



FEDERAL ELECTION COMMISSION
Washington, DC 20463

October 7, 2005

RECEIVED
FEDERAL ELECTION
COMMISSION
OFFICE OF GENERAL
COUNSEL
2005 OCT 12 A 10:59

MEMORANDUM

To: Lawrence H. Norton
General Counsel

Through: James A. Pehrkon *JAP*
Staff Director

Robert J. Costa *RJC*
Deputy Staff Director

From: Joseph F. Stoltz *JFS*
Assistant Staff Director
Audit Division

Martin L. Favin *MLF*
Audit Manager

Erica Lee *EL*
Lead Auditor

Subject: Lockheed Martin Employees' Political Action Committee (A03-54)-
Referral Matters

AUDIT REFERRAL # 05-10

On June 6, 2005 the Commission approved the final audit report on the Lockheed Martin Employee's Political Action Committee (LMEPAC). The final audit report includes the following matters that are referable:

- Finding 1 - Disclosure of Operating Expenditures
- Finding 3 - Failure to Maintain Contributor Payroll Deduction Authorizations (PDA)
LMEPAC was unable to provide a material number of PDAs in response to the final audit report. Per the Audit staff's recommendation, we will be conducting a follow-up review to assure that LMEPAC's PDA processing procedures are adequate.

27044182218

All work papers and related documentation are available for review in the Audit Division. Should you have any questions regarding this matter, please contact Erica Lee or Martin Favin at 694-1200.

Attachments: Finding 1 – Disclosure of Operating Expenditures
Finding 3 – Failure to Maintain Contributor Payroll Deduction
Authorizations

cc: Lorenzo Holloway

27044182219

Finding 1. Disclosure of Operating Expenditures

Summary

LMEPAC failed to accurately disclose sixty disbursements totaling \$69,500 to Mr. Kenneth Phelps, the Assistant Treasurer during the audit period. These items were unauthorized payments to Mr. Phelps, which LMEPAC disclosed as contributions and travel reimbursements to federal/non-federal candidates. LMEPAC complied with the Audit staff's recommendation by filing amended reports correctly disclosing these unauthorized disbursements.

Legal Standard

Reporting Operating Expenditures. When operating expenditures to the same person exceed \$200 in an election cycle, the committee must report the:

- Amount;
- Date when the expenditures were made;
- Name and address of the payee; and
- Purpose (a brief description of why the disbursement was made). 2 U.S.C. §434(b)(5)(A) and 11 CFR §104.3(b)(3)(i).

Background

Mr. Kenneth Phelps was the Assistant Treasurer of LMEPAC from August 11, 1997 to February 24, 2004. Mr. Phelps was responsible for the following: depositing contributions; receiving and opening bank statements; preparing and disbursing checks (which were required to have two signatures); data entering the information to create the FEC disclosure reports; and, maintaining all bank records. A Lockheed Martin Corporation internal audit report dated June 2001 recommended that some of the duties performed by the Assistant Treasurer should be assigned to other staff to ensure assets are safeguarded. It appears LMEPAC did not reassign any of Mr. Phelps' responsibilities. In October 2001, Mr. Phelps began writing checks, which according to LMEPAC officials were for unauthorized disbursements to himself. During the period covered by the audit, these 'unauthorized' disbursements totaled \$89,500.¹ As discussed below, \$69,500 was inaccurately disclosed and \$20,000 was not reported at all (See Finding 2). LMEPAC officials stated they were unaware of this activity until communication between the Audit staff and the Treasurer of LMEPAC regarding the upcoming Commission audit. It was at this point that LMEPAC officials discovered that Requests for Additional Information Letters from the Commission's Reports Analysis Division had not been addressed by the Assistant Treasurer. Upon discovery of Mr. Phelps' misappropriation of funds, LMEPAC stated they began an investigation and implemented procedures to improve its internal controls.

¹ There were additional unauthorized disbursements made subsequent to the period covered by the audit

Facts and Analysis

LMEPAC reported sixty disbursements totaling \$69,500 as either contributions or travel reimbursements to federal/non-federal candidates. The disbursements were actually 'unauthorized' disbursements to Mr. Phelps. According to the LMEPAC officials, Mr. Phelps issued these checks to himself without knowledge or approval from the Treasurer.

At the exit conference, LMEPAC representatives were given a schedule detailing the disclosure errors. They stated they would file amended reports to correct the errors.

Interim Audit Report Recommendation

The Audit staff recommended that LMEPAC:

- Amend its reports to correctly disclose the 'unauthorized' disbursements made to Mr. Phelps; and,
- Provide any additional information that addressed:
 - The efforts of LMEPAC to prevent the misreporting of disbursements (i.e., safeguards and internal controls);
 - The details of when and how LMEPAC officials learned of the 'unauthorized' disbursements; and,
 - The identities of the individuals responsible for establishing the duties of the LMEPAC assistant treasurer position.

Committee Response to Recommendation and Audit Staff's Assessment

In response, LMEPAC filed amended reports correctly disclosing the unauthorized disbursements made to Mr. Phelps and provided additional information regarding the actions taken by Mr. Phelps and LMEPAC.

LMEPAC Counsel (Counsel) stated that the Treasurer was not aware of the unauthorized disbursements until he was contacted by the Audit staff in December 2003 regarding the commencement of the audit. Prior telephone calls and correspondence from the Commission had been intercepted by Mr. Phelps. Furthermore, Counsel stated that LMEPAC officials believed the recommendations provided in the June 2001 Lockheed Martin Corporation Internal Audit Report had been implemented by Mr. Phelps. As a result of the internal audit report, Mr. Phelps was instructed by the Treasurer to outsource the administration of LMEPAC. Mr. Phelps repeatedly assured the Treasurer that this outsourcing was 'in process' and was being delayed because of firewall security issues. Eventually, Mr. Phelps informed LMEPAC officials that the outsourcing was complete and consequently no further action was taken by LMEPAC officials. Once LMEPAC officials were made aware of Mr. Phelps "embezzlement scheme," immediate internal controls and safeguards were incorporated in the administration of the LMEPAC's operations. The disbursement process was de-centralized by check requests being made in one location and the checks being issued in another location. Monthly LMEPAC bank statements were re-directed to the corporate accounting office and an independent reconciliation was completed. Moreover, LMEPAC by-laws were amended to require an audit by an independent accounting firm and federal election law counsel once a year.

Finding 3. Failure to Maintain Contributor Payroll Deduction Authorizations

Summary

Based on a review of all payroll deduction authorization forms (PDAs) provided by LMEPAC, the Audit staff determined PDAs were not available for 42% of the contributors. In response to the interim audit report, LMEPAC provided a description of policy changes implemented to ensure that such authorizations are maintained in the future and have taken measures to obtain the missing PDAs noted above.

Legal Standard

Recordkeeping. Each political committee or other person required to file any report or statement under this subchapter shall maintain all records relevant to such reports and statements. Records to be maintained with respect to the matters required to be reported, include bank records, vouchers, worksheets, receipts, bills and accounts, which shall provide in sufficient detail the necessary information and data from which the filed reports and statements may be verified, explained, clarified, and checked for accuracy and completeness. The Commission has determined that, under 11 CFR § 104.14(b)(1), separate segregated funds established pursuant to Part 114 of the Commission's rules must maintain copies of Payroll Deduction Authorizations for each individual who makes any contribution(s) via automatic payroll deduction. *See, e.g.* MUR 4955 (Metropolitan Life). 11 CFR §104.14(b)(1).

Facts and Analysis

The Audit staff reviewed all PDAs provided by LMEPAC both during the audit and subsequent to the conference held at the end of fieldwork. LMEPAC contacted Lockheed Martin Corporation's various payroll centers to obtain the PDAs. According to the Treasurer, Lockheed Martin Corporation merged with numerous companies in recent years, therefore, the PDAs were not always maintained at one location.

The review revealed that LMEPAC did not maintain 42% (1,272 of 3,015²) of PDAs required to be maintained. They submitted 14% of the PDAs during fieldwork and 44% of the PDAs following the exit conference.

Interim Audit Report Recommendation

The Audit staff recommended that LMEPAC demonstrate its compliance with the recordkeeping requirements and attempt to obtain replacement PDAs for those employees whose authorizations could not be located. It was further recommended that in the future

² This represents the number of contributors during the audit period

27044182223

LMEPAC implement procedures to ensure that PDAs are complete and maintained in an auditable state. Copies of the procedural instructions were to be submitted with LMEPAC's response and were to include an action plan for implementation of the changes. Once these procedures were in place, the Audit staff could verify that they were adequate to assure compliance via follow-up audit work. Although LMEPAC may choose to maintain PDAs at the payroll centers, it was recommended that the copies of PDAs be maintained at the committee headquarters.

Committee Response to Recommendation and Audit Staff's Assessment

LMEPAC stated the Lockheed Corporation and the Martin Marietta Corporation merged in 1995 and became Lockheed Martin Corporation. At the time of this merger there were multiple independent payroll centers in operation throughout the corporation. The following year, the Lockheed Martin Corporation acquired another company which also had numerous payroll locations. Because of the merger and the acquisition, the original PDAs were difficult to locate, especially for some employees who had been contributing for over twenty years. However, LMEPAC officials stated they used extensive resources to locate nearly 60% of the PDAs during the audit fieldwork.

In response to the interim audit report, LMEPAC officials stated they sent letters to individuals with missing PDAs who are still employed with Lockheed Martin Corporation and who are still active contributors.³ LMEPAC was able to obtain 197 of these missing PDAs. Further, LMEPAC officials stated they were exploring a plan to obtain the PDAs electronically.

To ensure compliance with the regulations, LMEPAC stated they have substantially merged all payroll systems into one location, have created a requirement that all PDAs be sent to the LMEPAC headquarters for permanent retention and have incorporated a review of the PDAs into the annual audit.

³ Of the 1,272 contributors missing PDAs, 633 are current active LMEPAC members