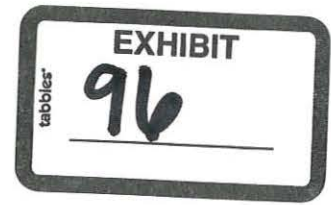


JOINT COMMITTEE ON GOVERNMENT AND FINANCE
WEST VIRGINIA OFFICE OF THE LEGISLATIVE AUDITOR



POST AUDIT DIVISION

LEGISLATIVE AUDIT REPORT

SUPREME COURT OF APPEALS OF WEST VIRGINIA *REPORT 2*

Legislative Auditor: Aaron Allred



GENERALLY ACCEPTED GOVERNMENT
AUDITING STANDARDS STATEMENT

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

POST AUDIT DIVISION



POST AUDIT DIVISION

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SUPREME COURT OF APPEALS OF WEST VIRGINIA

REPORT 2

MAY 20, 2018

LEGISLATIVE AUDIT REPORT

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Introduction

During the April 16, 2018 Post Audits Subcommittee meeting, the Legislative Auditor released a report on the Supreme Court of Appeals of West Virginia that focused on issues regarding Justice Ketchum's and Justice Loughry's use of state vehicles and the Court's failure to report personal use of Court vehicles as a taxable fringe benefit. The report also covered issues of questionable rental car use by Justice Loughry as well as his use of an antique desk valued at \$42,000 in his personal residence, and the lack of a front vehicle plate on Court vehicles. As a continuation of the audit of the Supreme Court of Appeals of West Virginia, this report is focused on the following issues, some of which are in relation to those issues previously reported.

- 1. Justice Davis had seven uses of a Court vehicle where a destination was provided, but no business purpose was provided.**
- 2. Former Administrative Director Steve Canterbury had six instances where a Court vehicle was reserved but no purpose or destination was provided. Also, Mr. Canterbury had 20 instances of rental car use that appear to be for personal use and he was improperly reimbursed \$911 in relation to those instances.**
- 3. In 2016 and 2017, the drug courts under the Supreme Court of Appeals of West Virginia purchased 529 gift cards totaling approximately \$105,000 with the State Purchasing Card, without permission from the State Auditor's Office to do so.**
- 4. The Supreme Court did not provide information regarding Justice Ketchum's use of a Court vehicle for commuting during the IRS audit of the Court's 2015 federal employment tax returns.**

Issue 1: Justice Davis had seven uses of a Court vehicle where a destination was provided, but no business purpose was provided.

As discussed in the previous Legislative Auditor's report released on April 16, 2018, the Supreme Court of Appeals of West Virginia provides the five Justices with exclusive access to three Buicks – a 2007 Lucerne, a 2009 Lucerne, and a 2012 LaCrosse. The most likely intention for use of the vehicles is for business purposes, such as attending meetings and conferences, visiting circuit courts, or speaking engagements. As a follow-up to issues in the previous report which focused on Justice Ketchum's and Justice Loughry's use of Court vehicles, the Post Audit Division reviewed the Court vehicle and rental car use for the other presiding Justices, former Justice Benjamin, and the current and former Court Administrators.

Justice Davis

Seven Court vehicle reservations for Justice Davis were noted where a destination was provided but no purpose was provided to substantiate the use of a Court vehicle for Court related business. Based on the Court vehicle reservations provided by the Court from 2011 to 2018, there were 75 reservations for Justice Davis. The Post Audit Division reviewed Court records and travel expense documentation to determine the business purpose for these instances. A letter was also sent to Justice Davis requesting clarification and to provide business use and destination for any of those reservations where such information was not available. Of the 75 reservations, the business purpose and destination for 55 reservations was determined. Based on Justice Davis's response and further review, **13 instances were found where, although there appeared to be a reservation, it was determined that Justice Davis did not use the vehicle.** Justice Davis stated she traveled in Court vehicles only when accompanied by the Director of Court Security, and for those thirteen instances neither Justice Davis nor the Director of Security have record of travel for those dates. Further, no fuel purchases or other travel expenses could be attributed to those dates. For the remaining seven instances, a destination was determined but not a business purpose. The vehicle use was confirmed for each of the seven instances through a review of the Director of Court Security's calendar which notes that he drove Justice Davis on all seven occasions. For each of these seven instances the business purpose could not be established. These instances are detailed in Table 1.

Table 1		
Justice Davis Vehicle Use Without Defined Business Purpose		
Date	Destination	Round Trip Mileage
September 14, 2011	Roanoke, WV	194
October 17, 2011	Clarksburg, WV	250
May 29, 2012	Jackson County, WV	80
August 4, 2012	Morgantown, WV	312
September 16, 2012	Snowshoe, WV	294
October 24, 2012	Huntington, WV	106
January 17, 2014	Clay County, WV	104
Total Mileage		1340

During the review of Justice Davis’s vehicle use, it was also noted that Justice Davis attended a political fundraiser during a three-day consecutive period for which she had reserved a Court vehicle. From November 13th through 15th, 2011, Justice Davis had reserved a Court vehicle and traveled with the Director of Court Security to attend anti-truancy meetings in Wheeling, WV and Parkersburg, WV. On November 13th, she was driven from Charleston to Wheeling and stayed overnight in Wheeling. The following day, November 14th, she participated in an anti-truancy event in Wheeling. At the conclusion of the program, she was driven to Parkersburg, WV where, according to her *State of West Virginia Campaign Financial Statement of 2012*, she attended a fundraising event. On November 15th, Justice Davis participated in the anti-truancy event in Parkersburg and then returned to Charleston. Both anti-truancy programs were announced in a press release from the Supreme Court of Appeals of West Virginia on November 10th, 2011. During this trip Justice Davis charged no lodging to the State, and only charged \$115 for meal expenses for the three days of travel. Justice Davis also had indicated she made a stop at the Raleigh County Armory for what she believed was a political event incidental to court business, but a date and time for this event could not be confirmed or correlated to any vehicle reservation.

Issue 2: Former Administrative Director Steve Canterbury had six instances where a Court vehicle was reserved but no purpose or destination was provided. Also, Mr. Canterbury had 20 instances of rental car use, totaling \$11,076, that appear to be for personal use and/or convenience. He was also improperly reimbursed \$911 in relation to those instances.

Steve Canterbury, Former Administrative Director

The vehicle use for former Administrative Director Steve Canterbury was also reviewed. Mr. Canterbury reserved a Court vehicle 78 times between 2012 and July of 2016. Mr. Canterbury did not complete the purpose section of the reservation form for 36 of the 78 uses. Mr. Canterbury responded to an inquiry from the Legislative Auditor and provided business purposes to substantiate the use in all but six instances. For the remaining six instances, the Legislative Auditor attempted to view the personal calendar maintained by the Court for Mr. Canterbury to determine if there was a business purpose; however, those calendars were missing. In a memo dated February 16, 2018, the Executive Assistant informed the current Administrative Director that, in response to a request outside of this audit, she was asked to provide the daily calendars from 2005 to present. However, the calendars for 2013 to 2016 that were previously in her files were now missing. As a result, the Legislative Auditor is unable to confirm the purpose, destination, mileage, or if in fact a Court vehicle was used by Mr. Canterbury for those six instances.

In regard to Mr. Canterbury's use of rental cars when traveling on out-of-state Court business, we noted 20 instances that appeared to be for personal use, similar to Justice Loughry's rental car use in the previous report. These 20 instances are detailed in Table 2.

Table 2
Rental Car Use by former Administrative Director Steve Canterbury

Dates	Location	Round-Trip Mileage Airport to Hotel	Mileage on Rental Car Receipt	Mileage Difference	Total Cost of Rental Car (with Parking, Upgrades, Fuel Option, and GPS)	Amount Improperly Reimbursed to Mr. Canterbury
July 23-27, 2010	Denver/Vail, CO	244	1922	1678	\$1,771.12	\$321.72
September 19-21, 2010	Salt Lake City, UT	18	56	38	\$144.88	\$ -
November 30-December 4, 2010	New Orleans, LA	33	91	58	\$721.42	\$ -
November 30-December 4, 2011	San Antonio, TX	20	144	124	\$671.13	\$75.80
April 22-25, 2012	Little Rock, AR	13	136	123	\$491.46	\$ -
May 9-12, 2012	Omaha, NE	14	235	221	\$514.42	\$30.00
November 28-December 3, 2012	Palm Springs, CA	481	1024	543	\$1,124.46	\$233.18
April 20-25, 2013	Boston, MA	34	163	129	\$404.27	\$ -
December 4-8, 2013	Naples, FL	68	344	276	\$1,395.09	\$77.78
January 26-28, 2014	Savannah, GA	21	207	186	\$294.44	\$ -
March 20-23, 2014	Pensacola, FL	120	168	48	\$684.58	\$79.78
April 26-30, 2014	Portland, OR	25	798	773	\$320.54	\$ -
September 15-19, 2014	Memphis, TN	24	155	131	\$180.91	\$ -
May 13-15, 2015	Arlington, VA	11	86	75	\$366.19	\$ -
May 16-20, 2015	Albuquerque, NM	12	273	261	\$331.63	\$ -
November 7-10, 2015	Austin, TX	21	88	67	\$277.30	\$ -
December 2-5, 2015	Monterey, CA	212	706	494	\$497.91	\$ -
March 17-20, 2016	Pensacola, FL	10	247	237	\$228.45	\$ -
July 20-26, 2016	Jackson Hole, WY	20	252	232	\$302.10	\$ -
November 29-December 4, 2016	Naples, FL	68	203	135	\$354.01	\$92.78
TOTALS		1469	7298	5829	\$11,076.31	\$911.04

As the table shows, for many of the instances Mr. Canterbury drove a significant number of miles in these rental cars in excess of the round-trip mileage to and from the airport and hotel where he stayed. Based on the rental car receipts, some instances are more egregious than others. For instance, during his trip to Denver/Vail, CO, Mr. Canterbury drove the rental car for 1,922 miles, 1,678 miles more than the round-trip mileage from the airport to his hotel. This car rental, including parking and additional days of use unrelated to Court business, cost a total of \$1,771.12. On his trip to Portland, OR, Mr. Canterbury drove the rental car 798 miles, 773 miles more than the round-trip distance from the airport to hotel, costing \$320.54. The total cost related to these rental cars is \$11,076.31. While not all instances noted have excessive mileage over the round-trip distance to the airport and hotel, the Legislative Auditor questions the need for these rental cars in lieu of using some less expensive means of transportation such as a taxi, shuttle, or ride share service. As similarly noted for Justice Loughry's use of a rental car in the April 16, 2018 Legislative Auditor's report, Mr. Canterbury's rental car use also appears to be for personal use at the cost of the State.

Also, in relation to these rental car uses, Mr. Canterbury was reimbursed for related rental car expenses that he should not have been reimbursed. For these 20 instances, the Legislative Auditor reviewed the cost of the rental car, associated expense reimbursements, adjustments made to the reimbursements to account for personal use, and the number of miles driven. To determine any improper reimbursements, the Legislative Auditor examined additional airport parking costs, vehicle upgrade charges, and other expenses resulting from rental car use for personal days taken on these trips. In many of these instances, Mr. Canterbury was reimbursed for costs related to his travel that he had paid for upfront. For several trips, Mr. Canterbury took additional "personal days" in the location he traveled to, essentially as personal vacations. To account for the personal expenses related to his use of rental cars Mr. Canterbury attempted to pro-rate the rental car costs and seek reimbursement only for those costs that were associated with Court business. However, in some instances he did not account for the higher rental rate charged over the base weekly rate for using the vehicle for additional days for personal use and was reimbursed based on the flat average daily cost of the rental he had calculated. Also, he sought reimbursement for hotel parking charges and upgrades to the rental cars, such as upgrading to a better vehicle and GPS, that were not necessary but were included in the costs in his pro-rated calculation. The additional personal days also incurred costs associated with the parking charges for his personal vehicle at the airport he departed from, which he was also reimbursed for by the Court. The result of this examination showed that **Mr. Canterbury was improperly reimbursed for \$911.04 of expenses he was not eligible to receive.**

The Legislative Auditor contacted Mr. Canterbury and informed him of the \$911.04 of expenses related to the rental cars that he was improperly reimbursed. On May 10, 2018, Mr. Canterbury provided the Legislative Auditor with a copy of a letter he sent to the Court's current Administrative Director. In this letter, Mr. Canterbury states that he was informed of these errors by the Legislative Auditor's Office and that, even though he had made every attempt to account for any costs incurred related to personal expenses for these trips, he had made several honest mistakes that were not caught by the Administrative Office's Finance Division when the reimbursements were processed. In regard to these errors, Mr. Canterbury provided the Court a

check in the amount of \$911.04 payable to the State of West Virginia to correct these errors, a copy of which was provided to the Legislative Auditor.

Remaining Justices' and Administrative Director's vehicle use.

Justice Benjamin (Former Justice)

The Legislative Auditor reviewed the use of Court vehicles by former Justice Benjamin and determined there were no issues. There were only six instances of Court vehicle use by Justice Benjamin and all uses stated a business purpose. Justice Benjamin had significantly more travel expenses reimbursed to him than other Justices, totaling \$122,457 from 2010 through 2016, but the Legislative Auditor found no issues in reviewing those records. Instances of rental car use were also reviewed with no issues. Justice Benjamin was very meticulous with his record keeping, planned trips in a manner that minimized the associated mileage reimbursements, and only claimed reimbursement for expenses that were reasonable and allowed.

Justice Walker

The Legislative Auditor reviewed the one Court vehicle reservation by Justice Walker and found no issues.

Chief Justice Workman

The Legislative Auditor reviewed the seven Court vehicle reservations by Chief Justice Workman and found no issues.

Administrative Director Gary Johnson

The Legislative Auditor reviewed the four Court vehicle reservations by the current Administrative Director and found no issues.

Recommendation

The Legislative Auditor recommends that the Supreme Court of Appeals of West Virginia comply with his recommendations from the April 16, 2018 report concerning its vehicle use and continue with its current course of action to administer its vehicle fleet under the Fleet Management Office of the Department of Administration.

Issue 3: In 2016 and 2017, the drug courts under the Supreme Court of Appeals of West Virginia purchased 529 gift cards totaling approximately \$105,000 with the State Purchasing Card, without permission from the State Auditor's Office to do so.

Based on documentation provided from the State Auditor's Office, in 2016 and 2017 drug courts under the purview of the Supreme Court of Appeals of West Virginia purchased approximately \$105,000 in gift cards, using the State Purchasing Card (P-Card), as part of its incentive program for drug court participants. The State Auditor's Office Purchasing Card Policies require P-Card holders to obtain prior approval to purchase gift cards, and this approval is not granted as a blanket approval but rather per instance. The Supreme Court of Appeals did not request this approval from the State Auditor's Office and therefore, was in violation of those Purchasing Card Policies. Due to this issue, the Legislative Auditor sought to determine the nature of the drug court incentive program and the purchase of these gift cards.

The purpose of the drug courts is to enhance public safety while reducing crime and drug-related convictions, increase the possibility of successful rehabilitation, reduce substance abuse, and reduce recidivism for substance abuse offenders. This is accomplished through judicially supervised substance abuse treatment, rehabilitation, and intense monitoring with the goal of returning drug-free, law abiding, and productive citizens to the community. As a component of this program, incentives are used to acknowledge progress within the program or remove barriers to the possible success of the individual participant.

The drug courts' incentive programs are administered through the county probation offices. Participants are required to pay a fee, up to \$700, to participate in the drug court program. These fees are deposited with the Supreme Court at the end of each month and maintained in separate accounts to be allocated to the appropriate drug court. Participants who cannot pay the fee can pay a reduced amount in addition to performing some form of court mandated activity, such as community service, in lieu of the full fee. These fees are used to pay for incentives, supplies, graduation ceremonies, participant meals and snacks, and other costs associated with the participants' treatment and activities, so long as the expenditures directly benefit drug court participants. Currently, incentive purchases are limited to \$1,000 per month for each probation office. The only instance where tax dollars are spent on drug court incentives is in the case of the juvenile drug courts, where participants are not required to pay a fee.

Each probation office is issued one Purchasing Card to make purchases with, including to purchase incentives needed for the drug court participants. According to the Adult Drug Court Reporting Requirements, all purchases made for the drug courts with participant fees must be paid for with the P-Card. While drug courts were purchasing gift cards as incentives to be given directly to drug court participants, these drug courts were also purchasing gift cards in large amounts, up to \$1,000. A summary of those gift cards purchased for large amounts, \$100 to \$1,000, is shown in Table 3.

Table 3 Drug Court Gift Card Purchases Over \$100		
Value of Gift Cards Purchased	Total Number Purchased	Total Cost
\$1,000	4	\$4,000.00
\$500-\$999	20	\$10,461.15
\$100-\$499	94	\$13,451.95
Total	118	\$27,913.10

The purpose for purchasing gift cards for large amounts was for convenience to purchase other incentives using the gift card instead of the P-Card. There is only one P-Card issued to each probation office, and therefore, there is only one person that can make purchases for the entire office, including for the drug court program.

To get around this issue, these offices began the practice of purchasing gift cards for large amounts and then allowing probation officers administering the incentive program to purchase incentives as needed with those cards. Gift cards were purchased for large amounts, up to \$1,000, for Wal-Mart as well as Visa and Mastercard gift cards that have no purchase location restriction. This practice makes it difficult to provide transparency of the use of the drug court participants' collected fees. The purpose of the State Auditor's Office Purchasing Card Policy prohibiting the purchase of gift cards without approval is due to the fact that once the gift card is purchased, the State Auditor's Office can no longer determine what was subsequently purchased using the gift card. The potential for fraudulent activity to occur is greatly increased and accountability is reduced without itemized receipts to account for each transaction made with the gift card. **The Legislative Auditor attempted to reconcile transactions made with gift cards by the Kanawha County Adult Probation Office and was unable to do so with the receipts provided.** The system currently in place that attempts to account for those purchases is inadequate and does not promote accountability and transparency.

On March 14, 2018, the Post Audit Division sent a letter to the Administrative Director of the Court recommending the drug court's practice of purchasing gift cards with the P-Card stop until approval is granted from the State Auditor's Office. This practice has since been suspended, and the Court is currently discussing the process with the State Auditor's Office to determine if the practice can be continued and to develop a method for doing so that would alleviate the State Auditor's Office's concerns with accountability and transparency.

Another issue identified by the Legislative Auditor relates to the current spending of those drug court participants' collected fees, which is limited to \$1,000 per month. Currently across the 55 counties operating drug courts, there is a current total balance of collected fees of approximately \$300,000, which has been the consistent balance since 2015. Some counties have accumulated a substantial balance of collected fees, such as Hampshire County with over \$60,000. The current

spending limit of \$1,000 per month makes it nearly impossible for Hampshire County to spend down this balance. Without some change to this current structure, these fees will continue to accumulate and remain unused.

Recommendations

- 3.1 The Legislative Auditor recommends that the Supreme Court of Appeals of West Virginia seek approval from the State Auditor's Office to purchase gift cards as incentives for drug court participants. Gift cards should be awarded directly to drug court participants, should be limited to a reasonable amount, and should be recorded in a manner that would allow the State Auditor's Office to confirm the recipient of the gift card was a participant in the drug court program. Further, it is recommended that the court abandon the practice of purchasing gift cards for large amounts that are in turn used to purchase other incentive items and determine and implement another method for purchasing these incentives.
- 3.2 The Legislative Auditor recommends the Supreme Court of Appeals of West Virginia determine and implement a method that will allow drug courts that have accumulated an excessive amount of participant fees to spend down this balance in a way that is equitable and meets the defined purpose for those fees. If changes to statute are required to do so, it is recommended that the Court work with the Legislature in order to make those required changes. The Supreme Court should report back to the Post Audits Subcommittee no later than the interim meeting held in September 2018 and inform the committee of this method.

Issue 4: The Supreme Court did not provide information regarding Justice Ketchum's use of a Court vehicle for commuting during the IRS audit of the Court's 2015 federal employment tax returns.

In April 2017, the Internal Revenue Service (IRS) began conducting an audit of the 2015 federal employment tax returns of the Supreme Court of Appeals of West Virginia. The scope of this audit covered the Court's payroll processes and procedures, travel reimbursements and related policies, payments to independent contractors, educational reimbursements, and the classification of employees. This audit, which concluded in January 2018, resulted in the Court paying the IRS \$227,541 concerning eight notices of adjustment issued to the Court. Seven of those adjustments were for workers classified as independent contractors who should have been treated as employees for tax purposes. The eighth required adjustment related to per diem payments that should have been treated as taxable to the employees who received them. The agreement reached on each of these adjustments stipulates that such agreement is "final and conclusive **except**" for the following three conditions:

1. The matter it relates to may be reopened in the event of fraud, malfeasance, **or misrepresentation of material facts**; [Emphasis Added]
2. It is subject to the Internal Revenue Code sections that expressly provide that effect be given to their provisions (including any stated exception for Code section 7122) notwithstanding any other law; and
3. If it relates to a tax period ending after the date of this agreement, it is subject to any law, enacted after the agreement date, that applies to the tax period.

In the IRS Information Document Request Number 4 (IDR No. 4), which is in Appendix C of this report, the Court was requested to provide employee and vehicle information for, "*any WV Supreme Court of Appeals owned or leased vehicles that were taken home overnight by an employee in 2015 (i.e. employees commute in vehicle).*" As a press release by the Supreme Court concerning the IRS audit clearly states, "**none of the employees listed are Justices.**" The Legislative Auditor just last month released a report clearly showing that Justice Ketchum, in his own words, "*... began commuting in the 2007 silver Buick Lucerne after January 9, 2012. The last time [he] drove the 2007 Buick Lucerne was June 15, 2016.*" Also, this report noted that the other Justices had approved this vehicle use prior to Justice Ketchum using the vehicle for commuting. In a memo to the Legislative Auditor dated February 26, 2018, he states:

I believe that I began commuting in the 2007 silver Buick Lucerne after a Court meeting on January 9, 2012. In this meeting, all the Justices authorized me to drive the 2007 Buick Lucerne. I believe our Court administrator, Steve Canterbury, was also present at this meeting.

In the Court's response to the April 16, 2018 Legislative Auditor's report, the Court stated:

The Court reached a resolution with the IRS on a number of other items, and one of the terms of the agreement was that issues related to tax years 2014, 2015, 2016, 2017, and 2018 through March 31, 2018 would be closed relative to the scope of the IRS Audit. Further, the IRS Auditors advised the Court as the IRS Audit was in the final settlement phase that it would not be necessary to issue revised W-2s for

employment tax issues encompassed by the IRS Audit for tax years 2014, 2015, 2016, 2017, and 2018 through March 31, 2018.

The Legislative Auditor posed three questions to the Court regarding this agreement reached with the IRS. The Court's response, which restates each of those questions, are quoted below:

- 1) *"Did the IRS auditors issue a verbal or written agreement with the Court on matters referred to in the two sentences above with regards to the use of automobiles? I have looked through the IRS documentation you provided us and do not see a Form 5701 Notice of Proposed Adjustment that deals with the cars or any comments about the use of the cars on the Form 144491. If I overlooked something, please let me know."*

Issues relating to the Court Fleet of Vehicles were within the scope of the IRS Audit, but not identified as an area of concern by the IRS Audit Agents. No Notice of Proposed Adjustment relating to the Court Fleet of Vehicles was issued.

- 2) *"If the Court's position is that the IRS formally waived any need for amended W-2s for the vehicles, did the Supreme Court of Appeals, when dealing with the IRS on the issue of the taxable fringe benefit of the use of the cars by the Justices (Form 4564 - Request Number 4), inform the IRS that the Court's Administrative Division Counsel had informed the members of the Court in 2016 in writing that the use of the cars were a taxable fringe benefit?"*

The Court's position is that the IRS Audit Agents instructed the Court not to produce amended W-2s as a result of the IRS Audit and resolution. As noted, the IRS Audit Agents were provided with information regarding the Court Fleet of Vehicles in response to IDR (Individual Document Request) No. 4. Conversation regarding the Court Fleet of Vehicles was minimal. The IRS Audit Agents neither requested nor were provided any other memoranda, minutes or other documents concerning vehicle usage.

- 3) *"Did the Supreme Court of Appeals, when dealing with the IRS on the issue of the taxable fringe benefit of the use of the cars by the Justices (Form 4564 - Request Number 4), inform the IRS that Justice Ketchum had used a Court vehicle for over 70,000 miles of commuting and other personal use?"*

The information regarding vehicles provided by the Court to the IRS in response to IDR No. 4 did not include any specific information regarding Justice Ketchum's use of a Court vehicle.

In addition, in a letter dated March 8, 2018, to the Legislative Auditor's Office, Sue Racer-Troy, Chief Financial Officer of the Supreme Court of Appeals, confirmed that, prior to the IRS' audit of the Court, she knew Justice Ketchum had used a state vehicle to commute. Moreover, Ms. Troy stated she had informed the previous Administrative Director that "commuting was a taxable event" when she became aware of Justice Ketchum's commuting in a state vehicle. Thus, the Legislative Auditor's Office questions why this information was not provided to the IRS.

Other potential issues concerning the IRS audit of the Supreme Court of Appeals.

The IRS audit also brought to light other issues that the Legislative Auditor calls into question. These issues include:

1. **Worker classification**, where employees were misclassified as “contract employees”, yet should have been treated as employees of the Court. The Legislative Auditor questions whether this misclassification may extend beyond the federal tax implication into areas concerning benefits that weren’t provided those employees such as health care and retirement benefits through the State and additional taxes incurred by the employee due to this classification.
2. **Per diems**, that were improperly reported on IRS Form 1099 rather than employees’ W-2s relating to daily compensation and mileage paid to circuit judges in accordance with W.Va. Code §6-7-5. The Legislative Auditor questions the rationale behind reporting these wages on IRS Form 1099 and if there may be confusion over the State’s use of the term per diem. The IRS resolution for these issues was for the Court to absorb the tax burden of the instances of non-compliance and pay the associated taxes due. No individual employee of the Court was required to pay, and the IRS indicated that issuing amended W-2s to those employees would not be appropriate or required.
3. **Payment of additional wages on IRS Form 1099 for employees** where it appears doing so may have been an attempt to limit the wages reported on a W-2 to circumvent salary limits set by statute or established for employees who are receiving retirement benefits from the Consolidated Public Retirement Board. It is the Legislative Auditor’s understanding that this was in fact the case, and for employees who had reached the cap limit of wages set out in statute the Court allowed them to continue to work and be paid in excess of this cap and intentionally reported these wages on IRS Form 1099 to avoid them being reported on a W-2 as wages which would have put those employees over the cap and in violation of statute.

These issues are currently being reviewed by the Legislative Auditor and his staff at the Post Audit Division. It is the intent to release a report concerning these issues to the Post Audits Subcommittee in the upcoming June 2018 meeting. This upcoming report will also cover issues concerning the Court’s General Revenue Fund re-appropriations which grew to \$29 million in 2012 and was spent down in a direct attempt to forestall legislative sponsorship of a constitutional amendment which would take away the Court’s budgetary authority.

Appendices

Appendix A

WEST VIRGINIA LEGISLATURE *Joint Committee on Government and Finance*

1900 Kanawha Blvd. East, Room E-132
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Aaron Allred
Legislative Manager

May 4, 2018

Gary Johnson, Administrative Director
Supreme Court of Appeals of West Virginia
Building 1, Room E-100
1900 Kanawha Boulevard, East
Charleston, WV 25305

Dear Director Johnson:

This is to transmit a draft copy of the Post Audit Division's second report on the Supreme Court of Appeals of West Virginia. This report is scheduled to be presented during the May interim meeting of the Post Audits Subcommittee. We will inform you of the exact time and location once the information becomes available, but at this time we anticipate that meeting to be held Sunday, May 20, 2018, at 1:00 pm in the Senate Finance Committee Room, Room 451-M. It is expected that a representative from the Supreme Court of Appeals of West Virginia be present at the meeting to respond to the report and answer any questions committee members may have during or after the meeting.

If you would like to schedule an exit conference to discuss any concerns you may have with the report, please notify Nathan Harris, at 304-347-4880 as soon as possible. In addition, if you would like to provide a written response to be included in the report, it must be submitted to our office by Noon on Thursday, May 17, 2018, for it to be included in the final report. Thank you for your cooperation.

Sincerely,

A handwritten signature in blue ink that reads "Aaron Allred".

Aaron Allred

Enclosure

Cc. Chief Justice Margaret L. Workman
Justice Menis E. Ketchum, II
Justice Robin Jean Davis
Justice Allen H. Loughry, II
Justice Elizabeth D. Walker
Lori J. Paletta-Davis, Esq

Appendix B

Objective, Scope, and Methodology

The Post Audit Division within the Office of the Legislative Auditor conducted this audit pursuant to Chapter 4, Article 2, Section 5 of the *West Virginia Code*, as amended.

Objectives

This is the second in a series of audits of the Supreme Court of Appeals of West Virginia. The first issue contained several audit objectives. The initial objective was to determine whether the Justices used the Court's vehicles for commuting and/or personal use, to what extent those vehicles were used for commuting and/or personal use, and whether the taxable fringe benefits were appropriately included on the Justices' W-2s. When it was determined that the taxable fringe benefits were not included, an objective was to determine why the taxable fringe benefits were not included, and if the Justices and/or Administrative Office of the Supreme Court were aware that the benefits should be reported. In this second report, we sought to analyze vehicle use by the remaining presiding Justices, Former Justice Benjamin, and the current and former Administrative Director of the Court. An additional objective was to determine the frequency that former Court Administrator Steve Canterbury rented vehicles paid for by the State during out-of-state business, whether the vehicles were for personal use, and whether he was properly reimbursed for expenses related to this use. The objective of the third issue was to determine the nature of the purchase of gift cards using the State Purchasing Card by drug courts under the purview of the Supreme Court, as well as any weaknesses in the procedures for doing so that make the practice susceptible to fraud, misuse, or abuse. Issue four was based on information reviewed regarding the outcome of the IRS audit of the Supreme Court which concluded in January 2018. The objective of issue four was to determine the Court's compliance with the IRS audit based on issues reported in the Legislative Auditor's April 2018 report on the Supreme Court, and to identify any other issues unrelated to federal taxes that may affect the Supreme Court based on the results of this audit.

Scope

The scope of this audit consists of the use of state-owned vehicles by the three presiding Justices not covered in the previous report as well as former Justice Benjamin and the former and current Administrative Directors of the Court for the period of 2011-2018, where such information was available. The scope for the vehicles rented by the former Administrative Director of the Court was from 2010 to 2016. Evidence gathered includes all reservations made in the Supreme Court's vehicle reservation system; travel expense reimbursements; rental car receipts and documentation; memos, Justice Administrative Conference notes, and other documents discussing the Court's use of state-owned or rented vehicles; and maintenance and fuel card records for the Court owned Buicks for use by the Justices. The auditors did not complete a full analysis on the use of these assets by **all** Court employees and it is not the intention of the Post Audit Division to audit the use of state assets by **every** employee of the Court over the scope of this audit. Further, the scope of this audit concerning the purchase of gift cards by the drug courts of the Supreme Court of Appeals consisted of a review of documentation provided by the State Auditor's Office for all purchases of gift cars using the State Purchasing Card for 2016 and 2017, the policies and procedures of the

drug courts, and interviews with agency personnel who oversee this program. Finally, the scope concerning issues related to the IRS audit of the Courts 2015 federal employment tax returns consisted of a review of the documents and final opinion issued by the IRS to the Supreme Court.

Methodology

Post Audit staff gathered and analyzed many sources of information and assessed the sufficiency and appropriateness of the information used as evidence. Testimonial evidence was gathered through interviews with various individuals who oversee, collect, or maintain information for the Court. The purpose for testimonial evidence was to gain a better understanding or clarification of certain issues, to confirm the existence or non-existence of a condition, and/or to understand the Court's position on an issue. Such testimonial evidence was confirmed by either written statements or the receipt of corroborating or physical evidence.

Auditors requested and received documentation from the Supreme Court Justices and staff in order to conduct this audit, including policies, memos, Administrative conference minutes, and other documentation relating to the use of any state-owned or rented vehicles by Justices and employees of the Court. Auditors also analyzed travel reimbursements, fuel card records, Court vehicle reservation records, and vehicle service records to determine the usage of the vehicles. The auditors also reviewed communications and documentation related to the IRS audit of the Court's 2015 federal employment tax returns.

Appendix C

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 4 - FRI
To: State of West Virginia Supreme Court of Appeals EIN: 55-6000760 1900 Kanawha BLVD E Charleston, WV 25305		Subject: Employment Taxes – Fringe Benefits
		Submitted to: [REDACTED]
		Dates of Previous Requests: Initial Request

Description of Documents Requested:

Please have the following information for the calendar year ending 2015 available at the appointment that was scheduled for the week of June 26th thru June 30th, 2017:

1. Copies of all written policies for the following, for review:
 - Accountable and/or Non-Accountable plan
 - Travel allowances and/or reimbursements
 - Automobile allowances and/or reimbursements
 - Employee use of employer provided automobile
 - Tuition reimbursements (either paid for directly or reimbursed)
 - Any other allowance and/or reimbursements (i.e. meal, entertainment, health insurance, etc.)

2. A list of all fringe benefit plans available to any employee or group of employees (current or retired), including but not limited to cafeteria plans (Section 125), health plans, HAS (Health Savings Accounts), medical reimbursement plans, etc

3. For any of the above plans that the WV Supreme Court of Appeals has, please provide copies of the plans for review

4. Provide a list of employees that have group term life insurance over \$50,000 and if it is included in their wages the amount that is included

5. Provide the following for any WV Supreme Court of Appeals owned or leased vehicles that were taken home overnight by an employee in 2015 (i.e. employees commute in vehicle):
 - Name of Employee, Job Title and SSN
 - Department
 - Make, Model and Year of Vehicle
 - Cost of the vehicle or FMV at the time placed in service
 - Mileage logs for 2015, if available
 - Amount included in wages, if any and date included
 - If amount was included in wages, provide documentation to support calculation and method used for calculation
 - WV Supreme Court of Appeals written Policy on take home vehicles

Information Due By June 26, 2017 At Next Appointment Mail In

	Name and Title of Requestor: [REDACTED]	Date: May 25, 2017
	Employee Identification Number: 0770895	
FROM	Office Location: [REDACTED]	Phone: [REDACTED] Fax: [REDACTED]

Appendix D



SUPREME COURT OF APPEALS
CHARLESTON, WEST VIRGINIA
25305

LEGISLATIVE MANAGER

MAY 17 2018

RECEIVED

MARGARET L. WORKMAN
CHIEF JUSTICE

May 17, 2018

Mr. Aaron Allred
1900 Kanawha Blvd. East, Room E-143
Charleston, WV 25305

Hand Delivered

Dear Mr. Allred:

The revised final draft of the Post Audit Division's second report on the Supreme Court of Appeals of West Virginia was received by the Court on May 15, 2018, and identifies the following issues to which this response is directed:

Issues 1 and 2 involve the use of State vehicles

As previously provided in response to the first report of the Post Audit Division, the Court has completely overhauled the vehicle use policy and adopted the State of West Virginia Motor Vehicle Use Policy, as well as initiated a record-keeping system requiring full documentation of any request for vehicle use by any Supreme Court employee. The Court is in the process of revising its travel-related policies and it will track the State policy. The travel policy will be approved in June.

Issue 3 concerns the purchase with State purchasing cards of gift cards as drug court incentives

In 2015 and 2016, there was significant internal debate by the Court regarding the propriety of monetary incentives in drug courts. Although the Court voted to continue Adult Drug Court monetary incentives (collected from funds paid by participants, not public funds), it was conditioned on the development of a single accounting system. The entire purpose of the Court voting to establish the system was to achieve the goal of transparency, accountability and better oversight, rather than multiple individual drug courts keeping track of the funds.

The Post Audit Division's second report indicates that a number of adult drug courts were purchasing gift cards in large amounts up to \$1,000. A chart in the report shows that there were 118 P-card purchases in amounts from \$100 to \$1,000. As the report points out, the reason was for the convenience of the one drug court employee in each court who was authorized to make these expenditures. The report also points out that this system made it difficult to provide transparency on the use of the drug court participants fees. Although there is no evidence of any fraudulent transactions, the Court recognizes that this can create the potential for fraudulent activity. We also recognize that the accounting system currently in place needs improvement.

The Court has suspended the practice of purchasing gift cards with P-cards and the

Court has been working with the State Auditor's Office to ascertain whether the practice should continue and, if so, to develop an improved accounting system. The Court will also undertake an examination of the drug court fees that have been accumulated and work to find an equitable means of allowing drug courts to utilize the balance of those fees for the purpose for which they were intended.

Issue 4 concerns the IRS Audit

The Post Audit Division's second report emphasizes in the discussion of the Court's agreement reached with the IRS that "[t]he agreement reached on each of these adjustments stipulates that such agreement is 'final and conclusive except' for the following three conditions:

1. The matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of material facts; [Emphasis Added]

The Post Audit Division's second report proceeds to note in bold that

[b]ased on the facts presented to the Legislative Auditor, it appears the Court was aware of the commuting use of a Court vehicle by Justice Ketchum and understood the tax implications of such use prior to the date the IRS audit began yet did not provide this information to the IRS in IDR No. 4.

But the Legislative Auditor also states that he is "unsure why this information was not provided given the amount of evidence that suggests the Court was aware of Justice Ketchum's commuting in a Court vehicle."

There is no evidence whatsoever that the Court or any employee affirmatively misrepresented any fact to the IRS during the audit. As is common practice, the IRS conducted a document-focused audit. The IRS issued an Individual Document Request (“IDR”) regarding vehicle-usage information and, through Administrative Counsel Lori Paletta-Davis, the existing information was provided. Ms. Paletta-Davis is an experienced lawyer with familiarity with audit issues while, at the same time, she was new to the Court and its practices. Rather, this issue appears to be a result of a mistake that was able to occur, in at least part, because of incomplete record keeping.

Administrative Counsel Lori Paletta-Davis worked closely with Director of Financial Services Sue Troy because of her relevant experience and familiarity with the Court’s financial and accounting history. Ms. Paletta-Davis coordinated the response through Mr. Johnson, but stated that she did not engage with any of the Justices directly at any time during the audit.

At the opening conference, the IRS Audit team explained that this was a “large audit,” which would be focused on how employment taxes were treated by the Court, particularly the classification of certain workers who provided services to the Court. The audit was described as routine for which a number of state government entities, particularly state courts, were undergoing across the country. Further, it was explained that the audit would be executed through Individual Document Requests (“IDRs”) rather than narrative

explanations for the issues that were raised. The procedure was that the IRS requested documents and wanted documents, not narratives, in response.

An IDR "FR-4" entitled "Employment Taxes - Fringe Benefits." FR-4 was comprised of a series of requests that included the following:

Provide the following for any WV Supreme Court of Appeals owned or leased vehicles that were taken home overnight by an employee in 2015 (i.e. employees commute in vehicle):

1. Name of Employee, Job Title and SSN
2. Department
3. Make, Model and Year of Vehicle
4. Cost of the vehicle or FMV at the time placed in service
5. Mileage logs for 2015, if available
6. Amount included in wages, if any and date included
7. If amount was included in wages, provide documentation to support calculation and method used for calculation
8. WV Supreme Court of Appeals written Policy on take home vehicles

To satisfy this request, Ms. Paletta-Davis obtained a spreadsheet of the Court's vehicle fleet list and the vehicle reservation calendar. Other than reformatting this information into a digital format, Ms. Paletta-Davis did not otherwise edit or revise the information she was provided. Ms. Paletta-Davis did recall that someone raised an issue about a member of the Court technology staff who had taken a state-owned car home from time-to-time to accommodate his extensive work-related travel and therefore the employee received a taxable fringe benefit on his W-2.

No one raised any issue regarding Justice Ketchum's use of a court vehicle during the course of the audit. Notably, Justice Ketchum had stopped using the Buick Lucerne, in June

of 2016, more than ten months before Ms. Paletta-Davis was hired in April 2017. Ms. Paletta-Davis stated that she shared all of the documents that were collected and produced as part of the audit with Mr. Johnson and Ms. Troy, and neither raised an issue regarding Justice Ketchum's use of a Court vehicle.

The IRS and Court entered into a "Closing Agreement on Final Determination Covering Specific Matters Regarding Worker Classification" on or about January 8, 2018, resulting in the Court issuing a check to the IRS in the amount of \$227,541 as a result of various proposed adjustments that were identified during the audit. None of the adjustments related to untaxed fringe benefits incurred as a result of a personal vehicle.

On or around January 17, 2018, the Legislative Auditor contacted Ms. Paletta-Davis and indicated that the Post Audit Division was commencing an audit regarding, among other things, an allegation that Justices used state vehicles for personal use. The Legislative Auditor provided a draft report to Ms. Paletta-Davis and the Court on or about April 6, 2018.

Ms. Paletta-Davis learned sometime in March 2018 that Justice Ketchum had used a state vehicle during a prior period of time to commute to and from his home in Huntington. Upon learning that fact, Ms. Paletta-Davis contacted the IRS and informed them of this new information. According to Ms. Paletta-Davis, both Revenue Agents indicated that the IRS would not be reopening the audit, that the matter was to remain closed and that no amended

W-2s should be issued.

Further, it is important to note that the audit by the IRS was an employment tax audit, in which the IRS was attempting to identify systemic issues that may have lead to underreporting of employment taxes. The IRS made clear that the audit was closed and they did not want the Court to issue amended W-2s for the tax year 2015 to any of the individually-affected employees for which the IRS did find an alleged error.¹ Moreover, this position is supported by the fact that neither of the lead Revenue Agents expressed any concern regarding the issue or desire to reopen the audit.

The Court wants to make clear that at no time did any representative of the Court make any knowing misrepresentation or omission.

We appreciate the Legislative Auditor's cooperation and collaboration with the Court on finalizing this portion of the audit.

Sincerely,



Margaret Workman
Chief Justice

¹It should be noted, however, that Justice Ketchum has stated that he did not know that commuting was a taxable event and he has since insisted that he be issued revised W-2s.

Appendix E



RECEIVED

MAY 18 2018

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SUPREME COURT OF APPEALS
CHARLESTON, WEST VIRGINIA
25305

MARGARET L. WORKMAN
CHIEF JUSTICE

May 18, 2018

Mr. Aaron Allred
1900 Kanawha Blvd. East, Room E-143
Charleston, WV 25305

Hand Delivered

Dear Mr. Allred:

Please include the attached letter which I received from Sue Racer-Troy in the response to your audit revision.

Sincerely,

A handwritten signature in black ink that reads "Margaret Workman, C.J.".

Margaret Workman
Chief Justice

SUPREME COURT OF APPEALS
OF WEST VIRGINIA

GARY L. JOHNSON
ADMINISTRATIVE DIRECTOR



May 18, 2018

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Chief Justice Margaret Workman
Supreme Court of Appeals of West Virginia
1900 Kanawha Blvd., East
Building 1, Room E-300
Charleston, WV 25305

LEGISLATIVE MANAGER

MAY 18 2018

RECEIVED

Dear Chief Justice Workman:

I wish to clarify my involvement with the IRS audit last year. We received at least 18 unique Information Document Requests covering various subjects. Many of the requests involved information that I produced while others did not.

The vehicle information was requested in IRD 4 – Employment Taxes and Fringe Benefits. The information was compiled with assistance from several employees including Kim Ellis (list of fleet vehicles) and Arthur Angus (registration calendar). At no point did either IRS agent ask me about my knowledge of anyone using a vehicle for commuting nor do I have any recollection of even being in the room when the issue was discussed (if it was). There were many meetings which I did not attend as they did not apply to records in my possession.

I did tell Steve Canterbury (the Administrative Director and my direct supervisor) that the use of a state vehicle by Justice Ketchum would be a taxable fringe benefit, if it was used for commuting. Mr. Canterbury told me that it was “none of my business”. My knowledge of Justice Ketchum’s vehicle use was my personal observation of seeing a state car parked in his parking space at the Capitol. But the extent of his usage (when he started using the vehicle, how frequently he used the vehicle, etc.) was not known to me. I would not risk my professional license to hide vehicle usage from the IRS.

Sincerely,

A handwritten signature in blue ink that reads "Sue Racer-Troy".

Sue Racer-Troy, Chief Financial Officer

cc: Aaron Allred, Legislative Manger



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WEST VIRGINIA OFFICE OF THE LEGISLATIVE AUDITOR
- POST AUDIT DIVISION -

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