) statewide projects utilizing ARC funds, (2) ARC's status as a Federal or non-Federal agency, and (3) applicability of OMB

Circulars to ARC. Based on OGC comments, audit work will be rescheduled in the area of technical assistance grants wherein ARC funds are utilized for statewide projects although only portions of the state are in Appalachia in order to better assess the eligibility and benefits of such activity.

VI. OTHER

The Inspector General continues to serve on the PCIE Task Force on Single Audit and participated in the development of questionnaires intended to obtain feedback from Federal, State, and local officials, including auditors, and public accounting firms about methods and procedures to improve single audit coverage and creditability. Questionnaires were finalized and issued during this reporting period, and ARC OIG assisted this process through preparation of necessary *Federal Register* notice and documentation required under paperwork reduction provisions.

The IG serves as the PCIE Coordinating Conference member on the PCIE Audit Committee and Audit Standards Subcommittee.

In March 1992 the IG hosted a half-day seminar for LDD Executive Directors and Finance Officers during the annual LDD conference during which OIG observations, conclusions, and recommendations with respect to OMB cost principles and Federal Travel Regulations were discussed in detail and where general subjects including the OIG mission and operating methodologies, complaint procedures, and ethics were also reviewed.

SCHEDULE OF AUDIT REPORTS ISSUED OCTOBER 1, 1991 TO MARCH 31, 1992

Audit Report No.	Title	Program Dollars or Contract/ Grant Amount	Questioned Costs*	Funds to Better Use**
92-1(G)	Northwest Pennsylvania Regional Planning and Development Commission	\$1,420,000 ^{1/}	\$100,000	
92-2(G)	Pennsylvania Welfare Reform Demonstration Project	130,000		
92-3(G)	Urban League of Pittsburgh	130,000		\$ 74,000
92-4(G)	Employment Opportunity Training Center of Northeastern Pennsylvania	95,343		56,000
92-5(G)	Section 207 West Virginia Housing Development Fund	1,500,000	223,000	206,000
92-6(G)	Section 302 West Virginia Housing Development Fund	300,000	250,000 ^{2/}	50,000 ^{2/}
92-1(H)	Lobbying Certifications			
92-2(H)	Drug-Free Work Place Certifications			
92-3(H)	B-J-H Planning and Development Commission	40,000 ^{3/}		
TOTALS		\$3,575,343	\$575,000	\$386,000

* A cost the Office of Inspector General has questioned because of an alleged violation of law, regulation, contract, or other agreements governing the expenditure of funds; such cost is not supported by adequate documentation; or the expenditure of funds for the intended purpose is unnecessary or unreasonable.

** Funds the Office of Inspector General has identified in an audit recommendation that could be used more efficiently by reducing outlays, deobligating program or operational funds, avoiding unnecessary expenditures, or taking other efficiency measures, such as timely use of funds.

1/ Review scope was limited to testing of travel activity and eligibility of administrative costs for a 3-year period.

2/ Includes grantee return of \$250,000 of grant funds advanced by ARC and deobligation of remaining \$50,000 available balance.

3/ Average annual contribution by ARC. Review suspended due to unavailability of posted records after identifying problems, including unstable entity financial condition. ARC followup in process.

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

	<u>No. of Reports*</u>	<u>Dollar Value (\$ in thousands)</u>
A. For which no management decision has been made by the commencement of the reporting period	4	\$ 850
B. Which were issued during the reporting period	4	\$ 314
Subtotals (A + B)	8	\$1,164
C. For which a management decision was made during the reporting period	5	\$ 850 ^{2/}
(i) dollar value of recommendations that were agreed to by management	3	\$ 427 ^{1/}
--based on proposed management action	3	\$ 427 ^{1/}
--based on proposed legislative action	0	0
(ii) dollar value of recommendations that were not agreed to by management	3	\$ 423 ^{3/}
D. For which no management decision has been made by the end of the reporting period	3	\$ 314
E. Reports for which no management decision was made within 6 months of issuance	0	0

^{1/} Includes action in process on \$107,000 potential deobligation and \$319,000 deobligated.

^{2/} An additional \$1,500,000 was deobligated resulting from on-going action in response to audit recommendations in prior reporting periods.

^{3/} Agreement reached to ensure timely use of funds, and grantees initiated action to utilize funds for eligible projects. Consequently, deobligations were not necessary.

**SCHEDULE OF AUDIT REPORTS WITH
QUESTIONED OR UNSUPPORTED COSTS**

(\$ in thousands)

	<u>No. of Reports*</u>	<u>Questioned Costs</u>	<u>Unsupported Costs</u>
A. For which no management decision has been made by the commencement of the reporting period	3	\$ 442	-
B. Which were issued during the reporting period	3	<u>\$ 573</u>	-
Subtotals (A + B)	6	\$1,015	-
C. For which a management decision was made during the reporting period	5	\$ 783	-
(i) dollar value of disallowed costs	2	\$ 341	-
(ii) dollar value of costs not disallowed	3	\$ 442	-
D. For which no management decision has been made by the end of the reporting period	2	\$ 231	-
E. Reports for which no management decision was made within 6 months of issuance	0	0	0

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.