AUDIT OF LEGAL FEES PAID TO TWOMEY, HOPPE & GALLANTY, L.L.P.

Audit Report No. 99-025
May 20, 1999

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: May 20, 1999

MEMORANDUM TO: James T. Lantelme
Assistant General Counsel
Legal Operations Section
Legal Division

FROM: Steven A. Switzer
Deputy Inspector General

SUBJECT: *Audit of Legal Fees Paid to Twomey, Hoppe & Gallanty, L.L.P.*
(Audit Report No. 99-025)

This report presents the results of an audit of fees paid to Twomey, Hoppe & Gallanty, L.L.P., a law firm hired by the FDIC to provide legal services. The audit was conducted by the independent public accounting firm of Metcalf Rice Fricke & Davis. The objective of the audit was to determine whether the law firm's legal bills were: (1) adequately supported by source documentation, (2) prepared in accordance with applicable agreements, and (3) representative of the cost of services and litigation that had been approved in advance by the Legal Division. The audit included a review of all FDIC payments to Twomey, Hoppe & Gallanty, L.L.P. from August 1, 1997 through August 31, 1998, which included 56 fee bills totaling $963,896.

The Legal Division issued a written response received May 13, 1999 (see Appendix II) to a draft of this report that provided the requisites for a management decision on each of the recommendations. In its response, the Legal Division disallowed questioned costs totaling $872. The OIG's evaluation of management's comments is presented in Appendix I.

If you have any questions, please call me at (202) 416-2412 or Allan H. Sherman, Deputy Assistant Inspector General, at (202) 416-2522.

Metcalf Rice Fricke & Davis Certified Public Accountants

600 Two Live Oak Center
3445 Peachtree Road, N.E.
Atlanta, Georgia 30326
(404) 264-1700 Fax (404) 264-9968

INDEPENDENT ACCOUNTANTS' REPORT
ON APPLYING AGREED-UPON PROCEDURES

Office of the Inspector General
Federal Deposit Insurance Corporation:

We have performed the procedures (Procedures) enumerated in the Appendix, which were agreed to by the Office of the Inspector General (OIG), Federal Deposit Insurance Corporation (FDIC), solely to assist OIG in determining whether the fee bills submitted by Twomey, Hoppe & Gallanty, L.L.P. (Firm) and paid by the FDIC from August 1, 1997 through August 31, 1998, were adequately supported, consistent with the terms and conditions of the governing agreements and were representative of the cost of services and litigation which was approved in advance. This agreed-upon procedures engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants and with applicable Government Auditing Standards. The sufficiency of these Procedures is solely the responsibility of the specified users of the report.

Consequently, we make no representations regarding the sufficiency of the Procedures described in the Appendix either for the purpose for which this report has been requested or for any other purpose.

The Procedures and Findings of this engagement are included in the accompanying pages 3 through 6 of this report.

We were not engaged to, and did not, perform an examination, with the objective of expressing an opinion on whether the fee bills present fairly the expenses and activities of the cases for which they were submitted. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of OIG and FDIC, and should not be used by those who have not agreed to the Procedures and taken responsibility for the sufficiency of the Procedures for their purposes.

Metcalf Rice Fricke & Davis

November 6, 1998
Atlanta, Georgia

TWOMEY, HOPPE & GALLANTY, L.L.P.
NEW YORK, NEW YORK

BACKGROUND

The FDIC incurs legal fees when attorneys and law firms are retained to assist the FDIC in litigation and other legal services. The authority and responsibility for the retention of outside counsel, oversight of services rendered, and approval of fee bills resides with the General Counsel and the Legal Division. The OIG performs audits of fee bills, similar to other contract audits, to ensure that such claims are adequately supported and comply with cost limitations set forth by the FDIC.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of the engagement was to determine whether the fee bills submitted by the law firm were: (1) adequately supported by source documentation, (2) prepared in accordance with the applicable agreements, and (3) representative of the cost of services and litigation which was approved in advance by the Legal Division. The engagement scope covered all FDIC payments to Twomey, Hoppe & Gallanty, L.L.P. from August 1, 1997 through August 31, 1998, which included 56 fee bills totaling $963,896.

Fieldwork included interviews and tests of transactions in the law offices of Twomey, Hoppe & Gallanty, L.L.P. in New York, New York. The engagement was conducted in accordance with standards established by the American Institute of Certified Public Accountants and with applicable *Government Auditing Standards* and, thus, included such tests of the accounting records and other procedures as we considered necessary under the circumstances. We obtained an understanding of the internal control structure related to the Firm's billing process. With respect to the internal control structure, we obtained an understanding of the design of the Firm's billing policies and procedures and whether they have been placed in operation. We assessed control risk in order to determine our procedures and for the purpose of evaluating the fees and expenses billed to the FDIC and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

The fee bills were tested for adequacy of source documentation, compliance with the cost provisions of the agreements in effect, and the appropriateness of the charges. The fee bills were tested for compliance with the FDIC’s policies and procedures for submitting fee bills as included in the *Guide for Outside Counsel* (Guide) and the Legal Services Agreements (LSA’s) in effect between the FDIC and the firm.

In order to identify billed amounts disallowed by the Legal Division prior to our engagement, we compared the amounts billed by Twomey, Hoppe & Gallanty, L.L.P. to the amounts paid by the FDIC. We have adjusted the questioned costs in our report for costs previously disallowed to preclude duplication.

The procedures tested covered relevant source documents supporting legal fee bills. The sampled fee bills were reviewed in terms of two major components: fees for professional services (charged based on hourly rates) and claims for reimbursable expenses such as travel, courier services and document reproduction. An exit conference was held with Twomey, Hoppe & Gallanty, L.L.P. representatives to discuss the preliminary conditions at the end of fieldwork.

SUMMARY OF SIGNIFICANT FINDINGS

We concluded that except for $872 in expenses detailed in the Findings and Recommendations section of this report, the billings submitted by Twomey, Hoppe & Gallanty, L.L.P. and paid by the FDIC from August 1, 1997 through August 31, 1998, were supported by source documentation, prepared in accordance with applicable agreements, and were representative of the cost of services and litigation which was approved in advance by the Legal Division. Questioned costs of $872 were related to expenses charged for facsimile, long distance telephone, secretarial overtime and postage which were not billed in accordance with the FDIC *Guide for Outside Counsel*. We also determined that the firm's time and billing system does not fully comply with the FDIC's Guidance for Electronic Billing. However, no exceptions were noted in the firm's time billed to the FDIC.

FINDINGS AND RECOMMENDATIONS

Expense Mark-ups and Non-Billable Expenses

Twomey, Hoppe & Gallanty, L.L.P. billed a mark-up of $.20 per page for facsimile transmissions and 20% on long distance telephone calls on 48 of the 56 invoices submitted to the FDIC. The FDIC's *Guide for Outside Counsel* states that "the FDIC will only pay actual costs for services." The firm billed the FDIC at the same rate for facsimiles that they bill their other clients which was $.20 per page plus the long distance charge. The actual cost to the firm only included the long distance charge. The firm's long distance vendor automatically includes a 20% mark-up on long distance and this mark-up was included in their invoices to the FDIC. As a result, the FDIC paid the firm $631 over the actual costs for facsimile and long distance during the audit period.

The firm also billed the FDIC for postage, secretarial overtime, and related mileage which was not approved in advance. The *Guide for Outside Counsel* states that "outside counsel may not submit and FDIC will not pay business operating expenses such as administrative support, secretarial or clerical overtime unless requested or approved by the FDIC Legal Division." Postage charges were disallowed by the Legal Division on 39 invoices and paid on 17 invoices. As a result of these non-billable expenses, FDIC overpaid the firm $241.

Recommendation 1

The Assistant General Counsel, Legal Operations Section, should disallow $872 for mark-ups and non-billable expenses.

Internal Controls Related to Time and Billing

The firm's electronic billing system does not fully comply with the FDIC's Memorandum, Electronic Billing Guidelines, dated December 31, 1997. Specifically, the system allows any member of the firm to access all system applications, does not identify the individual who entered, changed or deleted data, and does not provide for an audit trail that identifies dates of entry, changes, or deletions. The firm uses a standard "off the shelf" time and billing software package and has not upgraded, supplemented or modified the software or maintained alternative manual documentation as backup. Our review of 100% of the time charged to the FDIC disclosed that the charges appeared reasonable and that the time actually invoiced was less than the time originally recorded and reported in prebills produced by the system. However, the lack of controls allows for the potential of the FDIC being billed for time not recorded by the original timekeeper.

Recommendation 2: The Assistant General Counsel, Legal Operation's Section, should instruct the firm to maintain manual daily time sheets for FDIC matters until the firm’s electronic billing system is in compliance with Legal Division’s Electronic Billing Guidelines. To comply with the guidelines, the system should include:

1. Unique identifiers and/or passwords for each user of the system;

2. An access profile for controlling user access to each application;

3. Identification of the individual who entered, changed or deleted data;

4. An audit trail that identifies dates of entry, change, or deletion;

5. Information that shows the extent of the change or the reason for the deletion; and

6. Provisions for a user identification code or other certification when the information entered is approved and forwarded for processing of the final bill.

Appendix

TWOMEY, HOPPE & GALLANTY, L.L.P.
NEW YORK, NEW YORK

PROCEDURES

General

1. Obtained a listing of the population of legal fee invoices to be reviewed for FDIC payments from August 1, 1997 through August 31, 1998.

2. Obtained and reviewed copies of the FDIC Legal Services Agreements (LSA) in effect for the period August 1, 1997 through August 31, 1998, as well as the Firm's responses to the FDIC's law Firm questionnaire.

3. Requested a summary of the Firm's usage of the FDIC Legal Research Bank, including the matters referenced.

4. Obtained annotated copies of legal fee invoices from the, showing exceptions taken to the Firm's bills by case managing attorneys and fee bill review technicians.

5. Obtained a completed management representation letter from the Firm.

Fitness and Integrity

6. Determined whether the Firm requested and/or received any conditional waiver of a conflict of interest from the FDIC Legal Division.

7. Reviewed the Firm's malpractice insurance policy to determine the extent and duration of the Firm's coverage.

Quantitative Review of Legal Fee Bills

8. Performed quantitative test work and validated the mathematical accuracy of all 56 sampled invoices (the Sample).

9. Compared the names and billing rates used on all sampled invoices with the names and rates indicated on the LSA.

10. Selected a sample of attorneys who had devoted substantial time to FDIC related matters and interviewed them to obtain adequate explanation for hours worked each day when hours charged exceeded twelve hours.

11. Reviewed time sheets of the sampled attorneys for mathematical accuracy and scheduled total hours on a daily basis for one billing month. Reviewed schedules for reasonableness and obtained explanations for unusual entries.

12. Determined the Firm's standard billing rates and compared them to the rates billed on the invoices in the Sample.

13. Reviewed time sheets for a portion of the sampled invoices to determine if there had been any inefficiency indicated by excessive rotation between projects.

TWOMEY, HOPPE & GALLANTY, L.L.P.
NEW YORK, NEW YORK

PROCEDURES

14. Reviewed time sheets for a portion of the sampled invoices to determine if there had been excessive research time, and to determine if the Firm had used the FDIC's Legal Research Bank.

15. Reviewed a portion of the sampled invoices for extent of use of paralegals and summer help.

16. Reviewed time sheets and a portion of the sampled invoices to determine the Firm's billing policy for:
    - preparation of invoices,
    - traveling,
    - researching the Firm's own conflicts of interest, and
    - preparation of plans, budgets and status reports.

17. Reviewed a sample of deposition transcripts for:
    - amount of time spent and charged by the court reporters and the attorneys, and
    - unauthorized attorneys who attended the depositions.

Analysis of Expenses Charged

18. Performed an analysis of expenses charged; validated the mathematical accuracy of all invoices in the Sample and determined the percentage of the total expenses charged for each expense category.

19. Compared amounts billed for expenses charged to amounts paid by the Firm to outside contractors to determine if billing had occurred at cost for the following categories:

    - document reproduction charges,
    - outside database services,
    - deposition transcripts, hearing transcripts, court fees and filing fees, and
    - expert witness and consultant fees.

20. Evaluated the adequacy of supporting documentation for document reproduction charges, as well as the reasonableness of the quantities billed.

21. Verified that expenses billed were related to FDIC matters.

22. Reviewed expenses charged for outside database services for compliance with FDIC guidance.

Other

23. Reviewed payments received from the FDIC to determine whether any duplicate payments had been received by the Firm.

24. Reviewed billing periods on invoices to determine whether the Firm had double-billed FDIC for overlapping billing periods.

25. Evaluated the firm's electronic billing system for compliance with FDIC Legal Division guidelines dated December 31, 1997.

MANAGEMENT COMMENTS AND OIG EVALUATION

On May 13, 1999, the General Counsel provided a written response to the draft report. The response is presented in Appendix II to this report.

The Legal Division will disallow all the questioned costs in recommendation 1 totaling $872 for markups and non-billable expenses. On recommendation 2, the Legal Division accepted the corrective actions proposed by the law firm to maintain manually signed and dated, original daily electronic time sheets.

Appendix III presents management's proposed action on our recommendations and shows that there is a management decision for each recommendation in this report. After considering information provided by the firm and management's response to the draft report, we will report questioned costs of $872 in our *Semiannual Report to the Congress*.

FDIC

APPENDIX II

Federal Deposit Insurance Corporation
Washington, D.C. 20429 Legal Division

May 5, 1999

M E M O R A N D U M

MEMORANDUM TO: David H. Loewenstein
Assistant Inspector General

THROUGH: William F. Kroener, III
General Counsel

FROM: William S. Jones
Supervisory Counsel

John G. Karjala
Counsel

SUBJECT: Legal Division Response to FDIC Audit Report, *Legal Fees Paid by FDIC to Twomey, Hoppe, Gallanty, L.L.P.* (New York, New York)

This memorandum responds to the Federal Deposit Insurance Corporation ("FDIC"), Office of Inspector General ("OIG") draft audit report entitled, *Legal Fees Paid to Twomey, Hoppe, Gallanty, L.L.P. New York, New York* (Enclosure A). (Herein the FDIC OIG Report will be the "Report."). The Report concerns fee and expense billing practices of Twomey, Hoppe, Gallanty, L.L.P. ("Twomey" or "Firm").

The Legal Division's response was prepared with consideration given to the audited firm's reply to the draft audit report. The Legal Division received a copy of the Firm's comments regarding its view of the draft Report on March 26, 1999. *See,* Enclosure B.

Legal Division response addresses recommendations made by the OIG's independent public accounting firm, Metcalf Rice Fricke & Davis ("IPA"). The FDIC OIG engaged that firm to conduct an audit of legal fees paid to Twomey by the FDIC. Details of that engagement are found at Page 1 of the IPA's Report.

The IPA surveyed the Firm's FDIC fee bills that covered a period from August 1, 1997, through August 31, 1998. Those bills encompassed all 56 invoices paid by the FDIC in that period. Payments totaled $963,896. Questioned costs identified by the IPA were $872. We disallow all questioned costs.

The FDIC Report sets forth two numbered recommendations. After reviewing the Report and Twomey's comments thereto, the Legal Division provides this response to the FDIC Report recommendations. Each recommendation has been repeated seriatim, indented, and placed in bold type for ease of reference.

> **Recommendation No. 1: The Legal Division should disallow $872 for markups and non-billable expenses.**

This condition comprises four distinct expense-related deficiencies. Each deficiency's essential facts are addressed below.

(1) Ordinary postage charges were questioned in five invoices for a total of $139.78.

(2) Secretarial overtime and transportation were billed in one invoice for $100.

(3) A 20% markup was placed on the long distance calls by the carrier for a total markup of $239.48 that the Firm passed on to FDIC.

(4) A 20¢ per page markup for facsimile transmissions was found on 48 of 56 invoices. Those markups totaled $392.40.

The total questioned cost of Recommendation No. 1 is <u>$871.66</u>.

<u>Twomey's Response.</u>

Twomey has clarified or explained each Recommendation No.1 condition and has taken remedial action to avoid recurrence of those conditions. Summaries of Twomey's comments follow seriatim in (1) through (4).

(1) Twomey believes that a change in policy may have occurred, but states that it will no longer charge for regular postage.

(2) The firm states that the billing overtime and mileage were not the firm's practice. The questioned charges arose from an oversight during the billing process.

(3) Invoices issued by the long distance carrier had a 20% markup incorporated in them. That deficiency was identified by the Firm and they informed the auditors of the carrier's markup. The Firm no longer charges the long distance carrier's loaded rates to FDIC.

(4) The Firm stated that a misunderstanding existed regarding facsimile billing. It believed that authorized charges allowed 20¢ per page plus long distance charges. Now, however, only the long distance charge is billed.

Legal Division Response to the Report and to Twomey's Comments Concerning Items (1) - (4).

A mutually signed Legal Services Agreement ("LSA") with an effective date of June 19, 1997, provides the contractual framework for the Firm's expense charges. The LSA does not set forth expense charge limitations, but it does incorporate by reference the FDIC's *Guide for Outside Counsel* (April 1996), which does express general expense guidance. The *Guide for Outside Counsel* incorporates by reference, at page 31, the *Legal Services Payment Program Manual ("Fee Bill Manual")* (May 1995). Both have been superseded by the *Outside Counsel Deskbook* ("Deskbook").

(1) Twomey stated that it believed it had observed a change in FDIC's policy on reimbursement for ordinary postage. Early FDIC policy on postage was expressed clearly in FDIC's form LSAs (used from about 1990 to mid-1993), at Paragraph 5. F:

> Telephone, overnight mail, and delivery charges will be paid at actual cost. Overnight mail should be used with restraint. FDIC will not pay for ordinary postage charges.

Later, FDIC dropped the specific foreclosure of postage charge reimbursement from the LSAs and related billing guidance such as the FDIC *Fee Bill Manual* (May 1995). However, the prohibition on billing for ordinary postage charges is explicit in the *Outside Counsel Deskbook*.

Ordinary postage is an overhead expense that the Firm should have included in the hourly fee rate. We disallow the questioned costs of **$139.78.**

(2) Invoice entries totaling $100 were questioned for secretarial overtime and transportation. As the Firm indicated that these charges were mistakenly billed to FDIC, we disallow the questioned costs of **$100**.

(3) Markups are proscribed by the *Guide for Outside Counsel* (April 1996). The *Guide* is incorporated by reference in the parties' LSA. The *Guide* advises at page 34:

> Outside counsel must include in its fees and rates for legal services provided to the FDIC its costs of doing business, including all "overhead," general and administrative costs, fringe benefits, and profit. . . . "Markups" on any supplies or services procured by outside counsel for the Legal Division shall not be charged to the FDIC.

We will disallow markups on telephone charges based upon that caveat. We disallow **$239.48**.

(4) We will routinely disallow markups on facsimile charges also in accordance with the discussion above. However, in the instant matter, the questioned facsimile charges were only 20¢ a page for a net total of $392.40 or 1,972 total pages transmitted from 48 invoices.

Early 1990's FDIC LSAs specifically addressed facsimile charges. Paragraph 5. E, asserted that "FDIC will pay actual cost for facsimile transmissions . . . fax transmissions should be used with restraint." The Deskbook explicitly states that telephone long distance charges should be used to calculate actual cost. We disallow **$392.40**, subject to reconsideration if Twomey can provide documentation as to long distance charges incurred for the questioned facsimile charges.

In conclusion, we disallow $872 (rounded) based upon deficiencies (1) through (4) discussed above ((1) $139.78 + (2) $100 + (3) $239.48 + (4) $392.40 = $871.66).

Recommendation No. 1: The Legal Division will disallow questioned costs of $872 that were paid to the Firm for markups and non-billable expenses.

Recommendation 2: That the Legal Division instruct the Firm to maintain manual daily time sheets for FDIC matters until the Firm's electronic billing system is in compliance with Legal Division's Electronic Billing Guidelines.

On December 31, 1997, FDIC issued a memorandum entitled, "Electronic Billing System Guidelines." Twomey's electronic billing system does not contain all functions suggested in that "Guideline" for law firms that were to be engaged by the FDIC. Rather, the Firm uses unmodified "Off the Shelf" time and billing software. Functions listed by the FDIC memorandum, but absent from the Firm's system are: (a) limited access by firm members to all the time keeping system's applications; (b) a functionality that might be known as an "Addition/Deletion Library" associating persons making full or partial data entries or deletions with those entries or deletions; and (c) existence of an ancillary audit trail that identifies dates of each full or partial entry and deletion.

The Report lists six functions suggested by the memorandum for system compliance. In addition to controlled access with passwords, that list detailed two requirements other than those mentioned above. At least one of those requirements would supplement the "Addition/Deletion Library." That Library functionality would require an annotation to state the reason for an addition or deletion to a timekeeper's entry. The second additional listed functionality would require an electronic signature when an entry is ready for "final bill processing." The auditors concluded that the absence of those controls allow the FDIC to be billed for time not recorded by an original timekeeper. However, the IPA review "disclosed that the [Firm's] charges appeared reasonable and that the time actually invoiced was less than the time originally recorded and reported in prebills produced by the system."

The Firm did not maintain an "alternative manual documentation backup."

Twomey replied to that criticism by asserting its corrective procedures and pointing out that each time keeper does have his or her own password and, with the exception of the firm's partners and bookkeeping staff, only has access to his or her own entries in the system. The firm also does maintain a hard copy backup of the original entries into the system prior to any adjustments being made by the partner in charge. As a result of the audit, we also have instituted a system whereby each timekeeper now reviews and signs off on his or her original entries.

The Firm's maintenance of complete, and manually signed, copies of original daily electronic time sheet entries satisfies the requirement for original time sheets. Those documents can readily be used for audit purposes.

It is our belief that signed original printouts of daily electronic time sheet entries, although manually maintained, are adequate for audit purposes in lieu of an electronic "Additions / Deletions Library."

Recommendation No. 2: The Legal Division will accept the corrective actions proposed by Twomey, to include its maintenance of manually signed and dated, original daily electronic time sheets.

CONCLUSION

Recommendation No. 1 resulted in disallowances of $872. Recommendation No. 2 was a non-monetary recommendation.

The legal Division anticipates completion of all collection activities within 120 days after the concurrence of the General Counsel with the management decisions herein.

CONCUR:

WFKroener III ___________________ May 5, 1999 ___________

William F. Kroener, III — Date
General Counsel

Enclosures: A. FDIC OIG Audit Report.
B. Twomey's Response, March 23, 1999.

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cc: R. Harley

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid. Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Assistant General Counsel, Legal Operations Section, disallowed $872 for mark-ups and non-billable expenses.	120 days from Management Response	Law Firm Refund Check	$872 disallowed costs	Yes
2	The Assistant General Counsel, Legal Operations Section, accepted the firm's corrective action to maintain manually signed and dated, original daily electronic time sheets.	Completed	Management Response	N./A	Yes