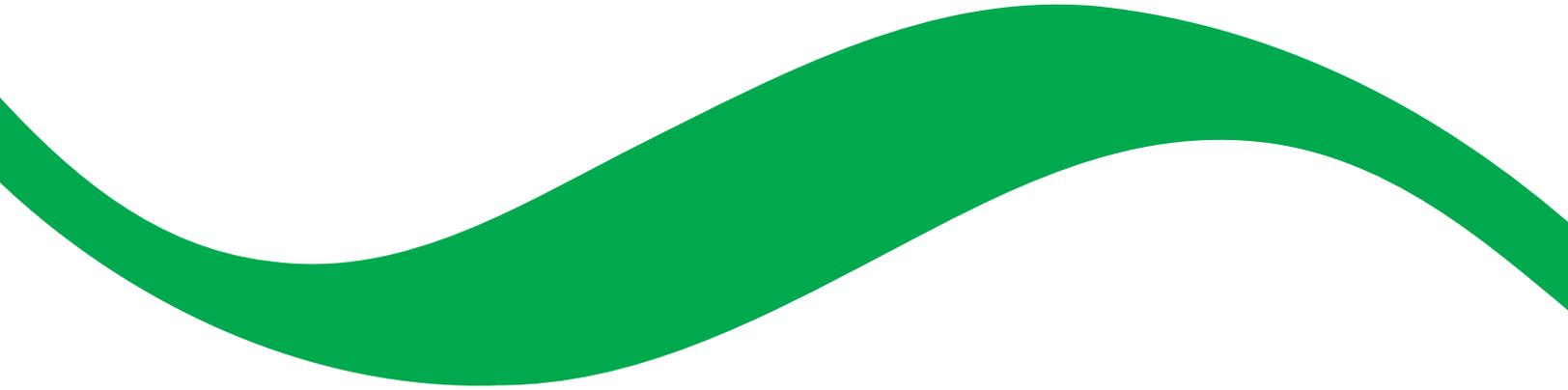




**PART IV:
OTHER ACCOMPANYING INFORMATION**



ARC PERFORMANCE MEASURES

As an investor in grassroots economic development, ARC's performance is in large measure dependent on the achievements of its local, state, and regional partners. To measure its effectiveness, ARC will look at the following four areas of performance:

- *Leverage.* ARC will measure additional public and private financial and technical support attracted by Commission investments.
- *Jobs.* ARC will gauge its involvement in job-generating programs by both the quantity and the quality of jobs created.
- *Employability.* ARC will measure improvements in high school graduation rates, increases in college attendance and graduation rates, the number of participants completing workforce training programs, and the number of children served in early childhood education programs.
- *Infrastructure Development and Connectivity.* ARC will look at the number of citizens served; connections made between modes of transportation, particularly between railways and highways; and highway miles opened to traffic.

PERFORMANCE GOALS

Assuming ARC's annual funding remains at the current level, the Commission is committed to the following six-year and twelve-year performance goals:

Six-Year Performance Goals

- 120,000 jobs will be created or retained.
- 120,000 households will be served with new or improved water and sewer infrastructure.
- 120,000 citizens of the Region will benefit from enhanced education and job-related skills.
- 150 miles of the Appalachian Development Highway System will be opened to traffic (based on the current level of transportation funding from the U.S. Congress).

Twelve-Year Performance Goals

- 240,000 jobs will be created or retained.
- 240,000 households will be served with new or improved water and sewer infrastructure.
- 240,000 citizens of the Region will benefit from enhanced education and job-related skills.
- 300 additional miles (net increase) of the Appalachian Development Highway System will be open to traffic (based on the current level of transportation funding from the U.S. Congress).

The Appalachian Regional Commission tracks the programs it supports and reports its findings regarding performance on a yearly basis. ARC's current performance and accountability report can be found on the ARC Web site at www.arc.gov.



APPALACHIAN
REGIONAL
COMMISSION

*A Proud Past,
A New Vision*

Office of Inspector General

November 2010

MEMORANDUM FOR FEDERAL CO-CHAIR GOHL

FROM: Clifford H. Jennings
Inspector General

A handwritten signature in black ink, appearing to read "Cliff Jennings", is written over the printed name.

SUBJECT: Management and Performance Challenges Facing the
Appalachian Regional Commission

The Reports Consolidation Act of 2000 requires we provide you with our perspective on the most serious management and performance challenges facing the Commission for inclusion in the Commission's annual performance and accountability report. Our compilation of these challenges was derived from our consideration of audit reports, open recommendations, discussions with contract auditors, ARC personnel, and new project undertakings.

This year ARC faces many of the same challenges that were reported last year but some of the details have changed. ARC has made progress in implementing many new processes which improve and safeguard its activities. However, more needs to be done to address previously identified issues and new issues that have arisen. See details below.

The accuracy of financial reporting improved during the year. This improvement addressed an important concern under our prior years Management Challenges, *Compliance with OMB Circular A-136*. Although ARC reporting was more accurate, the timeliness of year-end reporting continues to be a problem. ARC's FY 2009 audited financial statements should have been issued in November 2009, to be compliant with OMB requirements, but they were not issued until June, 2010. For FY 2010, timely issuance of the financial statements looked achievable, but once again reporting inaccuracies in child agency provided information delayed ARC's timely release of year end financial statements. Nonetheless, we are cognizant of improved accuracy; the most recent financial statement audit (for FY 2009) rendered a "clean opinion" for the first time since adopting federal financial reporting requirements. While reporting accuracy has improved, the timeliness of reporting remains a challenge.

Management has continued to address the Challenge, *Upgrading agency IT support infrastructure, agency accounting and grant management system*. Management continued to contract with outside vendors providing IT support and completed its first fiscal year utilizing accounting services provided by GSA. The 2010 financial statement audit will provide us a view into the degree of success of working with GSA.

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In November 2009, ARC finished a risk assessment of its IT security; the report addressed ARC system vulnerabilities and weaknesses. To date, ARC internal records reflect 70% implementation of recommendations made from this assessment.

The following policy or other related documents reportedly have been created.

- Incident Response Plan
- System Security Plan
- Configuration Management Plan
- Privacy Impact Assessment
- Risk Assessment Plan

In addition, ARC recently implemented *Websense* which provides web security and filtering. Other ongoing ARC IT activities include: creation of a contingency plan, which provides for continuity of ARC operations in the event of a disaster (or other incident); improvements to ARC's data backup facilities; and the creation of a document management system, to provide query capabilities to assist users in retrieving documents.

ARC's grant management system still has many weaknesses that were initially identified in an audit report from 2008. To date, all ten of the reports recommendation are still outstanding, although some effort has been recorded that partially addresses some of these recommendations.

Challenge 1 – Upgrading agency IT support infrastructure, agency accounting and the grant management system

ARC's transferred its accounting system operations to GSA's shared services facility, which is located offsite. This transfer created a myriad of challenges that include: ensuring documents are prepared according to GSA requirements; that they are prepared and received timely by GSA; that the data submitted is accurate and supported by ARC's other systems and sources of information; and then, the difficulties associated with not having an online real time system, such as delays in receiving reports and not being able to immediately see the results of entries. The financial statement audit will provide the first opportunity for an overall assessment of the success or failure of this ARC-GSA arrangement.

Concerning ARC's grant management system, developing and implementing system requirements has been slow and implementation of recommendations has not always followed a logical order of succession. A review of the system and its data was performed in 2008 which detailed our concerns and provided some order in which they should be addressed. Ten recommendations were made that included: developing requirements, evaluating competing systems and their costs, improving access controls, improving the accuracy and uniformity of data, and completing system documentation. Although some activity has been initiated on several of these recommendations, they have not been fully acted upon and therefore, they all remain open.

Always underlying the surface of IT operations is its security. ARC made strides in addressing issues raised in a risk assessment report issued in November 2009- 70% of issues raised were

reportedly addressed. Issues remaining that require management's attention include: insufficient safeguards leading to increased risk of malware propagation, inadequate physical controls for systems or reconstruction of attack tracing capabilities, separation of duties, and contingency planning. We consider contingency planning to be one of the most important issues remaining; however, we have been told that work on it has been initiated.

Challenge 2 – Grant management oversight

Grant management oversight continues to be a challenge. As discussed last year, we completed an inspection of ARC's grant management activities and found significant weaknesses in ARC's grant oversight and administrative processes. A previous inspection report made 17 recommendations (14 of which are still open) to address the development and enforcement of policies, for the development of grant monitoring plans, improving supervisory oversight, training, metric reporting, documentation, file organization, tracking grantee characteristics, and controls to safeguard grant files. In our reviews this year, we found a continued reluctance to enforce conditions of grant agreements when variances from the agreements were found. To address these issues and effectuate changes, management must continue to train staff on grants' management; make changes to the grant management system; draft and implement a grant management policy manual; and provide a control atmosphere which not only stresses grant performance, but enforcement of the rules under which grants are made. Hopefully, many of these issues will be addressed when management issues its grant policy manual, which we were told was a priority for fiscal year 2011.

Challenge 3- Compliance with OMB Circular A-136

The financial statement audit for FY 2009 was still very late for the third year in a row and was not issued until June 2010 (OMB required issuance in November of the previous year). However, for the first time since the adoption of federal accounting rules three years ago, ARC received an unqualified audit opinion. The financial statement audit for FY 2010 is evidently proceeding without too many problems, but certain information from at least one of the child agencies is creating a delay and the financial statement's issuance will be late.

An ongoing challenge for ARC is to comply with OMB Circular A-136. ARC is currently attempting to satisfy Section 3 Financial Section; II.4.2 Q&As; Question 5 of OMB Circular A-136, Financial Reporting Requirements, under which a parent agency (transferor of the appropriation) must report all budgetary and proprietary activity in its financial statements, whether that activity is material to its child agencies or not. ARC has parent relationships with five departments (reduced from seven, previously) and agencies to each of whom it transfers its appropriated funds for purposes of accomplishing economic development activities in the Appalachian Region, largely through Federal grants. These activities are authorized by the Appalachian Regional Development Act of 1965, as amended, 40 U.S.C. 14101-14704. ARC has significant parent/child relationships with the following departments/agencies:

- Department of Transportation
- Economic Development Agency of the Department of Commerce
- Rural Development of the Department of Agriculture
- Housing and Urban Development

ARC transfers a large and material portion of its appropriation annually to these child agencies to carry out its mission; however, the transfers are relatively minor for the child agency receiving them and are not material to their financial reporting. The child agency auditors do not audit at the materiality level needed by ARC and reports of activities and balances are not made a priority by the child agencies. ARC needs to continually work with these agencies to ensure timely and accurate data is received.

In addition, ARC has had difficulty reconciling its proprietary activities to its budgetary records and in the past has sought help from an outside/contacted accounting firm. Management anticipates that the transfer of its accounting records to a GSA shared services accounting platform will resolve this reconciliation issue but continued attention to this problem, we believe, will be needed.

Finally, ARC needs to finalize its accrual methodology for outstanding grants. The accrual affects both ARC's reported expenses and obligations. For the last few years, ARC has been obtaining historical grantee expenditure data as a means of determining the accrual amount- with each passing year the reliability of the accrual estimate should improve.

Challenge 4- Transparency

As with many agencies, transparency is a concept whose time has come. Increased transparency should not only allow all citizens to see where their funds are going, but should facilitate oversight of funds and projects. It is our belief that something similar to the Denali Commission's interactive project map would be of great service to the residents of Appalachia as well as the general public. This interactive application ideally would provide up to the minute data on the status of funds and projects and highlight the good that the Commission does for its constituents.