

SUMMARY REPORT OF INVESTIGATION

Date: August 20, 2021
To: Shannon Ragonesi, Esq.
Counsel for Tahoma School District
From: Martha Norberg, CPA, CFE, Principal
Seabold Group
Ref: Tahoma School District – Lori Cloud

I. INTRODUCTION AND SCOPE

Seabold Group was retained to investigate a complaint filed by Tahoma School District (District) Assistant Finance Director Marla McAlpine. The complaint alleges that Assistant Superintendent/Finance Director Lori Cloud knowingly failed to file, or caused the District to fail to file, informational returns with the Internal Revenue Service despite receiving numerous IRS notices over several years, resulting in over \$1.5 million in fines and penalties assessed against the District. Ms. McAlpine further alleges that Ms. Cloud restricted her access to their office building and made other changes in retaliation for her reporting Ms. Cloud's failure to file the returns and for Ms. McAlpine's separate inquiry into the overtime of another District employee.

During this investigation, Seabold Group interviewed nine District employees, some on more than one occasion, including Ms. Cloud, Ms. McAlpine, Superintendent Mike Hanson, HR Director Mark Koch, and five staff members. Additionally, we reviewed documents provided by the District and witnesses, including emails, letters, timelines, IRS notices, IRS transmittals, correspondence between the District and the Northwest Regional Data Center (NWRDC), and other documents.

This report is intended to be a summary report and is not intended as a comprehensive detail of all the information that was collected, reviewed, and considered as part of the investigation. The findings and conclusions set forth in this report are based on the entirety of the evidence considered and are not limited to the factual information contained herein. Nothing in this report is intended nor should be construed as a legal conclusion. Finally, the findings herein are based on a preponderance of the evidence; that is, whether it is "more likely than not" that a particular incident happened or did not happen as alleged.

II. EXECUTIVE SUMMARY

A. The District Failed to Timely File Information Returns 1094-C and 1095-C for 2015 through 2019.

IRS form 1095-C provides information to employees regarding the health insurance that an employer provides as part of the Affordable Care Act. The District was required to furnish forms 1095-C to its employees and electronically file the 1095-Cs and a cover letter, form 1094-C, with the IRS beginning with the 2015 tax year. The returns are informational only, but the IRS may assess a significant penalty if they are not timely furnished to employees and submitted to the IRS.

The District created and furnished forms 1095-C to each of its eligible employees for 2015 through 2019, but it failed to timely file the returns with the IRS. For 2016 and 2017, after two letters for each of the years informing the District that it may face penalties if it did not submit the forms, the IRS assessed penalties for failure to file, and for failure to furnish the forms to District employees because the IRS could not confirm that the District had supplied the required forms to its employees.

Before the District superintendent and HR became aware of the delinquencies, the IRS assessed over \$760,000 in penalties for 2016, over \$760,000 for 2017, and sent two letters informing the District that it may assess penalties for 2018. The total penalties and interest imposed on the District for the two years is over \$1.5 million.¹

The following factors contributed to the failure of the District to timely file the 1094-Cs and 1095-Cs for 2015 through 2019:²

1. Ms. Cloud failed to obtain a transmitter control code even knowing that her failure to do so would, and did, ultimately result in substantial penalties against the District.

The evidence establishes that the District's failure to timely file the 1094-Cs and 1095-Cs with the IRS was mainly due to Assistant Superintendent/Finance Director Lori Cloud's continued failure to obtain the necessary transmitter control code (TCC) required by IRS to electronically file the returns. Ms. Cloud was aware that the District could not file until she got the second transmitter code.³ In 2016 and 2017, Payroll Coordinator Kathy Thomas reminded Ms. Cloud on at least nine occasions to apply for her TCC so that she could file the returns. From July 2018 through on or about March 10, 2021, Ms. Cloud received 11 letters and notices of penalty and two detailed explanations supporting IRS's decision to assess penalties. After each letter and notice, she told the payroll coordinator that she would take care of it. But for several years and after each of the letters and notices, Ms. Cloud failed to obtain the code and continued to ignore the impact failing to file the returns would have (and was having) on the District.

Ms. Cloud provided several unpersuasive explanations for her failure to obtain the TCC necessary for the District to file: the IRS asked too many personal questions in the application process; she was waiting for changes to be made to her contract relating to the carry-over of vacation; she encountered technical problems (for over five years) and could not get help from the IRS. Finally, she said she just didn't know why she didn't obtain the TCC or direct another staff member to take on the task or make the resolution of the District's delinquent status a top priority.

In fact, the information the IRS requests is information it already has. It uses the application information to verify the identity of the requestor. It is not clear how Ms. Cloud's contract related to her failure to obtain a TCC. And neither Ms. Thomas nor, later, the benefits specialist had any

¹ The IRS did not send notices or assess penalties for the 2015 year. The Appendix to this report details the IRS letters, notices, penalties, and interest received by the District.

² In February 2021, the benefits specialist began submitting the current and delinquent returns to the IRS. By the end of April, all returns had been filed.

³ Kathy Thomas obtained her TCC without difficulty as soon as the District was required to file the returns, but a second authorization was required for the District to file.

difficulties applying for and obtaining a TCC. Ms. Cloud never asked Ms. Thomas to help her with the TCC application.

2. Ms. Cloud ignored the IRS letters and notices, was aware of the penalties imposed, and did not inform her manager or request help from anyone in the District to resolve the delinquencies.

The evidence overwhelmingly establishes that Ms. Cloud received each IRS letter and notice, and that she was aware of the penalties the IRS imposed on the District. Even if Ms. Cloud's failure to obtain a TCC were justified, which the evidence does not support, she made no effort to get support from her manager or HR. She made no effort to enlist the support or help of Ms. Thomas or anyone else in the District or elsewhere. And she took no steps to hire or train someone who could perform the tasks required to bring the District's filing status current. When, in November 2019, a benefits specialist was finally hired who was capable of doing the 1095-C work, she was not asked to get her TCC for a year after she was hired. And it wasn't Ms. Cloud who finally made getting the TCC and filing the returns a priority. After the IRS assessed penalties of over \$760,000 for the 2016 tax year, the payroll coordinator finally took the initiative and directed the benefits specialist to obtain her TCC and start filing the current and delinquent returns. If Ms. Cloud had made filing a priority when this employee was hired, it could arguably have saved the District over \$760,000 in penalties assessed for the 2017 tax year.

Finally, the first IRS letter, L5699, informing the District of its requirement to file and potential penalties if it does not file, includes a checklist of reasons from which an employer can select to explain why they did not file the returns, and gives the employer the option to attach a letter explaining their failure to file and "any actions you plan to take" to correct the delinquency.

Ms. Cloud never filled out the checklist or provided to the IRS an explanation for why the District did not file the returns, nor did she explain any actions the District was planning to take to correct the delinquency. She claims that she tried unsuccessfully to call the IRS, but the IRS provided in these letters a clear and straight-forward way to communicate with them. Ms. Cloud never replied to any of the letters.

3. Ms. Cloud conveyed to her staff, by action or inaction, that the IRS forms were a low priority for her.

Ms. Cloud failed to set the "tone at the top" regarding the importance of complying with the law and timely filing the returns. Other staff were aware that filing the returns was a very low priority for her because they were aware that she had not obtained the TCC for several years. Additionally, in early 2021, when the benefits specialist finally completed the 2020 1095-Cs for the employees and began to submit the 2020 and delinquent returns to the IRS, she ran into difficulties because she was not familiar with the process and didn't know where to get help. Ms. Cloud did not support her efforts or help her find resources to complete her task. The benefits specialist said she had two conversations with Ms. Cloud, both of which were incidental to other matters and not initiated by Ms. Cloud. In one conversation, Ms. Cloud told the benefits specialist that her work on the 1095-Cs was a "waste of time." In another, she indicated to the benefits specialist that the 1095-Cs weren't important, and she didn't need to file them.⁴

⁴ Ms. Cloud denied telling the benefits specialist that the forms were a "waste of time," but her actions, or inaction, over several years supports that she believed that. Additionally, Ms. Cloud told this investigator that she "probably didn't give them the level of attention they deserved."

4. Staff were aware of the delinquencies and penalties, and of Ms. Cloud's failure to address them, and did not report the problem to the superintendent or HR.

A secondary factor in the District's failure to file the returns over such a long period is that it appears several people in the payroll office were aware of the IRS notices, and at least a couple were aware that Ms. Cloud failed to obtain the code that would allow the District to submit the forms. However, no one reported the delinquencies or the increasingly large penalties to the superintendent's office or HR. For at least two years,⁵ it appears staff felt that giving the IRS notices to their manager, Ms. Cloud, was the fulfillment of their duty, even after it became apparent that Ms. Cloud was doing nothing to resolve the delinquencies. Finally, the payroll coordinator made the 1095-Cs a top priority, but even though she ultimately ensured that her staff worked to file the forms, she did not report to anyone but Ms. Cloud the significant penalties that the District had been assessed.

B. Allegation of Retaliation Against Ms. McAlpine

The evidence establishes that, on or about March 24, 2021, Ms. Cloud restricted Ms. McAlpine's access to the building in direct response to learning of Ms. McAlpine's complaint against her regarding Ms. Cloud's failure to file the IRS returns. It also establishes that Ms. Cloud did so in an effort to block Ms. McAlpine from gathering additional documentation that would support her claims against Ms. Cloud. Ms. McAlpine had always had 24/7 access to the building prior to Ms. Cloud restricting her access. Ms. Cloud did not restrict any other employee's access to the building.

The evidence also establishes that, on March 19, 2021, Ms. Cloud learned that Ms. McAlpine was gathering information related to the overtime of an employee over which Ms. Cloud had approval authority. She also was told that Ms. McAlpine was gathering negative information to use against her and/or others. Ms. Cloud restricted Ms. McAlpine's access to her calendar. Other staff withheld and hid documents that Ms. McAlpine was looking for because the clandestine way she asked for the documents, combined with telling a staff member she was keeping a "book of goodies," felt threatening to staff. The available evidence does not establish that Ms. Cloud directed or was aware of staff's actions. Staff's attitudes toward Ms. McAlpine changed but it is likely due to personality differences and staff's belief that Ms. McAlpine was trying to gather negative information to use against them. There is no evidence that it had a negative impact on Ms. McAlpine's ability to perform her duties.

Ms. McAlpine claims that Ms. Cloud's blocking her access to her calendar and to the office building negatively impacted her ability to perform her duties. We could not independently verify the impact. But she had always had complete access to both the calendar and the building, and that was taken away because of her investigation and complaint. The only thing that had changed when Ms. Cloud imposed the restrictions was Ms. Cloud's awareness of Ms. McAlpine's investigation and complaint against her.

To this investigator's knowledge, there has been no change in Ms. McAlpine's position, duties, or salary since she filed her complaint.

⁵ The first IRS letter was received in late July 2018, and the payroll coordinator did not direct her employee to get her TCC until November 2020.

Keating Bucklin: Tahoma S.D.
Summary Report of Investigation
August 20, 2021

Ultimately, Ms. McAlpine's job description gave her the authority and duty to investigate concerns of fraud and waste, and as part of that, to review relevant documents. She felt she had to do that initially "under the radar," which caused the office staff to suspect her motives and try to keep her from getting what she was looking for. The office staff did not know what "dirt" or "ammunition" she could be looking for and they felt threatened. But Ms. Cloud was aware that Ms. McAlpine knew of the IRS delinquencies and the penalties for at least one of the delinquent years. She knew at least some of the information that Ms. McAlpine was looking for to support her complaint against Ms. Cloud, and it appears that she took steps to block her from getting it.