LSC

Legal Services Corporation
Office of Inspector General

June 13, 2005

Helaine M. Barnett
President
Legal Services Corporation

Audit of LSC's Two Million Dollars ($2,000,000) Landlord Contribution
Report No. AU05-06(R)

Introduction

This report revises the original report "Audit of LSC's Two Million Dollars ($2,000,000) Landlord Contribution Report No. AU05-06," dated April 21, 2005. The purpose of the revision is to clarify the paraphrasing of management's comments to recommendation 3. Management was concerned that the paraphrase may be misinterpreted and wanted to ensure that it was understood that management has not reached any conclusion as to whether collections need to be made from the landlord. While the paraphrase did state that management indicated it will wait until its analysis of the accounting is complete before deciding on how to proceed and the full text of management comments were included as an attachment, the report has been revised to ensure there is no possibility for misinterpreting management's position.

Background

As a result of our review of LSC's lease at 3333 K Street, the Office of Inspector General conducted a limited scope review of the accounting of Friends of Legal Services Corporation's (FoLSC) $2 million Landlord Contribution.

On July 1, 2002, LSC signed a lease agreement with FoLSC to rent 45,000 square feet of space at 3333 K Street, NW. Article 3 of the Office Lease Agreement and Exhibit D of the Lease detail the Landlord and Tenant responsibilities. Exhibit D, Article 4, Section 1.1 states that the "Landlord shall [provide] an allowance ("Landlord's Contribution") of up to Two Million Dollars ($2,000,000), which shall be applied by Landlord toward the cost and expense of performing Leasehold Improvements. ... Upon completion of the Leasehold Improvements, any unused portion of the Landlord's Contribution shall be retained by Landlord."

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According to Exhibit D-1 of the lease agreement, the $2 million was to be used for the construction of Leasehold Improvements to bring the premises "to a standard comparable to the existing premises occupied by Tenant located at 750 First Street, N.E., Washington, D.C." The Leasehold Improvements were to be made in accordance with plans approved by LSC, including Architectural Plans prepared by the Landlord's Architect; mechanical, electrical, and plumbing (MEP) and/or fire protection and life safety plans prepared by the Landlord's MEP Engineers; and Structural Plans prepared by the Landlord's Structural Engineers (Exhibit D, Articles 1 and 2). The Leasehold Improvements were to be supervised by the Landlord's General Contractor (Exhibit D, Article 1, section 1.8).

Objectives, Scope and Methodology

The objective of our audit was to determine whether LSC received full and fair value of the $2 million build out funds that were available. To accomplish our objective we reviewed the terms of the Office Lease Agreement between FoLSC and LSC, reviewed documentation provided by both LSC and FoLSC, and interviewed key LSC employees. The audit was performed in accordance with *Generally Accepted Government Auditing Standards* from November 2004 to February 2005, and included such tests of internal controls as considered necessary under the circumstances.

Prior Audit Coverage

We found no prior audit coverage relevant to our review.

Audit Results

We were unable to determine whether LSC received full and fair value of the $2 million build out funds that were available because LSC did not have the accounting records and documentation to support the leasehold improvements. Although LSC made an attempt to obtain documents from the landlord to support the leasehold improvements in October of 2004, no information has been received by LSC from the landlord to fully account for the cost of leasehold improvements.

In addition to the $2 million available for leasehold improvements, the Office of Inspector General contributed $168,257 to build out its own space while LSC paid a total of $34,983 to CTI Telecom for network and telephone wirings. As a result, LSC may have paid over $200,000 for what should have been paid for with the leasehold improvement funds.

Also, a review of the March 25, 2003 Preliminary Project Budget Summary Report prepared by CB Richard Ellis, the landlord's representative, indicates that some of the items listed may not be leasehold improvements, such as the lease termination fee of

$149,680 that FoLSC had agreed to pay to LSC's former landlord, and $250,000 in unspecified base building renovations. As a result, LSC may not have received the full benefit of the $2 million leasehold improvement allowance. Since any unused portion of the leasehold improvement allowance reverted back to FoLSC, LSC derived no benefit, such as reduced rent, by keeping leasehold improvements below $2 million. Because LSC did not have a full accounting of the charges against the $2 million leasehold improvement allowance, we were unable to determine if the lease termination fee and the base building renovations were ultimately charged against LSC's leasehold improvement allowance.

This occurred because LSC did not have a representative monitoring the construction process solely for its own benefit. Because of the tenant's relationship to the landlord, LSC management did not install sufficient controls during the construction process. Our review indicated that no one in LSC was designated, solely for the benefit of LSC, to closely monitor the reasonableness of expenditures related to the build out or leasehold improvements.

Recommendations

The President of LSC should:

1. Obtain a full and detailed accounting from FoLSC of all costs associated with the $2 million landlord contribution

2. Conduct a detailed analysis of the costs to determine the reasonableness of these expenditures

3. Recoup from the landlord all payments made by LSC that should have been paid using the leasehold improvement funds.

LSC Management's Comments

On April 12, the LSC President provided a written response to the draft report stating that LSC management agreed with the findings and describing the actions LSC management would take to implement the recommendations.

Recommendation 1. LSC management stated that, while management was unable to locate any copy of the detailed accounting of all costs associated with the leasehold improvements in their records, LSC management had communicated with the Landlord, Friends of LSC, who has indicated a willingness to look for and provide such record to LSC management.

Recommendation 2. LSC management indicated that, once management had located or are provided a copy of the full and detailed accounting of the leasehold improvements, it will conduct a thorough analysis of the costs to determine the reasonableness of these expenses.

Recommendation 3. LSC management stated "With respect to Recommendation 3, how we will proceed will depend on our ability to document the expenditures and our analysis of the reasonableness of the expense."

The complete text of LSC management comments can be found at Attachment 1.

OIG Evaluation of LSC Management's Comments

LSC management's comments are responsive to our findings and recommendations. The OIG considers the actions taken or planned sufficient to address the issues we identified.

The OIG considers Recommendations 1, 2 and 3 significant, therefore, requiring OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the follow-up tracking system until the OIG formally notifies LSC management that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Christopher M. Aballe at (202) 295-1658 or me at (202) 295-1663.

Ronald D. Merryman

Ronald D. Merryman
Acting Assistant Inspector General for Audit

Attachment 1: Memo from Helaine M. Barnett to Ronald D. Merryman, dated 4/12/05

cc: Victor Fortuno
Vice President for Legal Affairs/
General Counsel/Corporate Secretary

LSC

OFFICE OF THE PRESIDENT

ATTACHMENT 1

Legal Services Corporation
America's Partner For Equal Justice

MEMORANDUM

TO: Ronald D. Merryman
Acting Assistant Inspector General for Audit

FROM: Helaine M. Barnett HMB
President

DATE: April 12, 2005

SUBJECT: Audit of LSC's Two Million Dollars ($2,000,000) Landlord Contribution

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Based on our meeting on April 4, 2005, and as a follow-up to my memo of March 16, 2005, following is management's response to the OIG's three recommendations in the draft Audit of LSC's $2 Million Landlord contribution, as of this date:

With respect to Recommendation 1, we have looked for and been in touch with Friends of Legal Services Corporation (FoLSC) about a full and detailed accounting of all costs associated with the 3333 K Street LSC space build-out. While we have been unable to locate any copy of such an accounting in our own records, FoLSC may have such a record and they have indicated a willingness to look for and provide it to us. (See attached correspondence on this point.)

With respect to Recommendation 2, once we locate or are provided a copy of a full and detailed accounting, we will conduct a thorough analysis of the costs to determine the reasonableness of these expenses.

With respect to Recommendation 3, how we will proceed will depend upon our ability to document the expenditure and our analysis of the reasonableness of the expense.

If you have any questions or require anything more, please let me know.

cc: Kirt West
Victor Fortuno