



CITY OF EAST RIDGE

Investigative Report
December 15, 2016

Justin P. Wilson, Comptroller





STATE OF TENNESSEE

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COMPTROLLER OF THE TREASURY

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December 15, 2016

City of East Ridge Mayor
and City Council
1517 Tombras Avenue
East Ridge, Tennessee 37412

Gentlemen:

We performed an investigation of selected records of the City of East Ridge, Tennessee, and its Needy Child Fund for the period July 1, 2014, through June 30, 2016. We noted several deficiencies, which are detailed in the finding below.

Background

The City of East Ridge is located in Hamilton County in southeastern Tennessee, and is governed by a mayor and City Council. The city operates the East Ridge Needy Child Fund (Needy Child Fund) through a separate bank account and as a component within the city's General Fund. Therefore, the City Council must authorize these funds through the city's budgetary process. Since its inception, the Needy Child Fund has been funded by donations and various fundraising activities for the purpose of helping and providing Christmas gifts to families in need. During the period under review, the city operated Christmas light shows at Camp Jordan Park, a city-owned property. During the light shows, the city's Fire Rescue Department, under the leadership of Fire Chief Mike Williams, operated Santa's Village, where vendors sold various Christmas goods and other items. Sales from Santa's Village served as the primary revenue source for the Needy Child Fund.

According to Chief Williams, an estimated 20 to 25 vendors participated and signed contracts that required weekly rental payments of \$50 or a percentage of sales, whichever was greater, and Chief Williams collected these rental payments. Certain vendors were not required to pay rent if Chief Williams determined the vendor was in financial distress. In addition, the Fire Rescue Department operated a vendor stand which sold trinket items. Various Fire Rescue Department employees worked the vendor stand, and Chief Williams served as custodian of the cash on hand and sales collections. Total Needy Child Fund deposits for 2014-15 and 2015-16 totaled \$35,338.55 and \$28,169.40, respectively, a \$7,169.15 decrease in deposits. Chief Williams stated the decrease resulted from flooding and bad weather during 2015-16, causing a decline in attendance and collections. For the

period July 2, 2015, through June 1, 2016, Chief Williams served in the additional role of interim city manager for the City of East Ridge.

The finding, recommendation, and management's response, as a result of our investigation, is presented in this report. Also, the finding and recommendation has been reviewed with the district attorney general for the Eleventh Judicial District.

INVESTIGATIVE FINDING AND RECOMMENDATION

FINDING

THE NEEDEY CHILD FUND HAD OPERATING DEFICIENCIES

The Needy Child Fund had several operating deficiencies. For the period July 1, 2014, through June 30, 2016, we reviewed all Needy Child Fund expenditures, related supporting documentation, and other selected records. Our examination revealed the following deficiencies, which are the result of a lack of management oversight.

- A. Fire Chief Mike Williams failed to remit cash collections totaling \$9,442.26 from Santa's Village sales made from November 6, 2015, through January 2, 2016, until May 27, 2016, which was 146 days after Santa's Village closed. We contacted the chief on May 26, 2016, to inquire about the accounting for the Needy Child Fund and other charities handled by the city. Chief Williams stated he had forgotten about depositing the cash until our inquiry, and the cash was mistakenly left in a locked safe within his city-issued vehicle. Section 6-56-111(a), *Tennessee Code Annotated (TCA)*, provides that municipal public funds should be deposited no later than three working days after receipt. The city did not issue prenumbered receipts for Santa's Village vendor rent collections or sales from the Fire Rescue Department vendor stand during the period under review. Section 9-2-103, *TCA*, requires official prenumbered receipts be issued for all collections. Due to the absence of official prenumbered receipts, we were unable to determine whether Santa's Village collections were accounted for properly.
- B. After the conclusion of the 2015 Santa's Village, Chief Williams deposited Needy Child Fund checks in 2016 on January 6, January 11, and February 2 totaling \$2,882.11; however, he did not deposit the cash until May 27, 2016.
- C. Chief Williams stated that the city signed contracts with most of the vendors, which provided rental terms and conditions; however, Chief Williams could not produce any of these contracts. Chief Williams also stated that if he knew the vendor well, he did not make them sign a contract. In addition, he stated that if a vendor was not doing well financially, he did not require them to pay anything. Due to the lack of signed contracts with all vendors, we were unable to determine whether Santa's Village collections were accounted for properly.
- D. Chief Williams inappropriately made disbursements in cash from Santa's Village collections. The city provided supporting documentation for these disbursements, and Chief Williams stated that he made the disbursements only for the purposes of

the Needy Child Fund. However, we could not determine whether the supporting documentation represented all disbursements made in cash.

Section 6-56-111(b), *TCA*, requires disbursements be made “by consecutively prenumbered checks, warrants or other generally accepted negotiable instruments drawn on the municipality's official bank account or accounts.” In addition, the City Council did not appropriate these cash disbursements with a budget ordinance. Section 6-56-203(1), *TCA*, provides that:

...no municipality may expend any moneys regardless of their source, including moneys derived from bond and long-term note proceeds, federal, state, or private grants or loans, or special assessments, except in accordance with a budget ordinance adopted under this section or through a proprietary type fund or a fiduciary type fund properly excluded from the budget ordinance.

Disbursements made in cash and without authorization from the City Council exposes the city to risks that collections may not be accounted for properly.

- E. Needy Child Fund expenditures for the period under review totaled \$54,324.66. Of those expenditures, we were unable to locate supporting documentation for certain credit card transactions totaling \$380.99; therefore, we could not determine the purpose of these transactions.
- F. Chief Williams did not maintain inventory records of items purchased for resale at Santa’s Village. Sound business practices dictate that an inventory listing be maintained for items purchased and available for resale, and the inventory listing should be reconciled between items sold and on hand. The lack of inventory records exposes the city to risks that inventory may not be accounted for properly.
- G. The city did not segregate duties adequately among individuals involved with Santa’s Village operations. Chief Williams received collections, counted collections, made deposits, was custodian over assets, and made cash disbursements from the collections. Accounting standards provide that internal controls be designed to give reasonable assurance of the reliability of financial reporting and of the effectiveness and efficiency of operations. The lack of segregation of duties is the result of management’s decisions based on the availability of financial resources and is a significant deficiency in internal controls that increases the risk of unauthorized transactions.
- H. Although the City Council budgets Needy Child Fund revenues and expenditures on an annual basis, we found no documentation defining the purpose or proper use of the Needy Child Fund. Without written documentation of the purpose or use of these funds, we could not determine whether disbursements from the Needy Child Fund were used appropriately.

RECOMMENDATION

Municipal public funds should be deposited no later than three working days after receipt, and prenumbered receipts should be issued for all collections as required by state statute. All vendors should sign rental contracts, and these contracts should be on file for inspection. All collections should be deposited with the city, and all disbursements should be made by checks, warrants or other generally accepted negotiable instruments drawn on the municipality's official bank account and through the city's budgetary process. Supporting documentation should be on file for all disbursements. Inventory records should be on hand for all items purchased for resale, and the inventory should be reconciled with sales and items on hand. Officials should segregate duties to the extent possible using available resources. Written documentation should be on file describing the purpose and proper use of the Needy Child Fund.

MANAGEMENT'S RESPONSE – CITY ATTORNEY HAROLD NORTH, JR.

Upon information and belief, the Needy Child Fund (NCF) has been in existence for decades. In addition, during the 1990s, it was operated as a nonprofit corporation, the East Ridge Needy Child Fund, Inc., and also as another entity, the Community Chest. Our office is currently researching these entities with the Office of Tennessee Secretary of State in conjunction with a more thorough investigation at the appropriate time.

Since its inception, the purpose of the NCF has been to assist those in need, particularly children during Christmas. The NCF has collected toys, gift cards, and financial donations to fulfill that purpose and has distributed those items/funds to East Ridge citizens in need of assistance during the Christmas holidays. A review of City Council meeting agendas from over 20 years shows various references to the NCF, none of which purport to contradict the purpose behind the NCF. NCF press releases and marketing materials reviewed by our office identify and support this mission.

Control of the NCF was eventually turned over to the East Ridge Police Department and later to the East Ridge Fire Department. Recently, with the addition of the Christmas Night of Lights celebration at Camp Jordan, the funds raised for the NCF have increased substantially. Your investigation addresses the NCF during this time frame (2014-2016).

At this time, our office has no proof to specifically contradict any of the information contained in the preliminary findings of your investigation nor does our office have any proof of any malfeasance on behalf of anyone associated with the NCF. We agree that the NCF has systemic internal control issues, and the city is already in the process of removing the NCF from the city's control. Such an organization is better suited to be run by an independent nonprofit organization under Section 501(c) (3) of the U.S. Internal Revenue Code and not by the city or its personnel. Steps will soon be taken by the City Council to help organize such a freestanding entity.

In June 2016, the city adopted and implemented uniform accounting systems and internal controls as required by your office and state law. In addition, I have enclosed a copy of the East Ridge Internal Control Manual for your review. These controls are in accordance with guidance from the U.S. Government Accountability Office. We are confident that these internal controls will prevent any future problems similar to those identified by your office.

If you have any questions concerning the above, please contact this office.

Sincerely,

A handwritten signature in black ink, appearing to read "Justin P. Wilson". The signature is fluid and cursive, with a prominent initial "J" and a long, sweeping underline.

Justin P. Wilson
Comptroller of the Treasury

JPW/kbh