

A LIMITED SCOPE PERFORMANCE REVIEW OF THE CITY OF DIAMONDHEAD, MS



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STATE AUDITOR

**A Report from the Performance Audit Division
#145
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**Office of the State Auditor
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Performance Audit Division Report #145

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January 30, 2017

Executive Summary

At the request of the City of Diamondhead, the Mississippi Office of the State Auditor (OSA) was engaged to conduct a limited Scope Performance Review of certain city operations to include:

- Staffing and workflow of Diamondhead's administrative services
- Grant and contract management
- City operations
- City financials/property/inventory control

The **purpose** of this project was to evaluate the strengths and weaknesses of the City's current administrative operations and identify areas of weaknesses in policies/procedures, operations, workflow, etc. that can lead to non-compliance, fraud, waste, and abuse. The **scope** of the project included administrative services, accounts payable, accounts receivable, municipal court, public works, property control, payroll, human resources, etc. The scope also included evaluating both current and historical activities. The **methodology** of this project utilized primary document review (invoices, communications, payroll records, etc.); interviews with staff and elected officials in office at the time of the review;¹ observation; compliance checks; control testing; and other fieldwork involving research, discussions, and interviews with people outside of City Hall.

OSA auditors conducted fieldwork in Diamondhead on four separate occasions, each time interviewing employees, testing controls, observing, and reviewing source documents. Between fieldwork visits, auditors reviewed grant information, contracts, policies and procedures, invoices, and state laws governing the Council-Manager form of government, contracting, procurements, and municipal expenditures. Follow-up visits provided the opportunity to finalize initial work and begin next areas of the review. Performance Audit Division staff worked closely with the Technical Assistance Division throughout the entire project. Additionally, as the project progressed, OSA auditors provided constant feedback to the City Manager and staff about issues that were identified during the audit process.

Though auditors identified some weaknesses with staffing structure and shared those concerns with management, OSA identified no violations of laws related to any of the areas examined. In fact, auditors found that even though property inventory had experienced some record-keeping errors a couple of years ago that affected a number of items, the property control personnel and other staff still had no problem tracing, identifying, and locating all property in the selected sample. Additionally, auditors noted that in several places where a lack of segregated duties occurred, informal practices had been put in place by individual staff so they would get a "double check" of their work. This shows a high level of effort and integrity.

¹ At the time of the review, Councilwoman Nancy Depreo had not taken office and was therefore not part of the interview process, but her predecessor, Councilman Joe Lopez was interviewed as part of the audit review.

Generally recordkeeping procedures are good. Ongoing changes, updates, and corrections are underway that will improve historical record retention and provide well organized records for the present and future. In prior years, it appears from OSA review of records and interviews with staff, the previous City Clerk may not have kept good records or kept records organized in a useful manner.

Grants and contracts are sufficiently managed. The administration is working with the City Attorney to strengthen contracts. Current contracts show improvement in protective controls compared to prior years. OSA recommends that grants, along with other municipal operations that require advance planning should become part of on-going, long-term strategic planning.

Property control is sufficient. In testing procedures from requisition to inventory control, OSA identified no areas of weakness or non-compliance. Auditors were made aware of a prior year (2015) inventory control error that was in the process of being corrected. OSA evaluated the process and found it to be sufficient to correct the problem.

Even though it is a relatively young municipality, the City of Diamondhead appears to be functioning very well, overall. The only area that OSA found to be lacking was segregation of duties in several departments. OSA auditors identified some areas related to staffing and organization structure that weakens the operating position of the City administration. OSA did not find any instances of non-compliance in these systems, but due to a lack of staffing in certain areas, there may be a higher risk for mistakes or fraud. These areas can be strengthened through the restructuring and/or addition of a few positions. OSA will continue to work with the City Manager on internal controls and improved segregation of duties as this project is finalized.

With regard to cash management, which encompasses several departments and numerous employees who may handle cash or checks throughout the day, OSA found that there are generally sufficient controls over cash management. Auditors did raise some questions regarding proper surety bonds for specific duties. It may be necessary for the Council to adjust job duties and therefore surety bonds as any changes or reorganization take place.

This report reviews the authority of the Council, the City Manager, and the staff. It also provides additional information about the need for internal controls and how to detect and prevent weaknesses. It is hoped that this additional information will assist Diamondhead moving forward.



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Operations

The City of Diamondhead operates under the Council-Manager form of government. While nationally a majority of municipalities utilize this form of government, only a handful of other cities in Mississippi—most of which are in the coastal counties—operate under these state statutes.² This form of government is different from others in Mississippi in several ways. The roles of the Mayor and the Council are also different, in some ways, from other forms of government such as the Mayor-Alderman or the Mayor-Council forms of government. The addition of a full-time, professional city manager is a major difference between this and other forms of government.

The governing body of elected officials has legislative, judicial, and executive powers, but no administrative powers.³ They are required to set the City budget and appropriate funds, make proclamations, pass ordinances, and approve all contracts, grants, and financial expenditures for the city. The theory of this form of government is that the elected officials are held “above the fray” by the very nature of its structure. They are elected and must approve the expenditures and make the ordinances that protect, grow, and enhance the city, but they hire a non-partisan, professional manager, who can oversee the money, the people, and the projects. They create the City vision, and the manager carries out their vision.

As a body, they have the authority and responsibility to inquire about various issues concerning the city.⁴ The Council only acts officially as a single body. As a body, they approve draft agendas, meeting minutes, conduct meetings, and make decisions by passing ordinances and motions. They approve all contracts, grants, financial expenditures, etc. that are brought before them. Individually, they have little authority, outside of inquiries for information. However, independent interactions with employees, including any appointed officials, should be conducted in a professional manner and as if the public was watching.

In addition, as with any elected officials, they are prohibited from directly contracting with or holding positions that would be in conflict with their duties as Council members.⁵

² Title 21, Chapter 9, Mississippi Code of 1972, Council Manager form of government authorizing statutes.

³ **§21-9-35.** Council's role: *...Except as limited in this chapter, the city council shall have, exercise and perform all executive, legislative and judicial powers, duties and obligations vested by law in the mayor and governing body acting for the city at the time of the adoption by such city of the council-manager form of government...* **§ 21-9-23.** Transfer of administrative functions to city manager: *Members of the city council shall have no administrative powers or duties. All such powers or duties vested in members of the governing body of the city before adoption of the council-manager plan of government shall be transferred to the city manager or his subordinates.*

⁴ **§21-9-31.** Council's role in administration: *Neither the mayor nor any of the members of the council or committees of the council shall direct or dictate the appointment of any person to or his removal from office by the manager or any of his subordinates. Except for the purposes of inquiring or receiving information or advice, the mayor and council and the several members thereof shall deal with the administrative services solely through the manager and neither the mayor nor any member of the council shall give orders to any subordinate of the city. The city council shall have the power to investigate any part of the city government and for that purpose to compel the attendance of witnesses and the production of documents and other evidence.*

⁵ **§21-9-43.** Multiple positions prohibited: *A member of the city council shall neither be a member of any commission or board appointed by the city council nor serve as a member of any commission or board under the jurisdiction of the city council, except as otherwise provided by law.*



The Mayor is the head of the Council, but has no veto power and no administrative authority. The Mayor signs payroll, meeting minutes, proclamations, etc. and is the executive to whom legal matters are initially addressed. He is the head of the Council and as such, presides over meetings.

The Council, in conjunction with the City Manager's recommendations, sets the budgets and makes long-term plans for the city. The Council is prohibited from interfering in the administrative operations of the city.⁶ This includes even volunteering to assist with anything that could be considered administrative such as helping by taking payments, writing receipts, etc. In fact, even though the Council has the authority to appoint the City Clerk, once appointed, that position still falls under the supervision of the City Manager.⁷ Council positions are generally considered part-time, but the City Manager, who is selected by the Council solely on qualifications and experience, is a full-time position. The addition of the professional city manager in this form of government is a mechanism to reduce the possibility of corruption. By design, it is supposed to remove the elected officials from the day-to-day operations of the municipality, including contracts, vendor selection, etc. and places such control under purely professional management.

While statutorily the Manager has the responsibility for day-to-day operations, organization, staffing, etc., state law also requires that the Mayor and Council, as the duly elected public officials, still have ultimate responsibility to the citizens related to expenditures. This is the reason that the Mayor, or in his absence, a majority of the Council "shall" sign such items as payroll and also must have a sufficient surety bond. On an as needed or temporary basis when the Mayor is unavailable, the Council may make a motion to temporarily have one of its members sign official documents, such as payroll. It is much more difficult in this form of government for elected officials to perpetrate fraud, but they still have to be vigilant about how the city is operating.

The Council and the Manager should work together to ensure that citizens are aware that the Manager is the administrative head and is the proper person from whom to seek help in resolving most municipal problems. It is fine for a citizen to direct a complaint to the Mayor or Council members—after all, they are elected representatives. However, any such complaints should then be forwarded to the City Manager with the expectation that he and his staff will work to resolve problems, and report back to the Council and citizens about such resolutions.

The City Manager serves at the will and pleasure of the Council for four-year, renewable terms, but may be removed by a vote of the majority of the Council for cause at any time.⁸ The success of a well-qualified City Manager is found in their ability to manage the fiscal and operational affairs of the city administration, and keep the Council informed of all important activities, especially those that require Council approval. The City Manager has broad latitude to make decisions about the operations of the city, including organization, staffing, and expenditures. He works with the Council, and although he has no vote, statutorily he has authority to participate in Council discussion.⁹

Unless the Council specifically creates a department or position, the City Manager is responsible—within budget constraints authorized by the Council—for the structure and staffing of the administrative departments of the City.¹⁰ Because of the broad and extensive nature of the City Manager's duties and responsibilities, it is easier to list them than to try to explain them separately:

⁶**§21-9-37.** Role of mayor; *The mayor shall be the titular head of the city for all ceremonial purposes and for all processes of law. He shall be the president of the council and shall have a voice and vote in its proceedings, but no power of veto. He shall have no administrative powers. In case of his absence or disability, the council may appoint another of its members to fulfill his duties temporarily.* § 21-9-23. Transfer of administrative functions to city manager: *Members of the city council shall have no administrative powers or duties. All such powers or duties vested in members of the governing body of the city before adoption of the council-manager plan of government shall be transferred to the city manager or his subordinates.*

⁷ Although appointments of a City Clerk and Municipal Judge and Municipal Attorney may be made by the City Council, under Sections 21-9-23 and 21-9-29(e), the City Clerk, as a department head, remains under the supervision and control of the City Manager... Op.Atty.[Gen. No. 2004-0583, Ramsey, November 30, 2004, 2004 WL 3015500.](#)

⁸**§21-9-27.** Manager's term, removal: *The city manager shall hold office for such period (not to exceed four years for any one specified period) as may be provided by ordinance, and shall be eligible for reemployment, successively or otherwise. The manager may be removed at any time by a vote of a majority of all the members of the council. However, he shall not be so removed until the reasons for his proposed removal have been furnished him in writing, and until he has received a public hearing thereon before the council, if he so requests. Pending and during such hearing the council may suspend him from office.*

⁹**§21-9-33.** Attendance at council meetings: *The manager and such other officers as the council shall determine shall meet regularly with the city council and have full privileges of discussion but no vote.*

¹⁰ According to Op.Atty.[Gen. No. 2004-0583, Ramsey, November 30, 2004, 2004 WL 3015500](#), Sections 21-9-29 and [21-9-45](#) authorize the city manager to reorganize city government and realign job responsibilities of the employment positions and offices reporting to him, except where the



§ 21-9-29. Functions of the City Manager

The city manager shall, subject to law:

- (a) be responsible to the council for the entire administration of the city government;*
- (b) prepare and recommend to the council an annual budget;*
- (c) administer and secure the enforcement of all laws and ordinances of the city;*
- (d) appoint and remove all department heads and other employees of the city, except that notwithstanding any other provisions of this chapter, the council shall appoint the city attorney, the auditor, and the police justice, if any, and the council may, in its discretion, appoint the city clerk and treasurer;*
- (e) supervise and control all department heads and other employees and their subordinates;*
- (f) negotiate contracts and make all purchases for the city, subject to existing laws and subject to the approval of the council;*
- (g) see that all terms and conditions imposed in favor of the city or its inhabitants in any statute or municipal ordinance regarding public utility franchises or other contracts are faithfully kept and performed, and upon knowledge of any violation thereof call the same to the attention of the council;*
- (h) make such recommendations to the council as he may deem expedient or necessary;*
- (i) make reports or recommendations to the council upon request, and at least once a year present a written report of his work and the financial condition of the city for the information of the council and of the public;*
- (j) perform such other duties as may be required by ordinance or resolution of the city council.*

The importance of the City Manager's role is emphasized in this report because everything good and bad that happens in the administration of the city will fall onto that position. The City Manager not only oversees operations, it is also his job to protect the elected officials from poor management that can have a negative impact on the city and citizens. In any form of government, it is considered a best practice for the administration to keep the governing body informed through regular reports and communication to be transparent. The Council may want any reports/updates from the City Manager to be made part of the record to show that open discussion is taking place, and to make related actions clearly official. The Council needs to have a professional in that position who they know can manage the resources of the city and enact their visions for the success of Diamondhead.



Two areas that any city manager or administrator needs to be diligent about are internal controls over operations and segregation of duties among staff as they relate to the financial or procurement processes. The tone set by the top administrator will filter down through the rest of the organization. If employees know and understand that the Council and the Manager are serious about internal controls over operations, then they will be too. It is when people within an organization think that the management is not watching, not caring, or not acting appropriately themselves that the employees see the opportunity to commit fraudulent acts.

The auditing world always talks about the “fraud triangle.” When fraud occurs in government, it almost always has all three of these elements: pressure, opportunity, and rationalization. Prevent

city council creates an office or department, and assigns those offices or departments specific powers and duties in accordance with [Section 21-9-45](#), the city manager is bound by the provisions of that ordinance. In addition, under the city manager's administrative authority he may reassign non-statutory duties except he may not do so where such reassignment would conflict with an ordinance adopted by the city council establishing the duties of an office or department pursuant to [Section 21-9-45](#).



any one of these elements, and the fraud triangle can be broken.

What can an organization do? The **pressure** to commit fraud can be anything from sick relatives, high debts, addictions, or simply the pressure to meet certain deadlines. The **rationalization** can be very subjective. While it may be the idea that “everyone is doing it,” it could just as easily be “I think I deserve this.” Either way, those may be harder for management to control. However, the easiest area an organization can affect through internal controls is the **opportunity** to commit fraud. If an organization maintains strong internal controls over processes, duties, oversight, and has equally high expectations of professional conduct of its employees, the chance of fraud will be reduced. Consistent enforcement of policies and procedures and simple actions like not sharing passwords can easily help protect the whole entity. However, management should always be aware that employees take their cues from their superiors and Diamondhead should continue to maintain its high expectations of integrity and professionalism that OSA observed at all levels.

Segregation of duties is one important way to break the link of the fraud triangle. Examples here will illustrate the point better, perhaps, than a narrative:

- A) If the same person who collects cash payments, also enters the payment into the financial software, then counts the cash received, prepares the deposits, makes the deposits, and then reconciles the bank accounts, then there are no duties that have been separated to ensure that fraud cannot happen.
- B) In the same way, if the person who prepares payroll is also the only person acting in a Human Resources capacity, it is possible to commit payroll fraud undetected. Examples of this may include over or double payments, ghost employees, benefit/leave accrual modifications, etc.
- C) The same type of examples can be made about procurement and accounts payable responsibilities. If the same person files a requisition (on behalf of a department), then obtains quotes/bids, prepares the purchase order, receives the inventory, pays the invoice and records the inventory into the property control system, the chance for fraud would be high.
- D) Even if it is not as obvious as the previous examples, if the same person prepares and deposits cash, then later reconciles accounts. There is opportunity for fraud. If the same person who receives or pays for equipment also inventories that equipment, then there may be opportunity for fraud.

One of the first items of discussion with the Diamondhead City Manager when OSA was requested to conduct this performance review was related to finding ways to ensure that opportunities for fraud were minimized in the future. These areas included cash management, staffing, segregation of duties, and property control.

Overall, the administration is doing well because it has some strong controls in place. Because auditors also conducted an historical review of certain activities like contracting, grants, and inventory control, OSA can say that currently, while there is still room for improvement with segregated duties, additional and stronger internal controls have been put into place and they appear to be followed by the staff. OSA recommends that the City Manager continue in the direction that has been started and maintain the policies and procedures that work for the City, while periodically reviewing and modifying others.

During this project, OSA auditors reviewed the various departments, organization charts, staffing, policies and procedures, job descriptions, etc. of the current administrative operations of Diamondhead. It should be noted that Diamondhead currently does not operate its own fire, water/sewer, or police departments. These services are currently all provided through interlocal agreements or other independent public entities. However, as the population and service expectations grow, the need for appropriate staffing levels to ensure that tax payers' money is protected and used properly increases as well.

For this project, OSA auditors reviewed the administrative departments, including the municipal court, and the public works department. The following report sections describe the work conducted, as well as the findings and recommendations that OSA provides to Diamondhead to maintain or improve its overall operations.



Workflow and Staffing

To examine workflow in the City of Diamondhead, OSA auditors evaluated the areas of procurements, accounts payable, accounts receivable, special projects, property control, payroll, and public works. To construct an accurate picture of the daily workflow, OSA auditors reviewed existing policies and procedures, observed activity in the main office area, interviewed staff, and examined documents. The review also included the city clerk and city manager's daily roles and oversight. OSA found that a lack of staff in a couple of areas has resulted in a lack of segregation of duties related to financial controls. While this is not currently creating non-compliance, it does raise some red flags and risk factors. The City Manager is aware of this issue and has been working toward reorganization efforts that will alleviate the risk.

In the Council-Manager form of government, the Council appoints the City Manager, the City Attorney, the Municipal Judge, and the City Clerk. The Manager has the sole responsibility of hiring and overseeing the employees who are tasked with ensuring the coordinated and efficient operations of the city, with the exception of the City Attorney and Municipal Judge who both report directly to the Council. The City Clerk, although appointed by the Council, reports to and is supervised by the City Manager. According to statute, the Manager must take a more macro view of the daily operations, entrusting other staff, including the City Clerk, to report to him timely and accurately whenever appropriate and in preparation for Council meetings.

During the performance review, OSA auditors observed and reviewed the day-to-day operations of the administrative staff. Auditors interviewed staff to determine what they did on a daily basis and what their background and experience levels were, and then compared these to the city's organization charts and job descriptions, as well as to expectations of similar positions.

For positions like the City Clerk and Manager, OSA auditors also reviewed specific governing statutes. Generally, OSA found that the current staff is knowledgeable, professional, and works together to achieve the goals of the administration. Further, through observation, auditors found that the staff is highly responsive to citizens and never appeared less than professional. OSA auditors did also observe that at times, the current staff is "stretched thin" trying to be responsive and fulfill their regular job duties, at the same time as they pick up "other duties as assigned." OSA found that at times, they face difficulty completing primary tasks, such as payroll, because they are taking on these other, non-primary duties to fill in small gaps such as reviewing another department's work, delivering, picking up, or receiving items, changing signs and posting notices, all of which could be remedied by additional support staff.

Related to strong internal controls and segregation of duties, OSA also observed that there are times when informal procedures have been put in place to mitigate segregation of duty weaknesses resulting from a lack of staffing. While this is a good solution for the short-term, it is not usually a sustainable means of maintaining strong operations.

Generally, in evaluating the existing job descriptions and comparing them to actual filled positions, OSA makes the following findings/observations:

1. Not all existing positions are funded or filled and should be modified to reflect current and future needs;
2. Of those that are filled in financial sections, there may be some lack of segregated duties or potential overlap that could lead to weaker city operations in the future—this is where the concentration of changes should occur;
3. There is a lack of depth in the current organization chart that could lead to less than ideal oversight and workflow (productivity and bottlenecks) which can lead to weak internal controls.
4. Because overtime is a part of municipal government, especially where a shortage of staff may occur, the new labor regulations related to overtime pay that will go into effect in December may have an impact on operation costs.

OSA makes the following preliminary recommendations related to staffing and workflow:

1. The City Manager should evaluate the current organization chart and modify it to add increased internal controls through depth and oversight, focusing on the necessary segregation of financial duties;



2. The City Manager should evaluate all existing positions. Unfunded positions should be evaluated, modified and/or eliminated as structural needs occur. Other positions might need to be added as well—such as consideration of a human resources manager, or additional administrative assistant positions. While the City Manager has the statutory authority to reorganize the administration as he believes is necessary, he should still bring his recommendations/plans to the Council in order to keep them aware of the changes.
3. OSA will continue to work with the City Manager to determine best practices and opportunities for structural changes in the organization chart to strengthen the segregation of duties related to payroll, procurements, and payments; and to adjust policies, procedures, and staffing in order to strengthen such controls.
4. The City Manager, with the City Clerk, should periodically review all personnel with surety bond requirements are properly bonded in at least the minimum amount and that their oath and surety bond provide them with the authority necessary to do their jobs.
5. By modifying the existing organization chart and potentially adding certain other positions as necessary, the workflow issues that OSA noted should be eliminated.

Diamondhead appears to be very efficient with its staff, even if it is not as effective as it could be due to a shortage of just a few administrative support positions. There are small, but numerous required daily activities that could be easily handled by an administrative assistant level position, which would then free current employees to concentrate on their primary jobs. Unfortunately, these “other duties as assigned” are impeding the effective workflow of the administration.

Policies and Procedures

OSA auditors reviewed current policies and procedures and found that the majority of the procedures are sufficient to conduct the business of the city, given that there may be staffing or organization changes to ensure continued strong internal controls over operations. As structural and staffing changes take place, the City Manager will also need to continue to modify existing policies and procedures. Additionally, OSA auditors compared existing policies and procedures to actual operations and determined that the staff is following existing written policies and procedures and there were no identified instances of non-compliance.

OSA auditors have found that Diamondhead currently has sufficient policies and procedures governing cash, procurements, inventory control, and personnel conduct, with the exception related to a lack of segregated duties over certain areas. As noted in the staffing section, a lack of segregated duties can lead to weak internal controls. Auditors noted through interviews and observations that the staff have implemented procedures that help protect the integrity of the financial system that results from a lack of staffing in certain areas.

OSA recommends that periodically, the City Manager, with the help of senior staff, should review policies and procedures, to ensure that they continue to be used to create an environment of efficiency, effectiveness, and accountability. Over time, procedures change due to technology advances, staff turnover, changes in experience and expertise, etc. As this happens, management should monitor the best methods to keep workflow efficient and effective, which in turn protects the integrity of the administration and helps maintain the correct tone of accountability.

Procurements and Property Control

The major expenditures in a city usually revolve around salaries and benefits (personnel), contracts for services (generally in the public works or personal services areas), and procurements. These three areas, contracts, payroll, and procurements are also where certain major frauds can occur.

Part of the performance review including testing property control procedures as part of the overall procurement process. Auditors tracked a sample of purchases from requisition to placement on inventory. In reviewing the process, OSA notes that the City of Diamondhead has a very good recordkeeping system that includes both electronic and paper documents and which is cross referenced. Auditors verified bids, supporting



documentation, approvals, time from requisition to receiving and payment, and inventory control tagging. OSA auditors also tested the property control system by tracking the sample items.

OSA found that Diamondhead had no instances of non-compliance or failed controls over the procurements and property control processes. When making visual confirmation of the sample inventory items, some of which were part of the Sheriff's services and some of which were located with the Public Works department, OSA found that the department employees and the inventory control staff had no difficulty immediately locating all of the items in the sample.

Contracts

In their simplest terms, government contracts should protect the financial interests of the taxpayers who fund the government and ensure the delivery of goods or services needed by the city, while paying a fair and equitable price to the vendor. Generally, besides conforming to any legal requirements, best practices show that such contracts should have well-defined deliverables, claw-back¹¹ features, specified time-frames, professionalism requirements (licensing, bonding, etc.), reporting and documentation requirements, and strong termination clauses.

Certain types of contracts may be governed by federal or state laws and regulations as well. These laws and regulations may include quote or bidding requirements, or minimum professional standards. States and the federal government have also determined that certain prohibitions are essential to government contract fairness. Perhaps these laws were originally implemented to stop contract fraud and abuse or perhaps it was merely a matter of foresight on behalf of lawmakers. Either way, requirements for selecting vendors and public/private contractual arrangements are designed to minimize fraud, graft, and corruption, while promoting fairness in business transactions with government entities.

As noted previously, in the Council-Manager form of municipal government in Mississippi, the professional City Manager has the sole authority in a Council-Manager form of government to negotiate contracts and apply for grants, but such contracts can only be executed after the approval of the Council, over which the Mayor presides. Neither the Mayor nor the Council has authority to negotiate contracts under the Council Manager form of government. While the manager has the responsibility and authority to negotiate contracts, he also has the responsibility to keep the Council informed as a best practice, because the Council has the ultimate authority and responsibility to set budgets and approve expenditures. For this, or any other form of government, constructive and regular communication of City operations between the administration and the Council is critical to good governance.

At the beginning of a contracting process, once the determination that a service or product is not sole source—that is, there is no other vendor who can also provide an equivalent product or service—the manager must follow any legal process established by state statute to select a potential vendor or vendors, with whom the city will conduct business. Using whatever process is appropriate, the manager then provides the Council with selected vendor(s) and any required contract terms for them to approve or not. It is important to note that contracts are generally not binding from one elected term to another, unless approved by the in-coming Council.

Once a vendor has been selected (either as an exempt personal services contract or as a bid service), the City Manager has negotiated the final contract, and the Council approves the contract, the mayor, as the titular head of the Council will sign all contracts, unless otherwise authorized by the Council under §21-9-29(j) or §21-9-37, Mississippi Code of 1972.

As part of the Diamondhead performance review, auditors reviewed a sample of contracts implemented since 2013. This review included reviewing documentation, communication, invoices, and payments. OSA found that contracts have been improving since 2014, however, prior to this, a number of contracts did not protect the city/taxpayers as they could have. OSA found the following problems with several contracts:

¹¹ A **clawback** provision in a contract requires that something or some amount of money be given back, depending on the circumstances. Often it is written into contracts to prevent or deter poor- or non-performance by a contract vendor, or it may be used in a case when contract requirements are not met. Governments build these into contracts as a method of protecting the taxpayer's money and assuring the government that they will receive the product the vendor is supposed to supply.



- A lack of specificity of services and deliverables
- A lack of claw-back features,
- A lack of penalties for non-performance
- No termination clauses to protect the city
- No mention of the required E-verification law that requires all contractors, vendors, etc. to ensure that they are registered and properly using the federal E-Verify system.
- No conflict of interest assurances on behalf of the vendors

While OSA auditors found no documentation showing any other elected officials undertook negotiations of contracts outside of the statutory authority of the Council-Manager form of government, during the contract review, it appears that at least once, the mayor may have negotiated on behalf of the city. The danger in such actions is that without statutory authority to bind the city to certain agreements, terms, and conditions, such action may have the potential to create a financial liability for both the individual and the city. In addition, if the city manager is negotiating a contract in good faith, and an elected official negotiates a similar agreement with another vendor, the liability may be even more pronounced. Generally, a public official may not obligate or bind a municipality in a contractual arrangement without proper authority, generally as part of a Council motion.

Usually, a contract can only become binding upon approval by the Council at an official meeting where it will become an official part of the municipal minutes. However, a miscommunication or the accidental implication that a contract will be approved or approved with certain terms by an individual not authorized to negotiate a contract may result in problems for the municipality. This is especially true in the Council-Manager form of government in Mississippi. Most vendors are familiar with the way that the Mayor-Alderman and Mayor-Council forms of government work—where the Mayor would be the one to undertake negotiations. The opportunity for misunderstanding or false assumptions on the vendor's part are more likely if they fail to understand the statutory limits placed on the elected body in a Council-Manager city.

Diamondhead elected officials should be aware of the potential personal and municipal financial liability, and OSA recommends that they should always work with the professional management and staff of the city to follow statutory guidelines. However, they should feel comfortable asking questions, requiring information, and whenever appropriate, reviewing the contracting process so that they have assurance that their approval and payments of any contracts will be in the best interest of the city and the taxpayers. In the auditing world, that is called "Trust, but Verify."

Similar to grant management, documentation and oversight are important for good business processes related to contracts. To ensure that correct amounts are billed and paid, that work is properly completed or services correctly provided, it is the responsibility of the City Manager and administrative staff to require appropriate and reasonable detail of work performed or service or products provided. All contracts should also include clauses allowing the city to audit the project related records of any vendor. The goal of this is similar to the internal controls found within the administration itself that protect the taxpayers and set the proper tone of governance. It is also important for the staff to always carefully review bills before approving them. While slightly more time-consuming, errors may be caught, and there will be greater accountability and efficiency in the long-term provided to the Council.

Cash Management

State law provides for a number of protections for local governments related to cash transactions. Possibly the most important of these are surety bond requirements to cover any elected or appointed official who might be able to misuse public funds. Specifically, surety bonds are required of employees who handle cash payments and transactions.¹² Most local governments choose to only obtain the minimum surety bond required for each

¹² **§21-9-21.** *Subordinate officials and employees: ...The city council shall require all officers and employees handling or having the custody of any of the public funds of such municipality to give bond, with sufficient surety, to be payable, conditioned and approved as*



individual required to have one. While this may save money in the short run, it can also lead to municipal losses in cases where embezzlement or other fraud may take place that is greater than the surety bond of the liable person. The surety bonds are required to protect the municipality from losses in case of fraud, abuse, embezzlement or other crimes by elected, hired, or appointed officials that cause a financial loss to the government, like an insurance policy that pays when losses are incurred. OSA finds that there are personnel performing dual functions for which they may lack surety bonds that would cover these specific, additional responsibilities. OSA recommends that all surety bond requirements be reviewed and all personnel be properly titled, oathed, and bonded for those duties required to be covered by state law.

Of course, strong internal controls over cash management, including segregation of duties related to transactions deposits, record-keeping, etc., are vitally important to protecting municipal funds and protecting the reputation of the city and its elected officials. The tone from the top related to professional conduct, standards of behavior, and uniform disciplinary actions must be consistent and serious to be a strong internal control. While the City Manager may not personally review all cash transactions, he must convey the expectation of correct conduct.

As part of the evaluation of Diamondhead's operations, OSA auditors reviewed the policies, procedures, workflow, and duties of the court department and the planning and zoning departments. Through interviews with the Treasurer, City Clerk, Court Clerk, Planning and Zoning Director, and others, OSA auditors find there is not sufficient segregation of duties related to cash management at this time. This appears to be due to lack of staff in the Court Department and in the administration in general.

The Building Department provides permits and licenses, the Court Department collects judgements, fines, and other ticket related fees, and Diamondhead also collects cash for golf cart fees and public records requests. All cash is collected and deposited by the Deputy City Clerk/Court Clerk. All money collected is recorded in the InCode computer system in the specific financial module for each department. Each user with access to a financial module has a unique login and password. OSA auditors did not find evidence that anyone has shared their unique logins or passwords. When new employees start, employees leave, or when they have issues with their computers, the City Clerk is currently considered the computer administrator. However, this does not give her access to other people's accounts. She is the conduit to the software vendors who actually set up account information.

There are employees who are allowed to collect cash payments, but do not have access to any of the financial modules. They are used when primary staff assigned to collect money is unavailable. They have a process where they issue a paper receipt and then the receipt book and cash are given to the primary employee who then enters the information into the correct financial module (by department). The cash payment is then turned over to the Court Clerk/Deputy City Clerk for deposit.

The Purchasing/Accounts Payable Clerk maintains a log of the receipt books that are in use during the year. Used receipt books are maintained in storage for use in auditing purposes. The receipt log must be signed by each person who is issued a receipt book. In the same way, one of the controls the Court Clerk uses for ticket books. Payroll checks are currently kept locked in the City's vault. OSA recommends that the administration should protect all checks and unused receipt books in this manner. The use of sign-in and sign-out logs for both checks and receipt books is a good internal control that should continue to be maintained.

As was found in several other departments, a shortage of staff causes a single person in the Court Department to have to collect money, process fines in the system, maintain all records, reconcile cash for deposits, and make the deposits. Auditors also determined that the Court Clerk has developed workflow and documentation procedures that allowed OSA to track deposits all the way back to a ticket or judges order—on both paper and in the software being used. Once such example is having the Accounts Payable Clerk (who also doubles as the Accounts Receivables Clerk) double check the daily collections and deposit slip. Another example is ensuring that deposits are made at the end of a day and always, regardless of the amount that may have been collected, on Fridays. The only exception to this is if more than \$1,000 is collected before the end of



the day, then an immediate deposit is prepared and completed. She was able to show the processes with the check points that prevent mistakes, or provide detail to any necessary adjustments.

The Court Clerk currently has many responsibilities. In addition to making Court deposits, she also makes all other cash deposits, oversees janitorial activities, handles key distribution, petty cash, custodian of the safe, and is the Deputy City Clerk. She has been signing paychecks in place of the City Clerk, as well. Some of the work as the Court Clerk included in her day-to-day activities are data entry; docket, warrant, bond forfeiture, and discovery preparation; case management updates; overseeing the community service work program; preparing monthly reports required by and sent to the State; handling record keeping for all tickets, ticket books, court documents; check for inmate intakes daily and schedule court time with the Judge; and numerous other activities. Several employees in City hall have numerous jobs they must do each day, in addition to their primary duties. The cash management issue, however, must be highlighted, due to the other functions the Court Clerk also manages. There may come a point where deposits may not be able to be made on time, mistakes may occur, etc. or her primary Court Clerk duties may suffer.

Grants

Grant applications and negotiations fall under the purview of the City Manager, with the statutory and management understanding that the Council must be kept in the loop prior to, during, and after such application is awarded. With regard to grant management, OSA auditors reviewed a sample of Diamondhead's grants and found that they appear to be adequately organized and managed. While reviewing grants, OSA auditors found no evidence of grant non-compliance, nor did they find any evidence of inaccurate, late, or missing required reports. Procurements and expenditures under existing grants appear to follow grant requirements, as well. Expenditure documentation matched expectations. However, OSA auditors, while reviewing communications, documentation, and interviewing staff, were made aware that on at least one occasion between 2014 and 2015, the Mayor improperly undertook to apply for and negotiate a tidelands grant¹³ for which the City Manager and Council were not aware until after it had been awarded. In addition to not adhering to the statutes governing the separation of power and duties in the Council-Manager form of government, there can also be financial repercussions to the individual who improperly obligated the city and to the city itself, especially if the City Council were to refuse to conduct the grant or if the City were unable to meet the obligations of the agreement. These statutes that govern the powers and duties of the various municipal operations help protect everyone and create orderly operations.

Good grant management is imperative, not just to ensure that agreements with the State and federal governments are met, but to protect the elected officials who have the ultimate responsibility for any grant accepted and approved by the municipality. There are many forms that grant management takes in a local government. Some use "in-house," full-time employees, while some, like Diamondhead, contract with experienced, professional grant managers—individuals or organizations that develop, apply for, and manage grants for local governments. Full-time employees should be bonded for the protection of the municipality and contract grant managers should hold certain liability insurance. However, regardless of how grant management is handled in the city, the elected officials will always have the final responsibility for the grants awarded to their municipality and may not abdicate that responsibility.

Having a full-time employee who manages grants is generally not feasible for most Mississippi municipalities. More often than not, that employee is not a dedicated grant manager, but instead, has a completely different "other" position and does the grant work as necessary. In the situation where that employee is being even partially paid through grant sources, the amount of detail and documentation needed to justify the grant/salary portion of the total salary can be burdensome and time consuming.

¹³ On or around April 2015, it appears that the Mayor alerted the Council to a grant that he applied for in 2014 with the assistance of Seymour Engineering, Inc. While it resulted in a tidelands grant for Diamondhead, the Mayor did not have the statutory authority to apply for, negotiate, or accept such a grant without the Council's knowledge and approval ahead of time. In addition, the City Manager, who is statutorily responsible for such applications, was also not made aware of the application until after it had been accepted.



When a municipality agrees to a grant from the state or federal government, such grants must be officially approved by the Council, and spread upon its minutes. Ultimately, because the elected governing body has responsibility for grants given to the municipality, it is important that they receive updates from the city manager or grants manager when appropriate to ensure that the Council understand their obligations, progress, and key dates important to grants. The governing body entrusts the management and execution of grants to the administration through the city manager and his staff. Members of the governing body (the Mayor and Council) may not apply for a grant. They may instruct the manager to apply for a grant, or they may approve the city manager's request to apply for a grant. Then they must approve the application and later the grant award as a body as an official action on their minutes.

As part of any strategic plan, the governing body should work with the city manager and the grants coordinator to determine what potential grant programs could be utilized to achieve the goals of the city and determine a long- and short-term plan for grants. In the short-term, it may seem like the city has numerous grants, however, being awarded a grant, especially a competitive or complex grant, can take six months, a year, or even longer. Small grants have just as much paperwork and reporting requirements as large grants and take just as much time and effort to manage and complete. Having an extended plan ahead of time ensures little or no lapse in the implementation of the city's strategic vision. Keeping these plans current also opens possibilities for more flexibility for grants that become available unexpectedly.

While Diamondhead does not appear to have problems in its grant management processes at this time, the governing body should be aware of the changing federal grant landscape. As can be currently evidenced in a number of state agencies and local governments, the federal government takes grant management very seriously and they no longer hesitate to claw back any money, even if correctly spent, that was not properly managed. What does this mean? Simply, that, in recent years, the federal government has concluded that it is not sufficient to properly spend grant proceeds according to an agreement—that is, the local government does what it says it was going to do—the subgrantee must also properly manage, oversee, and document the proof that they knew how those funds were spent. In some recent cases, subjective decisions by federal agencies are requiring subgrantees to repay grant funds, even if the funds were proven to be spent properly. Recently, the federal Office of the Inspector General has recommended that a small Mississippi town should re-pay more than \$25 million of a \$50 million disaster recovery grant. This demand for repayment was not based on them mis-spending the money, but rather a combination of a lack of documentation proving that they went to "sufficient" lengths to bid and contract a certain way, mistakes by the federal government in properly adjusting an award, and poor documentation of grant management and implementation efforts by the town. Maintaining sufficient controls related to grants is important. In addition to a well-versed grant manager, the Manager and any specific department employees involved in the execution of the grant should understand and always take their role in a grant very seriously. Diamondhead should continue to ensure that it maintains the strong grant management processes currently in place.

Services Long-Term

Interestingly, in Diamondhead, when the city incorporated, they did not—for various reasons—take on all normal municipal services. The goal of any city should be to pay for services and improvements as necessary. Diamondhead may, in the future, decide to absorb services like fire protection, water, sewer, etc. If this happens, the Council and Manager should work together to develop a long-term plan for successful transition. Bonding the larger expenses and having current citizens pay for current services is what State law and municipal best practices contemplate. There are liabilities that can be associated with collecting too much revenue, holding it, and then using it in the future. Therefore, the Council should consider these potential pitfalls in their planning. In other places citizens have gone to court in certain situations and forced local governments to pay back taxpayers.

OSA recommends that the millage rate and revenue collections be regularly evaluated with future plans in mind. Further, OSA recommends that the City consider over the long-term whether they plan on trying to provide other municipal services, such as fire, police, water, and sewer, and if so, how do they plan to complete



any such transfers. The real difficulty in having so many other entities providing services is that each can individually raise rates on citizens, which can lead to a situation where municipal taxpayers are paying far more for services being provided individually than they would have if the provision and administration of the services all fell under the elected officials of the city.

Finally, OSA auditors have been looking for best practices and other examples where an incorporated municipality owns almost no municipal services, but instead, maintains interlocal agreements with other entities to provide so many of those municipal services. One reason stated for Diamondhead's incorporation is to protect municipal assets in case of another natural disaster. The problem that remains is that the city's amenities may not be protected because they are not municipally owned. OSA offers the following for the consideration of the Council and the Manager from a long-term perspective of maybe more than a decade. Negotiate to purchase the amenities from the Property Owner's Association (POA), then have a management contract with the POA to care for the amenities. Revenue could be stabilized because the cost might be spread across all taxpayers; it would help alleviate any excess millage; reduce or eliminate POA fees; and provide the protection of financial recovery through federal disaster funds in the case of another natural disaster. Millage could be dedicated to the preservation of the amenities, and it could probably be built-in as a requirement of the sale of the amenities to the city. OSA recommends that the Council consider such options and explore them with the city attorney, the City Manager, and the POA.

Conclusion

OSA found through interviews and observation, that the Council of Diamondhead is highly qualified and are performing their duties as required by law with the exception of negotiating contracts—which is explained in the grant section. They have a long-term vision for their community and while they may not always agree on details, they certainly all agree they want a strong, vibrant community where everyone can feel welcome. OSA found the City Manager and his staff to be highly professional, well organized, easy to work with, competent and with a high degree of skill and integrity. In each of the areas that OSA reviewed, there were minor recommendations or adjustments that would improve operations.

However, OSA found no non-compliance with any State or federal regulations during its fieldwork phase. Grants, contracts, procurements, and property control were all adequate to meet known requirements. Cash management and workflow have room for improvement based on a lack of staffing at this time. OSA auditors and the City Attorney are working with the City Manager to ensure that controls are sufficient to protect the city's interests and the citizens' taxes.

This report contains a number of recommendations based on non-material findings that should help strengthen any needed areas of administration. Also, this report provides some additional information to better understand the need for internal controls.

While no organization is perfect and situations change on a sometimes daily basis, OSA sees tremendous potential for Diamondhead if the Council and the Manager remains on such a path toward constructive, positive growth and interactions on behalf of the community.

OSA stands ready to provide additional assistance as necessary or requested.



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