



Ralph Campbell, Jr.
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

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June 14, 2001

The Honorable I. Beverly Lake, Jr.
Chief Justice of the Supreme Court
Justice Building
2 East Morgan Street
Raleigh, North Carolina 27601

Dear Chief Justice Lake:

We received allegations through the State Auditor's Hotline concerning certain practices within the North Carolina Administrative Office of the Courts (AOC). The allegations addressed a number of issues including the use of salary reserves and lapsed salaries to award pay raises to AOC employees, acting Directors of the AOC retaining their position as Superior Court Judge, payment of travel expenses, and the use of funds in the Technology Division.

We have completed a special review of these allegations. Our review consisted of interviews with AOC personnel and examinations of personnel records, payroll records, and expense reimbursement requests. We also examined applicable North Carolina General Statutes and policies within AOC.

Salary Reserves

Salary reserves at AOC are generated not only by AOC staff, but also the 2957 deputy clerks, assistant clerks, and magistrates in the 100 clerks of Superior Court offices across the state. Salary reserves are generated when an individual assumes a position at a salary less than the salary budgeted for the position. As of May 24, 2001 salary reserves were \$1,110,700. Salary reserves for the previous fiscal years were:

- \$1,116,144 for the 1998-1999 fiscal year, and
- \$999,344 for the 1999-2000 fiscal year.

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The majority of the funds are generated by employees of the clerks of Superior Court. AOC, as part of the judicial branch of government, is not subject to the North Carolina State Personnel Act, which pertains to the administrative branch, and the accompanying rules on salary increases. The salary reserves can be used to give pay raises with the approval of the Chief Justice. However, since the employees in the offices of the clerks of Superior Court must abide by the pay scale set out in G.S. 7A-1025, AOC cannot use the salary reserves to adjust those salaries. AOC may use these funds to give pay raises to employees of AOC who are not subject to similar pay schedules. These raises may be in addition to any increase awarded State employees by the Legislature. There are 408 employees in AOC. The flexibility to use these funds gives AOC an advantage over other state agencies that must rely entirely on their own staffs to generate salary reserves.

AOC awarded pay increases totaling \$288,073 from salary reserves to 184 employees during the 1998-1999 fiscal year. Sixty-seven employees received pay increases totaling \$110,665 during the 1999-2000 fiscal year. AOC also used \$822,770 of salary reserves to cover a deficit in their cash account caused by a legislative reduction in their budget. In the current fiscal year, 384 AOC employees have received salary increases totaling \$786,159 from salary reserves. These increases were normally between 4% and 5% of the employees' salaries. On May 18, 2001 there was an unexpended balance of approximately \$480,000 in salary reserves. The year-end balance of unexpected salary reserves was:

- \$246,008 for the 1998-1999 fiscal year, and
- \$76,434 for the 1999-2000 fiscal year.

These funds do not revert at the end of the fiscal year.

We question the practice of using salary reserves generated from employees within the clerks of Superior Court to fund salary increases to AOC staff.

We recommend that the General Assembly examine the use of these salary reserves by AOC and determine if they are being used in accordance with legislative intent.

Lapsed Salaries

We examined the use of lapsed salaries by AOC for the fiscal years 1998 through 2000. Lapsed salaries accrue when positions are vacant for a portion of the year. They are generated by AOC personnel and the employees in the court system throughout the state. AOC had \$11,000,000 through May 24, 2001.¹ Lapsed salaries for previous years were:

- \$10,663,202 for the 1998-1999 fiscal year, and
- \$11,386,703 for the 1999-2000 fiscal year.

These funds are used by AOC to:

- hire temporary employees, primarily for the clerks of Superior Courts,
- pay for contractual services throughout the court system, and
- pay indigent counsel fees.

AOC, as of May 24, 2001, has transferred \$3,400,000 from lapsed salaries to the Indigent Defense Program during the current fiscal year. AOC transferred \$4,308,144 from lapsed salaries to the Indigent Defense Program during the 1998-1999 fiscal year and \$600,742 during the 1999-2000 fiscal year. AOC also transferred \$3,400,000 to the Hurricane Floyd relief fund during the 1999-2000 fiscal year. AOC expects to finish this fiscal year with unpaid invoices in excess of \$1,000,000 for this program.

During 1997-1998 and 1998-1999 fiscal years, AOC used \$1,564,347 and \$1,778,347, respectively, from lapsed salaries to cover a deficit in appropriations for the legislative pay increases awarded state employees.

We could not verify allegations that AOC attempted to hide these funds from the Office of State Budget and Management or the General Assembly. The General Assembly through its staff, has requested periodic reports on AOC's use of lapsed salaries. AOC has reported on the use of these funds and, as noted above, has consistently used them to fund shortfalls in the Indigent Defense Program.

¹This is an estimate provided by AOC as of May 24, 2001. The exact amount of lapsed salaries will be known after June 30, 2001 when the financial records for the year are closed.

Unexpended lapsed salaries revert to the State's General Fund at fiscal year-end. Reversions have been:

- \$5,695 in fiscal year 1997-1998,
- \$1,379,224 in fiscal year 1998-1999, and
- \$378 in fiscal year 1999-2000.

While we did not find any abuse of the lapsed salaries by AOC, we question whether the use of this fund to cover deficits in appropriations for the Indigent Defense Program or legislative pay increases is appropriate. We recommend that the General Assembly examine the use of lapsed salaries and determine whether they are being used in accordance with its intent.

Dual Offices

The current director and a former director of AOC retained their positions as Superior Court judges while serving as Director. The position of Director of AOC is established by G.S. 7A-341. The statute also establishes the salary and duties of the Director. The salary of the Director is the same as the salary for a Superior Court judge. The only difference is a \$7,000 per year subsistence allowance to Superior Court judges, as prescribed in G.S. 7A-44. This payment is in lieu of reimbursement for lodging and meals while attending court or transacting official business in a location other than the Judge's county of residence. Statutes do not provide the Director of AOC with this allowance. He is reimbursed for actual travel expenses.

The current director and a former director were Chief Resident Superior Court Judges when they were appointed and accepted the position of director. Rather than relinquishing their positions on the bench and occupying the position of AOC Director, they chose to remain in their judge's position. The former judge served as director from June 21, 1999 to December 31, 2000. He relinquished his position as a Superior Court judge on November 13, 2000 and assumed the director's position fulltime for the last six weeks. The former director held court on three different days while serving as director. He also performed administrative duties on two additional days. The current director was appointed effective January 8, 2001. From that date through May 24, 2001 he has held court on two days. He also said he performed administrative duties for his district on two additional days, ten Saturdays from 9:00 a.m. until 11:30 a.m., and on 57 nights from 8:00 p.m. until 10:00 p.m. Both directors have received, or are receiving, the annual subsistence payment.

A person appointed as the Director of AOC should be occupying the position as intended by the Legislature. Serving as director while retaining the judicial office ties up a Superior Court judge position, removes the individual the citizens elected from the bench, and necessitates the use of other judges to hold court in his place. The situation raises the question of what would happen when it is time for reelection. In addition, the question arises as to whether occupying the two positions creates a conflict of interest when the director holds court. In this regard it should be noted that Article VI, section 9 of the North Carolina Constitution prohibits dual office holding, subject to certain exceptions. While that provision does not prohibit this particular situation, the rationale that led to its adoption suggests that this arrangement should be limited to temporary situations at most.

In making this recommendation, we are aware that the director serves at the pleasure of the Chief Justice. We were advised that both directors initially assumed the position on a temporary basis. The former director assumed the duties shortly before the Chief Justice faced reelection. The current director indicated that he assumed the duties on a temporary basis so that both he and the Chief Justice could determine how to proceed. We recommend that the Chief Justice of the North Carolina Supreme Court address the issue of how long a Director of AOC can retain his elected position as judge before actually occupying the position established for the Director.

Further complicating this situation is the payment of mileage to the director. We examined the expense reimbursement requests submitted by the current and former directors. The current and former directors claimed mileage from their homes to Raleigh while serving as director. The former director was paid \$5,129.52 for mileage between his Greensboro home and Raleigh for the period of June 1999 through December 2000. The current director has been paid \$993.60 from January 2001 through March 2001 for commuting from his home in Louisburg to Raleigh. The Director of AOC would not be entitled to be paid for commuting from home to Raleigh. A Superior Court judge would be entitled to mileage reimbursement for attending court business outside his home county. We recommend that the Chief Justice of the Supreme Court determine if this mileage claim is appropriate.

AOC may want to consider asking the General Assembly to raise the salary of the Director of AOC to the level of the Chief Judge of the Court of Appeals. This would address the financial disincentives associated with the position, including the indefinite term of the appointment.

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Technology Fund

The complaint also alleged wasteful expenditures in the Technology Fund. We did not discover any discrepancies beyond the typical problems encountered when a new computer system is being developed and implemented. AOC reports expenditures from the technology fund every six months to the General Assembly. The fund is used to hire employees, pay for contracted services, and purchase equipment. Equipment purchased with technology funds is bought off state contract unless there is a need for an emergency purchase. The equipment is stored in a warehouse until it is installed in the field.

The new magistrate's computer system is now installed in approximately eighty (80) counties. AOC expects it to be in ninety-seven (97) counties by July 15, 2001. The system requires certification by the Information Resource Management Commission. Revenue to pay for the system is generated from private companies that use the system to gather information for services such as background checks.

The system has recently completed its third independent quality review, which indicated no major problems. The fund is operating in compliance with the legislation that created it.

Conclusion

We are presenting these areas of concern for your review and written response. The purpose of the response is to allow you the opportunity to outline any corrective actions taken or planned. We request that your written response be delivered by June 28, 2001. If you have any questions or wish to discuss this further, please contact us. We appreciate the cooperation received from you and your staff during the course of our review.

Respectfully,

Ralph Campbell, Jr., CFE
State Auditor

RCjr/smt

Management letters and responses receive the same distribution as audit report.

**Supreme Court
State of North Carolina
Raleigh**

CHAMBERS OF
I. BEVERLY LAKE, JR.
CHIEF JUSTICE

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July 12, 2001

The Honorable Ralph Campbell, Jr.
State Auditor
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HAND DELIVERED

Dear Mr. State Auditor:

I want to express to you again my appreciation for the opportunity to respond to your letter of June 14, 2001 and the concerns expressed therein arising from certain allegations received through your Hotline regarding certain practices within the Administrative Office of the Courts. These allegations related to use of salary reserves and lapsed salaries to award pay raises to AOC employees, dual offices held by the Directors of the AOC and related travel expenses, and the use of funds in the technology division.

With respect first to the use of salary reserves and lapsed salaries, as you letter reflects, the pay raises to AOC employees which formed the basis of the allegations of the complaint were made prior to my administration and of course prior to the assumption of office of the current Director, Judge Robert Hobgood. However, this does not address the underlying question of the propriety of the use of salary reserves in particular, which are generated primarily by employees of the Clerks of Superior Court and other Judicial Branch employees outside of Raleigh and the AOC. While the past use of salary reserves and lapsed salaries to award pay raises to AOC employees has been entirely within established guidelines and long-standing practice, Director Hobgood and I are of the opinion that it is fundamentally unfair and not good practice to use these funds so generated to reward primarily AOC employees in Raleigh. We are of the opinion that we need the flexibility within the Judicial Branch of our government to utilize these funds to reward primarily our employees throughout the state who render such valuable service to our people. This is consistent with the position which I took publically last year, primarily in a letter to all of our Clerks of Court, that my efforts as Chief Justice would be directed toward rendering better services to our people in the field as opposed to building a bureaucracy in Raleigh.

The Director of AOC now scrutinizes each request for salary adjustment. The Director has two nationally certified salary-study experts working in the AOC Human Resources Division (Margaret Wiggins and Patti Brooks). The Director requires that a written salary study be submitted to him for review as part of the decision-making process for salary raises from salary reserve. Additionally, employees working in the field are given every consideration for pay raises. The use of salary reserves for pay raises within AOC does not

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differ from the use of salary reserves for pay raises within the Legislative Branch. "Legislative intent" should not vary from branch to branch of state government.

There are several AOC pay increases which were made this fiscal year which both Director Hobgood and I fully support. These are the salary increases which went to Penny Taylor in the Procurement Division and to the Family Court support staff. Penny Taylor carried the full load of the Procurement Office before the hiring of the new Deputy Director for Procurement. She came to work early and left late. During that period, the Procurement Office ran smoothly entirely because of her efforts. The Director and I have placed great emphasis on the eight pilot Family Courts now ongoing in North Carolina. This pilot program is one recently established by the Legislature and is one in which the Legislature has great interest. A specific salary study was conducted by the Human Resources Division of AOC, including input from two nationally certified compensation specialists. That salary study recommended raises for the support staff of the eight Family Courts. That recommendation was implemented effective July 1, 2001. This is in line with the policy of rewarding personnel in the field.

Specifically, with respect to lapsed salaries, I note that the estimate provided for the expected lapsed salaries after June 30, 2001 is expected to be in line with the amount for this item for the 1998-1999 fiscal year and for the 1999-2000 fiscal year. Your letter also correctly indicates the transfer of \$3 to \$4 million dollars over the past two fiscal years from AOC to the Indigent Defense Program. I was also pleased to note from your letter that the AOC has properly reported on the use of lapsed salaries to the General Assembly and has consistently used them to fund shortfalls in the Indigent Defense Program. The use of lapsed salaries for funding shortfalls in the Indigent Defense budget is historical. This fiscal year, the newly created Office of Indigent Defense Services is budgeted separate from the AOC general budget. There is a pending special provision to the Budget Act, which will authorize the transfer of an additional \$1.5 million dollars from "funds available" in the AOC budget to Indigent Defense Services if it depletes all of its funds prior to June 30, 2002. The term "funds available" is generally understood to mean "lapsed salaries." Thus, the legislative intent is clear that the use of lapsed salaries to cover shortfalls in the Indigent Defense budget is expressly approved.

Historically, the AOC has also used lapsed salaries to fund temporary employees, primarily for the Clerks of Superior Court in the 100 counties, and to pay for contractual services to meet critical needs throughout the court system.

With respect to the issue of dual offices, the office of the Director of the Administrative Office of the Courts is, in my opinion, one of the top three most critical positions in all of state government. Without a competent, a highly competent, Director of AOC, the entire Judicial system, our third branch of government, simply could not function. This position first and foremost demands a person who is thoroughly familiar with the Judicial system, certainly a lawyer and preferably a jurist of extensive experience. This office requires a high degree of administrative and management skills, as well as extensive ability in the areas of budget and finance. Additionally, the Director deals with more elected officials on a daily basis than any other person in state government, and he or she must therefore be a competent diplomat and politician, and a person in whom the members of the General Assembly and the

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5,000 plus employees of the Judicial Branch have complete confidence. Judge Hobgood has been and continues to be that person.

In my opinion, I was exceedingly fortunate to have been able to persuade Judge Hobgood to assume this position, and I am convinced that the Judicial Branch could not have a better Director. As your letter points out, Article VI, Section 9 of the North Carolina Constitution does not prohibit this particular situation, but I agree that over time certain problems could arise, although I am advised that Judge Hobgood has been performing all of his administrative duties incident to his judgeship in addition to all that he has as Director of AOC. There has been no allegation that the work of the Senior Resident Superior Court Judge of the 9th Judicial District has not been performed and performed well. Additionally, Judge Hobgood has promoted independence and flexibility in his management and supervisory role as the Director of the AOC. He has required each of the six Deputy Directors to establish and meet ninety-day goals (March 31 and June 30). He has promoted a wellness program for all AOC employees and he has visited and inspected each of the nine buildings occupied by AOC employees in Wake County. Perhaps most important, Judge Hobgood has substantially enhanced the morale of all AOC employees, both in Raleigh and throughout the state.

With respect to the receipt of the annual subsistence payment allowed to all Superior Court Judges, while this is in accord with existing law and appropriate, as I stated in an article published a few months ago in the *News and Observer*, I believe this should be changed by the General Assembly, or redesignated, in that this annual subsistence amount should be added to the annual salaries of all Superior Court Judges. It should be noted in this regard that Judge Hobgood has saved the AOC in excess of \$100,000 in budgeted salaries in that over the past six months, he has performed his duties as Director of AOC without filling the vacant position of Senior Deputy Director of AOC. I fully concur in your recommendation that the General Assembly should be asked to raise the salary of the Director of AOC to the level of at least the Chief Judge of the Court of Appeals. This would be entirely in keeping with the importance and the responsibilities of this office.

Further, as a significant aside, I believe it would be fair to note that three of the last five Directors of AOC have retained their prior positions while also assuming the duties as Director of AOC. These would include: James Drennan of the Institute of Government, Judge Jack Cozort and Judge Tom Ross. To the best of my knowledge, no complaint or question was raised about the propriety of these dual roles throughout the number of years in which these roles and responsibilities were carried out.

With respect to the issue raised about the technology fund, the AOC cannot find any wasteful expenditure in the use of this fund. The AOC has reported all expenditures from the technology fund every six months to the General Assembly. Phase 2 of the Magistrate's System is now operational in ninety-two counties. Magistrates in five other counties are now in training to implement this program. Three remaining counties (Mecklenburg, Wake and Buncombe) are having active discussions with the AOC concerning the interfaces necessary to implement this program with their existing systems. Phase 2 of the Magistrate's System is totally separate and apart from the technology fund. The technology fund is funded by private companies that sign a contract with the AOC to obtain criminal background check information. These contracts are available for public inspection on any working day. The technology fund

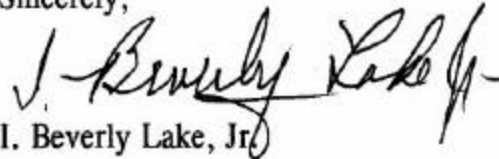
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is operated in compliance with the law. All AOC expenditures from the technology fund are available in written reports to the General Assembly, which are available for public inspection. This fund, which is internally generated by the Judicial Branch, is vital to our ongoing operations, and I am pleased that your review has found no problem and that this fund is being operated in compliance with the legislation that created it.

Again, I wish to express to you our appreciation for your very thoughtful and carefully prepared report, which we do take to heart and will use in our efforts to further improve our services to the people of North Carolina.

With kindest regards, I am

Sincerely,

A handwritten signature in cursive script that reads "I. Beverly Lake, Jr." with a horizontal line extending from the end of the signature.

I. Beverly Lake, Jr.