Statement of

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Legal Services Corporation

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Chairman Cannon, Ranking Member Watt, and Members of the Subcommittee. My name is Kirt West. I have been the Inspector General of the Legal Services Corporation (LSC) since September 1, 2004. Before becoming Inspector General, I served for nearly twenty years in various legal and executive capacities at the Postal Service, the Central Intelligence Agency, and the Department of Labor. I am a career Federal employee, not a political appointee, and came to LSC to keep Congress and the LSC Board of Directors informed as required by the Inspector General Act. I appreciate this opportunity, my first, to discuss the work of the LSC Office of Inspector General (OIG).

Introduction

Like all other Federal Inspectors General, the LSC OIG operates under the Inspector General Act of 1978. In 1988, Congress amended the IG Act and required LSC and about 30 other, mostly smaller, federally funded entities to establish independent Inspector General offices. LSC is headed by an 11- member Board of Directors appointed by the President and confirmed by the Senate. The OIG is headed by the inspector general who is hired by, reports to and is under the general supervision of the LSC Board of Directors. In addition to the duty of the inspector general to report to Congress, a similarly important role is to provide independent and objective information to the Board of Directors and to Congress, which may not always receive such information from other sources.

The OIG conducts audits, investigations and other reviews to assist management in identifying ways to promote economy, efficiency and effectiveness in the activities and operations of LSC and its grantees; and to prevent and detect fraud and abuse. In addition, beginning with LSC's FY 1996 appropriation, Congress directed that the primary tool for monitoring grantee compliance with legal requirements would be the annual audits of all grantees. These audits are conducted by independent public accountants under guidance developed by the OIG and the OIG monitors their compliance with the guidelines. Congress has also specifically authorized the OIG to conduct program reviews of grantee compliance.

Like all Inspectors General, my mission is to prevent and detect waste, fraud and abuse, and to promote efficiency and effectiveness in the operations of LSC and its grantees. Inspector General Quality Standards require me to adhere to the highest ethical principles by conducting my work with integrity. My job is to provide independent and objective information to the LSC Board of Directors, the Congress, and the public as to whether federally appropriated tax dollars are being spent wisely and prudently in carrying out the LSC mission. It is my role to report to management and it is their decision, subject to Congressional oversight, to act or not act on the information I report.

<u>Changes at the LSC's Office of Inspector General</u>

Over the past several years, the LSC Board and Congress may not have had the benefit of an independent and objective OIG. Prior to my appointment, there was an acting IG for nearly four years working under two different Boards of Directors. The former acting IG served as a caretaker and did not develop a comprehensive work plan.

Shortly after I started, I conducted an analysis of the activities of the OIG to determine whether the office was performing its mission adequately. Members of my staff, as well as some LSC managers, told me they thought the OIG was underperforming. In making courtesy visits to the Oversight and Appropriations Committees of the Congress, I heard similar concerns that the OIG was underperforming.

There were also Congressional concerns about the perceived lack of IG independence. The IG had failed to spend over one million dollars of previously appropriated funds. In FY 2005 Congress made one million dollars of these funds available to LSC management to establish a Loan Repayment Assistance Payment Program.

I observed that for several years, the OIG had not conducted reviews of LSC's internal operations. The OIG did not have any investigators on staff but used a contract investigator on the rare occasions when the former acting IG determined that a criminal investigation was warranted. The OIG had used contractors instead of OIG audit staff to oversee the review of the Independent Public Accountants, which LSC grantees are required to employ to conduct audits of the grantee financial statements as well as grantee internal controls and compliance with LSC prohibitions and restrictions. The OIG did not appear to be targeting high risk programs, was not very responsive to Hotline complaints received from concerned members of the public, and did not appear to pursue a consultative relationship with the Congress. I concluded the OIG was clearly underperforming.

Thus, in addition to continuing to carry out our responsibility to oversee the monitoring of LSC grantee compliance with the restrictions placed on them to refrain from certain activities, we have started to review the internal operations of LSC as authorized by the Inspector General Act. While we are including internal reviews of LSC operations, we are also strengthening our grantee compliance oversight procedures. Our investigative activity has increased markedly with the hiring of two investigators; our legal staff continues to support all of our efforts and to provide comments on significant LSC regulatory and policy initiatives. The OIG is also making progress by defining and setting new directions and allocating OIG resources to high-risk areas and by starting to identify major management challenges facing LSC.

Within the OIG, we are improving ourselves and our work environment by conducting training and undergoing a peer review. Staff received training in writing and editing reports. The OIG also is working toward becoming a high-performing organization, and we have begun that effort with the assistance of a consultant on staff at the Office of Personnel Management's Federal Executive Institute. In addition, in accordance with inspector general community standards, another OIG is completing an audit peer review of work done before I arrived. The results of this independent review should inform me of ways the new OIG can improve its performance.

The OIG is committed to delivering high-quality professional audit, investigative, and other services to help the Board and management improve LSC programs and operations. To that end, we will provide timely, accurate and fact-based audits, inspections, evaluations, and investigations to help LSC carry out its mission. That was our intention when we issued a report to the LSC Board concerning a 10-year, $17.1 million lease of 45,000 square feet of office space signed by LSC in 2002.

The decision to review LSC's lease and 2003 relocation from Capitol Hill to Georgetown came from a number of sources including inquires from the Subcommittee. There were concerns about how LSC could afford to relocate to Georgetown. Around the same time, staff from the OIG and LSC management had told me in confidence that they believed LSC was paying above market rent for its Georgetown space, that LSC's total rent was more than what LSC was paying for its Capitol Hill space and that some employees were unhappy with the longer and more difficult commute because the office was no longer near Union Station and Metro Rail.

At the time I was hearing these concerns late last year, I became aware that LSC was in the process of negotiating a lease extension with its landlord and felt the Board could benefit from independent and objective information as to whether LSC was paying fair market rent. That is why I decided the OIG should conduct a review of the lease.

As background, in 1998 LSC began pursuing the idea of purchasing its own building to provide LSC with higher visibility and a sense of permanence. LSC believed a permanent home would also cap its future occupancy costs. When LSC decided to look for a new home, it was hoping to find comparable space for a comparable price to their 40,000 square feet of office space.

Purchasing a building outright, however, concerned LSC advisors because it could have triggered Office of Management and Budget (OMB) "scoring" rules. The scoring rules could have required that the entire purchase price be counted against LSC's appropriation in the first year rather than being charged annually over the term of years of the mortgage. The purchase price would have exceeded the entire LSC annual budget for management and administration, including salaries, thereby making the purchase impossible. LSC was advised that establishing a not-for-profit supporting organization could avoid OMB scoring as long as the lease itself was not a capital lease. Consequently, Friends of Legal Services Corporation was established by three LSC officers in 2001.

OIG Lease Review

The OIG began the lease review by first discussing the project with the General Services Administration OIG because of its oversight responsibilities of GSA's commercial leasing operations for the Federal government. It recommended that the OIG consult an appraiser to determine whether LSC was paying fair market rent. As a result, we hired two experienced commercial real estate appraisal firms in January 2005 to determine whether LSC was paying fair market rent.

One of the real estate appraisal firms hired by the OIG was recommended and used by the U.S. Postal Service (Joseph J. Blake and Associates, Inc.) in its leasing of commercial office space, and the other firm's principal had experience working at GSA and OMB (MillenniuM). The appraisers met with OIG and were given the same task order, which included calculating how much rent LSC should be paying for the space it now occupies based on the Georgetown real estate market. No one from my office directed their work or suggested any outcome. The appraisers did not discuss details of their work or their results with each other.

OIG conducted this work in accordance with professional standards established by the President's Council on Integrity and Efficiency. The OIG and the appraisers conducted their work with impartiality and independence, and the OIG's conclusions were indexed to supporting documentation which in turn was checked for accuracy by an independent auditor.

Unlike a lender's appraisals whose main purpose is to support the purchase price so that a loan can be approved, commissions earned, etc., the OIG appraisers had the straightforward task of determining what would have been the fair market rent if LSC had entered into a lease at 3333 K Street in July 2002 in a business-like, arms-length transaction. I was prepared to seek a third appraisal in the event the two appraisals reached materially different conclusions, but both appraisals reached similar conclusions.

Both appraisers concluded that LSC is paying higher than market rent even though the landlord is Friends, which was established by LSC to help control its rent costs. The appraisers concluded LSC was paying above market rent in July 2002 when LSC entered into the lease with Friends and was paying above market rent in November 2004 when the OIG began the review. These appraisals also revealed that currently all non-LSC tenants are paying below market rent, including those that entered into a lease after LSC signed its lease.

Based on the two independent appraisal reports, the OIG calculated LSC would overpay at least $1.23 million and perhaps as much as $1.89 million in rent over a 10-year period as a result of paying above market rent. Based on information provided by the appraisers, the OIG also calculated that LSC could have saved at least $1.1 million over a 10-year period by remaining at its Class A location on Capitol Hill near Metro Rail instead of moving to its Class B location in Georgetown. The OIG also calculated that LSC could be due a rent credit of over more than $100,000 because it was paying Friends for 45,000 square feet when it only occupied 42,852 square feet between June 2003 and late 2004.

In gathering information concerning this project, the OIG ran into several unexpected challenges obtaining documents and interviewing people. LSC management was unable to locate some information that would have assisted us in our review. LSC did not have records tracking how much of LSC's $2 million tenant improvement allowance was spent. This lack of records made it impossible for the OIG to determine whether LSC received full value of the allowance and whether Friends owes LSC about $200,000 for costs incurred by LSC. We reported this to LSC management. Also, the only copies of some LSC records were not in LSC's files but were instead mixed up with the landlord's records which were kept by an LSC staff attorney serving as the custodian of records for Friends. While LSC was cooperative, Friends was not nearly as cooperative, and we found ourselves having to deal with an LSC staff attorney as well as Friends' President and outside counsel in order to obtain Friends records.

Throughout our review it has been difficult to ascertain who was on whose side. For example, private outside counsel who was retained by LSC to provide legal advice to LSC on creating Friends is now representing Friends. And in reviewing LSC Board meeting transcripts, it was difficult at times to determine whether those LSC employees and LSC Board members concurrently serving on the Friends Board of Directors were representing LSC or Friends.

Another challenge faced by my office was the lack of criteria used by most other OIGs to evaluate LSC actions. Unlike most other agencies that have OIGs, LSC is not subject to most Federal laws and regulations that provide criteria for evaluating management action. Some agencies, such as the CIA and Postal Service, where I previously worked, also are not subject to many of the rules applicable to other Federal agencies. However, even the CIA and the Postal Service are subject to laws such as the Ethics in Government Act, which prohibit conflicts of interest, and civil service laws that protect employees who report fraud, waste, abuse, and mismanagement. LSC is not subject to those requirements, and in some cases has not developed a counterpart policy, such as a corporate code of conduct.

I am extremely concerned there may have been conduct by LSC officials that, but for this lack of applicable laws and regulations, could constitute administrative and even possibly criminal violations of the conflicts of interest laws applicable to all Executive Branch employees. In addition, I am concerned that LSC is not subject to the Whistleblower Protection Act. All LSC employees, including the Inspector General, are at-will employees, not subject to the due process protections afforded Federal employees and most state and local government employees. This at-will environment and lack of due process protections present a challenge to the OIG to effectively carry out its mission because it can deter employees from reporting their concerns and observations without fear of retaliation. As a first step to encourage my own employees to report any of their concerns, I have asked the Office of Special Counsel to ensure that OIG employees have whistleblower protection. I also intend to propose to the LSC Board that it develop an LSC corporate code of conduct which, if adopted, would enhance employee integrity and provide criteria against which to measure employee actions.

Although our review has focused on the two independent appraisals and the question whether LSC is paying fair market rent, we also made the following observations.

- LSC is overpaying more in the earlier years of the lease than in the later years. The OIG calculates LSC already overpaid between $752,000 and

$872,000 for the first two year of the lease, June 1, 2003 – May 31, 2005, and will overpay between $301,000 and $363,000 in the next twelve months.

- The above market rate of $38 per square foot appears to have resulted from the amount of rent Friends needed from LSC to satisfy the lender. As a condition of providing financing to Friends, the Bank of America required Friends to have an income rent stream of $1.71 million per year, which resulted in LSC having to rent 45,000 square feet of office space at $38.00 per square foot for a term of 10 years.

- The two independent appraisals were not the only evidence that LSC is overpaying rent. In an April 1, 2004 email, Friends was told by its real estate management firm that " the rental rate for the first floor LSC space would likely fall somewhere in the $24-$26 range with 2.5 to 3.0 percent escalations. There will likely be 4-6 months down time to find a user."

- As the 10-year lease reaches its term, it becomes more favorable to LSC. Friends, however, has proposed a lease extension that would require LSC to pay pass through costs, which it does not currently pay, beginning in June 2013. These additional costs would make the lease less favorable to LSC.

- A Memorandum of Understanding between LSC and Friends regarding the lease extension uses a different method of measuring space and includes pass through costs. This new measurement standard would increase LSC's annual rental by more than $200,000 per year, not counting pass through costs.

- Some LSC employees and Board members were more sensitive to actual or apparent conflicts of interest than others. For example, LSC President and Board member John Erlenborn, who was also serving as Friends' President and Board member, recognized the importance of LSC and Friends being able to enter into arms length negotiations. Mr. Erlenborn resigned from Friends but two other LSC officers and one LSC Board member continued to serve on the Friends Board through as late as the spring of 2004.

- LSC lost control of Friends and therefore lost control of the building. At the time it was established, LSC had a controlling membership on Friends' Board of Directors. Over time, the Friends' Board expanded and the three LSC officers either resigned or were replaced. Today, although the LSC Board appoints one Friends Board member, there are no LSC employees or current LSC Board members on the Friends Board. In the recent past, Friends began taking calculated measures to gain distance and independence from LSC. Currently, the actual relationship between Friends and LSC is unclear.

- Friends made a $50,000 unrestricted contribution to an organization although LSC could not make such an unrestricted contribution.

- LSC does not own the building. Although the building is commonly referred to as LSC's permanent home, we were not able to identify any permanent or ownership interest of LSC in the building. LSC has a 10-year lease and the OIG is not aware of any legally binding agreement allowing LSC to stay permanently at market (or below market) rent or to take ownership of the building from Friends.

- There is only one document, a lender's appraisal, that could even possibly be construed to justify a $38.00 per square foot rent rate and it contains a flawed market rent analysis. The analysis compared the LSC headquarters, a Class B building, to among others, two Class A buildings, the Watergate Office Building and Washington Harbor. In Georgetown, Class A building rent commands about $8.00 per square foot more than Class B Buildings. In addition, the appraisal contained no analysis of the relative merits of the comparables nor did it provide any justification for the adjustments in comparables in determining fair market rent.

OIG Review of LSC Space Needs

The OIG will soon be issuing its review of whether LSC had a valid business case to lease 45,000 square feet for approximately 110 employees, or over 400 square feet per employee, when GSA guidelines recommend 230 square feet per employee unless justified by specific mission requirements and validated though benchmarking. As soon as our report is final, we will issue it to the Board of Directors and Congress.

Conclusion

Mr. Chairman, thank you for this opportunity to testify before the Subcommittee. I am proud of the work being done by the staff of the LSC Office of Inspector General. We look forward continuing to conduct independent and objective reviews so the LSC Board of Directors, the Congress, and ultimately the American taxpayers can be assured that their money is being spent wisely and prudently to provide legal services to those in need.