

APPALACHIAN REGIONAL COMMISSION

INSPECTOR GENERAL'S

SEMIANNUAL REPORT

TO CONGRESS

APRIL 1 - SEPTEMBER 30, 1992



APPALACHIAN REGIONAL COMMISSION

OFFICE OF
INSPECTOR GENERAL
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November 9, 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 am pleased to submit the semiannual report of the Office of Inspector General for the period April 1 through September 30, 1992.

During this period, operational activities included issuance of eight individual grant audit reports and two headquarters survey reports. Additionally, we summarized the testing at eight Local Development Districts (LDDs) with respect to administrative expenditures. 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, improved grantee documentation of expenditures, 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, additional inactive balances were deobligated by ARC and made available for other projects. Although ARC management continued its aggressive action to identify, follow up, and close inactive projects, we are reiterating our recommendations on two business development RLFs and the need for an interim spending schedule for RLFs.

During this reporting period, the Inspector General was selected as the Vice Chair of the Executive Council on Integrity and Efficiency (ECIE), which was established by Executive Order in May 1992. The ECIE is intended to ensure effective cooperation, coordination, and liaison between the 33 designated Inspectors General, OMB, and Congress and to assist the OIG community accomplish its missions.

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. 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.


Hubert N. Sparks
Inspector General

Enclosure

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EXECUTIVE SUMMARY

During this reporting period, eleven reports were issued, including eight grant reviews, two headquarters surveys, and one program review of Local Development District (LDD) administrative costs. Primary recommendations were directed at deobligation of funds, improved adherence to OMB cost principles and travel regulations, improved grant reporting, and updating of memorandums of understanding (MOUs) with other agencies. Questioned costs approximating \$566,000 resulted from purchase of approved equipment prior to submission of grant application, insufficient documentation of matching funds, and questionable expenditures.

Of particular significance was the selection of the Inspector General to be the Vice Chair of the Executive Council on Integrity and Efficiency (ECIE), which was established by Executive Order in May 1992 to provide for coordination and cooperation between the 33 designated Office of Inspectors General. This duty required extensive coordination and liaison between OIGs, OMB, and Congressional sources with respect to OIG activities.

Examples include:

- o A program review of LDD administrative costs identified questioned costs resulting from grantees not fully implementing Appalachian Regional Commission (ARC) travel regulations or OMB cost principles. As a result of the audit, ARC established an LDD committee to address the recommendations and revise and/or improve policy and procedures.
- o A review of three grants to one grantee for a three-phase project, to design and implement a program to establish an economic development research and training center, identified questioned costs of about \$396,000, or 51 percent of funds approved. Costs were questioned primarily due to the absence of sufficient documentation to support required matching funds.
- o In one case, grantee purchased \$150,000 of equipment prior to submission of the grant application or approval of the grant. Based on audit identification of the condition, the funds were deobligated prior to disbursement.
- o ARC followup, which included a financial audit at an LDD where an OIG review previously identified problems, confirmed serious deficiencies including insufficient funds to pay expenses, an inadequate accounting system, and questions about the viability of the entity. Actions are in process to address the issues.
- o Priority and emphasis by ARC and OIG continued to be placed on timely use of funds and resulting actions during the prior year included deobligation of several million dollars and use of the funds for other priority projects in Appalachia. OIG will continue to emphasize this area, including followup on open contracts with potential for better use of inactive balances and recommendations for improved controls.

- o The Inspector General, as ECIE Vice Chair, participated as a member of the President's Council on Integrity and Efficiency (PCIE), testified at a Congressional hearing, addressed four seminars/conferences on OIG related issues, and coordinated ECIE activities. Also, the Inspector General led two ECIE peer review teams.

PURPOSE AND REQUIREMENTS OF THE OFFICE OF INSPECTOR GENERAL SEMIANNUAL REPORT

The Inspector General Act of 1978 requires the Inspector General to keep the Federal Co-Chairman 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 Chairman by April 30 and October 31 and to Congress 30 days later.

The Co-Chairman 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	*
Section 5(a)(1)	Significant problems, abuses, and deficiencies	Page 3
Section 5(a)(2)	Recommendations with respect to significant problems, abuses, and deficiencies	Page 3
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)(7)	Summary of each particularly significant report	**
Section 5(a)(8)	Statistical table showing number of reports and dollar value of questioned costs	App B
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use	App C
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by end of the reporting period	*

S e c t i o n Significant revised management decisions *

5(a)(11)

S e c t i o n Significant management decisions with which the Inspector *

5(a)(12)

General disagrees

* None.

** See references to Sections 5(a)(1) and 5(a)(2) for discussion of significant reports.

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 ARC. The Appalachian Regional Commission (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 ARC was established 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 (ARC 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 was \$190 million, which was divided approximately \$143.57 million for highway projects, \$43.14 million for non-highway projects, and \$3.284 million for administrative expenses. The Commission's appropriation for FY 1993 is \$198 million, which is divided approximately \$136.6 million for highway projects, \$58 million for non-highway projects, and \$3.4 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 and 1991 and \$380,000 for FY 1992. For FY 1992, approximately 31 percent was expended for contract audit services; 52 percent, for salaries and benefits; 7 percent, for travel; and 10 percent, for all other activities (training, equipment, space, supplies, etc.). The OIG funding level represents about 35 percent of the total funds available to the Office of the Federal Co-Chairman. FY 1993 funding for OIG is \$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; no additional staff have been employed. 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. Investigative assistance is provided by other OIG offices on an as-needed basis. 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; 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 results in audit work being performed by a combination of permanent and contractor staff. During the reporting period, 11 reports were issued, including 8 grant reviews, 2 headquarters surveys, and 1 program review; 6 grant reviews and 1 program review were in process at the end of the reporting period. The OIG also provided information and recommendations with respect to inactive grants, resolution of open grants, and the ARC retirement plan.

- o An audit of three grants for a three-phase project to design and implement a program to establish an economic development research and training center and to conduct seminars regarding packaging economic development projects for public and private financing questioned the eligibility of \$396,000, or 51 percent of grant awards. Questioned costs included insufficient documentation to support matching costs, program income used as matching funds, reimbursement costs not supported by accounting documentation, reimbursement claims for costs outside the scope of the grants, and excessive travel claims. The audit also noted various

training courses that did not appear consistent with the achievement of grant objectives.

- o Our testing at one grantee relative to a \$150,000 grant for the purchase of equipment disclosed that the equipment had been purchased prior to grant approval and, therefore, was ineligible for reimbursement. Since the funds had not been disbursed, ARC deobligated the \$150,000. The condition also reflected a need for increased ARC followup to ascertain grant status, especially in cases such as this example where the grant period had expired without funds being requested.
- o Our program survey of administrative costs at eight Local Development Districts (LDDs) disclosed various conditions needing attention to ensure compliance with applicable regulations. Of primary importance was the need to clarify applicable policies and procedures to ensure consistent implementation of rules affecting allowable costs. We noted inconsistent application or interpretation of travel regulations, expenses related to third-party meals and in-kind cost determinations, matching determinations, and internal controls. ARC established an LDD committee to address the audit recommendations.
- o A financial audit obtained by ARC in response to our recommendations based on a survey identifying accounting and management problems at an LDD reported that the LDD did not comply with various regulations, including timely liquidation of obligations, and did not have sufficient cash to liquidate the obligations if necessary. The report notes that the LDD may be subjected to disciplinary actions, which may include the return of all Federal funds received during the period of noncompliance and/or a cessation of all future Federal funding. Primary problems included a large unfunded pension liability, questioned costs of about \$123,000, delayed posting of activity, inappropriate budgets, untimely reporting, delayed payments due to cash shortages, inadequate segregation of duties, unreconciled voucher registers.
- o We continued to emphasize timely use of funds, and made recommendations to deobligate outstanding balances in two revolving loan funds that totaled \$493,000. Timely use of funds remains a priority area, and audit followup will emphasize grants where there remains potential for action to deobligate inactive balances in order to allow the available funds to be used for other priority areas and additional Code revisions to address this area. Continuing ARC action to identify and resolve inactive grant balances in line with ongoing ARC and OIG emphasis resulted in deobligation of about \$2 million during the prior year and resolution of one account with accumulated funds of about \$330,000.
- o In several instances, grantee progress reports were not submitted timely. Consequently, we recommended that grantees and ARC emphasize timely report completion in order to provide officials with accurate status reports. Also, in some cases we noted that apparent approvals by ARC staff for grantees to waive grant agreement provisions were not documented and recommended that all agreed-to changes of grant agreement requirements be justified and documented.

- o Our review of memorandums of understanding (MOUs) with basic agencies identified several instances where the MOUs were outdated and in need of revision to address changed conditions and protect ARC's interests. ARC management initiated action to review the MOUs and identify necessary revisions on a priority basis.

B. INVESTIGATIONS

The Inspector General Act of 1978, as amended, provides that the Inspector General may receive and investigate complaints or information concerning the possible existence of an activity constituting a violation of law, rules, or regulations or mismanagement, gross waste of funds, or abuse of authority. The OIG does not employ special investigators. Should the need arise, the matter would be referred to the Federal Bureau of Investigation or assistance would be contracted with another Federal Office of Inspector General. The results of investigations may be referred to the appropriate Federal, state, or local prosecutive authorities for action.

There were no independent ARC OIG investigations during this period, but a planned grant audit was coordinated with an ongoing investigation by a state agency.

IV. AUDIT PLANNING

FY 1993 audit work planning provides for completion of a programmatic review of an ARC administered program to assist in placing physicians in Appalachia. 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.

Also, emphasis will be placed on audit followup to determine the extent to which specific report recommendations are addressed and to assess actions completed or necessary with respect to overall issues or causes resulting from individual reports. During FY 1993, audit work will also include, as previously, individual grant audits in about eight states; headquarters surveys, and followup testing in areas such as staff monitoring and followup on open grants with completed budget periods, administrative expenses, grant extensions, and enterprise development programs.

V. OTHER

The Inspector General was selected as the Vice Chair of the Executive Council on Integrity and Efficiency (ECIE), which was established by Executive Order in May 1992. The ECIE, which is chaired by OMB, is comprised of the 33 statutorily designated IGs and other administratively established IGs and is intended to promote the efficiency and effectiveness of the IG community. As such, the Vice Chair serves as a coordinator and liaison for ECIE members in dealings with OMB, Congress, and the President's Council on Integrity and Efficiency (PCIE).

Specific activities, which required considerable resource use during the reporting period, included coordinating monthly ECIE meetings, chairing an ECIE conference, transmitting IG related information to all members, correlating and summarizing ECIE positions on various issues, testifying at a Congressional hearing, briefing OMB and Congressional staff, and representing ECIE at PCIE meetings.

Additionally, the Inspector General continues to serve on the PCIE Task Force on Single Audit, which is finalizing recommendations to improve the single audit policy and procedures. Presentations were made at four seminars on IG related topics including: The OIG Budget Process; Educational Curriculum for Auditors; Auditor Frustration--Too Many Rules and More to Come; and New Information Sources for Congressional Oversight Committees.

The Inspector General provided informal comments and recommendations about the ARC early retirement plan that was initiated to address changed conditions at ARC. These comments and recommendations were directed at ensuring effective implementation of the plan.

SCHEDULE OF REPORTS ISSUED APRIL 1, 1992 TO SEPTEMBER 30, 1992

Report No.	Title	Program Dollars or Contract/Grant Amount	Questioned Costs*	Funds to Better Use**
92-6(G)	Alabama Technical Assistance Partnership	\$ 400,000		
92-7(G)	North Carolina Waste Products Marketing Initiative	387,900		
92-8(G)	Alabama Rural Wastewater Treatment Project	210,000		
92-9(G)	Pennsylvania Economic Research and Training Center	780,165	\$396,492	
92-10(G)	Tennessee Adult Literacy	350,000		
92-12(G)	North Carolina Infant Mortality Program	619,950	21,622	
92-2(H)	LDD Administrative Costs	240,000		
92-3(H)	Alabama Industrial Development Training Institute	150,000	150,000 ^{1/}	
92-4(H)	Western Piedmont RLF	250,000		\$175,387
92-5(H)	RLF Issues			330,993 ^{2/}
92-7(H)	Memorandums of Understanding			
TOTALS		\$3,388,015	\$568,114	\$506,380

* 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/ The \$150,000 was deobligated.

2/ Grantee refunded \$272,278; \$260,000 was made available for use on another project, and \$12,278 was returned to the Treasury as interest earned on cash advance.

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

	No. of Reports*	Dollar Value (\$ in thousands)
A. For which no management decision was made by the commencement of the reporting period	3	\$ 314
B. Which were issued during the reporting period	2	\$ 506
Subtotals (A + B)	5	\$ 820
C. For which a management decision was made during the reporting period	4	\$ 645
(i) dollar value of recommendations that were agreed to by management	3	\$ 493 ^{1/}
--based on proposed management action	3	\$ 493 ^{2/}
--based on proposed legislative action	0	0
(ii) dollar value of recommendations that were not agreed to by management	1	\$ 152 ^{3/}
D. For which no management decision has been made by the end of the reporting period	1	\$ 175
E. Reports for which no management decision was made within 6 months of issuance	0	0

^{1/} In one instance, deobligation exceeded audit recommendation by \$6,000. Table reflects audit recommended amount.

^{2/} Includes \$169,000 where recommendations were agreed with by management and final action is awaiting grantee final reports. Audit report was issued in April 1992.

^{3/} Recommendations not agreed with include one report and part of two other reports where the majority of the funds questioned were agreed with by management and reports were included in category (i).

**SCHEDULE OF AUDIT REPORTS WITH
QUESTIONED OR UNSUPPORTED COSTS**
(\$ in thousands)

	No. of Reports*	Questioned Costs	Unsupported Costs
A. For which no management decision was made by the commencement of the reporting period	2	\$ 231	-
B. Which were issued during the reporting period	3	\$ 546	22
Subtotals (A + B)	5	\$ 777	22
C. For which a management decision was made during the reporting period	4	\$ 381	22
(i) dollar value of disallowed costs	2	\$ 281	- ^{1/}
(ii) dollar value of costs not disallowed	1	\$ 100	22
D. For which no management decision has been made by the end of the reporting period	1	\$ 396	- ^{2/}
E. Reports for which no management decision was made within 6 months of issuance	0	0	0

^{1/} Includes \$131,000 where management decision was made to disallow costs and final action is awaiting additional and final information from grantee. The subject audit report was issued in April 1992.

^{2/} Report issued September 30, 1992.

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.

