CITY OF LOS ANGELES

Outside Counsel Costs Have Increased, and Continued Improvement in the City's Selection and Monitoring Is Warranted

Audit Highlights . . .

Our review of the Office of the City Attorney's (Attorney's Office) use of outside counsel revealed:

- ☑ *The costs for outside counsel have risen from $17.5 million to $31.9 million over the six-year period ending in fiscal year 2004–05.*
- ☑ *The Attorney's Office lacked documents necessary to demonstrate it followed its policies and procedures when assessing the need to retain outside counsel and when performing its role in selecting outside counsel.*
- ☑ *Although its policies for monitoring the work performed by outside counsel provided sufficient direction for good case management, the Attorney's Office did not always follow them.*
- ☑ *The Attorney's Office eliminated numerous charges from outside counsel invoices, but it could improve its invoice review as it paid outside counsel for some costs its policies did not allow.*

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City of Los Angeles, Office of the City Attorney and City of Los Angeles, Office of the City Administrative Officer responses as of July 2006

The Joint Legislative Audit Committee (audit committee) directed the Bureau of State Audits to review the City of Los Angeles' (City) contracting practices for outside legal services. Specifically, the audit committee asked us to:

- Review trends in the use of outside legal services in recent years, including costs associated with outside consultants and experts.
- Assess the potential impact of legal expenses on the City's budget.
- Examine the processes the City uses for selecting outside counsel, including justification for noncompetitive processes.
- Determine whether departments sufficiently monitor the services provided by outside legal counsel and associated services such as consultants and experts.

Finding #1: The City's overall outside counsel costs have increased for various reasons.

Annual outside counsel costs for the City increased from $17.5 million in fiscal year 1999–2000 to $31.9 million in fiscal year 2004–05, an increase of more than 82 percent. For the six-year period, outside counsel costs totaled $162.5 million and consisted of both legal fees (costs related to attorneys and paralegals working on cases) and expenses (other goods and services incurred by law firms, such as the costs of expert witnesses and consultants). The proprietary departments—Department of Water and Power (DWP), Los Angeles World Airports (Airports), and the Port of Los Angeles—accounted for some of the largest increases. Typically funded by revenue generated by providing services, each proprietary department is controlled by a board of commissioners rather than the city council and has control

over its own funds. The outside counsel costs for those three entities increased from $7.9 million in fiscal year 1999–2000 to $16.2 million in fiscal year 2004–05, an increase of $8.3 million, or about 105 percent. DWP and Airports accounted for most of the overall increase.

The Office of the City Attorney (Attorney's Office) generally cites a lack of expertise and/or staff resources as the reason for retaining outside counsel. In an August 2004 letter outlining certain reforms regarding the use of outside counsel, the city attorney discussed the formation of an outside counsel committee responsible for reviewing and approving all requests for outside counsel. The city attorney's letter also said the committee would review trends in the use of outside counsel and recommend when it would be more prudent to build capacity and hire additional in-house attorneys and support staff. The committee was formed, and according to the Attorney's Office in October 2005, the committee considered trends in the use of outside counsel and ultimately decided to request internal staff to reduce outside counsel costs for cases involving workers' compensation, intellectual property, and labor employment.

We recommended that the Attorney's Office continue its efforts to ensure that the outside counsel committee periodically reviews trends in the use of outside counsel and make recommendations regarding areas in which it would be prudent to build capacity and hire additional in-house attorneys and support staff. The Attorney's Office should consider that information when evaluating its overall staffing needs and requesting resources.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office told us that it continues to periodically review trends in the use of outside counsel and consider this information in developing budget requests for internal resources. In addition, the Attorney's Office noted that as it begins its budget development process for fiscal year 2007–08, it intends to fully consider trends in the use of outside counsel and internal resource needs.

Finding #2: The City could improve its reporting of outside counsel costs.

Until recently, the City did not have a process to periodically and comprehensively report on the amount that it spent citywide on outside counsel costs. However, in response to questions from a city council member about the City's outside counsel costs, city staff gathered information from various departments and reported citywide information in an October 2004 memorandum (memo). The memo listed outside counsel costs by city department for fiscal years 1999–2000 through 2003–04. In August 2005 the Attorney's Office requested and subsequently received outside counsel cost data from the same departments for fiscal year 2004–05. Using the data reported in the memo and gathered by the Attorney's Office, we performed various tests on the costs paid by the General Fund and the proprietary departments, which constituted 76 percent of the total outside counsel costs over the six years reported. However, we found some significant inaccuracies and inconsistencies in the reported data we reviewed.

Since issuing the October 2004 memo, the City has taken steps that may help improve reporting of outside counsel costs. Noting that members of the city council had expressed interest in having the Attorney's Office provide a periodic report of all outside counsel costs incurred on a citywide basis, the Attorney's Office issued a letter in September 2005 asking city departments to report quarterly on outside counsel costs and to maintain all the necessary source documents substantiating cost data submitted. The letter directed departments to report costs based on payment date, which might help

address the inconsistency in reporting we noted during our review. Additionally, the letter asked departments to designate an outside counsel coordinator, which might help decrease inaccuracies and could increase the consistency of reporting.

We recommended that the City ensure that the outside counsel costs it reports are accurate and prepared consistently and that costs are adequately supported by source documentation.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office indicated to us that it continues to ensure that outside counsel costs are reported accurately, that the cost reports are prepared consistently and supported by source documentation. In addition, the City's recent approval of staff to supplement the outside counsel oversight unit is expected to help in achieving this goal.

Finding #3: The Attorney's Office lacks necessary information to demonstrate that it follows its needs assessment policy and that its outside counsel recommendations are based on a competitive process.

After the city attorney took office in July 2001, the Attorney's Office established policies and procedures on the use of outside counsel. Those policies and procedures require the Attorney's Office first to establish a need for outside counsel and then to select a firm through either a competitive or noncompetitive process. The selection process culminates in the Attorney's Office making a recommendation to the city council or appropriate board, which makes the final contracting decision. Although the Attorney's Office's December 2001 policy, as enhanced by reforms outlined in an August 2004 memo on the use of outside counsel, are generally sound, they do not require the Attorney's Office to document how it reaches its decisions for recommending outside counsel or to prepare key documents, such as rating sheets and interview notes, when it conducts a competitive selection process. As a result, the Attorney's Office lacks the necessary documentation to demonstrate that it follows its policies and procedures when performing its role in determining the need to contract with outside counsel and selecting a law firm. The reports the Attorney's Office typically prepares and presents to the city council or appropriate board contain recommendations to contract with outside counsel. However, those reports do not provide sufficient evidence of the Attorney's Office decision-making process. Without sufficient documentation of the decision-making process that takes place within the Attorney's Office when determining the need for and selecting outside counsel, the Attorney's Office leaves itself vulnerable to criticisms that its recommendations on outside counsel are not prudent or made in a fair and objective manner.

In November 2005, after we had substantially completed our fieldwork, the Attorney's Office issued a new policy on the use of outside counsel. The policy outlines the procedures for assessing the need for outside counsel and that a brief decision memo will be generated following a request to use outside counsel. It does not specify the nature or extent of the analysis to be included in the decision memo. Further, the policy indicates that the outside counsel committee must oversee the selection process and draft a recommendation as to which firm or firms should be hired. However, it does not require the creation or retention of the documents necessary to demonstrate the fairness and objectivity of the competitive process.

We recommended that to ensure that the decisions it reaches within the outside counsel committee to retain outside counsel are justified in accordance with the policy of the Attorney's Office and to enable it to demonstrate the justification to interested parties, the Attorney's Office should ensure that it follows the new policy of preparing a memo to document each of its decisions. The Attorney's

Office should ensure that the memo sufficiently reflects the analysis used in reaching its decision to recommend the retention of outside counsel. Further, to ensure that its recommendations for contract awards are less vulnerable to criticism, the Attorney's Office should develop and implement comprehensive policies and procedures that specify standards for applying evaluation criteria such as the use of rating sheets and retaining documents.

Attorney's Office's Action: Partial corrective action taken.

The Attorney's Office, in its July 2006 response, stated that its outside counsel committee prepares memos documenting its decisions to retain outside counsel. In addition, the Attorney's Office at that time was reviewing criteria that might be useful in its outside counsel selection process and hoped to have a review sheet operational by late October 2006.

Finding #4: The Attorney's Office does not adequately document how it justifies using a noncompetitive process.

Under the city charter, the Attorney's Office has the discretion to select outside counsel in a noncompetitive manner. Noncompetitive selection still requires the approval of the city council or the appropriate board. The Attorney's Office has outlined the types of situations in which it uses a noncompetitive selection process. However, it has not established a policy for retaining the documents necessary to demonstrate its decision-making process. The Attorney's Office provided only limited documentation to justify its noncompetitive selection of outside counsel in three of the five contracts we reviewed and had no documentation for two of the selections. As a result, in an area where the Attorney's Office is particularly vulnerable to criticism—selecting outside counsel without a competitive process—it lacks all the necessary documentation to demonstrate how it made its decisions on recommending outside counsel.

In its new November 2005 policy, the Attorney's Office outlined a role for the outside counsel committee with regard to selecting outside counsel in a noncompetitive manner. The November 2005 policy states that in cases in which one firm is uniquely qualified to perform the work, or in which time is of the essence, the committee can recommend a noncompetitive selection process to award the contract. Additionally, the November 2005 policy requires the committee to oversee the drafting of a transmittal recommending to the city council or appropriate board that the firm be selected as a result of the process. However, it does not specify the nature or extent of the analysis to be included in the memo.

We recommended that the Attorney's Office make certain that the outside counsel committee follows the new policy of drafting a memo regarding the firm it recommends for selection. The Attorney's Office should ensure that the memo sufficiently reflects the analysis used by the outside counsel committee in concluding a noncompetitive selection was necessary and appropriate.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office reported that its outside counsel committee prepares memos documenting its decisions, including the decisions to retain outside counsel in a noncompetitive manner.

Finding #5: The Attorney's Office often relied on informal means to oversee its contracts with outside counsel.

The Attorney's Office's policies in place at the time of our fieldwork called for the use of recommended case management tools, such as case budgets and quarterly reports, to help control the costs of outside counsel. Although those policies provided sufficient direction for good case management, Attorney's Office staff did not always follow the policies, often relying on informal monitoring of outside counsel through telephone, e-mail, or in-person communications.

As part of its new policy on the use of outside counsel issued in November 2005, the Attorney's Office revised its standard contract language. Although we reviewed the November 2005 policy and contract, we did not evaluate the Attorney's Office's compliance with it. The November 2005 policy changed the Attorney's Office's monitoring procedures for case budgets and quarterly reports. The use of case plans continues to be discretionary under the new policy.

We recommended that the Attorney's Office require budgets and case plans. Specifically, it should ensure that contracts with outside counsel contain provisions requiring comprehensive budgets and case plans and ensure that the requirements are met. Further, to ensure that its November 2005 policy change of eliminating quarterly reports has not limited its insight into the activities of outside counsel, the Attorney's Office should periodically evaluate its process of obtaining status updates to report to the city council or appropriate board on significant outside counsel cases and modify that approach if necessary.

Attorney's Office's Action: Partial corrective action taken.

The Attorney's Office told us that its outside counsel committee requires budgets prior to retaining outside counsel and before requesting any supplemental funding for an outside counsel contract. In addition, the Attorney's Office reported that its amended outside counsel contract requires both budget and case plans. The Attorney's Office also noted that it is working on including an abbreviated status update on all quarterly financial status reports. It reported that the quarterly financial status reports will supplement the comprehensive biannual reports. In addition, the Attorney's Office told us that is will continue to evaluate the frequency of reporting to ensure that the City Council and various boards are appropriately updated.

Finding #6: The Attorney's Office's policies and procedures for reviewing outside counsel's invoices are reasonable, but it could better identify and eliminate certain questionable costs.

Although its prescribed process for reviewing outside counsel's invoices for contracts paid by the General Fund and proprietary departments is reasonable, the Attorney's Office does not consistently apply its invoicing policies and procedures. In establishing comprehensive invoicing policies and implementing a review process to ensure that outside counsel follow them, the Attorney's Office has helped control outside counsel costs. Our testing of 41 invoices demonstrated that the Attorney's Office often eliminated charges that conflicted with its policies. Nevertheless, we identified certain instances in which the Attorney's Office did not apply its invoicing policies and paid outside counsel for costs that were not allowed. Those costs were primarily related to block billing—the practice of grouping tasks and invoicing for an aggregate amount of time, rather than specifying the time spent and costs associated with each task. In addition, attorneys and paralegal staff were sometimes billed to the City without prior written approval. Although the Attorney's Office's invoicing policies seek to establish a standard for reasonable billing practices and to encourage accountability based on cost-benefit considerations, it undermines those efforts by not consistently identifying all unallowable costs. In addition, the Attorney's Office risks paying more for outside counsel than it has to or is contractually obligated to pay.

We recommended that to help control the costs of outside counsel, the Attorney's Office should enforce its contract requirements and billing guidelines. Specifically, the Attorney's Office should do the following:

- Disallow payment for invoices that it receives in a block-bill format and require that outside counsel resubmit the charges in the prescribed manner.

- Ensure the formal approval of attorneys and paralegals not previously listed on the contracts with outside counsel.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office reported that it continues to strictly enforce all billing guidelines.

Finding #7: The Attorney's Office could more efficiently and effectively monitor outside counsel costs by comparing budgeted to actual costs for activities.

The Attorney's Office could more efficiently and effectively monitor outside counsel costs if it prepared budgets detailed by activity and required outside counsel to submit invoices that had the same level of detail and could thus be compared to the budget. For cases we reviewed in which outside counsel provided budgets to the Attorney's Office, the budgets were in varying formats and showed varying levels of detail.

The Attorney's Office's December 2001 policy stated that managing attorneys should participate in the creation of a litigation budget that describes, in detail, the total estimated cost of outside counsel's assistance in a matter. The policy also directed managing attorneys to periodically compare outside counsel's actual costs against budgeted costs. However, the November 2005 revised policy states that budget updates are generally required from outside counsel as contract amendments are proposed, and managing attorneys are not required to compare budgeted costs with actual costs. Thus, it appears that reacting to the need for more funding, rather than proactive cost control, now drives budget reviews, because their use is tied to requests for supplemental funding.

Although comparing budgets against actual costs was required by the policy in effect during the period of our audit, our review of selected contracts found no evidence that Attorney's Office staff made the comparisons. Even though Attorney's Office staff ensured that total invoices did not exceed total contract costs and reviewed lengthy invoices that reflected time charged in increments as small as six minutes, this invoice review is labor intensive, and its comprehensiveness and effectiveness are limited. Comparing outside counsel costs to budgeted costs by activity within litigation or project phase should enable the Attorney's Office to better facilitate effective communication on the progress of its cases and any deviations from established budgets.

We recommended that the Attorney's Office require outside counsel to prepare monthly invoices and cumulative cost reports that sort charges both by attorney within activity and by activity within litigation or project phase. Further, the Attorney's Office should compare cumulative charges and estimated remaining charges to agreed-on budgets.

Attorney's Office's Action: Pending.

The Attorney's Office noted only that this recommendation was under review.

Finding #8: The attorney conflicts panel is generally managed appropriately, although the selection of firms for the panel could be better documented.

When the Attorney's Office has an actual or potential conflict of interest—that is, a case in which it cannot ethically represent a city employee whose interests may be adverse to those of the City—it refers the matter to the attorney conflicts panel (conflicts panel). The conflicts panel comprises law firms selected by the Attorney's Office, in conjunction with the Office of the City Administrative Officer (CAO), to provide legal services to the City in the event of a conflict of interest. The selection process culminates in a committee from the Attorney's Office (selection committee) making a recommendation to the city council, which makes the final contracting decision. The major types of litigation for the conflicts panel are cases involving police or employment issues.

In reviewing the process used to evaluate firms responding to the 2005 request for qualifications (RFQ), which took place during our audit, we concluded that the Attorney's Office could better document how it made its decisions when selecting firms to recommend for placement on the conflicts panel. The Attorney's Office has overall responsibility for the selection process, although CAO staff were involved in the process, including participating in the selection committee. It was evident that the selection committee interviewed prospective firms, but it did not sufficiently document its rationale for choosing some firms over others. As in our review of other selection processes that the Attorney's Office conducted, we found that the RFQ that was released cited evaluation criteria, in this case focusing on ability and experience, but that the selection committee could not provide sufficient documentation to support the decisions it made based on the criteria.

The contracts that the City enters into with outside counsel through the CAO contain the CAO's invoicing policy, which is comparable to the policies of the Attorney's Office. The contracts specify the frequency with which outside counsel must invoice the City and the form the invoices must take. The policy included in the contracts places restrictions on certain types of fees and expenses. In addition, the CAO has established an internal process for reviewing outside counsel invoices for compliance with its invoicing policy and disallows costs that do not comply. As a result, the CAO focuses on eliminating costs for which it is not contractually obligated to pay. Our review of 10 invoices showed that the CAO consistently followed its review process and applied its established invoicing policy by disallowing costs that were not in accordance with its policy.

The CAO's policies for monitoring cases handled by outside counsel are similar to those of the Attorney's Office in that its contracts require outside counsel to submit reports that are useful for monitoring, including budgets and quarterly status reports. The CAO's procedures manual states that the CAO is responsible for ensuring that outside counsel comply with the terms and conditions of its contracts. Our review revealed that the CAO generally has performed an adequate job of monitoring outside counsel. However, we found some contracts that did not require outside counsel to submit budgets.

In a separate finding we recommended that the Attorney's Office develop comprehensive policies and procedures that specify standards for applying evaluation criteria. With regard to the CAO and its oversight of outside counsel, we recommended that in order to help control the costs of outside counsel, the CAO should require budgets for all contracts with outside counsel that it manages.

CAO's Action: Corrective action taken.

The CAO acknowledged the importance of budgets as a mechanism for controlling outside counsel costs. The CAO stated that it will require budgets in all cases that it handles.