AUDIT OF LEGAL FEES PAID TO PEABODY & ARNOLD, L.L.P.

Audit Report No. 99-033
August 5, 1999

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20434

Office of Audits
Office of Inspector General

DATE: August 5, 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 Peabody & Arnold, L.L.P.*
(Audit Report No. 99-033)

This report presents the results of an audit of fees paid to Peabody & Arnold, L.L.P., a law firm hired by the FDIC to provide legal services. The independent public accounting firm of Mir-Fox & Rodriguez conducted the audit. 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 covered all payments to Peabody & Arnold, L.L.P., from January 1, 1998 through December 31, 1998, which included 87 fee bills totaling $3,128,208.

The Legal Division provided a written response on July 21, 1999 (see Appendix II) to a draft of this report that furnished the requisites for a management decision on each of the recommendations. In its response, the Legal Division agreed to disallow questioned costs totaling $4,037. The OIG's evaluation of management's comments is presented in Appendix I.

If you have any questions, please call me at (202) 416-2543 or Allan H. Sherman, Deputy Assistant Inspector General, at (202) 416-2522.

MIR•FOX & RODRIGUEZ, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

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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 Peabody & Arnold and paid by the FDIC from January 1, 1998 through December 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 2 through 5 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.

Mir Fox & Rodriguez

March 26, 1999
Houston, Texas

PEABODY & ARNOLD
BOSTON, MASSACHUSETTS

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 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 made to the firm from January 1, 1998 through December 31, 1998, which included 87 fee bills totaling $3,128,208.

Fieldwork included interviews and tests of transactions in the law offices of Peabody & Arnold in Boston, Massachusetts. 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 that 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. In addition, we reviewed the adequacy of the physical access to the on-line electronic time and billing system, as well as, the related transaction trails. 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 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 the firm 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 (charges based on hourly rates) and claims for reimbursable expenses such as telephone and courier services. A preliminary exit conference was held with Peabody & Arnold representatives to discuss the preliminary conditions at the end of on-site fieldwork.

RESULTS OF AUDIT

We concluded that except for $4,037 in fees and expenses detailed in the Findings and Recommendations section of this report, the invoices submitted by Peabody & Arnold, and paid by the FDIC from January 1, 1998 through December 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 $110 are related to fees at unauthorized hourly rates. Questioned costs of $3,927 are related to excess long distance telephone charges and an unsupported courier charge.

Summary of Questioned Costs		
Description	Finding Number	Questioned Costs
Unauthorized Hourly Rates	1	$ 110
Subtotal Fees		110
Excess Long Distance Telephone Charges	2	3,636
Unsupported Courier Charge	3	291
Subtotal Expenses		3,927
Total Fees and Expenses		$ 4,037

FINDINGS AND RECOMMENDATIONS

Unauthorized Hourly Rates

Peabody & Arnold billed the FDIC at hourly rates that exceeded those agreed to in the FDIC Legal Services Agreement(s) or the Amendments thereto (collectively the LSA). Outside counsel must provide legal services in accordance with the hourly rate structure set forth in the schedules attached to the LSA. Hourly rates for one attorney were found on two invoices that exceeded the authorized rate by an amount of $19 per hour. As a result, a total of $110 was billed in excess of the authorized hourly rates.

Recommendation 1:

The Assistant General Counsel, Legal Operations Section, should disallow $110 for unauthorized hourly rates.

Excess Long Distance Telephone Charges

Peabody & Arnold billed long distance telephone charges in excess of actual cost. FDIC agreements and cost guidelines require that long distance charges represent actual costs. Our analysis of long distance telephone charges included the selection of a representative sample of invoices paid by the firm. We compared the amounts paid by the firm to amounts billed to the FDIC. Based on our analysis, we determined that the firm charged an additional 88 percent, on average, for each long distance call invoiced to the FDIC. Subsequently, we identified all of the long distance calls billed by the firm and paid by the FDIC during the period January 1, 1998 through December 31, 1998 and determined that a total of $3,636 was billed in excess of cost in connection with long distance telephone charges.

Recommendation 2:

The Assistant General Counsel, Legal Operations Section, should disallow $3,636 for long distance telephone charges in excess of cost.

Unsupported Courier Charge

Peabody & Arnold did not provide adequate support for a courier expense totaling $291 incurred by the firm for a FDIC related matter. The *Guide for Outside Counsel* mandates law firms to retain supporting documentation for all submitted expenses for a period of not less than four years after date of final payment.

Recommendation 3:

The Assistant General Counsel, Legal Operations Section, should disallow $291 for an unsupported courier charge.

PEABODY & ARNOLD
BOSTON, MASSACHUSETTS

PROCEDURES

Preliminary Field Work

1. Obtained a listing of the population of legal fee invoices to be reviewed for FDIC payments from January 1, 1998 through December 31, 1998 (the “Scope”).

2. Obtained and reviewed copies of the FDIC Legal Services Agreements issued to the firm for the period of January 1, 1998 through December 31, 1998, as well as, the firm’s responses to the FDIC law firm questionnaire.

3. Requested a summary of the firm’s usage of the FDIC Legal Research Bank (LRB), including the matters referenced.

4. Obtained annotated copies of legal fee invoices from the FDIC, 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.

Evaluation of Electronic Billing System

6. Determined that the firm had received the FDIC Legal Division’s letter regarding special requirements dated December 31, 1997.

7. Determined that the firm’s computer system had a complete transaction trail through the Scope of the audit.

8. Documented the controls pertaining to the computer system including assignment of unique user passwords, access to each application, access to the on-line information and on-line approval codes. Determined that the system was functioning as designed.

Evaluation of Fitness and Integrity

9. Determined whether the firm requested and/or received any conditional waiver of a conflict of interest from OIG/FDIC.

10. Reviewed the firm’s malpractice insurance policy to determine the extent and duration of the firm’s coverage.

Review of Fees Paid

11. For the sample of 87 FDIC invoices (the Sample) selected by FDIC, we performed quantitative test work and validated the mathematical accuracy of the Sample.

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

13. Selected a sample of attorneys who had devoted substantial time to FDIC related matters.

14. For the attorneys selected in the sample, reviewed timesheets 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.

Appendix, Continued

PEABODY & ARNOLD
BOSTON, MASSACHUSETTS

PROCEDURES

15. Determined the firm's standard billing rates and compared them to the rates billed on the invoices in the sample.

16. Reviewed timesheets for selected Sample of invoices to determine if there had been any inefficiency indicated by excessive staff rotation on the projects.

17. Reviewed timesheets for selected sample of invoices to determine if there had been excessive research time, and to determine if the firm had used the FDIC's "Research Bank."

18. Reviewed selected Sample of invoices for extent of use of paralegals and summer help.

19. Reviewed timesheets and selected Sample of invoices to determine the firm's billing policy on time spent for:

    - preparation of invoices,
    - traveling,
    - researching the firm's own conflicts of interest, and
    - preparation of plans, budgets and status reports.

20. Reviewed a sample of deposition transcripts for:

    - amount of time spent and charged by the court reporters and the attorneys, and
    - unauthorized multiple attorneys who attended the depositions.

Review of Expenses Paid

21. For the Sample of invoices selected by the FDIC-OIG, 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.

22. 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.

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

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

25. Examined expense charges to determine whether charges for outside database services were:

    - in compliance with the LSA and FDIC guidelines,
    - related to the applicable FDIC matters, and
    - adequately documented.

Other

26. Reviewed payments received from FDIC to determine whether any duplicate payments had been received by the firm.

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

MANAGEMENT COMMENTS AND OIG EVALUATION

On July 21, 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 recommendations 1, 2, and 3, totaling $110 for unauthorized hourly rates, $3,636 for long distance telephone charges in excess of cost, and $291 for unsupported courier charges.

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 $4,037 (including unsupported costs of $291) in our *Semiannual Report to the Congress*.

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20429

Legal Division – Outside Counsel Unit

July 21, 1999

MEMORANDUM TO: David A. Switzer
Deputy Inspector General

THROUGH: William F. Kroener, III
General Counsel

William S. Jones
Supervisory Counsel

FROM: Chris J. Conanan
Counsel

SUBJECT: Audit of Legal Fees and Expenses Paid by the FDIC to the Law Firm of Peabody & Arnold LLP (Boston, MA)

This memorandum constitutes the Legal Division's response to the draft audit report (Exhibit A) of the Office of Inspector General (OIG) on payments made by the FDIC to the law firm of Peabody & Arnold LLP ("Firm"). Our memorandum takes into account the Firm's responses, dated June 15 and 16, 1999, to the report (Exhibit B). The report covered $3,128,208 in fees and expenses paid to the Firm by the FDIC from January 1, 1998 through December 31, 1998. The report questioned $4,037 in costs paid by the FDIC to the Firm. The Firm does not object to the findings of questioned costs. After reviewing the report and the Firm's responses, the Legal Division will disallow $4,037 in fees and expenses paid to the Firm.

The Legal Division's position regarding each audit condition is explained below in the order in which it appears in the report.

Recommendation 1: The report recommends that the FDIC disallow $110 for unauthorized hourly rates charged by one attorney on two invoices that exceeded the authorized hourly rate for that attorney by $19 for 5.8 hours billed by that attorney.

We have reviewed the hourly rates authorized for the Firm's attorneys under the Legal Services Agreement in effect for the audit period. The auditors correctly found in the report that the attorney in question should have been billed at the hourly rate of $171 instead of the rate of $190 as billed on the two invoices in question. **Accordingly, the Legal Division will disallow all questioned costs under this recommendation.**

Recommendation 2: The report recommends that the FDIC disallow $3,636 in long distance telephone charges in excess of costs incurred by the Firm.

The report questions $3,636 in excess of actual costs incurred by the Firm for long distance phone calls. Our Guide for Outside Counsel (1996) makes it clear that the "FDIC will only pay actual costs for services or supplies provided in the course of representation." Guide at 34. The auditors reviewed the total population of long distance phone calls made by the Firm. The auditors found that the cost billed the FDIC for long distance phone calls ($7,762) by the Firm was greater than the actual cost of the long distance phone calls ($4,126) incurred by the Firm under its telephone operating system.

The Firm has explained that its telephone operating system initially establishes "a reasonable approximation of the actual costs as determined by the [long distance telephone] carrier at the time of billing [to the FDIC]." However, as conceded by the Firm the actual costs incurred and ultimately paid by the Firm disclose "a slight discrepancy between what [the Firm] pays and what [the Firm] pass[es] on to clients." Firm Response of June 16, 1999 at 2. Irrespective of the reason for the discrepancy, long distance phone calls are billed at "approximate" cost, which turns out, in this case, to be greater than the Firm's actual cost for the calls. **Accordingly, the Legal Division will disallow all questioned costs under this recommendation.**

Recommendation 3: The report recommends that the FDIC disallow $291 of courier expenses billed to the FDIC that were unsupported by any invoices from the courier.

The report questions $291 in courier expenses incurred by the Firm. The Firm could not produce any supporting reliable supporting documentation for the expenses. **Therefore, the Legal Division will disallow all costs questioned under this recommendation.**

In summary, the Legal Division will seek to recover $4,037 in costs disallowed under this memorandum. The Assistant General Counsel is authorized to make such minor accounting corrections as may be required by the OIG but which do not affect the substantive positions stated in this memorandum. The Legal Division expects to complete the collection process within 90 days from the issuance of the final audit report by the OIG.

Attachments:
Tab A - OIG Draft Audit Report
Tab B - Firm's Response (and Supplemental Response)

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 $110 for unauthorized hourly rates.	90 days from issuance of Final Audit Report	Law Firm Refund Check	$110 disallowed costs	Yes
2	The Assistant General Counsel, Legal Operations Section, disallowed $3,636 for long distance telephone charges in excess of cost.	90 days from issuance of Final Audit Report	Law Firm Refund Check	$3,636 disallowed costs	Yes
3	The Assistant General Counsel, Legal Operations Section, disallowed $291 for unsupported courier charges.	90 days from issuance of Final Audit Report	Law Firm Refund Check	$291 disallowed costs	Yes