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cc

Subject Comments to Proposed Embezzlement and Internal
Controls Policy

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Mr. Joseph Stolz Audit Division Director Federal Election Commission 999 E Street NW Washington, DC 20463	
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Re: Comments Regarding Proposed Commission
Policies on Embezzlement and Internal Controls

Dear Mr. Stolz:

These comments are submitted in response to the proposed 'policies' on the issue of embezzlement of political committee funds and the companion document from the Audit Division on internal controls for political committees.

As a preliminary matter, I appreciate the fact that the Commission recognizes that there is absolutely nothing in any of the Commission's published literature on either of these issues. As someone who represents two committees victimized by theft, I have scoured everything published by the Commission and relied upon by the regulated community to ascertain the Commission's guidance on this subject, and long ago concluded no such information has ever been provided to political committees: no regulations, no policies, no training materials, no reference(s) in any of the published guides from the Commission whatsoever. Whatever internal guidelines may exist within the Commission's infamous enforcement manual, none of those have heretofore been made public.

Accordingly, to that extent, it is useful for the Commission to publish these two documents to allow the regulated community to advise the Commission of the realities in which political committees function – in a forum other than an enforcement proceeding.

In this area, as in *any* subject area within the Commission's jurisdiction, the current practice of case-by-case adjudication and "knowing violations when we see them" is not an appropriate substitute for articulating standards and promulgating regulations in accordance with constitutional safeguards and the Administrative Procedures Act. The opportunity to comment and to help shape the ultimate standards and regulations governing entities within the Commission's jurisdiction is vital to

ensuring the Commission's proper understanding of the manner in which political committees actually function and this exchange of information must be allowed *prior* to Commission enforcement action.

Overall comments relative to both proposed policies:

A. If enforcement actions or penalties of *any* kind against political committees are envisioned by the Commission relative to the proposed policies, the Commission is obligated to follow the procedures for promulgating such standards as regulations.

The Internal Controls Policy states quite clearly: "While neither FECA nor the regulations require any particular set of internal controls...". If the Commission is to penalize committees for not having internal controls, the Commission must articulate through a proper rulemaking that such controls are required and what constitutes acceptable controls. The policy Memorandum, while potentially helpful (if amended as indicated herein), contains no indication of how it is to be disseminated to the regulated community or how it is to be relied upon in 'after-the-fact' reviews by the Commission, whether that occurs through audits or enforcement actions. This is simply not a proper manner for conducting the regulatory powers of the agency. If these are educational policies only to be relied upon by the various training functions of the Commission, that is one thing. If, however, committees who fail to adopt procedures similar to those outlined in the two memoranda are subject to penalty for such failure, then the Commission has no option but to issue regulations that clearly state what is required and what happens if/when committees fail to comply.

B. The Commission should abandon its efforts to 'punish the victim' of these crimes. The Commission is seemingly in the process of adopting through enforcement actions an approach that essentially punishes the victims of embezzlement.. The very idea that if only sufficient controls were in place no one could have stolen from a political committee is preposterous. Strict liability for filing inaccurate reports is the Commission's legal basis for punishing committees who have been the victims of embezzlement - -which is nonsense. The very idea that there are enough rules or policies or procedures in the world to stop a dishonest person from stealing is utterly absurd. Were that true in the real world, the Commission would need only adopt that magic bullet from wherever it currently exists – and all would be well and none of these procedures or policies or memos would be necessary. Forcing a political committee that has already lost funds to embezzlement to bear the additional burdens and costs of a lengthy enforcement action and possible civil penalties is outrageous, particularly when these committees are staffed primarily by volunteers and are largely temporary in nature.

What the Commission *should* adopt, if anything, is a policy that simply adds one additional component to the Post-Discovery of Misappropriation Activity which should states: "In order to encourage the notification of authorities and voluntary amendment of FEC reports, and absent evidence of deliberate and willful misconduct that directly resulted in defalcation of committee funds, no further enforcement proceedings or penalties will occur."

When there is no evidence that the persons responsible for the committee have acted wrongfully or irresponsibly within the context of normal conduct of operations by political committees, there should be no additional punishment.

And the Commission must recognize through its own affirmative efforts that its regulated entities are *different* from other types of entities, whether business or government. The Commission should understand much better than it apparently does what is normal conduct for political committees and establish operating standards within *that* context for identifying or measuring anomalies.

Comments to Proposed Embezzlement Policy:

The proposed minimum safeguards involve two components: internal controls and post-discovery actions. Part A, Internal Controls *presumes* the existence of an internal controls policy – which most political committees do not have. If the Commission has determined that political committees should have a written internal controls policy and could be penalized for *not* having one, then the Commission should (must) promulgate a regulation that requires committees to adopt an internal controls policy. Period. And if the Commission has standards for what such a policy should (must) include, then that also should (must) be articulated in a regulation.

With respect to the content of such internal controls, my comments are as follows:

1. Bank accounts. It is difficult to conceive of a situation where a committee would knowingly authorize a bank account to be opened on its behalf in an individual's name, unless there are extenuating circumstances such as a failure to change an account after a 'testing the waters' phase or some similar situation. Normally, only an individual with bad intentions would open a committee bank account in his/her individual name. All the best internal controls in the world will not keep a dishonest person from opening a bank account that is not authorized by those in control of a political committee and doing so without their knowledge. While it is fine to articulate a policy on this point, if someone without authority opens a bank account in his/her personal name without authorization to do so and then uses the account for unauthorized or illegal purposes to steal money from the committee, why would that subject the committee to an enforcement action? Absent more, it is certainly no indication of some failing on the part of the committee.

The Commission should not hold political committees responsible for some person's unauthorized use of any bank account to misappropriate funds of the committee absent evidence of overt or inappropriate conduct which knew of and somehow condoned the misappropriation.

What would be helpful is if the Commission promulgated a regulation which stated: "A political committee must obtain from the Internal Revenue Service an employer identification number ("EIN") in the name of the committee and all committee bank accounts must be solely in the name of the committee name and shall utilize the

committee EIN. Any individual who deposits committee funds into an unauthorized bank account not established in accordance with this provision will be held personally accountable individually for violating the regulation”.

2. Checks. The Commission surely is aware that there is no way to enforce this provision as an insurance against a dishonest person’s forging the names of a second signatory. Banks have taken great pains to insulate themselves from any responsibility for enforcing such requirements regardless of how the signature cards are signed or despite the directions provided to the bank regarding multiple signatures. If a person decides to sign a check over \$1,000 either by signing only his/her name or forging another signature, there is nothing that keeps such a check from being duly processed by the bank and there is no remedy against the bank under normal circumstances. While this may seem to be and is a good policy, it is rarely a safeguard against theft.

3. Segregation of duties between banking authority and check processing. This standard presumes that having such a policy will protect against theft and also presumes that there are sufficient numbers of people in most committees to segregate such duties. It also fails to take into consideration this factor: not all checks received by a committee can be readily or automatically accepted for deposit. Because of the restrictions on the types of contributions that can legally be received by political committees, there must be a procedure in place for review of contributions prior to deposit in order to conform to Commission regulations. In my experience, one of the sources of potential (and actual) theft has been the step in the process in which checks of questionable status (such as corporate checks) are remanded to an expert in the FEC compliance field who, instead of handling in accordance with FEC regulations, uses his expertise and knowledge to steal the checks and then processes the funds without authority, in violation of the procedures of the committee and appropriates the funds to himself. This standard would not protect against that situation.

4. Bank reconciliation. This standard is on the right track but is not sufficient. This standard should require that the bank statements and all bank accounts be reconciled to the FEC reports, which is the *only* way in which to insure that the actual accounting and the FEC reporting are identical. This is the primary and largely only internal control necessary to protect against theft of committee funds. Having one person prepare the FEC reports and another person reconcile the FEC reports to the financial records and the bank statements is the segregation of duties that is most likely to prevent embezzlement. All the other proposed controls can be easily circumvented in a standard political committee environment.

My recommendation to the Commission that it promulgate regulations which specifically require a committee treasurer to set up all bank accounts in the name of the committee using the committee EIN, and then requires the treasurer to insure that there are at least two persons involved in managing the committee’s accounting and compliance: one whose job it is to process funds and prepare/report the receipt/disbursement of funds to the FEC and another to reconcile the bank statements of all accounts to the financial records *and* the FEC reports. Having two different people

performing those separate functions is the primary and perhaps best protection against theft and the Commission should issue such requirements in the form of regulations.

5. Petty cash. The instances of theft from political committees I have represented would not have been protected in the slightest by this standard. A dishonest individual responsible for the petty cash of a committee would only have to falsify vouchers and avail himself/herself of the funds from such falsified documents. While the amounts stolen in the form of cash might be smaller, the presence of large sums of cash was not the basis on which the thieves I've met were able to steal funds.

If the Commission requires political committees to have internal controls, my recommendation for what the regulations mandating such controls should say:

1. The committee must adopt and adhere to a written internal controls procedure that segregates duties and minimizes the opportunity for embezzlement and theft.
2. A political committee must obtain from the Internal Revenue Service an employer identification number ("EIN") in the name of the committee and all bank accounts must be in the committee and shall utilize the committee EIN. Any individual who deposits committee funds into an unauthorized bank account not established in accordance with this provision will be held personally accountable individually for violating the regulation.
3. The Treasurer is responsible for insuring that an individual *other* than the individual who prepares the FEC reports shall receive unopened the bank statements of all committee bank accounts and reconciles the bank accounts to the committee's financial records and the FEC reports duly filed with the Commission. This reconciliation shall be performed on at least a quarterly basis and more frequently during periods of increased committee financial activity.

If the Commission is serious about stopping embezzlement, the Commission should undertake serious efforts such as promulgating regulations similar to those above.

Comments to Internal Controls Memorandum ("the Memorandum"):

1. The internal controls outlined in the Memorandum fail to account for the unique nature of political committees generally, and further fail to recognize between and among types of political committees.

Political Committees are *different* from businesses, corporations, and governments because of the unique reporting and accounting requirements of the Federal Election Campaign Act of 1971, as amended ("the Act"). The source(s) of information for the types of internal controls procedures and systems contained in the Audit Division's

Memorandum are useful – but ultimately fail to recognize and accommodate the realities of how political committees function. Business entities are governed by generally accepted accounting procedures (“GAAP”), government accounting is guided by similar principles articulated by the Federal Accounting Standards Board (“FASBO”) and such standards and principles are taught to those engaged in and governed by the respective accounting and reporting under those standards.

The Act requires very different standards of accounting and reporting of receipts and disbursements than those with which accounting professionals are accustomed from their training under GAAP or government accounting. While there are potential lessons to be learned from other sources, in the final analysis, it is incumbent upon the Commission to articulate the standards and procedures by which political committees are to be governed in accordance with the unique provisions of reporting and accounting under the Act and Commission regulations.

The Commission’s current practice and approach is that the Act requires reports to be filed and if there are errors or omissions in any report, the law is a strict liability statute and any erroneous filing, whether intentional or inadvertent, subjects the filer to penalty.

Under that approach, the Commission has created a situation where the agency accepts no responsibility for promulgating standards and regulations for the systems and procedures necessary to prepare correctly filed reports. And presumably, that is why the Commission sees fit to issue the proposed memoranda as policies not regulations.

However, the failure of the Commission to articulate standards in a regulatory context also allows the Commission to avoid any in depth understanding of the differences between the essential nature of political committees, which are largely voluntary associations of citizens with no training or skill in accounting of any kind, versus the types of entities discussed in the Internal Controls Memorandum, which reference businesses and government entities. Those are simply *irrelevant* for political committee purposes.

The result of the Commission’s ‘strict liability’ approach has inadvertently created another problem with regard to reporting. For all other types of financial reporting, there is an ongoing requirement and incentive to continually review and amend reports as additional information becomes available. Whether it is a tax return or quarterly earnings report or other type of financial report, it is accepted industry practice to amend reports to reflect the most current information available. Generally, absent extenuating circumstances which are articulated in applicable regulations, such amendments do not result in penalties to the filer. Recent actions by the Office of General Counsel and the Commission reflect a shift in prior practice where amendments were accepted without penalty in an effort to encourage voluntary and accurate reporting. This ‘strict liability’ philosophy now means that discovery of an error and filing of corrective amendments may well result in an enforcement proceeding if the error is of a

certain amount, that specific amount being yet another 'secret' within the Commission's enforcement procedures.

It is no longer wise counsel to encourage committees to file amendments upon the discovery of errors or omissions in previously filed reports. Whether that is what the Commission intends, certainly that is the effect.

This arises from the Commission's notion that it is the committees' responsibility to file perfectly accurate reports and there is 'strict liability' for failing to do so, regardless of the reason. Such an attitude thus absolves the Commission from responsibility for facilitating the reporting process through regulations that establish real standards and a formal framework for the filing and amending of reports. The present system is one in which the agency offers little more than a loose amalgam of handouts and regulations that focus solely on the results required, not the process for arriving at the result. This is particularly problematic in a system that necessarily relies almost exclusively on volunteers and minimally paid staff members, virtually none of whom are trained professionals in the intricacies of the Act and Commission regulations.

While the Memorandum is an initial recognition that the Commission should address the procedures by which political committees account for funds and develop their reports, something the Commission has not previously formally done, there is much that the Commission should and could do in working with the regulated community to develop actual standards and systems applicable to these types of entities.

The Internal controls Memorandum fails to distinguish between/among various types of political committees and thus, the internal controls procedures are not particularly useful for most political committees.

The Memorandum states that it is targeted for 'smaller committees'. However, what the Memorandum fails to recognize is that the system it outlines is, in my experience, only applicable to the very *largest* committees, certainly not the smallest ones which predominate the system.

Neither does the Memorandum distinguish between or among the different types of political committees, indistinguishable in Commission regulations but certainly very different in actual operation. The types of political committees vary not just by size but by function: campaign/principal authorized committees, joint fundraising committees, political party committees, connected PACs and non-connected PACs each of which have separate characteristics and operating systems which the Commission is long overdue in recognizing.

A joint fundraising committee, for instance, operates totally differently from a candidate committee or campaign. It normally has *no* staff and normally hires or appoints one professional to receive and disburse funds and file the requisite reports.

A candidate's campaign committee may well have *no* paid individual whose responsibility is the processing and reporting of contributions and receipts. For the

Commission to believe that a 'small committee' will have two to three people involved in this process is unrealistic, unless the Commission is counting volunteers who open mail among those individuals. Only the very largest campaign committees would ever have as many as three people responsible for the accounting and banking and compliance functions. The decisions about staffing a committee are made by individuals skilled in political campaigns, *not* accounting and compliance and there is one truism among them: a dollar spent on accounting or compliance is one less dollar available to get votes, which is what campaign professionals are hired and trained to do.

A non-connected PAC, unless it is very unusual among such entities, normally has one person (often the fundraising professional) who manages all the operations of the PAC including the accounting and the reporting. To suggest that there be even three separate individuals involved in compliance and accounting duties in order to segregate the duties is far removed from the reality of most such committees.

The Memorandum wholly ignores the realities of the functions and operations of most political committees. It would be my suggestion that if the Commission is serious about this exercise, the Commission should develop a manual for operations of (not just reporting by) different types of political committees, and should develop the best practices of the different entities. And such a manual should not be developed by Commission staff working in isolation from the regulated community.

There simply cannot be a one-size-fits-all approach. Different kinds of committees function differently, have different purposes, different operations and different cultures. None of that reality is reflected in the Memorandum. A better approach for developing guidelines for operations would be to appoint working groups for different kinds of committees to include representatives of the regulated community as well as commission staff. Regrettably, most agency staff have *never* worked in a political committee environment or for a political committee of any kind. Often, explaining to Commission staff how committees function in the real world is an impossibly frustrating experience. Despite the Commission's 'best efforts' to develop a memorandum that is helpful regarding internal controls, it is clear from one reading that the authors of the Memorandum are fairly devoid of significant experience or background in the actual functioning of political committees of any type, let alone the nuances of the different types of committees.

My recommendation is that the Commission start over, involve individuals with actual experience in the real world of political committees, recognize that there should be different operating systems for different types of committees and give this another try.

Against that backdrop, here are some examples of flaws in the Memorandum's approach:

Bank Accounts. My comments to some of these provisions are included earlier under the section related to the proposed embezzlement policy. In addition, the Memorandum addresses the reconciliation of bank statements. What the Memorandum doesn't take

into account is the fact that the FEC reports are filed on dates covering time periods when bank statements may not yet be available. The segregation of FEC reporting and reconciliation of the bank statements to the financial records and the FEC reports may well result in the need to file amendments to the FEC reports. Presently, the filing of amendments subjects the filer to potential fines and penalties for reporting errors or mistakes after the fact. If the process is truly to encourage voluntary compliance, the regulated community should be instructed and required to have an individual other than the report preparer/filer balance the books and reconcile to the FEC report and to encourage, not discourage, the timely filing of corrective amendments.

Rather than tying enforcement procedures to the *amount* of an amendment, the Commission's inquiry should be (if there is to be one) to the length of time between the initial filing and the corrective action and the circumstances giving rise to the correction. If the amendment results from an ongoing effort to insure proper reporting, the Commission should not punish a committee for notifying the Commission of a mistake by filing an amended report.

With respect to wire transfers, the recommendations included in the Memorandum should be part of the Commission's regulations or at the very least included in an operations manual and training provided to committees. And any committee which discovers and voluntarily notifies the Commission of a previously unreported wire transfer should not be penalized for such *sua sponte* disclosure.

Receipts

Again, the lack of real life experience is evident in the Memorandum's discussions of the processing and handling of receipts. The section presumes that all receipts arrive via the mail – which is largely untrue. Direct mail receipts are normally processed through a lockbox, but event proceeds cannot be and are never processed in that manner. Professional fundraisers, political fund designees and candidates themselves handle large sums of funds raised for candidate committees, normally by being handed checks at events or in personal meetings or individual followup by the fundraising professionals.

This section on receipts needs substantial work to be useful. It should distinguish among the types of committees, the various ways in which each type raises its money and best practices for the processing of receipts from the different ways in which the funds are solicited and received.

Disbursements

Again, the absence of context in the operations of committees is problematic in this section. In one embezzlement case with which I am familiar, the candidate specifically stated to the staff that no debit cards would be allowed to be obtained for the committee for the very reasons stated in this section. Notwithstanding that directive, one staff person disregarded those instructions, obtained a campaign debit card without the

knowledge or authority of the candidate or treasurer, and proceeded to misappropriate campaign funds using the debit card. Other controls in place subsequently revealed the embezzlement and appropriate steps were taken thereafter – but there is nothing in this section that would have prevented this dishonest staff person from doing what he did and stealing from the committee.

Similarly, there is nothing that keeps a dishonest person from forging checks, forging invoices, and ignoring safeguards that others believe are in place for the committee.

While these suggestions may be good ideas, their efficacy depends on the type and size of the committee and the honesty of what are normally a very few people involved in the receipt, processing and reporting of committee funds.

Computerized Systems

There are so many issues that should and could be raised with respect to this section of the Memorandum that it is difficult to know where to begin. One of the ways that a dishonest professional compliance person is able to steal from a political committee is that his knowledge of the intricacies of the compliance software makes others much less able to track and discover theft. There are rarely more than one or two people in any committee who are familiar with the campaign software. That knowledge confers great power on the individuals who know how to use it and an opportunity to abuse the system.

Political committees require two types of software: a bookkeeping system and a compliance / reporting software. Until quite recently, the most popular software system did not allow the exporting of the disbursements directly from the bookkeeping software into the compliance and reporting software. The inability of most software systems to account for both receipts *and* disbursements from both an accounting *and* compliance perspective is a huge problem. It is still one of the biggest problems in the system. Manual entering of records into two systems is hugely problematic and fraught with possibility for error, mistake and mischief.

The fact that this section doesn't recognize one of the biggest headaches and problems for committees is, itself, a problem and demonstrates why this Memorandum is wholly insufficient as educational, instructive or informative to committees and why the Commission cannot rely on this Memorandum for any enforcement decisions.

Conclusion

The Commission should not approve or adopt the Memorandum without substantial reworking. It is not possible to make sufficient comments or to offer revisions sufficient to sufficiently revise the present draft to make it workable. It would be extremely problematic for the Commission to rely on the Memorandum as presently drafted as grounds for determining whether a committee has or has not done something

correctly because it fails in so many ways to address the manner in which committees actually operate.

The Commission has made a good start by opening this discussion. But that is all this is: a start.

For too long, the loudest voices at the Commission have been those who espouse great theories of regulation of political speech and activity and offer noble notions of combating 'corruption' in the political process, but who do not have a clue about the day to day world of political committees, their practice or function in the real world.

It is long overdue for the Commission to begin to pay attention to the actual operations of the committees regulated by the agency. The Commission should do more to inform itself and require at least a minimal level of knowledge by the staff of the actual operations of the regulated community in order to better regulate the covered entities.

I would gladly volunteer to assist as part of a working group to help develop operating procedures more closely attuned to the realities of various types of committees, should the Commission be willing to entertain that sort of assistance.

Thank you for the opportunity to present these comments.

Respectfully submitted,

/s/ Cleta Mitchell

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