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**APPALACHIAN REGIONAL COMMISSION  
OFFICE OF INSPECTOR GENERAL**

**AUDIT OF GRANT AWARD**

**City of Galax  
Galax, Virginia**

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**Final Report Number: 17-13**

**Project Number: VA-17576**

**May 2017**

**Prepared by:**

**Leon Snead & Company, P.C.**



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Leon Snead & Company, P.C. completed an audit of grant number VA-17576, awarded by the Appalachian Regional Commission (ARC) to the Virginia Department of Housing and Community Development (DHCD) on behalf of the City of Galax, Virginia (the City). The audit was conducted at the request of the ARC Office of Inspector General to assist the office in its oversight of ARC grant funds.

The audit objectives were to determine whether: (1) program funds were managed in accordance with the ARC and Federal grant requirements; (2) grant funds were expended as provided for in the approved grant budget; (3) internal grant guidelines, including program (internal) controls, were adequate and operating effectively; (4) accounting and reporting requirements were implemented in accordance with generally accepted accounting principles (or other applicable accounting and reporting requirements); and (5) the matching requirements and the performance goals and objectives of the grant were met.

The City's award and administration of the construction contract were considered adequate. The majority of ARC funding expenditures reimbursed to the City and non-ARC matching fund amounts claimed that we examined were considered adequately supported and allowable. The construction portion of the project and initial operation of the Studio was complete and most of the related planned goals and results had been met and adequately documented. However, we questioned the results on two of the performance measures, relating to the number of jobs created and the number of businesses created. The City had written financial and procurement policies and procedures for most areas applicable to grant activities, which were considered to be reasonably adequate for administering the grant funds. However, the City's written procurement policies and procedures were not fully compliant with ARC and federal grant requirements and should be revised to include the applicable requirements. The issues identified and the recommended corrective actions are discussed in the Findings and Recommendations section of this report.

A draft report was provided to City on April 4, 2017, for comments. The City provided a response to the report on April 24, 2017. These comments are included in their entirety in Appendix I. Leon Snead & Company appreciates the cooperation and assistance received from the City and ARC staffs during the audit.

Sincerely,

*Leon Snead & Company, P.C.*  
Leon Snead & Company, P.C.

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## **Background**

Leon Snead & Company, P.C. completed an audit of Basic Agency grant number VA-17576 awarded by the Appalachian Regional Commission (ARC) to the Virginia Department of Housing and Community Development (DHCD) on behalf of the City of Galax, Virginia (the City). The audit was conducted at the request of the ARC, Office of Inspector General, to assist the office in its oversight of ARC grant funds.

The DHCD served as the basic agency responsible for administering the grant in accordance with the Virginia ARC Program Construction Project procedures established November 2010. The DHCD subsequently awarded an agreement to the City (as grantee) that provided the specific terms and conditions required by the ARC grant.

The ARC grant was to expand the Chestnut Creek School of Arts, located in the City of Galax, by demolishing an existing structure and constructing a new Woodworking Studio to provide training and space to local artisans. The project was intended to help continue economic development in downtown Galax. It was expected to create eight new businesses, provide training for 40 Workforce Development workers, provide training for 40 students, result in 18 regional artisans teaching classes in the studio, and foster \$780,000 in private investment in the downtown area.

## **Objectives, Scope, and Methodology**

The audit objectives were to determine whether: (1) program funds were managed in accordance with the ARC and Federal grant requirements; (2) grant funds were expended as provided for in the approved grant budget; (3) internal grant guidelines, including program (internal) controls, were adequate and operating effectively; (4) accounting and reporting requirements were implemented in accordance with generally accepted accounting principles (or other applicable accounting and reporting requirements); and (5) the matching requirements and the performance goals and objectives of the grant were met.

The grant provided \$500,000 in ARC funding and required \$377,000 in non-ARC matching funds from the grantee to meet the \$877,000 in total estimated project costs. The approved grant period in the DHCD agreement was October 1, 2013 to September 30, 2014, which was subsequently extended to November 14, 2015. The period of performance in the agreement between DHCD and the City was from February 19, 2014 to February 18, 2016. The construction was completed but the grant had not been administratively closed by either DHCD or ARC.

Of the \$500,000 in expenditures charged to VA-17576 and claimed for reimbursement, we selected \$498,039 for testing to determine whether the charges were properly supported and allowable. We reviewed \$302,000 in non-ARC matching funds to determine whether they were properly supported and allowable.

We reviewed documentation provided by the City and DHCD and interviewed personnel to obtain an overall understanding of the grant activities, the accounting system, and general operating procedures and controls. We reviewed financial and project progress reports to determine if they were submitted in accordance with requirements. We reviewed the most recent financial statements and A-133 report to identify any issues that significantly impacted the ARC grant and the grant audit.

The on-site fieldwork was performed at the City's offices in Galax, Virginia during the period of February 27 to March 3, 2017. The preliminary results were discussed with the City and DHCD staff at the conclusion of the on-site visit. City staff did not fully agree with the preliminary results and indicated additional comments and information would be provided in responding to the draft report.

The primary criteria used in performing the audit were the grant agreement and the related agreement between DHCD and the City; Office of Management and Budget (OMB), Circular 2, CFR 200; and the ARC Code. The audit was performed in accordance with *Government Auditing Standards*.

### **Summary of Audit Results**

The City's award and administration of the construction contract were considered adequate. The majority of ARC funding expenditures reimbursed to the City and non-ARC matching fund amounts claimed that we examined were considered adequately supported and allowable. The construction portion of the project and initial operation of the Studio was complete and most of the related planned goals and results had been met and adequately documented. However, we questioned the results on two of the performance measures, relating to the number of jobs created and the number of businesses created. The City had written financial and procurement policies and procedures for most areas applicable to grant activities, which were considered to be reasonably adequate for administering the grant funds. However, the City's written procurement policies and procedures were not fully compliant with ARC and federal grant requirements and should be revised to include the applicable requirements. The issues identified and the recommended corrective actions are discussed in the Findings and Recommendations section of this report.

## Findings and Recommendations

### A. Performance Measures

The City's grant application to DHCD identified numerous expected outputs and outcomes including: constructing a new 4,450 sq. ft. studio building; creating six new businesses and 12 new jobs; creating four new downtown housing units; \$600,000 in new private investment for the downtown; as well as several other performance measures. The agreement between DHCD and City did not include all of the metrics listed in the application but described the construction of the 4,450 sq. ft. studio as a product and listed the following expected project benefits:

- creating 12 new jobs
- providing skills training to 40 students and 40 workers
- creating six new businesses
- \$600,000 in leveraged private investment downtown
- 18 regional artisans teaching classes in the studio

We found that the grant agreement between ARC and DHCD had some differences in outputs and outcomes from the agreement between DHCD and the City. The ARC agreement called for \$780,000 in leveraged private investment, included for eight new entrepreneurial businesses to be created, and did not specify for the direct creation of 12 new jobs.

The actual results provided by the City for these measures as of August 2016 were as follows:

- 16.5 FTE jobs created
- skills training provided to 135 workers and 51 students
- six new businesses created
- \$725,787 in downtown private investment
- 18 regional artisans teaching classes in the studio

We applied the metrics described above to determine if the goals of the grant were met and verified that three of the five grant performance measures contained in the DHCD agreement with the City were met or exceeded. The metrics for skills training provided, the level of private investment, and the number of artisans teaching classes appeared to be reasonable and adequately supported. However, we questioned the reported number of new jobs created and the number of businesses created as a result of the project. The agreement between DHCD and City stated that "the project will result in the direct creation of 12 new jobs and creation of 6 new businesses..." The documentation reviewed did not support the conclusion that the 12 new jobs and six new businesses being reported were actually a direct result of the project and studio that was built.

For example, the 12 new jobs reported included 10 employees of the Twisted Fork Restaurant, the City's Director of Human Resources, an Assistant Director of Tourism, and an After School Prevention Coordinator. The reported six new businesses included two restaurants, a gallery, a variety-type store, and an herbal store. Most of data and supporting information reflect that the Woodwork Studio project has contributed to improving economic development and new job creation realized in the downtown area. The students and instructors at the studio and visitors that may come to town just to visit the studio likely do eat and shop downtown and to that extent the project has had a direct impact, and we agree has been successful. However, it is difficult to substantiate that all of

the 12 jobs and six businesses were created solely because of the studio. In discussing this matter with City staff, we were told that one restaurant directly across the street from the studio opened just because of the studio, and therefore all the related jobs were valid. We found no documentation to support this or that the other businesses and jobs reported also resulted directly from the grant project.

### **Recommendation**

At the time of grant closeout, determine the final performance measures accomplished and report the data to ARC for review and any action deemed necessary.

### **Grantee's Response**

The City does not concur with a finding that the performance measures were not accomplished and reported.

Economic development measures and results are important to the City. The City worked closely with the state administrative staff to provide economic development measures for Chestnut Creek School of the Arts Woodworking Studio. In fact, the City was required to revise and fine tune these metrics to report on economic development. As a result, the City did produce measures that were acceptable to the administrative agency and reported on these. The agency accepted these results and the City's documentation.

In the case of the Chestnut Creek School of the Arts Woodworking Studio, the buildings across the street were vacant before the project began. A new restaurant business announced its decision to open directly across the street as a direct result of the project. The restaurant created 10 new jobs. Similarly, an art gallery that displays original hand crafted wood sculpture and wood furniture opened one block over and created a new job in that new business. Other new businesses and jobs were created having a positive impact upon the entire downtown environment, spurring our economy and improving the community as a whole. Chestnut Creek School of the Arts Woodworking Studio has created new jobs and new businesses.

### ***Auditor's Comments***

*ARC will determine whether the actions taken by the grantee are adequate to resolve the finding and close the recommendation.*

## **B. Procurement Policies and Procedures**

The City's written procurement policies and procedures did not fully comply with the federal standards and requirements. 2 CFR 200.317 provides procurement standards for States and other Local Governments. Entities, other than a State, including sub-recipients of a state (i.e. the City), are required to follow the general procurement standards outlined in sections 200.318 through 200.326. These general standards require the City to use its own documented procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards. The standards establish requirements including: having written standards of conduct governing all individuals involved in procurements; keeping adequate records describing the general history of the procurement; performing and documenting some type of cost or price analysis for every procurement; and providing guidance on the selection and award of contracts, such as the use of sealed bidding procedures.

We requested the City's written procurement policies and procedures, and were provided the Purchasing Policy & Manual (Manual). We determined the Manual did not include many of the provisions in the general standards. For example, we did not find a written standard of conduct for persons involved in procurements, or any requirement for performing a cost or price analysis on procurements. Although there was guidance for procurements under \$50,000, the Manual had no policy or guidance for larger procurements, such as the \$560,000 construction contract related to the ARC grant project. This information should include how contracts must be awarded, the best type of contract to use, how they must be documented and administered.

We were told that the City follows the state requirements on the procurements valued over \$50,000. Although no significant issues were identified with how the construction contract under the grant was awarded and administered, having a written City policy indicating that the state requirements must be followed and providing some guidance on how that should be done is consistent with the federal procurement standards for having written policies. At a minimum, the City should establish written policies and procedures that incorporate and implement the federal requirements in order to have a compliant procurement process.

### **Recommendation**

The City should revise the Purchasing Policy and Manual to incorporate all requirements in 2 CFR 200, sections 318-326, and provide guidance on procurements over \$50,000.

### **Grantee's Response**

The City has obtained an opinion of legal counsel, Stephen V. Durbin, Attorney, of Sands Anderson PC. Legal counsel reviewed the Audit and the City's Purchasing Policy and Manual and has provided a response.

The City will amend our purchasing policy and adopt the recommendations of its legal counsel. The attorney has suggested specific revisions to the City's Purchasing Policy and Manual with a statement on Policy, definitions and for purchases in excess of \$50,000. The City does adopt the recommendations of its legal counsel for the revisions of its Purchasing Policy and Manual.

### **Auditor's Comments**

*ARC will determine whether the actions taken and planned by the grantee are adequate to resolve the finding and close the recommendation.*



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# CITY OF GALAX

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Office of the City Manager

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April 21, 2017

Leon Snead

Via Email to Leon Snead & Company at: leonsnead.companypc@erols.com

Re: Draft Report- City of Galax

Dear Mr. Snead:

Thank you for the opportunity to provide input on the draft audit report. The City does wish to address the findings and recommendations contained in the draft report. There were two specific findings in the audit and we will address them in order.

## A. Performance Measures

### Recommendation

*At the time of grant closeout, determine the final performance measures accomplished and report the data to ARC for review and any action deemed necessary.*

The City does not concur with a finding that the performance measures were not accomplished and reported.

Economic development measures and results are important to the City. The City worked closely with the state administrative staff to provide economic development measures for Chestnut Creek School of the Arts Woodworking Studio. In fact, the City was required to revise and fine tune these metrics to report on economic development. As a result, the City did produce measures that were acceptable to the administrative agency and reported on these. The agency accepted these results and the City's documentation.

The City believes in a diversified approach to economic development, capitalizing on our strong cultural heritage, the arts, downtown revitalization, the promotion of entrepreneurs and small businesses in addition to more traditional methods of industry recruitment. The City of Galax was built upon manufacturing, especially wood and textiles. Our City seal proudly depicts this manufacturing base, with steaming smoke stacks of its industry. However, several years ago, a majority of textile and wood manufacturers closed. Our reliance solely upon large manufacturers had to be revised. Our economic development strategy now seeks to be diversified and inclusive, building upon our assets, engaging our community and encouraging investments.

Economic development in a small locality such as the City of Galax, with a population of 7,042 residents in eight square miles, has a broad impact upon the community and this project did produce tangible economic development outcomes. In the case of the Chestnut Creek School of the Arts Woodworking Studio, the buildings across the street were vacant before the project began. A new restaurant business announced its decision to open directly across the street as a direct result of the project. The restaurant created 10 new jobs. Similarly, an art gallery that displays original hand crafted wood sculpture and wood furniture opened one block over and created a new job in that new business. Other new businesses and jobs were created having a positive impact upon the entire downtown environment, spurring our economy and improving the community as a whole. Chestnut Creek School of the Arts Woodworking Studio has created new jobs and new businesses.

## **B. Procurement Policies and Procedures**

### **Recommendation**

*The City should revise the Purchasing Policy and Manual to incorporate all requirements in 2 CFR 200, sections 318-326, and provide guidance on procurements over \$50,000.*

The City has obtained an opinion of legal counsel, Stephen V. Durbin, Attorney, of Sands Anderson PC. Legal counsel reviewed the Audit and the City's Purchasing Policy and Manual and has responded as follows:

"Although the processes followed by the City for the ARC procurement did in fact comply with applicable law and regulation, the auditor raised concerns because the applicable procurement processes and requirements were not set forth in writing in the purchasing manual.

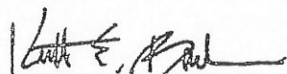
Unlike some states, Virginia has explicit mandatory standards comprehensively addressing the procurement process, including, for example: handling of proprietary vendor information, ethics in public contracting, and step by step processes for procuring various types of goods and services. In my view, each of the requirements in the referenced federal regulations are addressed by the Virginia Public Procurement Act, the Virginia State and Local Government Conflicts of Interests Act, and the Virginia Freedom of Information Act. Compliance with these state laws will, in all but the rarest of circumstances, comply with the mandates of federal law. I have added language to the purchasing manual to address those situations where the federal regulations should control. (Note that the VPPA explicitly authorizes localities to follow federal procedures when required by the term of the federal grant). Because Virginia law already prescribes standards compliant with the federal requirements, I would recommend, at a minimum, that the purchasing manual be updated to explicitly reference the aforementioned acts, and make the current text of each of these laws available to City Staff in online and hard copy format at the City offices."

The City will amend our purchasing policy and adopt the recommendations of its legal counsel. The attorney has suggested specific revisions to the City's Purchasing Policy

and Manual with a statement on Policy, definitions and for purchases in excess of \$50,000. The City does adopt the recommendations of its legal counsel for the revisions of its Purchasing Policy and Manual.

If there are any questions, please feel free to contact me at 276-236-5773.

Sincerely,



Keith Barker  
City Manager

cc: Judy Taylor-Gallimore, Finance Director  
Brenda Marrah, Grants Administrator  
Chris Pollins, CCSA