

**Written Testimony of H. David Kotz  
Inspector General of the  
Securities and Exchange Commission**



**Before the Federal Financial Management, Government  
Information, Federal Services, and International Security  
Subcommittee of the U.S. Senate Committee on  
Homeland Security and Government Affairs  
Thursday, August 4, 2011  
2:30 p.m.**

## **Introduction**

Thank you for the opportunity to testify before this Subcommittee on the subject of “Federal Leased Property: Are Federal Agencies Getting a Bad Deal?” as the Inspector General of the U.S. Securities and Exchange Commission (SEC or Commission). I appreciate the interest of the Chairman, the Ranking Member, and the other members of the Subcommittee, in the SEC and the Office of Inspector General (OIG). In my testimony, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my remarks by briefly discussing the role of my Office and the oversight efforts we have undertaken during the past few years. The mission of the OIG is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. The SEC OIG includes the positions of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates, and supervises independent audits and evaluations related to the Commission’s internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules, and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities, or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules, and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation, as appropriate.

### **Audit Reports**

Over the past three and one-half years since I became the Inspector General of the SEC, our audit unit has issued numerous reports involving matters critical to SEC programs and operations and the investing public. These reports have included an examination of the Commission's oversight of the Bear Stearns Companies, Inc. and the factors that led to its collapse, an audit of the Division of Enforcement's (Enforcement) practices related to naked short selling complaints and referrals, a review of the SEC's bounty program for whistleblowers, an analysis of the SEC's oversight of credit rating agencies, and audits of the SEC's compliance with Homeland Security Presidential Directive 12 and its oversight of the Securities Investment Protection Corporation's activities. In addition, in March 2009, we conducted a review of an agency restacking project in which over \$3 million was expended to relocate approximately 1,750 SEC

employees in its headquarters building and, in September 2010, we completed an audit of the SEC's real property and leasing procurement process.

### **Investigative Reports**

The Office's investigations unit has conducted numerous comprehensive investigations into significant failures by the SEC in accomplishing its regulatory mission, as well as investigations of allegations of violations of statutes, rules, and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Members of Congress, and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removal of employees from the federal service, as well as recommendations for improvements in agency policies, procedures, and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of failures by Enforcement to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, conflicts of interest by Commission staff members, post-employment violations, unauthorized disclosure of nonpublic information, procurement violations, preferential treatment given to prominent persons, retaliatory termination, perjury by supervisory Commission attorneys, failure of SEC attorneys to maintain active bar status, falsification of federal documents and compensatory time for travel, abusive conduct, and the misuse of official position and government resources.

In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's \$50 billion Ponzi scheme. In March 2010, we issued a 151-page report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's \$8 billion alleged Ponzi scheme. Most recently, on May 16, 2011, we issued a comprehensive and thorough report of investigation into the circumstances surrounding the SEC's decision to lease approximately 900,000 square feet of office space at a newly-renovated office building known as Constitution Center, which is the subject of this hearing.

### **Commencement and Conduct of the OIG's Leasing Investigation**

On November 16, 2010, the OIG opened an investigation as a result of receiving numerous written complaints concerning the SEC's decisions and actions relating to the leasing of office space at the Constitution Center office building in Washington, D.C. These complaints alleged that the decision to lease space at Constitution Center was ill-conceived, resulted from poor management practices, and was made without Congressional funding for the significant projected growth necessary to support the decision.

As part of our investigative efforts, we took the sworn testimony of 18 witnesses in the investigation and interviewed 11 other individuals with knowledge of facts or circumstances surrounding the SEC's leasing of this space.

We made numerous requests to the SEC's Office of Information Technology (OIT) for the e-mails of current and former SEC employees for various periods of time pertinent to the investigation. The e-mails were received, loaded onto computers with specialized search tools, and searched on a continuous basis throughout the course of our

investigation. In all, OIT provided e-mails for a total of 27 current and former SEC employees for various time periods pertinent to the investigation. We estimate that we obtained and searched over 1.5 million e-mails during the course of the investigation.

We also made several requests to the SEC's Office of Administrative Services (OAS), which oversees the SEC's leasing function, for documents relating to its leasing practices. We carefully reviewed and analyzed the information we received as a result of our document requests. These documents included all records relating to the Constitution Center lease, as well as documents relating to the leasing of additional office space by the SEC for the past several years.

### **Issuance of Comprehensive Report of Investigation in Leasing Matter**

On May 16, 2011, we issued to the Chairman of the SEC a comprehensive report of our investigation in the leasing matter that contained over 90 pages of analysis and more than 150 exhibits. The report of investigation detailed all of the SEC's recent leasing-related decisions and analyzed all of the facts and circumstances that led to the SEC's decision to lease space at Constitution Center.

### **Results of the OIG's Leasing Investigation**

The OIG investigation found that the circumstances surrounding the SEC's entering into a lease for 900,000 square feet of space at the Constitution Center facility in July 2010 were part of a long history of missteps and misguided leasing decisions made by the SEC since it was granted independent leasing authority by Congress in 1990. The OIG investigation further found that based upon estimates of increased funding, primarily to meet the anticipated requirements of financial reform legislation that was enacted on July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-

Frank), between June and July 2010, OAS conducted a deeply flawed and unsound analysis to justify the need for the SEC to lease 900,000 square feet of space at the Constitution Center facility. We found that OAS grossly overestimated (by more than 300 percent) the amount of space needed for the SEC's projected expansion and used these groundless and unsupportable figures to justify the SEC's commitment to an expenditure of approximately \$557 million over 10 years.

The OIG investigation also found that OAS prepared a faulty Justification and Approval document to support entering into the lease for the Constitution Center facility without competition. This Justification and Approval document was prepared after the SEC had already signed the contract to lease the Constitution Center facility. Further, OAS backdated the Justification and Approval, thereby creating the false impression that it had been prepared only a few days after the SEC entered into the lease. In actuality, the Justification and Approval was not finalized until a month later.

A brief summary of our specific findings is set forth as follows. In 1990, Congress provided the SEC with independent leasing authority, which exempted the SEC from General Services Administration (GSA) regulations and directives. See 15 U.S.C. § 78d(b)(3). The House Conference Report for this legislation expressed the clear intention that "the authority granted the Commission to lease its own office space directly will be exercised vigorously by the Commission to achieve actual cost savings and to increase the Commission's productivity and efficiency." H.R. Conf. Rep. 101-924, 101<sup>st</sup> Cong, 2d Sess. 1990 at 20.

Subsequent to Congress's granting of independent leasing authority to the SEC, several expensive missteps related to the SEC's leasing actions and management of its

space have occurred. For example, in May 2005, the SEC disclosed to a House Subcommittee that it had identified unbudgeted costs of approximately \$48 million attributable to misestimates and omissions of costs associated with the construction of its headquarters facilities near Union Station, known as Station Place One and Two. In 2007, merely a year after moving into its new headquarters, the SEC embarked on a major “restacking” project pursuant to which various SEC employees were shuffled to different office spaces in the same buildings at a cost of over \$3 million. An OIG audit of that project found that there was no record of a cost-benefit analysis having been conducted before this undertaking. An OIG survey found that an overwhelming majority of Commission staff affected by the restacking project had been satisfied with the location of their workspace before that project was initiated, and did not believe the project’s benefits were worth the cost and time of construction, packing, moving, and unpacking.

The OIG investigation further found that, as a result of a mistaken belief that the SEC would receive significant additional funding, OAS made grandiose plans to lease the upscale facility at Constitution Center. On May 14, 2010, the SEC submitted an authorization request to the Chairman of the U.S. Senate Committee on Banking, Housing, and Urban Affairs, requesting \$1.507 billion for Fiscal Year (FY) 2012 to fund an increase of 800 new staff positions. On May 20, 2010, the U.S. Senate passed a version of the financial regulatory reform bill that eventually became Dodd-Frank (the U.S. House of Representatives had passed a version of the legislation on December 11, 2009). The SEC estimated that it would need to add another 800 positions in FY 2011 and FY 2012 to implement Dodd-Frank. After the reconciliation process between the



two versions of the financial regulatory reform bills, Dodd-Frank became law on July 21, 2010.

Authorization of funding for an executive agency like the SEC does not guarantee that the agency will be appropriated the funds. An authorization request is the first step in the SEC's lengthy budget process. Under that process, an authorization request is submitted to Congress in May of the fiscal year two years prior to the fiscal year for which the authorization is requested (*e.g.*, the FY 2012 authorization request takes place in May 2010). The following September, several months after the authorization request is made, the SEC submits a proposed budget request to the Office of Management and Budget (OMB). In November, the next step of the budget request process takes place: OMB replies to the SEC with a "pass-back," and the SEC and OMB then usually negotiate the amount of the budget request. Several months later, the President formally submits a budget proposal to Congress. Once the President makes the budget request to Congress, Congress then begins the decision-making process as to how much money to appropriate to the SEC and other agencies. SEC employees interviewed in connection with the OIG's leasing investigation acknowledged that an authorization may indicate an intention for Congress to provide funding, but circumstances frequently change and, therefore, federal agencies understand that until funds are appropriated, they cannot count on receiving those funds.

Notwithstanding the uncertainty of actually being appropriated the amount requested through the budget process, in May 2010, OAS began planning for an expansion at SEC Headquarters based on the agency's FY 2012 budget request. Initially, the SEC's Associate Executive Director of OAS, Sharon Sheehan, and the former Chief

of OAS's Leasing Branch decided that the agency needed to lease approximately 300,000 square feet of space to accommodate the SEC's needs through FY 2012. As of May 2010, the Chief of the Leasing Branch's plan was to solicit offers from three properties within walking distance of Station Place to meet the SEC's additional space needs. However, on June 2, 2010, the Chief of the Leasing Branch received an e-mail from the real estate broker for a facility at Constitution Center, located on 7<sup>th</sup> and D Streets, SW, approximately two miles from the SEC's Station Place facility near Union Station, regarding Constitution Center's availability and some of its features.

The 1.4 million square foot Constitution Center had just been renovated in "one of the largest office redevelopment projects in Washington, DC," according to promotional literature. One of the more attractive features of the Constitution Center facility was its 5,000 square foot lobby with spacious accommodations for a guard desk(s), security screening room, shuttle elevator lobby, and display space, as well as Jerusalem limestone floors, marble walls, wood and metal paneling, decorative lighting and a floor-to-ceiling glass wall facing the landscaped courtyard. The facility promised abundant daylighting, panoramic views of the city and surrounding region, and an open plaza area that contained a one-acre private garden.

Almost immediately after being contacted by the broker for Constitution Center, OAS decided to expand the previous delineated locality of consideration to add Constitution Center to the other three buildings that would be included in the solicitation for offers for approximately 300,000 square feet of space.

On June 17, 2010, OAS briefed SEC Chairman Mary Schapiro on its immediate expansion plans at SEC Headquarters. At that briefing, the Chief of the Leasing Branch

informed the Chairman that the SEC needed to lease immediately 280,000 to 315,000 square feet of office space in Washington, D.C., and identified on a map specific locations for that expansion, including Constitution Center. Both Chairman Schapiro and her former Deputy Chief of Staff, Kayla Gillan, recalled the Chairman expressing clear preference for the locations that were within walking distance of Station Place, as opposed to the Constitution Center facility. Chairman Schapiro also questioned whether the SEC needed 300,000 additional square feet, given that she believed the SEC should concentrate its growth in the agency's regional offices.

The OIG investigation found notwithstanding Chairman Schapiro's expressions in mid-June 2010 of her preference for a facility closer to Station Place and her questioning of why the SEC needed as much as 300,000 square feet of space, by mid-July, OAS came back to the Chairman with an urgent recommendation that the SEC immediately lease 900,000 square feet of space with the only available option being the Constitution Center facility. The OIG investigation found that the analysis OAS performed to justify the need for three times its original estimate of necessary square footage, and its determination that the Constitution Center facility was the only available option, was deeply flawed and based on unfounded and unsupportable projections. We found that, as a consequence of its flawed analysis, OAS grossly overestimated the amount of space needed at SEC Headquarters for the SEC's projected expansion.

Specifically, the OIG investigation found that OAS erroneously assumed that all of the new positions projected for FY 2011 and FY 2012 would be allocated to SEC Headquarters and that none of those new positions would be allocated to the SEC's regional offices. This assumption was contrary to the position the Chairman had

communicated to OAS at the June 17, 2010 meeting that as much as possible of the SEC's future growth should occur in the regional offices, not at Headquarters. We found that although the need for a calculation reflecting the allocation of a number of the new positions to the regions was discussed, none was ever prepared. Sheehan testified that "OAS had difficulty getting the breakout," and acknowledged that, assuming all of the new positions would be located at Headquarters would "inflate the number."

We also found that OAS conducted its analysis of the SEC's space needs by using a standard of 400 square feet per person when calculating how much space would be needed for the additional positions it believed it would gain as a result of Dodd-Frank and associated increases in the SEC's budget. A Realty Specialist in OAS explained to the OIG that the Chief of the Leasing Branch and she developed the 400 square feet standard by dividing the square footage of office space by the number of people the SEC had authority to hire for the offices in that space at Headquarters and several of the SEC's regional offices. The Realty Specialist described the standard as a "WAG" (wild-assed guess) and a "back of the envelope" calculation, and acknowledged in her OIG testimony that OAS "didn't do this scientifically." OAS's 400 square feet per-person standard was an "all-inclusive number" that included common spaces and amenities. It also included an additional 10 percent for contractors, 10 percent for interns and temporary staff, and five percent for future growth. Notwithstanding this "all-inclusive" number, we found that when OAS later performed its calculations to justify the Constitution Center lease, it added even more unnecessary space by double-counting contractors, interns and temporary staff and by improperly incorporating future growth into the projections of

space needed. We also found that each one of these estimates was wildly inflated and unsupported by the data being used by OAS.

The OIG investigation found that OAS inflated its estimate of new positions that would require space by including an estimate of the number of contractors who would be hired in addition to the number of SEC employees. In early June 2010, OAS Associate Executive Director Sheehan asked the OAS Branch Chief for Space Management & Mail Operations to obtain information about the number of contractors in the agency. On June 12, 2010, the Branch Chief reported back, “Right now, based on the Contractor numbers I have at [Station Place], I can justify us using a 10%, Contractor to Position, factor.” The Branch Chief later learned that OAS needed the numbers to be larger. He testified as follows regarding his understanding of why the Chief of the Leasing Branch needed the number to be larger: “[W]hat I understand she was trying to do was to make sure that whatever size lease she entered into was enough to meet our needs. And I think that in this case, if we were going to take the whole building, the numbers needed to be larger.” Ultimately, OAS ignored the data that had been gathered during the first two weeks of June 2010, which indicated the correct contractor ratio was 10 percent, and inflated its calculation of space by adding contractors using a completely arbitrary 20 percent ratio.

In addition, we found that OAS’s estimate of new positions that would need space included an estimate of the number of interns and temporary staff who would be hired, in addition to new employees. OAS’s estimate of interns and temporary staff to be hired assumed a ratio of 16.5 percent (9 percent for interns and 7.5 percent for temporary staff). However, the OIG found that OAS’s estimate of intern and temporary staff positions was significantly higher than the estimate in the data it had received. On July 16, 2010, a

management program analyst in the SEC's Office of Human Resources provided OAS with "the [peak] numbers [for interns and temporary staff]," which ranged from approximately 4 to 7 percent for the six fiscal years of data analyzed.

Further, the OIG investigation found that OAS's calculations increased the amount of space required for every person to be hired in FY 2011 and FY 2012 by 10 percent for "inventory" representing "vacant offices you have for expansion and unanticipated growth, that kind of thing," according to an OAS Assistant Director. However, as was the case with the estimate for contractors, temporary staff and interns, an inventory factor had already been incorporated into the calculation of the 400 square foot standard. Moreover, the 10 percent inventory factor added was double the 5 percent factor previously determined to be appropriate.

We also found that OAS's estimate of new positions that would need space included an assumption not only about FY 2011 and FY 2012, but also reflected an assumption that, in FY 2013, Congress would increase the SEC's appropriation by 50 percent of the assumed FY 2012 increase. We found that the assumption of 50 percent growth in 2013 was arbitrary and unsupported. Based on the assumed FY 2013 growth, OAS calculated that the SEC would add another 295 positions in that year and again assumed that all of those positions would be allocated to SEC Headquarters. We found that this estimate was not based upon any firm numbers or projections and was contrary to the SEC's planning and budget process, which does not project growth more than two years into the future.

The OIG investigation found that OAS used the above-described overinflated estimates to calculate a space need of 934,000 square feet. On Friday, July 23, 2010,

Executive Director Diego Ruiz met with Chairman Schapiro, Chief of Staff Didem Nisanci, and then-Deputy Chief of Staff Gillan to recommend that the SEC lease 900,000 square feet of space at Constitution Center. Gillan recalled the July 23, 2010 meeting with Ruiz, and stated that Ruiz had come to her “and said that he needed to see Mary [Schapiro] quickly because he needed to make a quick decision on Constitution Center. That the other possible space opportunities had evaporated, gone to others, were no longer available. And that this one was really all that was left and that we needed to act quickly.”

Chairman Schapiro testified as follows regarding the July 23<sup>rd</sup> meeting with Ruiz:

I remember explicitly being told there really wasn't any other space available that could fulfill our needs and that there was a time – a sense of we were about to lose this. We had lost other space that we had apparently indicated an interest in and that we were about to lose this. So there was a sense of urgency on their part.

Gillan testified that Ruiz did not explain in the July 23, 2010 meeting, or at any other time, that the assertion that SEC Headquarters needed an additional 900,000 square feet was predicated, in part, on the assumption that all of the agency's new positions in FY 2011 and FY 2012 would be allocated to Headquarters. Gillan testified, “[I]n fact, that's inconsistent with what I had understood, because ... [Chairman Schapiro] specifically said that, to the extent possible, she wanted new hires to go to the regions.” Gillan also testified that Ruiz did not explain in the July 23, 2010 meeting, or at any other time, that the assertion that SEC Headquarters needed an additional 900,000 square feet was predicated, in part, on OAS's projections of significant growth in FY 2013.

On July 23, 2010, Ruiz sent an e-mail to Sheehan and others stating, “Met with Chairman this morning, and we have her approval to move forward.” The OIG

investigation found that the SEC negotiated the contract for 900,000 square feet at Constitution Center in three business days, signing the contract on July 28, 2010. On July 27, 2010, the SEC staff involved in that negotiation discussed the fact that they had “no bargaining power” because “Sharon [Sheehan] wants this signed tomorrow.” Internal e-mails show that OAS feared losing the building to the National Aeronautics and Space Administration, which had also expressed an interest in the facility.

On July 28, 2010, the SEC executed a Letter Contract committing the SEC to lease approximately 900,000 square feet of space at Constitution Center. The contract established a multiphase delivery schedule, in which Phase 1, approximately 350,000 square feet, would be delivered no later than September 2011, and Phase 2, approximately 550,000 square feet, would be delivered no later than September 2012. The contract stated that “the SEC’s interests require that [the owner] be given a binding commitment so that the space required will be committed to the SEC and initial build out for the Phase 1 space can commence immediately . . . .” The lease term in the contract was ten years. The Chief of the Leasing Branch estimated the costs associated with the SEC’s leasing and occupying Constitution Center would be \$556,811,589.

The Letter Contract also granted the SEC the right of first refusal for the remaining approximately 500,000 square feet of space at Constitution Center until December 15, 2010. If the SEC had exercised this option, it would have leased the entire 1.4 million square feet of space at Constitution Center. The Chief of the Leasing Branch testified that OAS wanted a right of first refusal on all of the remaining space at Constitution Center “because the Congress was throwing money at us” and “Sharon



[Sheehan] was always hoping that we wouldn't have anybody else in the building. That we would be able to ultimately justify the need for the whole building or something.”

After the SEC committed itself to the ten-year lease term at a cost of \$556,811,589, it entered into a Justification and Approval for Other than Full and Open Competition, which is required by the Federal Acquisition Regulation (FAR) when an agency decides not to allow for full and open competition on a procurement or lease. The FAR permits other than full and open competition “when the agency’s need for the supplies or services is of such an unusual and compelling urgency that the Government would be **seriously injured** unless the agency is permitted to limit the number of sources from which it solicits bids or proposals.” 48 C.F.R. § 6.302-2 (emphasis added).

The OIG investigation found that the Justification and Approval to lease space at Constitution Center without competition was inadequate, not properly reviewed, and backdated. The Justification and Approval provided as follows:

To fulfill these new responsibilities it is necessary to significantly increase full-time staff and supporting contractors by approximately 2,335 personnel to be located at the SEC’s headquarters in Washington, DC. However, the SEC’s current headquarters is full. Accordingly the SEC has a requirement of an unusual and compelling urgency to obtain approximately 900,000 rentable square feet (r.s.f.) of additional headquarters space in the Washington, D.C. Central Business District, as this is the amount of space required to accommodate the approximately 2,335 new staff and contractors in headquarters.

The Justification and Approval asserted that the 900,000 square feet “must be in a single building or integrated facility to support the SEC’s functional requirements and operational efficiency.”

An OAS Management and Program Analyst signed the Justification and Approval as the SEC's Competition Advocate. She testified that she did not take any steps to verify that the information in the Justification and Approval was accurate, "[o]ther than asking the contracting officer, you know, just general questions, 'Is this indeed urgent and compelling[?]'". She further testified that when she signed the Justification and Approval, she was not aware that funding for the projected growth had not been appropriated. She also did not have an understanding of when the projected 2,335 personnel were expected to be hired. Further, she acknowledged in testimony that the SEC would, in fact, not be "seriously injured" if it lost the opportunity to rent one contiguous building and had to rent multiple buildings to fill its space needs.

The FAR also requires that a Justification and Approval for Other than Full and Open Competition be posted publicly "within 30 days after contract award." The Letter Contract was signed on July 28, 2010. Accordingly, the deadline for publication of the Justification and Approval was August 27, 2010. However, the SEC did not publicly post the Justification and Approval on the Federal Business Opportunities website until September 3, 2010. The document was signed by four individuals, with all four signatures dated August 2, 2010.

However, the OIG investigation found that the Justification and Approval was not finalized until September 2, 2010, and substantial revisions were being made up to that date. We found that three of the four signatories executed the signature page on August 2, 2010, before a draft even remotely close to the final version existed. The OIG found that the SEC's Competition Advocate executed the signature page on August 31, 2010, and initially backdated her signature to August 27, 2010, but subsequently whited-out the

“7” on the date to make it appear that she also had signed the document on August 2, 2010. The actions of the signatories to the Justification and Approval gave the public the false impression that the document was finalized a few days after the Letter Contract was signed, and that there was only a delay in its publication.

The OIG investigation also found that there is significant uncertainty among the SEC staff regarding important requirements in connection with government leasing and there are serious questions as to whether the SEC complied with several of those requirements in connection with its leasing of Constitution Center. Appendix B of OMB Circular No. A-11 states, “Agencies are required to submit to OMB representatives the following types of leasing and other non-routine financing proposals for review of the scoring impact: Any proposed lease of a capital asset where total Government payments over the full term of the lease would exceed \$50 million.” Although the evidence showed the SEC initially contemplated providing OMB with the written notification and senior agency officials believed that OMB had been formally notified, no written notification to OMB was provided.

In addition, we found that there is a possibility that the SEC violated the Antideficiency Act in connection with its lease of Constitution Center. The Antideficiency Act prohibits officers or employees of the government from involving the government “in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.” 31 U.S.C. § 1341(a)(1)(B). The incurring of an obligation in excess or advance of appropriations violates the Antideficiency Act. Notwithstanding its July 28, 2010 commitment to a ten-year lease at Constitution Center, the SEC did not obligate the entire amount of rent payments due

under the lease. Although the SEC has been granted independent leasing authority statutorily and is generally granted authority to enter into multiyear leases in its annual appropriations, the U.S. Government Accountability Office (GAO) has found that “[t]he existence of multiyear leasing authority by itself does not necessarily tell [an agency] how to record obligations under a lease.” GAO has distinguished agencies that have “specific statutory direction” to obligate funds for multiyear leases one year a time, such as the GSA, from agencies such as the Federal Emergency Management Agency (FEMA), which do not have such explicit direction. Because the SEC, like FEMA, does not have specific statutory direction to obligate funds for its multiyear leases on an annual basis, its lease obligations may have to be obligated in their entirety at the time they are incurred. Thus, SEC may have violated the Antideficiency Act in connection with its commitment to lease space at Constitution Center.

In early October 2010, the SEC informed the owner of the building that it could not use approximately 600,000 of the 900,000 square feet of space it had contracted for at Constitution Center and asked for the owner’s assistance in finding other tenants for that space. In November 2010, the owner of the building began negotiations with the Federal Housing Finance Agency (FHFA) and the Office of the Comptroller of the Currency (OCC) to lease portions of Constitution Center. In January 2011, OCC and FHFA entered into contracts for space at Constitution Center, leaving approximately 350,000 square feet to which the SEC remains committed. On January 18, 2011, counsel for the building owner sent a demand letter to the SEC, asserting that the SEC’s actions had caused him to incur \$93,979,493 in costs at Constitution Center.

The OIG investigation further found that a “closed” and “rigid” atmosphere within OAS may have contributed to the irresponsible decisions made with respect to the Constitution Center lease. In the course of this OIG investigation, several witnesses who sought to remain anonymous came forward to the OIG to provide information concerning the environment and the decision-making processes within OAS. These witnesses described an environment in which inexperienced senior management make unwise decisions without any input from employees who have significant knowledge and experience. We found that questioning of upper management decisions by the staff is “not allowed” and that OAS Executive Director Sheehan surrounds herself with “yes-men” and “does not want to hear what [experienced staff] will tell her.” These individuals testified that upon learning of the SEC’s decision to lease 900,000 square feet of space at Constitution Center, they “just couldn’t understand how [OAS] could justify that amount of space ...” and were “flabbergasted” by the decisions. One experienced employee testified that OAS management had “grandiose plans” and was significantly influenced by the upscale nature of the facility.

### **Recommendations of the OIG’s Leasing Investigation**

Our Report of Investigation made numerous recommendations designed to ensure that the requisite improvements to policies and procedures are made and that appropriate disciplinary action is taken. Specifically, we recommended that the Chief Operating Officer carefully review the report’s findings and conduct a thorough and comprehensive review and assessment of all matters currently under the purview of OAS including, but not limited to:

- (1) The adequacy of written policies and procedures currently in place for all aspects of the SEC's leasing program, including, but not limited to, putting in place written procedures for leasing approvals;
- (2) The methods and processes utilized to accurately project spacing needs based on concrete and supportable data;
- (3) The determination to employ a standard of 400 square feet per person for planning agency space needs;
- (4) The necessity of retaining architects, furniture brokers, or other consultants to assist in the work generally performed by OAS officials; and
- (5) All pending decisions in which OAS is committing the SEC to expend funds, including decisions relating to regional office lease renewals.

We further recommended that the Chief Operating Officer, upon conclusion of this review and assessment, determine the appropriate disciplinary and/or performance-based action to be taken for matters related to subject of this report of investigation, as well as other issues identified during the review and assessment. We specified that such disciplinary action should include, at a minimum, consideration of disciplinary action, up to and including dismissal, against two senior individuals, and consideration of disciplinary action against a third individual, for their actions in connection with the gross overestimation of the amount of space needed at SEC Headquarters for the SEC's projected expansion, failures to provide complete and accurate information to the Chairman's office, and the preparation of a faulty and back-dated Justification and Approval to support eliminating competition.

Finally, we recommended that the Office of Financial Management, in consultation with the Office of General Counsel, request a formal opinion from the

Comptroller General as to whether the Commission violated the Antideficiency Act, by failing to obligate appropriate funds for the Constitution Center lease.

### **Follow-Up Efforts**

My Office is committed to following up with respect to all of the recommendations we made in our Report of Investigation to ensure that appropriate changes and improvements are made in the SEC's leasing operations as a result of our findings.

Subsequent to the issuance of our Report of Investigation on May 16, 2011, my Office received a corrective action plan with regard to the substantive recommendations we made for improvements in the operations of the Office of Administrative Services. We are also monitoring the planned activities carefully to ensure that the necessary improvements have been made. We have communicated with the SEC's Office of General Counsel with regard to its review of the evidentiary record to determine appropriate disciplinary action, and have provided the Office of General Counsel with records requested to assist in those efforts. We are monitoring the disciplinary process to ensure that the individuals who we identified as being responsible for the failures and improprieties described in our report are held appropriately accountable for their actions.

We understand that the Chief Operating Officer, under the direction of Chairman Schapiro, has already begun to implement the improvements needed in the SEC's leasing functions. We are confident that under Chairman Schapiro's leadership, the SEC will continue to review our report and take appropriate steps to implement our recommendations and ensure that fundamental changes are made in the SEC's leasing

operations so the errors and failings we found in our investigation are remedied and not repeated in the future.

### **Conclusion**

In conclusion, I appreciate the interest of the Chairman, the Ranking Member, and the Subcommittee in the SEC and my Office and, in particular, in the facts and circumstances pertinent to our leasing report. I believe that the Subcommittee's and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.