



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

SECRETARIAT

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February 24, 2006

MEMORANDUM

AGENDA ITEM

For Meeting of: 5-04-06

To: The Commissioners

Through: Robert J. Costa *RC*
Acting Staff Director

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

Marty Favin *MLF*
Audit Manager

Erica Lee *EL*
Lead Auditor

Subject: Report of the Audit Division on the New Democrat Network (A03-45)

Attached for your approval is the subject report.

Recommendation

The Audit staff recommends that the report be approved.

This report is being circulated on a tally vote basis. Should an objection be received, it is recommended that the report be considered at the next regularly scheduled open session. If you have any questions, please contact Erica Lee or Marty Favin at 694-1200.

Attachment:

Report of the Audit Division on the New Democrat Network



Report of the Audit Division on the New Democrat Network

January 1, 2001 – December 31, 2002

Why the Audit Was Done

Federal law permits the Commission to conduct audits and field investigations of any political committee that is required to file reports under the Federal Election Campaign Act (the Act). The Commission generally conducts such audits when a committee appears not to have met the threshold requirements for substantial compliance with the Act.¹ The audit determines whether the committee complied with the limitations, prohibitions and disclosure requirements of the Act.

Future Action

The Commission may initiate an enforcement action, at a later time, with respect to any of the matters discussed in this report.

About the Committee (p. 2)

The New Democrat Network (NDN) is a non-connected committee. NDN qualified for multi-candidate status on December 18, 1996, and is headquartered in Washington, DC. For more information, see chart on the Committee Organization, p. 2.

Financial Activity (p. 2)

- **Receipts**
 - Contribution from Individuals \$ 758,329
 - Other Political Committees 816,545
 - Transfers from Non-Federal Accounts for Joint Activity 2,930,831
 - Other Receipts 126,545
 - **Total Receipts** \$ 4,632,250
- **Disbursements**
 - Operating Disbursements \$ 4,139,717
 - Contributions to Federal Candidates 318,470
 - Transfers to Non-federal Accounts 200,091
 - **Total Disbursements** \$ 4,658,278

Findings and Recommendations (p. 3)

- Misstatement of Financial Activity (Finding 1)
- Itemization of Disbursements (Finding 2)
- Reporting of Debts and Obligations (Finding 3)
- Disclosure of Federal Activity Paid from Non-federal Accounts (Finding 4)

¹ 2 U.S.C. §438(b).

Report of the Audit Division on the New Democrat Network

January 1, 2001 – December 31, 2002



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Part I

Background

Authority for Audit

This report is based on an audit of the New Democrat Network (NDN), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 2 U.S.C. §438(b).

Scope of Audit

This audit examined:

1. The receipt of excessive contributions and loans.
2. The receipt of contributions from prohibited sources.
3. The disclosure of contributions received.
4. The disclosure of disbursements, debts and obligations.
5. The disclosure of expenses allocated between federal and non-federal accounts.
6. The consistency between reported figures and bank records.
7. The completeness of records.
8. Other committee operations necessary to the review.

Limitations

NDN supported Federal candidates through various fundraisers and by providing information on its website. NDN hosted events throughout the 2002 cycle on behalf of Federal candidates and collected earmarked contributions they later forwarded to the respective campaigns. Solicitations relating to these events were paid for by NDN and staff was provided to organize the events. The Audit staff reviewed disbursement documentation to determine costs associated with the events. Due to incomplete records, the Audit staff was unable to ascertain costs for all events. Numerous requests were made to NDN for these records during fieldwork, at the exit conference and after fieldwork concluded. The Commission issued subpoenas to NDN on October 5, 2005 and to various other vendors on January 31, 2006. NDN submitted incomplete records in response to the subpoenas.

NDN stated they were “unable to locate some of the details of the proposed and actual events which were the subject of the subpoenas.” Furthermore, they believe that despite their inability to clarify the costs associated with the events they have responded in good faith.

The various other vendors subpoenaed by the Commission have not responded to date.

Changes to the Law

On March 27, 2002, President Bush signed into law the Bipartisan Campaign Reform Act of 2002 (BCRA). The BCRA contains many substantial and technical changes to the federal campaign finance law. Most of the changes became effective November 6, 2002. Except for the period November 6, 2002, through December 31, 2002, the period covered by this audit pre-dates these changes. Therefore, the statutory and regulatory requirements cited in this report are those that were in effect prior to November 6, 2002.

Part II

Overview of Committee

Committee Organization

Important Dates	New Democrat Network
• Date of Registration	June 18, 1996
• Audit Coverage	January 1, 2001 – December 31, 2002
Headquarters	Washington, DC
Bank Information	
• Bank Depositories	Two
• Bank Accounts	Two Federal Accounts and Nine Non-Federal Accounts
Treasurer	
• Treasurer When Audit Was Conducted	Simon Rosenberg
• Treasurer During Period Covered by Audit	Simon Rosenberg
Management Information	
• Attended FEC Campaign Finance Seminar	Yes
• Used Commonly Available Campaign Management Software Package	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

Overview of Financial Activity (Audited Amounts)

Cash on hand @ January 1, 2001	\$ 26,357
○ Contributions from Individuals	758,329
○ Other Political Committees	816,545
○ Transfers from Non-federal Accounts	2,930,831
○ Other Receipts	126,545
Total Receipts	\$ 4,632,250
○ Operating Disbursements	4,139,717
○ Contributions to Federal Candidates	318,470
○ Transfers to Non-federal Accounts	200,091
Total Disbursements	\$ 4,658,278
Cash on hand @ December 31, 2002	\$ 329

Part III

Summaries

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

A comparison of NDN's reported figures to its bank records revealed that receipts, disbursements and the beginning cash balance for calendar year 2002 were misstated. The Audit staff recommended that NDN amend its disclosure reports to correct the misstatements. In response to the interim audit report, NDN filed amended reports that materially corrected the misstatements. (For more detail, see p. 5)

Finding 2. Itemization of Disbursements

A review of credit card statements showed that NDN failed to itemize 31% (\$52,277) of the ultimate payees² as memo entries on these disbursements. Additionally, of the memo entries that were disclosed, 13% (\$22,265) were not adequate because they failed to provide the full address of the payee. The Audit staff recommended that NDN amend its reports. In response to the interim audit report, NDN filed amended reports correctly disclosing the required information. (For more detail, see p. 7)

Finding 3. Reporting of Debts and Obligations

The Audit staff identified debts and obligations totaling \$140,613 that were not reported on Schedules D (Debts and Obligations). The Audit staff recommended that NDN file amended reports disclosing these debts and obligations. In response, NDN filed amended reports disclosing the requested information. (For more detail, see p. 8)

Finding 4. Disclosure of Federal Activity Paid from the Non-federal Accounts

NDN made payments from its non-federal account totaling \$173,419 that appears to be for both allocable expenses and 100% federal expenses. Such payments are not permitted under the Commission's regulations. Nevertheless, such transactions should be disclosed, albeit in "Memo schedule" fashion, to complete the public record. The Audit staff recommended that NDN file memo Schedules H-4 and B to disclose the expenses. In response to the interim audit report, NDN disputed the Audit staff's analysis. They stated that the expenses at issue could be paid wholly from the non-federal account. (For more detail, see p. 9)

² The provider of goods or services purchased with the credit card.

Part IV

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

Summary

A comparison of NDN's reported figures to its bank records revealed that receipts, disbursements and the beginning cash balance for calendar year 2002 were misstated. The Audit staff recommended that NDN amend its disclosure reports to correct the misstatements. In response to the interim audit report, NDN filed amended reports that materially corrected the misstatements.

Legal Standard

Contents of Reports. Each report must disclose:

- The amount of cash on hand at the beginning and end of the reporting period;
- The total amount of receipts for the reporting period and for the calendar year;
- The total amount of disbursements for the reporting period and for the calendar year and
- Certain transactions that require itemization on Schedule A (Itemized Receipts), Schedule B (Itemized Disbursements) or Schedule H-4 (Joint Federal/Non-federal Activity Schedule).

2 U.S.C. §434(b)(1), (2) and (4).

Facts and Analysis

The Audit staff reconciled NDN's reported activity to bank records for calendar year 2002. The following chart outlines the discrepancies for the beginning cash balance, receipts, disbursements and the ending cash balance. Succeeding paragraphs address the reasons for the misstatements.

2002 Committee Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance @ January 1, 2002	\$29,596	\$53,431	\$23,835 Understated
Receipts	\$2,078,011	\$2,198,041	\$120,030 Understated
Disbursements	\$2,107,607	\$2,251,143	\$143,536 Understated
Ending Cash Balance @ December 31, 2002	\$0	\$329	\$329 Understated

The \$23,835 understatement of the beginning cash balance on January 1, 2002 was due to minor prior period reporting errors. NDN officials were made aware of these errors.

The understatement of receipts resulted from the following:

• Transfers from non-federal accounts not reported	\$ 95,354
• Contributions from individuals not reported	17,035
• Unexplained Difference	<u>7,641</u>
Total understatement of receipts	<u>\$120,030</u>

The net understatement of disbursements resulted from the following:

• Operating disbursements not reported	\$ 54,581
• Transfers to non-federal accounts not reported	83,059
• Payroll not reported	6,729
• Contributions to Federal Candidates not reported	1,875
• Reported disbursements not associated with checks	(374)
• Unexplained Difference	<u>(2,334)</u>
Total net understatement of disbursements	<u>\$143,536</u>

As a result of the misstatements detailed above, the ending balance was understated by \$329.

Contributions not reported were contribution checks totaling \$51,535 that were deposited into the federal account and then portions of these contributions (\$17,035) were transferred to the non-federal accounts. NDN did not report the contribution amounts transferred to the non-federal accounts on Schedule A or the transfers on Schedule B.

Included in operating disbursements not reported is \$39,804 of expenses that appear to be associated with the 2002 NDN East Coast Retreat (See Finding 4). Although NDN Counsel states that only non-federal funds were received for this event and the expenses were paid entirely from the non-federal account, this amount was paid from a federal account and not reported.

NDN did not explain why transfers from the non-federal account and the remaining transfers to the non-federal accounts were not reported.

The Audit staff discussed this finding with NDN's Counsel (Counsel) during the exit conference and provided him with schedules detailing the discrepancies. Counsel did not provide an explanation for the discrepancies.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that NDN amend its reports to correct the misstatements noted above and amend the most recent report to show the adjusted cash on hand balance with an explanation that it resulted from audit adjustments from a prior period. In response, NDN filed amended disclosure reports that materially corrected the misstatements noted above.

Finding 2. Itemization of Disbursements

Summary

A review of credit card payments showed that NDN failed to itemize 31% (\$52,277) of the ultimate payees³ as memo entries on these disbursements. Additionally, of the memo entries that were disclosed, 13% (\$22,265) were not adequate because they failed to provide the full address of the payee. The Audit staff recommended that NDN amend its reports. In response to the interim audit report, NDN filed amended reports correctly disclosing the required information.

Legal Standard

A. Reporting Operating Expenditures. When operating expenditures to the same person exceed \$200 in a calendar year, 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).

B. Reporting Allocable Expenses. A political committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report these kinds of disbursements on Schedule H-4. 11 CFR §104.10(b)(4).

C. Credit Card Transactions. In the case of operating expenditures charged on a credit card, a committee must itemize all payments to a credit card company in accordance with 11 CFR §104.10(a)(4). The committee must also itemize, as a memo entry, any specific transaction charged on a credit card for all payments to the actual vendor. The memo entry must include the name and address of the vendor, the purpose, and the amount of the disbursement. 11 CFR §§102.9(b)(2) and 104.9.

Facts and Analysis

The Audit staff reviewed payments totaling \$167,313, made to three committee credit card companies: Advanta MasterCard, American Express and Bank of America Visa. NDN failed to itemize, as memo entries, the ultimate payee for 31% (\$52,277) of these disbursements. NDN itemized the credit card company as the payee for these items. The credit card disbursements were for such items as meals, travel, hotels, subscriptions, transportation, internet service, and various other expenses.

Additionally, of the memo entries itemized, 13% (\$22,265) were not adequately disclosed because the payee's address was missing from the disclosure reports.

³ The provider of goods or services purchased by the credit card.

The Audit staff presented these matters to Counsel during the exit conference along with workpapers to show the credit card disbursements in question. Counsel made no comment.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that NDN submit amended reports for the applicable reporting periods to correct the itemization and disclosure errors. In response, NDN filed amended reports correcting the errors noted above.

Finding 3. Reporting of Debts and Obligations

The Audit staff identified debts and obligations totaling \$140,613 that were not reported on Schedules D (Debts and Obligations). The Audit staff recommended that NDN file amended reports disclosing these debts and obligations. In response, NDN filed amended reports disclosing the requested information.

Legal Standard

- A. **Continuous Reporting Required.** A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished. 2 U.S.C. §434(b)(8) and 11 CFR §§104.3(d) and 104.11(a).
- B. **Separate Schedules.** A political committee must file separate schedules for debts owed by the committee and debts owed to the committee, together with a statement explaining the circumstances and conditions under which each debt and obligation was incurred or extinguished. 11 CFR §104.11(a).
- C. **Itemizing Debts and Obligations.**
 - A debt of \$500 or less must be reported once it has been outstanding 60 days from the date incurred (the date of the transaction); the committee reports it on the next regularly scheduled report.
 - A debt exceeding \$500 must be disclosed in the report that covers the date on which the debt was incurred. 11 CFR §104.11(b).

Facts and Analysis

During a review of NDN's operating expenditures, the Audit staff identified credit card statements from Advanta MasterCard, American Express and Bank of America Visa totaling \$137,270 that were not reported as debts on Schedules D. NDN did not disclose any of the debt owed to Advanta MasterCard or American Express. NDN disclosed debt to Bank of America Visa for only four of the required reporting periods.

Additionally, \$3,343 was not reported as debt to an internet company.

The Audit staff discussed this matter with Counsel at the exit conference and provided them with a schedule of the items noted above. Counsel made no comment.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that NDN file amended reports, including Schedules D, reporting these debts and obligations. In response to the interim audit report, NDN correctly filed amended reports⁴ disclosing the debts and obligations noted.

Finding 4. Disclosure of Federal Activity Paid from Non-federal Accounts**Summary**

NDN made payments from its non-federal account totaling \$173,419 that appear to be for both allocable expenses and 100% federal expenses. Such payments are not permitted under the Commission's regulations. Nevertheless, such transactions should be disclosed, albeit in "Memo schedule" fashion, to complete the public record. The Audit staff recommended that NDN file memo Schedules H-4 and B to disclose the expenses. In response to the interim audit report, NDN disputed the Audit staff's analysis. They stated the expenses could be paid wholly from the non-federal account.

Legal Standard

Accounts for Federal and Non-federal Activity. A committee that finances political activity in connection with both federal and non-federal elections must establish two accounts (federal and non-federal) and allocate shared expenses--those that simultaneously support federal and non-federal election activity—between the two accounts. Alternatively, the committee may conduct both federal and non-federal activity from one bank account, considered a federal account. 11 CFR §102.5(a)(1)(i).

Federal vs. Non-federal Account. The federal account may contain only those funds that are permissible under the federal election law; the non-federal account may contain funds that are not permitted under the federal law (but are legal under state law), such as contributions that exceed the limits of the federal law and contributions from prohibited sources, such as corporations and labor organizations. 11 CFR §102.5(a)(1)(i) and (a)(3).

Reporting Allocable Expenses. A political committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report these kinds of disbursements on Schedule H-4 (Joint Federal/Non-federal Activity Schedule). 11 CFR §104.10(b)(4).

Facts and Analysis

NDN maintained several federal and non-federal bank accounts. They paid shared expenses from the federal accounts and transferred funds from the non-federal accounts to the federal accounts to cover the non-federal share of those expenses. The Audit staff reviewed disbursements from both the federal and non-federal accounts.

⁴ Due to outdated software, NDN was not able to file electronic Schedules B and D for calendar year 2001. NDN disclosed the required information on Form 99 (Miscellaneous Text).

The review of all payments from NDN's non-federal accounts identified disbursements totaling \$166,419 that appear to be for allocable expenses associated with a NDN event. NDN Counsel states that only non-federal funds were received for this event and the expenses were paid entirely from the non-federal account. Although the federal accounts did not receive funds as a result of this event, the following circumstances dictate that this event was a shared federal/non-federal event:

- The same event held in the prior year was reported as an allocable event on Schedules H-2 and H-4 and expenses were paid from the federal accounts.
- The solicitation for this event states it will “feature more than twenty Members of Congress; discussions on top issues facing policy makers in Washington; an overview of national politics with top Democratic strategists...”
- A speech was given by Senator Hillary Rodham Clinton.
- A panel was conducted discussing the NDN Candidates, which are both federal and non-federal.
- The federal account paid at least \$39,845 in allocable expenses relating to this event. Of this amount, \$39,804 was not reported. See Finding 1.

After applying the federal/non-federal administrative ratio (27%) for allocable expenses, the federal portion of expenditures relating to this event paid from the non-federal account is \$44,933. These expenditures should have been paid from the federal accounts and the non-federal portion reimbursed by the non-federal accounts. In order for the correct disclosure of these expenditures to be made without causing imbalances in NDN's accounting records, they may be reported as memo entries on Schedules H-4.

Although the non-federal account paid for these shared expenses, a repayment to the federal account is not required. The federal account paid a greater share of the overall allocable expenses than required.⁵

Also, the non-federal accounts paid disbursements for 100% federal activity totaling \$7,000. These expenses included:

- \$1,000 - Contribution to Rhode Island Democratic Party.
- \$2,500 - Contribution to South Carolina Democratic Party.
- \$2,500 - Contribution to the Democratic Congressional Campaign Committee.
- \$1,000 - Available documentation does not indicate the payee.

These contributions were reported on the recipient committee's federal disclosure reports and the NDN contribution check did not indicate it was from a non-federal account. Rather, the imprint on the NDN check stated “The New Democrat Network, FEC #C00319772.” The Audit staff requested documentation showing NDN's intent for these contributions to be deposited into the non-federal accounts of these committees. In response, Counsel stated that the political parties maintain both federal and non-federal accounts.

⁵ Pending the analysis of the information obtained as a result of the subpoenas, this conclusion may change.

A schedule detailing these expenditures was given to Counsel at the exit conference. Counsel did not comment.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that NDN demonstrate that the identified disbursements paid from non-federal accounts are not allocable or 100% federal expenses. Absent such a demonstration, NDN should have filed Schedules H-4 (Joint Federal/Non-federal Activity Schedule) and B (Itemized Disbursements) disclosing as memo entries the allocable expenditures paid from the non-federal accounts.

In response to the interim audit report, Counsel disputes the Audit staff's analysis of the non-federal disbursements noted above. Counsel states that the event was a fundraiser and as with similar past events, the costs were allocated on a funds received basis. The funds received at this event were deposited into the non-federal account only, thus Counsel asserts costs paid entirely with non-federal funds were permissible because the federal account did not receive any funds. Additionally, he states that the expenses associated with this event were not administrative expenses such as rent, utilities, office supplies, and salaries per 11 C.F.R. 106.6(b)(2)(i). Further, Counsel contends that any costs paid by the federal account above the minimum amount is permissive, rather mandated.

Additionally, Counsel states "[the] activities at the event - remarks by Senator Hillary Rodham Clinton, who was then out-of-cycle, panel discussions on various issues; meals and social events were in character with other fundraising events held by NDN, and by other major political organizations at the time." Also, because members of Congress and federal candidates attended the event, Counsel considers this allowable because it was prior to the Bipartisan Campaign Reform Act (BCRA), when federal office holders could raise funds in connection with non-federal elections.

The \$166,419 in expenses for this event does fall into the general category of administrative expenses and therefore are subject to the requirements of the Act. As explained above, the event had federal as well as non-federal components. The fact that funds received from this event were deposited only into the non-federal account is irrelevant when determining whether a disbursement is allocable. The funds received appear to represent fees to gain access to the different federal/non-federal receptions, discussions, panels and NDN membership, rather than contributions to solely support non-federal activity. Although the activities may be aligned with other fundraising events, it does not lessen the fact that the activities benefited both federal and non-federal elections. Furthermore, Counsel does not dispute the fact that this event had a federal component, rather that this was allowable because it occurred prior to BCRA. Counsel correctly states that federal officeholders could solicit funds for non-federal purposes prior to BCRA, but that does not mean that an event that has a federal component is not required to allocate expenses between the federal and non-federal accounts.

With respect to the contributions made to the Rhode Island Democratic Party, the South Carolina Democratic Party and the Democratic Congressional Campaign, Counsel states that "the information available to the Committee lead it to conclude that the donations

were intended as nonfederal donations, but because of an administrative error, were made under circumstances that led the recipients to believe that the donations could be deposited in a federal account.” Furthermore, Counsel states that these contributions were made at the end of the 2002 cycle when they were making non-federal contributions and these contributions were disclosed on reports filed with the Internal Revenue Service (IRS).

These explanations do not demonstrate that these contributions were intended for the non-federal accounts. Counsel fails to explain the details of the ‘administrative error’ that caused the recipient committees to believe that these contributions could be deposited into the federal account. Also, NDN made both federal and non-federal contributions at the end of the 2002 cycle. Finally, other disbursements paid from the federal account were also disclosed on IRS reports.

Counsel did not address the \$1,000 check to the unknown payee.