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May 21, 2007

AGENDA ITEM

For Meeting of: 05-31-07

MEMORANDUM

TO: The Commissioners

THROUGH: Patrina M. Clark *one*
Staff Director

Margarita Maisonet *nm*
Chief Compliance Officer

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

Thomas J. Nurthen *TJN*
Audit Manager

Mary E. Moss *MEM*
Lead Auditor

SUBJECT: Final Audit Report – Kerry-Edwards 2004, Inc. and Kerry-Edwards 2004 Inc.
General Election Legal and Accounting Compliance Fund

Attached for your approval is the subject audit report. Also attached is the legal analysis provided by the Office of General Counsel, dated May 17, 2007. With respect to the matters addressed in the Report, the Audit Division and the Counsel's office are in agreement. Counsel's recommended changes have been made.

Please note that two matters discussed in the Findings and Recommendations section of the Preliminary Audit Report (Non-Qualified Campaign Expense – Candidate Biographical Film and Receipt of Impermissible Contribution/Loans) have been moved to the Additional Issues section of this report. Previously, they were Audit Findings 6 and 7 and are now Additional Issues 4 and 5. The move was made since the Commission did not approve the staff's recommendations.

Recommendation

The Audit staff recommends that the report be placed on the Open Session agenda for May 31, 2007. If you have any questions, please contact Mary Moss or Tom Nurthen at extension 1200.

Attachments:

Report of the Audit Division on Kerry-Edwards 2004, Inc. and Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund

OGC's Legal Analysis, dated May 17, 2007



Report of the Audit Division on the Kerry-Edwards 2004, Inc. and the Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund

February 18, 2003 – December 31, 2004

Why the Audits Were Done

Federal law requires the Commission to audit every political committee established by a Presidential candidate who receives general funds for the general campaign.¹ The audits determine whether the candidate was entitled to all of the general funds received, whether the campaign used the general funds in accordance with the law and whether the campaign otherwise complied with the limitations, prohibitions, and disclosure requirements of the election law.

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 Campaign

Kerry-Edwards 2004, Inc. (General Committee) is the principal campaign committee for Senator John F. Kerry, the Democratic Party's nominee for the office of President of the United States. The Committee is headquartered in Washington, DC. For more information, see chart on the Campaign Organization, p 2.

Financial Activity (p. 3)

Receipts

• Federal Funds Received	\$ 74,620,000
• Offsets to Operating Expenditures	10,676,685
• Loans Received	2,561,925
Total Receipts	\$ 87,858,610

Disbursements

• Operating Expenditures	\$ 86,541,761
• Loan Repayment	500,000
Total Disbursements	\$ 87,041,761

Findings and Recommendations (p. 4)

- Interest Earned (Finding 1)
- Expenditure Limitation (Finding 2)
- Undocumented Media Disbursements (Finding 3)
- Failure to Disclose Outstanding Debts (Finding 4)
- Stale-dated Checks – General Committee (Finding 5)

Additional Issues (p. 32)

- In-Kind Contributions – Democratic National Committee Hybrid Ads (Issue 1)
- Sale of an E-mail Address List (Issue 2)
- Interest Earned (Issue 3)
- Non-Qualified Campaign Expense – Candidate Biographical Film (Issue 4)
- Receipt of Impermissible Contribution/Loans (Issue 5)

¹ 26 U.S.C. §9007(a)

About the Compliance Fund

Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund (Compliance Fund) was established pursuant to 11 CFR. §9003.3(a)(1)(i). Contributions to the Compliance Fund shall be used to defray the cost of legal and accounting services provided solely to ensure compliance with the Federal Election Campaign Act (Act). Contributions may also be used to defray other expenditures as defined at 11 CFR §9003.3(a)(2)(i). The Compliance Fund is also headquartered in Washington, DC. For more information, see chart on the Campaign Organization, p 2.

Financial Activity (p. 3)

Receipts

• Individual Contributions	\$ 8,571,621
• From Authorized Committees	2,372,066
• Offsets to Operating Expenditures	483,857
• Other Receipts	500,000
Total Receipts	\$11,927,544

Disbursements

• Operating Expenditures	\$ 3,465,611
• All Other Disbursements	2,842,734
Total Disbursements	\$ 6,308,345

Findings and Recommendations (p. 6)

- Receipt of Impermissible Contributions (Finding 1)
- Stale-dated Checks – Compliance Fund (Finding 2)

**Report of the Audit Division on
the Kerry-Edwards 2004, Inc. and
the Kerry-Edwards 2004 Inc.
General Election Legal and
Accounting Compliance Fund**

February 18, 2003 – December 31, 2004

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Part I

Background

Authority for the Audits

This report is based on audits of Kerry-Edwards 2004, Inc. and Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund undertaken by the Audit Division of the Federal Election Commission (the Commission) as mandated by Section 9007(a) of Title 26 of the United States Code. That section states that in the case of publicly financed campaigns, “after each presidential election, the Commission shall conduct a thorough examination and audit of the qualified campaign expenses of the candidates of each political party for President and Vice President.” Also, Section 9009(b) of Title 26 of the United States Code states, in part, that the Commission may conduct other examinations and audits as it deems necessary.

Scope of the Audits

These audits examined:

1. The receipt of excessive contributions and loans.
2. The receipt of contributions from prohibited sources.
3. The receipt of transfers from other authorized committees.
4. The disclosure of contributions and transfers received.
5. The disclosure of disbursements.
6. The disclosure of debts and obligations.
7. The recordkeeping process and completeness of records.
8. The consistency between reported figures and bank records.
9. The accuracy of the Statement of Net Outstanding Qualified Campaign Expenses
10. The campaigns compliance with spending limitations.
11. Other campaign operations necessary to the review.

Inventory of Campaign Records

The Audit staff routinely conducts an inventory of campaign records before it begins the audit fieldwork. The committees’ records were materially complete and the fieldwork began immediately.

Part II

Overview of Campaign Campaign Organization

	General Committee	Compliance Fund
Important Dates		
• Date of Registration	07/30/2004	02/20/2003
• Audit Coverage Dates	07/28/2004 thru 12/31/2004	02/18/2003 thru 12/31/2004
Headquarters	Washington, DC	Washington, DC
Bank Information		
• Bank Depositories	1	1
• Bank Accounts	6 Checking Accounts	1 Checking Account
Treasurer	Robert Farmer 07/29/2004 – 07/21/2005 David Thorne 07/22/2005 - Present	Matthew Butler 02/20/2003 – 05/19/2004 Peter D. Nichols 05/20/2004 – 07/21/2005 David Thorne 07/22/2005 – Present

Overview of Financial Activity (Audited Amounts)

	General Committee	Compliance Committee
Opening Cash on Hand	\$ 0	\$ 0
Receipts		
• Contributions	\$ 0	\$ 8,571,621
• General Funds	74,620,000	0
• Transfers from Other Authorized Committees	0	2,372,066
• Offsets	10,676,685	483,857
• Loan Received	2,561,925	0
• Other Receipts	0	500,000
• Total Receipts	\$ 87,858,610	\$ 11,927,544
Disbursements		
• Operating Expenses	\$ 86,541,761	\$ 3,465,611
• Loan Repayments Made	500,000	0
• Refunds to Contributors	0.00	280,707
• Other Disbursements	0.00	2,562,027
• Total Disbursements	\$ 87,041,761	\$ 6,308,345
Closing Cash Balance @12/31/2004	\$ 816,849	\$ 5,619,199

Part III

Summaries

Findings and Recommendations – General Committee

Finding 1. Interest Earned

The General Committee's media vendor, Riverfront Media SMLLC (Riverfront), invested public funds on behalf of the General Committee and earned interest on these investments totaling \$41,277. It appears that the interest earned was used to pay for media buys and/or to offset amounts owed to Riverfront. The Audit staff recommended that the General Committee provide evidence to demonstrate that either no interest or a lesser amount of interest was earned on public funds; and, what federal, state and local taxes were paid by the General Committee, if any, or that the General Committee did not benefit from the interest earned. In response to the recommendation, the General Committee contends that it did not benefit from any interest earned. It is further stated that if it is determined that interest was earned; the correct amount was \$6,632, not \$41,277. The General Committee also provided an affidavit from Mr. Brad Perseke, Partner and Media Director of Riverfront.

The General Committee did not demonstrate that the amount of interest calculated was incorrect or that the interest was not used to pay for media buys and/or offset amounts owed to Riverfront. Therefore, the Audit staff recommends that the Commission make a determination that \$41,277 is repayable to the United States Treasury. (For more detail, see p. 8)

Finding 2. Expenditure Limitation

The expenditure limitation for the 2004 general election for the office of the President of the United States was \$74,620,000. The Audit staff's review of financial activity through September 30, 2005 indicated that the General Committee incurred expenditures totaling \$76,005,359 or \$1,385,359² in excess of the limitation. In response to the preliminary audit report, the General Committee addressed several issues concerning adjustments made by the Audit staff. Where appropriate, the Audit staff has made the necessary

² As discussed in Part V, below, some Commissioners are of the opinion that the 50% allocation of the cost of hybrid ads between the DNC and the General Committee was not in compliance with the Act and Commission regulations and that, therefore, the General Committee should have paid more than 50% of these costs. Approval of this FAR does not reflect approval by those Commissioners of a 50% allocation. The Audit Staff notes that, had the Commission taken action on the issues raised in Part V, such action would have resulted in an adjustment of the expenditure limit calculations, and therefore, a finding of increased expenditures over allowable limits. Some Commissioners considered the 50% allocation to be in accord with past precedent and relevant Commission regulations, so there was no adjustment required to the amount applied to the expenditure limits applicable to the General Committee.

adjustments. However, the General Committee's spending still remains over the limitation. Therefore, the Audit staff recommends that the Commission make a determination that \$1,344,082 (\$1,385,359 - \$41,277 [see Finding 1 for the repayment of this amount]) is repayable to the United States Treasury. (For more detail, see p. 11)

Finding 3. Undocumented Media Disbursements

The General Committee did not maintain station affidavits for media buys totaling \$893,432. In response to the preliminary audit report, the General Committee provided additional documentation that materially completed the media records. (For more detail, see p. 27)

Finding 4. Failure to Disclose Outstanding Debts

The General Committee did not correctly disclose 361 debts totaling \$1,590,248 on Schedule D. In response to the preliminary audit report, the General Committee, while continuing to contend that it is not required, agreed to, but has not filed, the necessary amended disclosure reports. Therefore, the General Committee has not complied with the recommendation. (For more detail, see p. 28)

Finding 5. Stale-dated Checks – General Committee

The Audit staff identified 104 stale-dated checks totaling \$50,334. The Audit staff recommended that the General Committee provide evidence that the checks were not outstanding or make a payment to the United States Treasury. The General Committee contends that stale-dated checks equal \$39,331 but has neither provided any support for that figure or made a payment to the U.S. Treasury. (For more detail, see p. 30)

Additional Issues – General Committee

Issue 1. In-Kind Contributions – Democratic National Committee Hybrid Ads

See page 31 for a discussion of this issue.

Issue 2. Sale of an E-mail Address List

The General Committee sold a database of e-mail addresses to Friends of John Kerry, Inc. (Senate 08), Senator Kerry's authorized committee for his 2008 Senate re-election campaign for \$2,000,000. The database was made up of approximately 1,000,000 names along with other information, including e-mail addresses and often postal addresses, as a result of individuals "opting in" to the campaign website. The Commission discussed whether the General Committee received a contribution or income from this sale. After considering the available information, the Commission could not reach consensus on this issue. (For more detail, see p. 32)

Issue 3. Interest Earned

The General Committee's media firm used funds transferred to it for media buys, to make loans to its parent company. Interest earned of \$159,446 was calculated but never paid to

the General Committee. After a discussion of this issue, no repayment was required. (For more detail, see p. 33)

Issue 4. Non-Qualified Campaign Expense – Candidate Biographical Film

The cost of a biographical film (\$207,000), produced for use at the Democratic National Convention, was split between the Democratic National Campaign Committee (DNCC), the DNC and the General Committee. The Commission considered whether the allocation percentages used by the three committees were reasonable. After considering the available information the Commission concluded that the cost of the film had been reasonably allocated. (For more detail, see p. 34)

Issue 5. Receipt of Impermissible Contribution/Loans

The Audit staff concluded that the General Committee received a contribution from the Primary Committee (\$555,598) and received two loans from the Compliance Fund (\$1,216,262) that were not permissible. The contribution from the Primary Committee resulted from primary assets being made available for use by the General Committee without prompt or full payment. The loans from the Compliance Fund were relative to press (\$250,000) and United States Secret Service (\$966,262) travel reimbursements. The Commission voted to receive this finding, without any determination on the merits of the analysis, or the facts, or interpretation of the law contained therein. (For more detail, see p. 35)

Findings and Recommendations – Compliance Fund

Finding 1. Receipt of Impermissible Contributions

The Compliance Fund failed to provide evidence that 160 excessive contributions received by the Primary Committee, totaling \$177,556, were properly redesignated to the Compliance Fund. In response to the recommendation, the Compliance Fund provided copies of presumptive redesignation letters sent to the contributors whose excessive contributions totaled \$167,006. With respect to the remaining excessive contributors, the Compliance Fund notes that it is unable to locate the contributors. Therefore, \$10,550 is payable to the U.S. Treasury. (For more detail, see p. 38)

Finding 2. Stale-dated Checks – Compliance Fund

The Audit staff identified 14 stale-dated checks totaling \$14,800. In response to the preliminary audit report, the Compliance Fund provided additional information for some of the checks and made a payment to the U.S. Treasury in the amount of \$13,800. These actions materially complied with the recommendation. (For more detail, see p. 39)

Summary of Amounts Owed to the U.S. Treasury

Finding 1.	Interest Income	41,277
Finding 2.	Expenditure Limitation	1,344,082
Finding 5.	Stale-dated checks – General Committee	50,334
	Total due United States Treasury – General Committee:	\$1,435,693
Finding 1.	Receipt of Impermissible Contributions	10,550
Finding 2.	Stale-dated checks – Compliance Fund	13,800
	Total due United States Treasury – Compliance Fund:	\$24,350

Part IV

Findings and Recommendations – General Committee

Finding 1. Interest Earned

Summary

The General Committee's media vendor, Riverfront Media SMLLC (Riverfront), invested public funds on behalf of the General Committee and earned interest on these investments totaling \$41,277. It appears that the interest earned was used to pay for media buys and/or to offset amounts owed to Riverfront. The Audit staff recommended that the General Committee provide evidence to demonstrate that either no interest or a lesser amount of interest was earned on public funds; and, what federal, state and local taxes were paid by the General Committee, if any, or that the General Committee did not benefit from the interest earned. In response to the recommendation, the General Committee contends that it did not benefit from any interest earned. It is further stated that if it is determined that interest was earned; the correct amount was \$6,632, not \$41,277. The General Committee also provided an affidavit from Mr. Brad Perseke, Partner and Media Director of Riverfront.

The General Committee did not demonstrate that the amount of interest calculated was incorrect or that the interest was not used to pay for media buys and/or offset amounts owed to Riverfront. Therefore, the Audit staff recommends that the Commission make a determination that \$41,277 is repayable to the United States Treasury.

Legal Standard

Investment of Public Funds - Other Uses Resulting in Income. Investment of public funds or any other use of public funds that results in income is permissible, provided that an amount equal to all net income derived from such a use, less Federal, State and local taxes paid on such income, shall be paid to the United States Treasury. 11 CFR §§9004.5 and 9007.2(b)(4).

Facts and Analysis

During a review of media activity, the Audit staff requested that the General Committee provide bank statements that supported media buy transactions performed by Riverfront. Riverfront provided statements for three accounts. These accounts all identified Riverfront as the account holder. The accounts were used to purchase media for both the General Committee and the DNC.

One of these accounts had posted to its statements interest of \$61,607. Since Riverfront commingled General Committee funds with DNC funds it is not possible to determine the

ownership of the funds that earned interest.³ Therefore, the Audit staff allocated interest earned based on the ratio of funds provided by the General Committee and the DNC. The amounts transferred to the account by the General Committee and the DNC were reduced by the amount of commissions earned. General Committee funds, net of commissions earned, totaled \$43,576,252 (of a total of \$64,619,743), or 67%. Applying this percentage to the total interest earned, the Audit staff calculated that \$41,277 (\$61,607 x 67%) in interest was earned on General Committee funds. Funds in this account, including interest earned, were used to cover checks issued for media buys. As a result, the General Committee received interest income in the form of additional disbursements by the media company.

This matter was discussed in several meetings with representatives of both the General Committee and Riverfront. During those meetings General Committee representatives maintained that they had no knowledge of any interest being earned on funds maintained in the Riverfront account.

Subsequent to the exit conference, General Committee representatives stated that to treat interest earned by the media vendor as interest earned by the General Committee requires one to assert that either Riverfront paid the interest to the General Committee or that Riverfront's bank accounts were actually the General Committee's bank accounts.

The General Committee continued by stating that the first assertion is incorrect because Riverfront did not make any interest payment to it. Further, the second assertion is incorrect as a matter of fact and law. The General Committee stated Riverfront is a separate, independent legal entity. It conducted all of its dealings with the General Committee on an arms' length basis as a vendor. It provided services not simply to the General Committee but to the DNC as well; and is a subsidiary of GMMB, a premier Democratic media firm with a myriad of other clients. After the General Committee paid funds to Riverfront for services to be rendered, it had no legal right to access those funds.

Finally, the General Committee stated that the Commission dealt with a virtually identical situation in a 1984 campaign, finding that a publicly funded presidential campaign and its specially formed media vendor were separate entities (Advisory Opinion 1983-25). Asked to review the relationship between Mondale for President, Inc. and the Consultants '84, a corporation formed by two principals who had previously provided consulting services in their individual capacities to the campaign, the Commission concluded that the firm had "a legal existence that is separate and distinct from the operations of the Committee," and did not require the Committee to report the payments made by the firm to sub-vendors on the Committee's behalf.

In the preliminary audit report the Audit staff concluded that interest earned on public funds by Riverfront was repayable to the United States Treasury. This potential

³ These same accounts were used to pay the Primary Committee's media expenses, and on occasion there were primary funds in the account. The exact amounts were difficult to determine, however, they are not believed to have been significant during the general election period.

repayment existed because the funds were actually used for campaign purposes and, therefore, triggered the regulation involving receipt of income.

Preliminary Audit Report Recommendation

The Audit staff recommended that the General Committee provide evidence that demonstrated either no interest or that a lesser amount of interest was earned on public funds; and, what federal, state and local taxes were paid by the General Committee, if any; or that the General committee did not benefit from the interest earned. Absent such evidence, the Audit staff would recommend that the interest income of \$41,277, less applicable taxes paid by the General Committee is repayable to the United States Treasury.

Committee Response to Recommendation and Audit Staff's Assessment

In response to the recommendation, the General Committee stated the sworn facts are that the Committee was unaware of the interest being earned and that it was not taken into account by either party during the negotiation of fees, or used for the Committee's benefit. The General Committee further stated that the Audit staff acknowledged that they could not point to any particular invoice or expense paid for by the interest and even if the General Committee somehow "received" the interest at issue – which it did not – the information that Riverfront provided in response to this audit shows that the proper interest calculation is \$6,632, not \$41,277.

The General Committee provided an affidavit from Mr. Brad Perseke, Partner and Media Director of Riverfront. Mr. Perseke stated as is industry practice, all monies housed in Riverfront Media's bank account were subject to earning interest and being assessed bank fees. He went on to relate that due to campaign and media timelines, the vast majority of all monies received (net dollars for vendors) were immediately paid back out of media outlets. Interest was earned primarily on Riverfront's media commissions. Finally, Mr. Perseke related the interest earned by Riverfront Media did not affect the financial terms offered to the General Committee.

The Audit staff accepts that the General Committee had no knowledge that interest was being earned. Further, it is fact that no interest payments were paid **directly** to the General Committee by Riverfront. However, the Audit staff disagrees with the interest calculation provided by Riverfront and that the interest was not used to offset General Committee expenses. Riverfront's calculation is based on the period between when funds were received from the General Committee and DNC, and checks were issued to various media outlets. The proper calculation, and the common practice among banking entities, is the period between when funds were received and checks cleared the account. Using this methodology and the exhibit provided by Riverfront, interest in the amount of \$61,607 was credited to the Omnicom Capital Inc. – Statement of Account.

Finally, it is interesting that the General Committee noted that the Audit staff could not point to any particular invoice or expense paid by the interest. Later in its response the General Committee notes:

“It is true that to create a perfect match between individual Riverfront Media invoices and particular media buys would require a massive, time-consuming and laborious undertaking to integrate the Committee’s media buy spreadsheet and Riverfront Media’s Campaign Master Spreadsheet”

On the Omnicom Capital Inc. - Statements of Account, the interest is credited as earned, along with payments from the General Committee and the DNC. Likewise, charges for media buys and commissions are posted as they occurred and a running balance maintained. Interest payments are treated the same as any other amount credited to the account.

Payments for media buys were made by checks issued from the JP Morgan Chase, Chase Manhattan Bank USA (Chase) bank account. As these checks cleared this account on a daily basis, an equal amount was debited against General Committee funds represented in its Omnicom account to cover the checks. As a result, it is likely that the interest earned at some point was used to pay for General Committee media buys. Further, the Audit staff has determined that the General Committee owes Riverfront in excess of \$900,000. Even if the interest was not used to pay for media buys it remains part of the balance posted to the Omnicom account; as such, these funds would be used to pay a portion of the amount owed Riverfront.

The General Committee did not demonstrate that the amount of interest calculated was incorrect or that the interest was not used to pay for media buys and/or offset amounts owed to Riverfront. It remains the Audit staff’s opinion that the General Committee’s share of the interest earned (\$41,277) on public funds is repayable to the United States Treasury.

Recommendation

The Audit staff recommends that the Commission make a determination that the interest earned on public funds (\$41,277) is repayable to the United States Treasury.

Finding 2. Expenditure Limitation

Summary

The expenditure limitation for the 2004 general election for the office of the President of the United States was \$74,620,000. The Audit staff’s review of financial activity through September 30, 2005 indicated that the General Committee incurred expenditures totaling \$76,005,359 or \$1,385,359 excess of the limitation. In response to the preliminary audit report, the General Committee addressed several issues concerning adjustments made by the Audit staff. Where appropriate, the Audit staff has made the necessary adjustments. However, the General Committee’s spending still remains over the limitation. Therefore, the Audit staff recommends that the Commission make a determination that \$1,344,082 (\$1,385,359 - \$41,277 [see Finding 1 for the repayment of this amount]) is repayable to the United States Treasury.

Legal Standard

Expenditure Limitation. No candidate for the office of President of the United States, eligible under 26 U.S.C. 9003 to receive payments from the Secretary of the Treasury may make expenditures in excess of \$20,000,000 as adjusted for the increases in the Consumer Price Index. 2 U.S.C. §441a(b)(1)(B) and (c).

The expenditure limitation for the 2004 general election for publicly funded candidates for the office of President of the United States was \$74,620,000.

Attribution of Expenditures. General Rule – Any expenditure for goods and services that are used for the primary election campaign, other than those listed in paragraphs (e)(2) through (e)(7) of this section, shall be attributed to the primary election. Any expenditure for goods and services that are used for the general election campaign, other than those listed in paragraphs (e)(2) through (e)(7) of this section, shall be attributed to the general election. 11 CFR §9034.4(e)(1).

Attribution of Travel Costs. Expenditures for campaign-related transportation, food, and lodging by any individual, including a candidate, shall be attributed according to when the travel occurs. If the travel occurs on or before the date of the candidate's nomination, the cost is a primary election expense. Travel to and from the conventions shall be attributed to the primary election. Travel by a person who is working exclusively on general election campaign preparations shall be considered a general election expense even if the travel occurs before the candidate's nomination. 11 CFR §9034.4(e)(7).

Repayments. If the Commission determines that eligible candidates of a political party and their authorized committees incurred qualified campaign expenses in excess of the aggregate payments to which the candidates were entitled, it shall notify such candidates of the amount of such excess and such candidates shall pay to the United States Treasury an amount equal to such an amount. 26 U.S.C. §9007(b)(2).

Net Outstanding Qualified Campaign Expenses (NOQCE). Within 30 days after the end of the expenditure reporting period, the candidate must submit a statement of net outstanding qualified campaign expenses. The statement must contain:

- The total of all committee assets including cash on hand, amounts owed to the committee and capital assets listed at their fair market value;
- The total of all outstanding obligations for qualified campaign expenses; and
- An estimate of necessary winding-down costs. 11 CFR §9004.9(a)(1) and (b).

Expenditure Report Period. In the case of a major party, the expenditure report period begins on the earlier of September 1 before the election or the date on which the major party's nominee is chosen. The period ends 30 days after the Presidential election. 11 CFR §9002.12(a). For Senator John F. Kerry the expenditure report period ran from July 30, 2004 to December 2, 2004.

Generally Accepted Accounting Principles (GAAP)

Fixed Assets – Initial Acquisition Cost. Costs that are capitalized upon acquisition are any reasonable cost involved in bringing the asset to the buyer and incurred prior to using the asset. Examples include sales taxes, finders' fees, freight costs, installation costs, and setup costs. Barry J. Epstein, Ralph Nach, Steven M. Bragg, Wiley GAAP 2007 Interpretation and Application of Generally Accepted Accounting Principles. Hoboken, NJ: John Wiley & Sons, Inc., 2006, p. 376.

Facts and Analysis

The General Committee received \$74,620,000 to finance its election activity. In the preliminary audit report, the Audit staff concluded that the General Committee exceeded the limitation by \$1,632,442. Each adjustment is discussed below; followed by the General Committee's response to the preliminary audit report and the Audit staff's assessment of the response. A revised limitation calculation follows the discussion.

Explanation of Audit Adjustments to Reported Amounts

The General Committee reported expenditures subject to Limitation at June 30, 2005 of \$74,788,665.

Excess Compliance Fund Reimbursement for Shared Overhead – The Audit staff increased the reported amount by \$36,950. The General Committee agrees that the reported amount should be increased by \$19,656 (rent \$18,956 and computer expenses of \$700) but disagrees with the remaining adjustment of \$17,294. The General Committee believes that the Commission's Compliance Manual allows computer expenses associated with the accounting office to be allocated 85% compliance and 15% operating. The Audit staff disagrees. The Compliance Manual states that a committee may allocate 85% of payroll, payroll taxes, overhead, and other costs which relate to the operations of the accounting office and 50% of computer expense as exempt compliance. Therefore, the Audit staff is of the opinion that computer expenses associated with the accounting office should be allocated on a 50/50 basis. Further, to be consistent with the General Committee's theory, the remaining computer expenses would follow the allocation for salary and overhead expenses for non-accounting office charges. That allocation would be 5%. The consistent application of this allocation method would be to the General Committee's detriment.

No adjustment is warranted.

Secret Service Travel - The General Committee charged to the expenditure limitation payments it made for transportation for members of the United States Secret Service (\$2,285,385). The General Committee also reduced the expenditure limitation for reimbursements it received (\$1,652,834). The unreimbursed amount as of June 30, 2005 was \$632,551. This amount is exempt from the limitation. A portion of the amount was subsequently reimbursed by the United States Secret Service. Any remaining amount will be reimbursed by the Compliance Fund.

The General Committee stated that the unreimbursed amount as of June 30, 2005 was \$644,441, which would require an additional adjustment of \$11,890. The General Committee further stated that it provided comprehensive documentation for its United States Secret Service reimbursement calculations during the course of the audit, and the preliminary audit report presents no analysis or explanation to dispute those figures. The General Committee further states that it received additional information about these figures from the Audit staff on December 22, 2006, the deadline for the response and that it did not have a chance to incorporate that information into the response.

During the course of the audit, the General Committee was provided the Audit staff's calculation of the amount paid for transportation for the United States Secret Service (\$2,285,385). At that time, the General Committee believed the amount charged was \$2,287,093, a difference of \$1,708. The General Committee was asked to provide documentation to support its calculation; it did not. The General Committee has also not provided any documentation in response to support their current calculation.

At the General Committee's request, a meeting was scheduled in November 2006 in order to discuss the open matters addressed in the preliminary audit report. The General Committee did not question this matter at that meeting. Further, it was not until December 19, 2006, that the General Committee requested documentation supporting the Audit staff's calculation.

Since, the General Committee has not provided documentation in support of either of its calculations, no adjustment is warranted.

Explanation of Other Audit Adjustments

Due to the Primary Committee – In the preliminary audit report, the Audit staff determined that the Primary Committee paid \$1,310,394 to vendors for general election expenditures. Of this amount, \$1,277,186 related to the reconfiguration and other costs for both Senators Kerry and Edwards' aircraft. The remaining \$33,208 related to media production costs for ads that aired in the general election period (\$5,395) and additional costs⁴ reimbursed by the General Committee (\$27,813).

Reconfiguration and Lease Costs

Boeing 757

The Primary Committee leased a Boeing 757 for Senator Kerry for the period April 2, 2004 through November 2, 2004, a period of 7 months. The aircraft interior was reconfigured to accommodate the campaign's needs and the exterior was marked to identify it as the campaign's aircraft.

- **Sale of Reconfiguration Assets** – The Primary Committee paid \$925,997 to reconfigure this aircraft to suit its needs. The cost of the reconfiguration includes

⁴ Represents additional capital assets purchased by the General Committee (from the Primary Committee) and chargeable to the limitation.

\$679,237 for material and equipment with the remainder being the labor necessary to assemble that material and equipment into a useful aircraft configuration. The lease agreement required the General Committee to restore the aircraft to its original configuration. A subsequent agreement between the General Committee and the plane's owner stated that in lieu of paying this cost, the plane's owner would purchase the hard assets⁵ (assets) used in the original reconfiguration from the General Committee.

The General Committee received \$60,000 from the sale of these assets.⁶ However, the assets were originally purchased by the Primary Committee. The General Committee determined that the assets had a value of \$260,798. Therefore, the General Committee disclosed this amount as a debt owed to the Primary Committee. On September 29, 2005, the General Committee paid the Primary Committee \$260,798.

The Audit staff disagreed with the General Committee's valuation of the assets for the following reasons:

- While all assets were sold to the plane's owner, the General Committee did not include all assets in its valuation.
- The General Committee reduced the original cost of each asset by 25%⁷ before applying the standard capital asset depreciation rate of 40%.
- The General Committee did not include the cost of labor that the Primary Committee paid to have the assets assembled into a useful aircraft configuration.

The original reconfiguration of the aircraft cost the Primary Committee, including labor, \$925,997. That is the cost of the asset that was sold to the General Committee. Without the labor required to assemble materials and equipment into a configured aircraft, the General Committee would have had to incur the cost to assemble a collection of material and equipment into a usable asset. That was done by the Primary Committee. The purpose of depreciation is to allocate a portion of an asset's costs over the estimated useful life of the asset in a systematic and rational manner. Excluding a portion of the cost of an asset defeats the purpose of the depreciation and fails to match the use of the asset with the cost of the asset. The General Committee should have paid the Primary Committee 60% of its cost or \$555,598. Instead, the General Committee paid \$260,798, a difference of \$294,800.

⁵ Hard asset is a term used in the lease agreement.

⁶ In addition the General Committee was relieved of an obligation to have the Boeing 757 returned to its original state, and to pay a \$10,000 per day for each day the aircraft was not available to the owner.

⁷ General Committee representative stated that included in the purchase price of material and equipment used in the configuration was a manufacturer's built-in engineering cost of 25%.

The General Committee representatives stated that there is no legal basis for the auditors' calculation of the purchase price beyond what was calculated by the General Committee. The General Committee representatives do not believe the 25% engineering costs should be included in the asset, nor do they believe that the cost of labor should be included.

The Audit staff disagreed with the General Committee's 25% reduction for engineering costs. The value of any asset includes not only parts and materials, but labor and any expenditures necessary to place the asset in "a ready for use" condition. It should be noted that when the General Committee purchased other capital assets from the Primary Committee it did not reduce the cost of these assets by 25% prior to applying the allowable depreciation. The purchase of these assets should not be treated differently. With respect to the cost of labor involved in reconfiguring the aircraft, the Audit staff's position is supported by the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment), which is just one of many non-exclusive examples of this accounting principle that can be found in many other sources. Within its discussion of Asset Recognition, it states, all general property, plant and equipment (PP&E) shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring PP&E may include, among others, amounts paid to vendors; labor and other direct or indirect production costs (for assets produced or constructed); and, engineering, architectural and other outside services for designs, plans, specification, and surveys.

It was the Audit staff's position that the General Committee should have paid \$555,598 ($\$925,997 \times 60\%$) to the Primary Committee for the reconfiguration of the aircraft.⁸

The General Committee objected to the Audit staff's reliance on the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Standard No. 6) as justification for including the cost of labor and engineering to the cost of an asset. In response to the preliminary audit report, the General Committee stated:

"As the audit approaches its third year, the Committee observes that the Audit staff's decision after the completion of field work to introduce the complexities of Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment), discussed below, has only prolonged this process – in furtherance of no regulatory mandate or even any discernible policy goal. To the contrary, if the Commission adopts this novel approach, it will

⁸ Treatment of the reconfiguration as an asset by the General Committee was considered reasonable in this situation and is consistent with the treatment of assets relative to the Boeing 727 aircraft.

be opening a Pandora's box of future regulatory uncertainty that will inevitably yield a long line of matters that center on the proper calculation of capital assets.”

The General Committee considered the Audit staff's use of Standard No. 6 as inappropriate because it did not explicitly apply to the General Committee or its assets. Further, the General Committee stated additional costs should have also been included if Standard No. 6 was applied which would cause “widespread complexity and uncertainty” to the capital asset valuation process. Finally, it was the General Committee's opinion that including labor and engineering costs in the definition of capital assets would require new rulemaking under 11 CFR § 112.4(e), and ultimately revisions to 11 CFR § 9003.5(d) before they could be applied. The General Committee stated by “explicitly adopting the 60% valuation rule in 11 CFR §9004.9(d), the Commission moved away from the time-consuming inquiries into the useful life of assets that could tie up Commission resources for years. It further stated:

“In accordance with 11 C.F.R. § 9004.9(d)(1), the Committee determined the purchase price of the property owned by the primary committee that was subsequently transferred to the Committee, and treated those assets with purchase prices above the \$2000 threshold set forth in 11 C.F.R. §§ 9003.5(d) and 9004.9(d)(1) as ‘capital assets.’ Because the definition of capital asset refers to ‘property’ and gives common examples of property that might be owned by a committee, the Committee did not believe that labor or engineering costs associated with leased equipment belonged in the category of property owned by the primary committee. Indeed, neither the Commission's regulations and related Explanation and Justification, nor any Commission precedent on the public record, define the ‘property’ which a candidate committee owns as a ‘capital asset’ to include labor and engineering.”

As previously stated, the Audit staff disagrees with the General Committee's valuation of the assets for the following reasons:

- While all assets were sold to the plane's owner, the General Committee did not include all assets in its valuation.
- The General Committee reduced the original cost of each asset by 25% before applying the standard capital asset depreciation rate of 40%.
- The General Committee did not include the cost of labor that the Primary Committee paid to have the assets assembled into a useful aircraft configuration.

Reduction for Engineering Cost 25% - This reduction was applied only to the assets used during the reconfiguration of the Boeing 757. However, the General Committee did not apply this reduction to other assets it purchased from the

Primary Committee. The General Committee paid the Primary Committee \$256,282 for other capital assets. The original cost to the Primary Committee was \$427,137. This amount was supported by vendor invoices. The General Committee paid the Primary Committee 60% of the original cost ($\$427,137 \times 60\% = \$256,282$). As can be seen, the original costs of these assets **were not** reduced by 25% prior to applying the standard depreciation rate. In effect the General Committee contends that if it purchased a finished aircraft seat to be used in the reconfiguration, it should be able to reduce the purchase price of the seat by 25% to account for the manufacturer's labor and engineering costs when considering the value of that seat as a capital asset. There no Commission Regulation or precedent⁹ to support this novel calculation. As will be discussed below, standard accounting practice leads to the opposite conclusion and adds the cost of freight and installation when valuing the asset.

Reduction for Labor Cost – The General Committee excluded the cost of labor associated with the reconfiguration it purchased (\$246,760). It is the Audit staff's opinion that the inclusion of labor (and engineering) in the cost of a capital asset is not a new or unique legal theory, but rather, it is a generally accepted accounting principle that has been applied for decades. Under GAAP, capitals assets can be either tangible or intangible. Tangible capital assets include property, plant and equipment. Intermediate accounting texts with copyright dates as far back as 1986 (and more than likely earlier) include labor and installation as the cost of a capital asset.

A more recent accounting text states:

[t]he cost of equipment includes the purchase price plus any sales tax (less any discounts received from the seller), transportation costs paid by the buyer to transport the asset to the location in which it will be used, expenditures for installation, testing, legal fees to establish title, and any other costs of bringing the asset to its condition and location for use. To the extent that these costs can be identified and measured, they should be included in the asset's initial valuation rather than expensed currently.¹⁰

Further, a reference book pertaining to the interpretation and application of GAAP relates that costs that should be capitalized include any reasonable costs involved in bringing the asset to the buyer and incurred prior to using the asset in actual production, to include freight costs, installation costs, and setup costs.¹¹

⁹ There is no Commission precedent on this matter because this is the first time any committee (primary or general) reduced the cost of its assets in this manner prior to applying the standard depreciation rate.

¹⁰ J. David Spiceland, James F. Sepe, Lawrence A. Tomassini, Intermediate Accounting, 4th ed., vol. 1. New York: The McGraw-Hill Companies, Inc., 2007, 455.

¹¹ Barry J. Epstein, Ralph Nach, Steven M. Bragg, Wiley GAAP 2006 Interpretation and Application of Generally Accepted Accounting Principles. Hoboken, NJ: John Wiley & Sons, Inc., 2005, 340.

It is the Audit staff's opinion that the definition of a capital asset is well established in accounting literature. GAAP advises profit and non-profit entities to establish a specific threshold cost to identify when an asset will be capitalized. The Commission established a threshold of \$2,000. The determinations of the costs that are associated with a capital asset are already well-defined.

In the preliminary audit report, the Audit staff cited Standard No. 6. The information contained within that standard, promulgated by the Federal Accounting Standards Advisory Board (FASAB), is based upon GAAP. Any accounting regulatory body, such as the FASAB, the Government Accounting Standards Advisory Board (GASB), or the Financial Accounting Standards Board (FASB) base their regulatory guidance on GAAP.

The General Committee believes calculating the amount of costs associated with the purchase of plant, property or equipment is a daunting task. In the matter at hand, the information was detailed on invoices in possession of the General Committee. Rather, the more daunting task would be requiring a committee to dissect a vendor's invoice. A committee is not required to determine how much of the cost is associated with engineering or how much of the cost is associated with labor.

It remains the Audit staff's position that the General Committee should have paid \$555,598 ($\$925,997 \times 60\%$) to the Primary Committee for the reconfiguration assets it purchased.

- Leased Equipment - Included in the original reconfiguration costs paid by the Primary Committee was the cost of leased equipment. The equipment was leased for 8 months. Since four months of the lease period extended into the general election period, lease payments totaling \$152,680 should have been paid by the General Committee. General Committee representatives agreed to reimburse the Primary Committee but provided an e-mail from the vendor that reflected the leasing cost had since been recalculated and should have been less than the Primary Committee paid. Based upon this e-mail, the General Committee only agreed to reimburse the Primary Committee \$60,680, but did not provide any additional information that would explain the difference.

In response to the preliminary audit report, the General Committee has indicated that the difference between the amount determined by the Audit staff (\$152,680) and the amount calculated by the General Committee (\$60,680) represent the cost of labor and engineering. Again the General Committee objects to including these costs.

For the reasons discussed above, it remains the opinion of the Audit staff that the cost of labor and engineering should be included in the value of this asset.

- Exterior Decals - In the latter part of July 2004, the Primary Committee paid \$63,103 in costs for exterior decal work. These decals identified the aircraft as that of the Kerry/Edwards campaign. The General Committee representatives stated that the "bright line" test found in 11 CFR §9034.4(e) permits these costs to be paid by the Primary Committee. The Audit staff disagrees. As noted above, the general rule at 11 CFR §9034.4(e) states that expenditures for goods and services that are used for the primary campaign shall be allocated to the primary and those used for the general election shall be attributed to the general election. This provision is followed by a list of five types of expenses that are discussed individually.¹² Under the 11 CFR 9034.4(e)(7) that governs the transportation food and lodging of individuals, there is an exception for travel in the primary period that relates exclusively to preparations for the general election. Under either section, these expenses were for the general election. Records relating to the use of the aircraft do not reflect any usage of the aircraft after the reconfiguration and before the beginning of the expenditure report period. All use subsequent to the reconfiguration was in the expenditure report period. The decals installed on the 757 identified Senator Edwards as Senator Kerry's Vice-Presidential running mate. They clearly referred to the general campaign, as the Democratic Party's Presidential and Vice-Presidential nominees, and not to Senator Kerry's primary campaign. It is the Audit staff's opinion that these decal costs should be considered general election expenses.

In response to the preliminary audit report, the General Committee stated that the bright-line rule of 11 CFR §9034.4(e) can not be expanded beyond its enumerated exceptions, as the Audit staff seeks to do and that the Audit staff's creative interpretation of section 9034.4(e)(7) is not appropriate in this context.

As previously stated, the decals were part of the reconfiguration of the Boeing 757 that occurred in the latter part of July 2004. The General Committee believes that 11 CFR 9034.4(e) permits the cost of the decals to be paid by the Primary Committee, apparently because the installation occurred in the primary period. The Audit staff disagrees. The regulation states that expenditures for goods and services that are used for the primary campaign shall be allocated to the primary and those used for the general election shall be attributed to the general election. There has been no evidence or suggestion that the aircraft was used during the primary period. As a result, the General Committee should reimburse the Primary Committee \$63,103.

- Banked Flight Hours - The lease agreement was based on the aircraft being used 60 hours each month. If the aircraft was used more than the allotted hours, additional charges were incurred. If the aircraft was not used for the allotted hours, those hours could be banked and used in subsequent months. At the end of the Primary Committee's portion of the lease, it had banked 10.4 hours. These hours were subsequently used by the General Committee. The General

¹² These included polling, state and national campaign office expenses, campaign materials, campaign communications, and travel costs

Committee determined it owed the Primary Committee \$203,060. However, the General Committee did not use the correct hourly rate. The correct amount is \$205,067, an increase of \$2,007. The General Committee has agreed with this adjustment.

Boeing 727

The General Committee leased a Boeing 727 for Senator Edward's travel for the period August 1, 2004, through November 2, 2004. In July 2004,¹³ the Primary Committee paid \$401,760 in reconfiguration costs for this aircraft. The General Committee has agreed to reimburse the Primary Committee \$149,206 for work performed after the convention, but disagrees that the remaining cost (\$252,553) should be paid by the General Committee.

The \$252,553 represents part of the overall reconfiguration that occurred between July 11, 2004 and July 18, 2004 in Oklahoma City. It included \$224,894 to have a telephone system installed and \$27,659 for exterior decal work. Since the reconfiguration of the aircraft was an asset of the Primary Committee and transferred to the General Committee, it is the opinion of the Audit staff that the asset should have been transferred to the General Committee at 60% of the original cost, or \$151,532 ($252,553 \times 60\%$). 11 CFR 9004.9(d)(1).

As a result, General Committee should have reimbursed the Primary Committee \$300,738 ($\$151,532 + \$149,206$) for the reconfiguration of this aircraft.

In response to the preliminary audit report, the General Committee stated it does not agree that labor and engineering costs associated with installing leased phone equipment on a leased airplane during the primary are attributable to the General Committee under the Commission's regulations. However, the General Committee appears to have agreed that the General Committee should reimburse the Primary Committee \$56,923 or 60% of the cost of the phone system (absent labor and engineering cost). Further, the General Committee disagrees with the treatment of exterior decals as a capital asset and believes that the bright line test for primary and general expenses at 11 CFR §9034.4(e) applies.

As previously stated, the Primary Committee purchased (not leased) a phone system that was part of the reconfiguration costs of the Boeing 727. The purchase price, including installation was \$224,894. The Primary Committee also paid \$27,659 for decals, including installation.

It should be noted that the General Committee has indicated that phone system was sold to the Compliance Fund. Therefore, as discussed with respect to the reconfiguration of the Boeing 757 above, and for the same reasons, the Audit staff applied 60% of the cost of the phone system, including labor and engineering, and decals to the General Committee.

Media Production Costs - The Primary Committee paid \$5,395 in production costs for a media ad that aired only in the general election period. The General Committee

¹³ The final invoices for plane decals and installation were paid in September 2004.

representatives agreed the ad aired only in the general election period, and the production cost should have been paid by the General Committee. The General Committee did not address this matter in its response.

Recap – Due to Primary Committee

Boeing 727		
Reconfiguration Costs	\$300,738	
Total Boeing 727		\$300,738
Boeing 757		
Lease Payments	\$152,680	
Reconfiguration Costs	63,103	
Banked Flight Hours	205,067	
Sale of Reconfiguration Assets	<u>555,598</u>	
Total Boeing 757		<u>976,448</u>
Total Aircraft Costs		\$1,277,186
Media Production and Other Costs		<u>33,208</u>
Total Due to Primary Committee		<u>\$1,310,394</u>

Due to Media Vendor – The General Committee transferred \$45,911,385 to its media vendor and, at the time of the preliminary audit report had received \$462,619 in refunds. Therefore, the media vendor could have disbursed \$45,448,766 for media buys. As previously stated, the DNC also transferred funds to the same media vendor; both General Committee and DNC funds were deposited into the same account. A number of meetings were held with both General Committee and media vendor representatives. During those meetings, representatives of the media firm provided worksheets detailing 100% General Committee media buys, General Committee/DNC hybrid media buys, and media buys paid for by the DNC pursuant to 2 U.S.C. §441a(d).

Using these worksheets, the Audit staff determined that the General Committee did not pay the correct amount for its media buys. The preliminary audit report contained a chart that indicated that the General Committee owed Riverfront \$944,768.

In its response submitted subsequent to the exit conference, the General Committee stated that every invoice received from the vendor was paid; therefore, they do not believe that the General Committee owes the media vendor any additional funds. The Audit staff agrees that the General Committee paid the invoices it received. The Audit staff calculations were reviewed with representatives of the media vendor who could not point to any error. The same vendor worksheets indicate that the DNC appears to have overpaid its share of media buys and is due a refund.

In response to the preliminary audit report, the General Committee stated:

“The PAR is silent as to the basis for this opinion. It is clearly not based upon the records of the Committee – which demonstrate that Riverfront Media was paid in full. It is not based upon the written contract between the parties, under which Riverfront has been paid in full *See* Exhibit A. It is not based upon any statement of Riverfront Media – they submitted a sworn affidavit saying that it had been paid in full for its services. *See* Riverfront Affidavit, 10, 21-23. The Committee concedes that when the amount the Committee paid to Riverfront Media [\$45,911,385] is subtracted from the Committee’s net media buys [\$43,794,095] and media buy and production commission fees [\$2,164,713, *see* Riverfront Affidavit, 21, there remains a \$47,423 discrepancy.”

The preliminary audit report was anything but silent with respect to the basis for the conclusion that the General Committee owed Riverfront in excess of \$900,000. As previously stated the chart contained in the preliminary audit report was based on records provided by the General Committee and Riverfront.

The General Committee’s response discusses changes to various figures used in the preliminary audit report calculation, the most significant being the amount of refunds received by the General Committee, and provides a new calculation showing an underpayment of \$47,423. All of the individual components of the General Committee’s calculation are accepted.

The difference between the amount calculated by the General Committee and the amount calculated by the Audit staff continues to be the treatment on refunds received or due the General Committee from Riverfront Media. Even though refunds received by the General Committee, deposited in its checking accounts, and reported to the Commission are netted against the cost of media purchased, the amount is not netted against the amount the General Committee paid. Prior to the issuance of the preliminary audit report, the matter of refunds was discussed with the General Committee and representatives of Riverfront, including the author of the Riverfront affidavit. At that time, representatives of Riverfront agreed that refunds received by Riverfront and forwarded to the General Committee should be deducted from the amount of funds paid by the General Committee and from the amount of the media purchased. The calculation submitted in response to the preliminary audit report again excludes these refunds without explanation or comment.

Based on the General Committee's response the chart below was revised to reflect the new amount owed to Riverfront.

Line	Description	Audit Staff Calculation	General Committee Calculation	
1	Funds transferred to Riverfront Media	\$45,911,385	\$45,911,385	a
2	Less - Refunds Made to the General Committee (Excluded by the General Committee)	<u>887,276</u>	<u>0</u>	b
3	Funds Transferred to Riverfront Media Net of Refunds	45,024,109	\$45,911,385	
4	General Committee Media Buys	\$44,681,371	\$44,681,371	c
5	Less - Refunds Made to the General Committee for buys that did not run.	727,333	887,276	d
6	Less - Additional Refunds Due the General Committee	<u>159,943</u>	<u> </u>	
7	Media Buys Net of Refunds	\$43,794,095	\$43,794,095	e
8	Add – Commissions Earned by Media Vendor	<u>2,164,713</u>	<u>2,164,713</u>	f
9	Cost of Media Buys to the General Committee	45,958,808	45,958,808	
10	Amount Due from the General Committee (Line 9 – Line 3)	<u>\$934,699</u>	<u>\$47,423</u>	

- a – Riverfront and the General Committee agree with this amount.
b – Riverfront issued and the General Committee reported receiving \$727,333 in refunds. Riverfront has indicated that additional refunds of \$159,943 are due the General Committee.
c – Riverfront affidavit provided this amount.
d – Riverfront affidavit provided this amount.
e – Based upon the Riverfront affidavit, the General Committee calculated this amount.
f - Riverfront affidavit provided this amount.

As the chart indicates the General Committee owes Riverfront \$934,699. The basis for this conclusion, similar to the basis for the conclusion in the preliminary audit report, is documents provided by the General Committee and Riverfront. The General Committee

calculated that it owed Riverfront \$47,423. Had the General Committee correctly applied the \$887,276 in refunds received and/or due from Riverfront, it, like the Audit staff, would have concluded that it owed Riverfront \$934,699 (\$47,423 + \$887,276).

As a result, the General Committee owes Riverfront \$934,699. Absent some explanation of the shortfall, this imbalance results in a potential contribution from the DNC. Since the \$934,699 is being added to expenditures subject to the limitation, there is no need to seek a repayment for the potential contribution.

Accounts Payable as of June 30, 2005 - The General Committee disagrees with the inclusion of \$100,000 due Riverfront for reconciliation and recordkeeping services. In response to the preliminary audit report, the General Committee stated these were wind down expenses that were paid by the Compliance Fund.

The Riverfront agreement, paragraph 2.3 states that \$100,000 was due to Riverfront for costs incurred by the consultant to complete the required reconciliation and other related recordkeeping requirements set forth in Section 10.3(b), (d) and (e)¹⁴ by November 2, 2005. As described in the footnote, costs incurred for reconciliation of media buys, calculations of commissions earned, collection of affidavits relating to media buys and application of refunds, all relate to activities that occurred during the campaign; normal operating expenditures that are subject to the limitations. Therefore the Audit staff remains of the opinion that payments for reconciliation and/or maintaining records in support of services performed are not wind down expenses but rather operating expenses of the General Committee. Therefore, no adjustment is necessary.

In addition, paragraph 9 of this agreement stated that the General Committee agreed to reimburse Riverfront for reasonable attorneys' and accountants' fees, up to a maximum of \$400,000, including attorneys' and accountants' fees, incurred in connection with any audit or investigation of the Campaign.

As the agreement specifies, any fees for attorneys or accountants incurred in connection with the audit would qualify as a wind down expense. None of these fees were charged to the limitation by the Audit staff. In October 2006, the Compliance Fund reported paying Riverfront \$100,000 for audit services. That appears to be related to the \$400,000 budget for audit assistance and has no impact on the spending limitation.

The General Committee demonstrated that \$63,710 in payables were paid by the DNC pursuant to 2 U.S.C. §441a(d). The Audit staff has deleted this amount from accounts payable.

¹⁴ Section 10.3 (b) stated Riverfront should provide a complete and sufficient itemization for each time buy of all commissions, including, but not limited to, the amounts paid, methodology of calculating the commissions, the identity of the recipients and the date of the commission payment. Section 10.3(d) related to collection of affidavits and other documents and Section 10.3(e) related to the collection of refunds.

Refund of Expenditures Subject to the Limitation Received after June 30, 2005 and GELAC Reimbursements– In response to the preliminary audit report, the General Committee demonstrated that it received \$579,725 in additional refunds. In addition, the General Committee demonstrated that the Compliance Fund reimbursed it \$6,585, for expenditures that were charged to the limitation but reimbursable by the Compliance Fund. The necessary adjustments have been made.

Shown below is the Audit staff's revised analysis of expenditures subject to the limitation:

1	Reported Expenditures Subject to Limitation at June 30, 2005	\$74,788,665
	<u>Audit Adjustments to Reported Amounts:</u>	
2	Excess Compliance Fund Reimbursement for Shared Overhead	36,950
3	Less: Unreimbursed Costs Incurred for Providing Transportation to the U.S. Secret Service	<u>(632,551)</u>
4	Adjusted Reported Expenditures Subject to Limitation at June 30, 2005	74,193,064
	<u>Audit Adjustments:</u>	
5	Add: Due to the Primary Committee	1,310,394
6	Due to Media Vendor	934,699
7	Accounts Payable as of June 30, 2005	153,512
8	Less: Refunds of Expenditures Subject to the Limitation Received after June 30, 2005 Reimbursement from the Compliance Fund	<u>(579,725)</u> <u>(6,585)</u>
9	Total Expenditures Incurred Chargeable to the Limitation at September 30, 2005	\$76,005,359
10	Expenditure Limitation	<u>74,620,000</u>
11	Amount in Excess of Limitation	<u>\$1,385,359</u>

Recommendation

The Audit staff recommends that the Commission make a determination that \$1,344,082 (\$1,385,359 - \$41,277 [see Finding 1. for the repayment of this amount]) is repayable to the United States Treasury.

Finding 3. Undocumented Media Disbursements

Summary

The General Committee did not maintain station affidavits for media buys totaling \$893,432. In response to the preliminary audit report, the General Committee provided additional documentation that materially completed the media records.

Legal Standard

Qualified Campaign Expense. Each of the following expenses is a qualified campaign expense.

- An expense that is:
- Incurred to further a candidate's campaign for election to the office of President or Vice President of the United States;
- Incurred within the expenditure report period or before the beginning of the expenditure report period to the extent that property, services or facilities will be used during that period; and
- Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9002.11(a).

Expenditure Report Period. The period begins on September 1 before the election or on the date on which the major party's presidential nominee is chosen, whichever is earlier, and ends 30 days after the Presidential election. 11 CFR §9002.12(a).

Non Qualified Campaign Expense. Each candidate shall have the burden of proving that disbursements made by the candidate or his authorized committee are qualified campaign expenses. 11 CFR §9003.5(a).

Repayments. A candidate who has received public funds for a General Election campaign must repay the United States Treasury those funds under any of the circumstances described below:

- If the candidate or candidates authorized committee incurs expenses in excess of the aggregate payments to which it was entitled, or
- If funds were used to pay for non-qualified campaign expenses

One example of the basis for a Commission repayment determination is a determination that amounts spent by a candidate, the candidate's authorized committee or agent were not adequately documented. 11 CFR §9007.2(b)(1) and (2).

Preserving Records and Copies of Reports. The treasurer of a political committee must preserve all records and copies of reports for 3 years after the report is filed. 2 U.S.C. §432(d).

Facts and Analysis

Media buys for the General Committee, including hybrid ads, were placed by both Riverfront and Chambers, Lopez & Gaitan (Chambers). Net media buys placed by

Riverfront and Chambers totaled approximately \$58,331,691 and \$1,617,582 respectively.

With respect to Riverfront, station affidavits for media buys totaling \$1,129,078 were not available for review. The General Committee paid for 76% (\$44,187,536 / \$58,331,691) of the net media buys. Therefore, the Audit staff applied that percentage to the total dollar value of missing station affidavits. As a result, missing station affidavits for General Committee media buys with respect to Riverfront totaled \$858,099 (\$1,129,078 x 76%).

With respect to Chambers, the General Committee's portion of the media buys was \$455,092. Media buys totaling \$126,189 were not supported by station affidavits. The General Committee allocable portion of this activity was 28% (\$455,092 / \$1,617,582). The General Committee's ratio (28%) was applied to the total undocumented media buys (\$126,189). As a result, \$35,333 in General Committee media buys was not supported by station affidavits.

This matter was discussed at the exit conference. Subsequent to the exit conference, the General Committee provided additional affidavits pertaining to media buys made by Chambers which were considered in the above analysis. No additional affidavits were provided pertaining to the missing Riverfront affidavits.

Preliminary Audit Report Recommendation and Committee Response

The Audit staff recommended that the General Committee provide station affidavits for the Riverfront and Chambers media buys. Absent such documentation, the Audit staff would recommend that the Commission make a determination that \$893,432 (\$858,099 + \$35,333) was repayable to the United States Treasury.

In response to the recommendation, the General Committee provided additional affidavits and evidence of vendor refunds due from media stations pertaining to Riverfront and Chambers media buys. As a result, the General Committee has materially complied with the Audit staff's recommendation.

Finding 4. Failure to Disclose Outstanding Debts

Summary

The General Committee did not correctly disclose 361 debts totaling \$1,590,248 on Schedule D. In response to the preliminary audit report, the General Committee, while continuing to contend that it is not required, agreed to, but has not filed, the necessary amended disclosure reports. Therefore, the General Committee has not complied with the recommendation.

Legal Standard

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).

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.
- If the exact amount of a debt is not known, the report shall state that the amount reported is an estimate. Once the exact amount is determined, the political committee shall either amend the report(s) containing the estimate or indicate the correct amount on the report for the reporting period in which such amount is determined.
- 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

The Audit staff identified material errors in the reporting of debts. The General Committee failed to disclose or incorrectly disclosed the amount for 361 debts totaling \$1,590,248.

General Committee representatives indicated that accounts payable were not consistently recorded in its accounting system. In a majority of cases, payables that were entered into the accounting system had the check date entered as the invoice date. In other instances, certain payables were never entered into the accounting system. These factors contributed to the lack of disclosure.

This matter was discussed at the exit conference. General Committee representatives were provided schedules and agreed to amend their reports.

Preliminary Audit Report Recommendation and Committee Response

The Audit staff recommended that the General Committee file amended reports to disclose the above debts on Schedule D (Debts and Obligations). In response to the recommendation, the General Committee again agreed to file the amended reports and disclose the debts. At the same time, it did not concede that it was necessary to do so for all of the debts identified by the Audit staff.

Since the amended reports were not filed, the General Committee has not complied with the recommendation.

Finding 5. Stale-dated Checks – General Committee

Summary

The Audit staff identified 104 stale-dated checks totaling \$50,334. The Audit staff recommended that the General Committee provide evidence that the checks were not outstanding or make a payment to the United States Treasury. The General Committee contends that stale-dated checks equal \$39,331 but has neither provided any support for that figure or made a payment to the U.S. Treasury.

Legal Standard

Handling Stale-dated (Uncashed) Checks. If a committee has issued checks that the payees (creditors or contributors) have not cashed, the committee must notify the Commission of its efforts to locate the payees and encourage them to cash the outstanding checks. The committee must also submit a check payable to the U. S. Treasury for the total amount of the outstanding checks. 11 CFR §9007.6.

Facts and Analysis

The Audit staff identified 104 stale-dated checks totaling \$50,334. The checks were issued between August 19, 2004, and February 9, 2005, and had not cleared the bank as of September 30, 2005.

The Audit staff provided General Committee representatives with a schedule of the stale-dated checks at the exit conference. Even though the General Committee was advised not to reissue the stale-dated checks, it reissued 7 checks, totaling \$7,521. As of the end of fieldwork, the General Committee had not demonstrated that the reissued checks had cleared the bank.

Preliminary Audit Report Recommendation and Committee Response

The Audit staff recommended that the General Committee provide evidence that:

- The checks were not outstanding by providing copies of the front and back of the negotiated checks along with bank statements; or
- The checks had been voided by providing copies of the voided checks with evidence that no obligation exists.

Absent such evidence, the General Committee was to repay \$50,334 to the United States Treasury.

In response to the recommendation, the General Committee indicated its stale-dated checks totaled only \$39,331. However, the General Committee has neither provided documentation that it issued a check to the United States Treasury in the amount of \$39,331 nor provided documentation that demonstrated that the remaining stale-dated checks (\$11,003) had either cleared the bank or were voided because no obligation existed.

As a result, the General Committee has not complied with the recommendation.

Part V. Additional Issues

Issue 1. In-Kind Contributions – Democratic National Committee Hybrid Ads

Facts and Analysis

The cost of one series of media ads that referred to either, Senator Kerry and a general reference to Democrats, or President Bush and a general reference to Republicans was allocated 50% to the General Committee and 50% to the DNC. Senator Kerry and President Bush were the only candidates clearly identified in the ads. Since these ads contained references such as the Democrats, Democrats in Congress, Republicans, Republicans in Congress, right wing Republicans, etc., the General Committee termed these ads as “hybrid ads.”

The Commission addressed whether a 50% allocation of the cost of these hybrid ads is consistent with Commission precedent and existing regulations.

First, the Commission considered the extent to which, if any, 11 CFR §106.1(a) provides guidance regarding the proper allocation for these hybrid ads. Section 106.1(a) of the Commission’s regulations provides that expenditures made on behalf of more than one clearly identified candidate should be attributed to each candidate according to the benefit reasonably expected to be derived (determined by the proportion of space or time devoted to each candidate as compared to the total space or time devoted to all candidates).

Second, the Commission considered the extent to which, if any, 11 CFR §106.8 provides guidance regarding the proper allocation for these hybrid ads. Section 106.8 of the Commission’s regulations provides that a flat 50% allocation is appropriate for the costs of a phone bank conducted by a political committee that refers to one clearly identified federal candidate and “generically refers to other candidates of the Federal candidate’s party without clearly identifying them,” regardless of the space or time devoted to the clearly identified Federal candidate.

Third, the Commission considered the extent to which, if any, the Commission’s advisory opinion issued to Washington State Democratic Central Committee (AO 2006-11) regarding mass mailings provides guidance regarding the proper allocation for these hybrid ads. In AO 2006-11, the Commission noted that although there are no Commission regulations specifically addressing cost allocation for “hybrid ads” (other than for phone banks), “nonetheless an appropriate method for allocating the costs of” such ads (involving mass mailing costs) is to “apply analogous ‘space or time’ principles” as set out in the Commission’s rules that address ads featuring more than one clearly identified candidate. In advising the Washington State Democratic Central Committee that a “space or time” analysis is relevant, the Commission explained that for mass mailing “hybrid ads” where only one candidate is clearly identified, the ad “serves in large measure the purpose of influencing the election of [that] clearly identified

candidate” and therefore the Commission set a floor, that is, a minimum, of 50 percent that must be attributed to the clearly identified candidate, “no matter how much of the space in the mailing is devoted to that candidate.” AO 2006-11 did not, however, involve a presidential candidate; additionally, AO 2006-11 was issued after the 2004 election.

Fourth, the Commission considered the application of 11 CFR §109.21 and AO 2004-01, issued to Bush-Cheney ‘04, Inc. and Alice Forgy-Kerr for Congress, which provided guidance on attribution of coordinated communications between two authorized committees.

There were not the minimum four affirmative votes among the Commissioners required to make a finding as to whether or not the 50% allocation complied with the Act and Commission regulations. Some Commissioners considered the 50% allocation to be in accord with past precedent and relevant FEC regulations, so there was no adjustment required against the expenditure limitation applicable to the General Committee. Some Commissioners were of the opinion that the Act and the Commission regulations regarding hybrid ads require the General Committee to pay more than 50%, in which event any adjustment above 50% would apply against the expenditure limits applicable to the General Committee and a finding by the Audit staff of increased expenditures over allowable limits.

Issue 2. Sale of an E-mail Address List

Summary

The General Committee sold a database of e-mail addresses to Friends of John Kerry, Inc. (Senate 08), Senator Kerry’s authorized committee for his 2008 Senate re-election campaign for \$2,000,000 on January 3, 2005. The database was made up of approximately 1,000,000 names along with other information, including e-mail addresses and often postal addresses, as a result of individuals “opting in” to the campaign website. The Commission discussed whether the General Committee received a contribution or income from this sale. After considering the available information, the Commission could not reach consensus on this issue.

Legal Standard

Investment of Public Funds; Other Uses Resulting in Income. Investment of public funds or any other use of public funds that results in income is permissible, provided that an amount equal to all net income derived from such a use, less Federal, State and local taxes paid on such income, shall be paid to the Secretary. 11 CFR §§9004.5 and 9007.2(b)(4).

Contribution Defined. A gift, subscription, loan (except when made in accordance with 11 CFR §§100.72 and 100.73), advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office is a contribution. Unless specifically excepted under 11 CFR part 100, subpart C, the provision of any goods or services without charge or at a charge that is less than the usual

and normal charge for such goods or services is a contribution. The term anything of value includes all in-kind contributions. 11 §§CFR 100.52(d)(1) and 9002.13.

Facts and Analysis

The General Committee sold a database of e-mail addresses to Senate 08 for \$2,000,000 on January 3, 2005. The database was made up of approximately 1,000,000 names along with other information, including e-mail addresses and often postal addresses, as a result of individuals “opting in” to the website www.johnkerry.com between July 30, 2004 and November 2, 2004.

The General Committee provided an appraisal estimating the fair market value of the list as \$2,000,000. Valuation sources identified by the Audit staff indicated a lower fair market value. The Audit staff also recommended that the list be valued in part on the marginal cost of its development. The Commission agreed that a “cost of development” approach was impractical and inappropriate and that the relevant cost was the fair market value of the list.

The Commission discussed whether the General Committee received a contribution or income from this sale. The Commission did not view the facts as presenting a case under which an income analysis would be appropriate. Three Commissioners believed that the General Committee should provide additional information to explain the different valuations. Other Commissioners believed that no additional information was necessary.

Issue 3. Interest Earned

Summary

The General Committee’s media firm used funds transferred to it for media buys to make loans to its parent company. Interest earned of \$159,446 was calculated but never paid to the General Committee. After a discussion of this issue, no repayment is required.

Legal Standard

Investment of Public Funds - Other Uses Resulting in Income. Investment of public funds or any other use of public funds that results in income is permissible, provided that an amount equal to all net income derived from such a use, less Federal, State and local taxes paid on such income, shall be paid to the United States Treasury. 11 CFR §§9004.5 and 9007.2(b)(4).

Background

According to representatives of Riverfront and the General Committee, Riverfront is “a separate, wholly-owned business unit of Greer, Margolis, Mitchell and Burns (GMMB). Riverfront’s only clients were Senator John Kerry’s primary and general presidential election campaigns and Kerry related general election ads paid for by the DNC. Riverfront’s accounting functions, media buying and general operations, were performed by employees of GMMB. GMMB is owned by Fleishman-Hillard International Communications and according to the Fleishman-Hillard International Communications’

website; it is part of Omnicom Group Inc., a leading global advertising, marketing and corporate communications company.

Facts and Analysis

In addition to the interest earned discussed in Finding 1, the Commission considered whether additional interest earned on public funds was repayable to the United States Treasury.

According to GMMB representatives, intracompany transfers, or “demand loans” were made by Riverfront to Fleishman–Hillard, Inc. (Fleishman-Hillard) to cover Fleishman-Hillard operating expenses. During the period, October 1, 2004, to June 22, 2005, 11 loans were made to Fleishman-Hillard totaling \$17,250,000. These loans were outstanding between 9 and 250 days. Interest was calculated and recorded by GMMB each month, but was not transferred back to a Riverfront Omnicom account. The total calculated interest was \$159,446. Unlike the interest discussed in Finding 1, this interest was retained by the vendor. GMMB representatives stated if funds were needed for media buys, an intracompany transfer was made immediately to return the funds to Riverfront.

The Commission discussed whether the \$159,446 in interest would be subject to repayment pursuant to 11 CFR §9007.2(b)(4). See 11 CFR §9004.5. Some Commissioners held the view that the standard for repayment should be whether the General Committee actually received or benefited from the interest earned by having the interest used to make media buys or offset commissions. They concluded that because the General Committee did not receive or benefit from the interest earned, no finding or repayment determination would be appropriate. Other Commissioners considered that the purpose for repayment of interest or income was to ensure that any income received through the use of public funds benefits the public financing system. They concluded that repayment under these circumstances may be appropriate. As a result, no repayment is required.

Issue 4. Non-Qualified Campaign Expense – Candidate Biographical Film

Summary

The cost of a biographical film (\$207,000), produced for use at the Democratic National Convention, was split between the Democratic National Campaign Committee (DNCC), the DNC and the General Committee. The Commission considered whether the allocation percentages used by the three committees were reasonable. After considering the available information the Commission concluded that the cost of the film had been reasonably allocated.

Legal Standard

Cost of Biographical Films. The convention committee is permitted to produce biographical films, or similar materials, of the candidate for nomination for use during the convention. However, if any other committee uses part or all of the films or similar

materials, it shall pay the convention committee for the reasonably allocated cost of the films. 11 CFR §9008.7(a)(4)(xiii).

Qualified Campaign Expense. Each of the following expenses is a qualified campaign expense.

- An expense that is:
- Incurred to further a candidate's campaign for election to the office of President or Vice President of the United States;
- Incurred within the expenditure report period or before the beginning of the expenditure report period to the extent that property, services or facilities will be used during that period; and
- Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9002.11(a).

Repayments. A candidate who has received public funds for a General Election campaign must repay the United States Treasury those funds under any of the circumstances described below:

- If the candidate or candidates authorized committee incurs expenses in excess of the aggregate payments to which it was entitled, or
- If funds were used to pay for non-qualified campaign expenses. 11 CFR §9007.2(b)(1) and (2).

Facts and Analysis

The Audit staff reviewed the cost allocation of a biographical film, A Remarkable Promise, about Senator John Kerry. The DNCC showed the film during the 2004 Democratic National Convention. The General Committee represented that they utilized excerpts in ads. The cost of the film was allocated 29% to the DNC, 29% to the General Committee and 42% to the DNCC.

The Commission considered whether the derivation of the allocation percentages was reasonable. It concluded that the cost of the biographical film had been reasonably allocated among the DNC, DNCC and the General Committee. As such, the payment by the General Committee was not considered a non-qualified campaign expense.

Issue 5. Receipt of Impermissible Contribution/Loans

Summary

The Audit staff concluded that the General Committee received a contribution from the Primary Committee (\$555,598) and received two loans from the Compliance Fund (\$1,216,262) that were not permissible. The contribution from the Primary Committee resulted from primary assets being made available for use by the General Committee without prompt or full payment. The loans from the Compliance Fund were relative to press (\$250,000) and United States Secret Service (\$966,262) travel reimbursements. The Commission voted to receive this finding, without any determination on the merits of the analysis, or the facts, or interpretation of the law contained therein.

Legal Standard

Definition of a Contribution. The term contribution includes the payments, services or other things of value. A gift, subscription, loan (except for a loan made in accordance with 11 CFR §§100.72 and 100.73), advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office is a contribution. 11 CFR §§100.51(a) and 100.52(a).

Definition of a Loan. A loan is a contribution at the time it is made and is a contribution to the extent that it remains unpaid. The aggregate amount loaned to a candidate or committee by a contributor, when added to other contributions from the individual to that candidate or committee, shall not exceed the contributions limitations set forth at 11 CFR part 110. A loan, to the extent it is repaid, is no longer a contribution. 11 CFR §100.52(b)(2).

Definition of a Person. Person means an individual, partnership, committee, association, corporation, labor organization, and any other organization, or group of persons, but does not include the Federal government or an authority of the Federal government. 11 CFR §100.10.

Facts and Analysis

Contribution From the Primary Committee – As previously stated the assets used in the reconfiguration of the Candidate’s aircraft were sold by the General Committee to the owner of the aircraft on November 5, 2004. The General Committee took possession of the assets on July 30, 2004, the start of the general election expenditure report period. It was not until September 29, 2005, that the General Committee paid the Primary Committee \$260,798 for these assets; 14 months after taking possession and approximately 11 months after selling them. Further, the General Committee did not pay the Primary Committee the fair market value for the assets. It should have paid \$555,598.

It is the opinion of the Audit staff that the Primary Committee made a contribution to the General Committee for the period of time the assets were used and no payment was made.

Loans From the Compliance Fund – On December 10, 2004, the Compliance Fund loaned the General Committee \$966,262. This loan was secured by outstanding receivables due the General Committee from the United States Secret Service (Secret Service). Further, on December 14, 2004, the Compliance Fund loaned the General Committee an additional \$250,000. This loan was secured by outstanding press receivables due the General Committee.

Advisory Opinion 1992-38 addressed the issue of a compliance fund loan secured by Secret Service receivables.¹⁵ The Clinton/Gore ’92 Campaign Committee asked if it could receive “a one time loan” of \$1 million after the general election from the

¹⁵ The Advisory Opinion does not address compliance fund loans secured by outstanding press receivables.

Clinton/Gore Compliance Fund. The Commission concluded that the described loan and its terms of repayment were permitted.

The Commission reasoned that the proposed loan would be made on the basis of anticipated reimbursements from the Secret Service. The committee proposed using the loan proceeds to pay non-deferrable qualified campaign expenses that, but for the temporary hiatus in obtaining Secret Service reimbursements, would have been paid from committee operating funds. In essence, the short term loan merely enabled the committee to make payment of urgent obligations very promptly after the election and prior to receiving payment of accounts receivable owed to the committee by the Secret Service. Moreover, the loan did not convey to the committee additional funds to defray new campaign expenses not already incurred before the loan proceeds are received.

The Commission emphasized that approval of the loan proposal was conditioned on its use of the proceeds to defray only qualified campaign expenses and the campaign's compliance with the expenditure limit. In addition, the campaign was required to immediately apply all receipts that result from the Secret Service reimbursements to satisfy any outstanding loan balance owed by the committee.

The \$966,262 loan was made (December 10, 2004), after the end of the expenditure report period (December 2, 2004). It is obvious that at the time this loan was made, the General Committee had exceeded the expenditure limitation. The limitation calculation, noted in Finding 2, shows the General Committee approximately \$1.4 million over the limit, as of that date.

With respect to the Compliance Fund loan of \$250,000 on December 14, 2004 it was not repaid until March 30, 2005, even though the General Committee received \$408,772 in press reimbursements during the period December 15, 2004 through December 23, 2004

It is the opinion of the Audit staff that the facts addressed in the Advisory Opinion support the conclusion that, under the circumstance, the two loans were not permissible. The General Committee exceeded the expenditure limit and, did not repay the \$250,000 until March 30, 2005, even though within two weeks of receiving the loan, it received in excess of \$400,000 in press reimbursements.

The Commission voted to receive this finding, without any determination on the merits of the analysis, or the facts, or interpretation of the law contained therein.

Part VI. Findings and Recommendations – Compliance Fund

Finding 1. Receipt of Impermissible Contributions

Summary

The Compliance Fund failed to provide evidence that 160 excessive contributions received by the Primary Committee, totaling \$177,556, were properly redesignated to the Compliance Fund. In response to the recommendation, the Compliance Fund provided copies of presumptive redesignation letters sent to the contributors whose excessive contributions totaled \$167,006. With respect to the remaining excessive contributors, the Compliance Fund notes that it is unable to locate the contributors. Therefore, \$10,550 is payable to the U.S. Treasury.

Legal Standard

Authorized Committee Limits. An authorized committee may not receive more than a total of \$2,000 per election from any one person. 2 U.S.C. §441a(a)(1)(A), (2)(A) and (f); 11 CFR §§110.1(a) and (b) and 110.9.

Permissible Contributions to the Compliance Fund. A major party candidate, or an individual who is seeking the nomination of a major party, may accept contributions to a legal and accounting compliance fund if such contributions are received and disbursed in accordance with 11 CFR §9003.3.

Redesignation of Excessive Contributions. When an individual makes an excessive contribution to a candidate's primary election, the campaign may presumptively redesignate the excessive portion to the GELAC if the contribution:

1. Is not designated in writing for a particular election; 11 CFR §110.1(b)(5)(ii)(B)(2).
2. Would be excessive if treated as a primary election contribution; 11 CFR §110.1(b)(5)(ii)(B)(3).
3. As redesignated, does not cause the contributor to exceed any other contribution limit. 11 CFR §110.1(b)(5)(ii)(B)(4).
4. Excessive contributions made with respect to the primary election may be redesignated and transferred by the candidate to the GELAC if the contribution was not designated for a particular election, the contribution would exceed the primary election contribution limit. 11 CFR §110.1(b)(5)(ii)(B)(5).
5. The committee is required to notify the contributor of the redesignation within 60 days of the treasurer's receipt of the contribution, and must offer the contributor the option to receive a refund instead. Further, a political committee must retain written records concerning the redesignation in order for it to be effective. 11 CFR §110.1(b)(5)(ii)(B)(6).

Facts and Analysis

The Primary Committee transferred the excessive portions of contributions it received to the Compliance Fund. The Audit staff reviewed supporting documentation relative to the excessive contributions. As a result, the Audit staff identified 160 excessive contributions, totaling \$177,556, that were not supported by letters or other notices to the contributors notifying them that their contributions were being redesignated to the Compliance Fund.

Subsequent to the exit conference, representatives of the Compliance Fund were given a list of contributions that were missing evidence of the redesignation notice. The treasurer stated he would continue searching for the missing documentation.

Preliminary Audit Report Recommendation

The Audit staff recommended that the Compliance Fund provide evidence that the excessive contributions were properly redesignated. Absent such evidence, the Compliance Fund should have refunded the excessive contributions to the contributor and provide evidence of such refunds (photocopies of the front and back of the negotiated refund checks). If any contributors could not be located, or if any refund check was not negotiated by the contributors at the time of the final audit report, the sum of the excessive contributions was to be paid to the United States Treasury.

Representatives of the Compliance Fund were later advised that in lieu of refunding the excessive contributions to the contributors they could send each contributor a presumptive redesignation letter which offered a refund. Copies of such letters were to be provided to the Audit staff. If any contributors could not be located, or if any refund check issued was not negotiated by the contributors at the time of the final audit report, the sum of the remaining excessive contributions was to be paid to the United States Treasury.

Committee Response to Recommendation and Audit Staff's Assessment

In response to the recommendation, the Compliance Fund provided copies of presumptive redesignation letters sent to the contributors whose excessive contributions totaled \$167,006. The Compliance Fund stated that the mailing address for the remaining 9 contributor's (excessive contributions totaling \$10,550) could not be located. Counsel for the Compliance Fund stated it materially complied with the recommendation.

With respect to the remaining unresolved excessive contribution, \$10,550 is payable to the U.S. Treasury.

Finding 2. Stale-dated Checks - Compliance Fund**Summary**

The Audit staff identified 14 stale-dated checks totaling \$14,800. In response to the preliminary audit report, the Compliance Fund provided additional information for some

of the checks and made a payment to the U.S. Treasury in the amount of \$13,800. These actions materially complied with the recommendation.

Legal Standard

Handling Stale-dated (Uncashed) Checks. If a committee has issued checks that the payees (creditors or contributors) have not cashed, the committee must notify the Commission of its efforts to locate the payees and encourage them to cash the outstanding checks. The committee must also submit a check payable to the U. S. Treasury for the total amount of the outstanding checks. 11 CFR §9007.6.

Facts and Analysis

The Audit staff identified 14 stale-dated checks totaling \$14,800. The checks were dated between June 20, 2004, and November 18, 2004, and had not cleared the bank as of August 31, 2005.

The Audit staff provided the Compliance Fund representatives with a schedule of stale-dated checks subsequent to the exit conference. The Compliance Fund representatives agreed to repay the U.S. Treasury for any checks that had not been voided.

Preliminary Audit Report Recommendation and Committee Response

The Audit staff recommended that the Compliance Fund provide evidence that:

- The checks are not outstanding by providing copies of the front and back of the negotiated checks along with bank statements; or
- The checks have been voided by providing copies of the voided checks with evidence that no obligation exists.

Absent such evidence, the Audit staff recommended that the Compliance Fund pay \$14,800 to the United States Treasury.

In response to the recommendation, the Compliance Fund provided evidence that it disgorged \$13,800 to the United States Treasury. The difference of \$1,000 is a combination of two factors, voided checks and an additional disgorgement of a check not on the Audit staff schedule.

The Compliance Fund materially has complied with the recommendation.



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

May 17, 2007

MEMORANDUM

TO: Margarita Maisonet
Chief Compliance Officer

Joseph F. Stoltz
Assistant Staff Director

THROUGH: Patrina M. Clark *MLC*
Staff Director

FROM: Thomasenia P. Duncan *TPD*
General Counsel

Lawrence L. Calvert *LAC*
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Assistant General Counsel
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Delanie DeWitt Painter *DDP*
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Attorney

SUBJECT: Kerry-Edwards 2004, Inc. and Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund -- Audit Report (LRA # 658)

I. INTRODUCTION

The Office of General Counsel has reviewed the Audit Report ("proposed Report") on Kerry-Edwards 2004, Inc. (the "General Committee") and Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund that you submitted to this Office.¹ We concur generally with the findings in the proposed Report, but we have comments on several findings. First we comment on finding 1, regarding interest earned by the General Committee that is

¹ The Office of General Counsel recommends that the Commission consider this document in Open Session. See 11 C.F.R. § 9007.1(e)(1).

repayable to the United States Treasury. We recommend that the auditors more fully explain and clarify the basis for their conclusions. *See* 26 U.S.C. § 9007(b)(4); 11 C.F.R. §§ 9004.5 and 9007.2(b)(4). Second, we comment on the attribution of several types of expenditures to the General Committee's expenditure limitation, resulting in a repayment of \$1,382,417. *See* 2 U.S.C. § 441a(b)(1) and (c); 26 U.S.C. § 9007(b)(2). Specifically, we comment on airplane reconfiguration costs and exterior decals, amounts due to a media vendor and media reconciliation and recordkeeping expenses. We concur with any findings that we do not comment on specifically in this memorandum. If you have any questions about our comments, please contact Delanie DeWitt Painter or Margaret J. Forman, the attorneys assigned to this audit.

II. INTEREST EARNED (Finding 1)

This Office generally concurs with the recommendation that \$41,277 is repayable to the United States Treasury as interest earned, and specifically concurs with the calculation of the interest amount, but we recommend that the auditors more fully explain and clarify the basis for their conclusions. *See* 26 U.S.C. § 9007(b)(4); 11 C.F.R. §§ 9004.5 and 9007.2(b)(4). We comment on two points in this finding.

Specifically, the auditors should explain why they conclude that the Committee received, or used, the interest for media buys. An explanation of how the interest was used for media buys is important. At the Preliminary Audit Report ("PAR") stage, the Commission examined, but did not make a finding on an additional issue in this Audit involving similar facts. There, the Commission decided not to make a finding because some Commissioners held the view that a finding or repayment would not be appropriate where the General Committee "did not receive or benefit from the interest earned." Proposed Report at 37. Thus, for this finding to receive majority support, it will likely be necessary to be clear about precisely how the interest benefited the General Committee.

The proposed Report currently does not explain how the interest was actually used for the media buys, or the accounting methodology used to conclude that interest income was used for media buys. Instead, the proposed Report currently states that "[f]unds in [the General Committee media] account, including interest earned, were used to cover checks issued for media buys." Proposed Report at 9. The proposed Report does not explain the basis for this statement. The proposed Report then concludes that this activity resulted in the General Committee receiving "interest income in the form of additional disbursements by the media company." *Id.* Again, the proposed Report states that the auditors disagree with the General Committee that the interest was not used to offset the General Committee's expenses, but the proposed Report does not explain the basis for this statement. Proposed Report at 10. The General Committee, in its response, states that the auditors "could not point to any particular invoice or expense paid for by the interest." Response at 6. The proposed Report should either show how the interest was actually used for the media buys, or explain the accounting methodology used to conclude that the interest income was used for media buys.

We agree, however, with the auditors' analysis regarding the amount of interest earned. The auditors' calculation of the amount of interest earned is based on the period between when Riverfront Media received funds from the General Committee and when the checks for media buys cleared the account, resulting in an interest calculation of \$41,277. The General Committee's interest calculation is based on the period between when Riverfront Media received funds from the General Committee and when the checks were issued to the media outlets, which would be a shorter period of time than the period to check clearing -- resulting in a lower interest calculation of \$6,664. The auditors state that their calculation is "as utilized by every banking entity," and is correct. Proposed Report at 10. This is consistent with the common understanding of how interest is paid: interest is paid on money until it leaves an account, and money is not deducted from an account until a check clears. We note that as a legal matter, financial institutions are required to disclose to account holders how interest is calculated and when interest begins to accrue on deposits and withdrawals. *See* 12 C.F.R. Part 230. The General Committee could have produced a copy of the required bank disclosures for the calculation of interest to demonstrate that the General Committee's interest calculation should be used, but failed to do so.²

III. EXPENDITURE LIMITATION (Finding 2)

In addition to the proposed repayment determination for interest earned on the use of public funds, the proposed Report contains a proposed repayment determination because the General Committee exceeded the expenditure limitation. This Office concurs with the Audit staff that the General Committee incurred expenditures in excess of its expenditure limitation and must make a repayment to the United States Treasury for the amount in excess of the limitation.³ *See* 2 U.S.C. § 441a(b)(1) and (c); 26 U.S.C. § 9007(b)(2). The expenditure limitation finding addresses a number of Audit adjustments to the General Committee's calculation of its expenditures subject to the limitation. Because the General Committee has exceeded its expenditure limitation, every additional dollar that counts against that limitation increases the amount of its repayment. The General Committee contests the calculation of a number of different expenditures and asserts that various expenditures should be reduced or eliminated. The amount of the repayment in the proposed Report is \$1,382,417.⁴ We comment on several expenditures including airplane reconfiguration and exterior decals, amounts due to a media vendor and accounts payable-media. We do not comment specifically here on the

² The General Committee can still submit this information during an administrative review. *See* 26 U.S.C. §§ 9007 and 9011.

³ The expenditure limitation for the 2004 presidential general election was \$74,620,000.

⁴ The repayment for exceeding the expenditure limitation does not include the \$41,277, which the auditors recommend should be repaid as interest earned in Finding 1. This amount was subtracted from the repayment calculation. According to our discussions with the Audit staff, there would be an adjustment to include this amount in the repayment determination for expenditures in excess of the limitation if the Commission does not seek repayment of this amount as recommended in Finding 1.

remaining expenditures contested by the General Committee because we agree with the Audit staff's attribution and discussion of those expenditures in the proposed Report.

A. Airplane Reconfiguration and Exterior Decals

The largest amount in contention, \$1,277,186, is an adjustment to the General Committee's expenditure limitation that reflects money due to John Kerry for President, Inc. ("the Primary Committee") for reconfiguration and lease costs for two airplanes used during the primary and general elections: a Boeing 757 used by Senator Kerry and a Boeing 727 used by Senator Edwards.

The Primary Committee leased the Boeing 757 for the period between April and November 2004. The lease agreement contained two provisions pertinent here. First, the agreement allowed the Primary Committee to transfer all its rights and obligations under the lease to the General Committee as its successor for the general election campaign. Second, the lease allowed the Primary Committee to custom configure and modify the aircraft to its specifications at its own expense, provided that the Primary Committee (or the General Committee, as its successor) restored the aircraft to its original configuration at the end of the agreement – also at its own expense and with separate charges during the installation and removal of the custom modifications.

The Primary Committee reconfigured the aircraft at a total cost of \$925,997. Of this total amount, \$679,237 represented material and equipment and the rest represented labor costs. When the general election period began, the Primary Committee transferred its leasehold interest – which included the obligation to restore the Boeing 757's original configuration at the termination of the lease agreement – to the General Committee. At the end of the campaign, the airplane's owner agreed not to insist that the airplane be returned to its original configuration; instead, the owner took the aircraft back "as is" and paid the General Committee \$60,000, in essence, to purchase the reconfiguration asset.

The General Committee regarded the reconfiguration as a capital asset, valued it in the amount of \$260,798 and paid that amount to the Primary Committee. Applying the rule at section 9004.9(d)(1)(ii) for calculating the purchase price of capital assets acquired by a general committee from a primary committee, the Audit staff began with the original purchase price of the reconfiguration of \$925,997 and depreciated that amount by 40% to determine the value of the reconfiguration asset at \$555,598. This amount was \$294,800 more than the General Committee transferred to the Primary Committee. The auditors added this amount to the General Committee's expenditures subject to the limitation. The General Committee argues that the reconfiguration's original purchase price should be reduced by 25% for engineering costs, and that none of the labor costs should be included.

Consistent with the treatment of the Boeing 757, the auditors applied a capital asset depreciation method to allocate \$151,532 in reconfiguration and exterior decal costs of the Boeing 727 leased for Senator Edwards' travel from August through November 2004. The

General Committee argues that this amount was a primary expense because the reconfiguration work was done during the primary period, does not include labor and engineering costs in its calculation, and disagrees with the treatment of exterior decals as a capital asset.

We agree with the Audit staff's attribution of the expenses for both the Boeing 757 and the Boeing 727. Other than the standard 40% depreciation for a capital asset, there should be no additional reductions to the original purchase price of a customized airplane reconfiguration for engineering or labor costs. If a candidate's general committee acquires capital assets from the candidate's primary committee, the purchase price is 60% of the "original cost of such assets" to the candidate's primary committee.⁵ 11 C.F.R. § 9004.9(d)(1). This is a simple regulation. "Original cost" means just that. The plane reconfigurations were customized to suit the Kerry campaign's unique campaign needs and specifications. The cost of any customized capital asset should include the *entire* original cost, including labor and engineering costs necessary to customize the various parts and materials used. Limiting the purchase price of a customized airplane reconfiguration to parts and materials and not including labor or engineering costs as the General Committee proposes is analogous to considering the purchase price of a custom made designer dress to be only the cost of the fabric and thread.

Consistent with the PAR, the Audit staff allocated the entire \$63,103 cost of exterior decals on the Boeing 757 to the General Committee.⁶ Instead of treating these decals as a depreciated capital asset, the proposed report applies the "bright line" rule for attribution of expenditures between the primary and general election at section 9034.4(e) which provides that goods or services used for the general election should be allocated to the general election, on the grounds that unlike the other reconfiguration costs, the Boeing 757 never actually flew after the Kerry-Edwards decals were applied until after the convention. We do not disagree with this distinction, but we do note that one result of it is that expenses for similar decals on similar planes are treated differently.

We also suggest that this section be revised to clarify earlier in the discussion that citations to specific accounting standards are intended to provide non-exclusive examples of a generally accepted audit principle (GAAP) that can also be found in many other sources. This could be accomplished by moving the discussion at pages 17-18 of the proposed Report closer to the beginning of this section.

B. Due to Media Vendor

The Audit Division also adjusted the expenditure limitation by \$934,699 to account for the amount the General Committee underpaid its media vendor, Riverfront Media. The General Committee asserts that the underpayment is only \$47,423. We agree with the Audit staff. The

⁵ Committees must keep a list of the purchase price and other information for capital assets. 11 C.F.R. § 9003.5(d).

⁶ This amount is a separate expense and is not included in the reconfiguration cost of \$925,997.

amount of the underpayment is calculated by subtracting the net funds the General Committee paid to Riverfront Media from the net cost of media buys and commissions owed by the General Committee. The General Committee agrees that refunds it received from Riverfront Media for advertisements that did not run should be subtracted from the gross cost of its media buys and commissions. Inexplicably, it does not agree that these refunds should be subtracted from the other side of the equation – the funds it paid to Riverfront Media. In fact, the General Committee offers no rationale for its position. We agree that refunds received by the General Committee and deposited into its accounts should reduce both the calculation of the General Committee's total media costs and the total of the General Committee's payments for those media costs because the General Committee's approach inaccurately inflates the total amount it paid to Riverfront Media by not accounting for refunds it received from Riverfront Media. We suggest, however, that this section be revised to clarify the facts. Specifically, the chart on page 24 should be revised and simplified to include headings and set forth the auditor's calculations in one column and a parallel column for the General Committee's calculations.

C. Accounts Payable – Media

Finally, we comment on the Audit Division's adjustment to the expenditure limitation to account for reconciliation and recordkeeping services. Specifically, we recommend that the proposed Report be revised to more fully explain why \$100,000 due to Riverfront Media for reconciliation and recordkeeping services should be treated as accounts payable for operating expenses rather than as winding down costs. Winding down costs are costs associated with terminating the campaign such as compliance and other necessary administrative costs. 11 C.F.R. § 9004.11. The agreement with Riverfront Media states that \$100,000 was due for all reasonably documented recordkeeping and reconciliation expenses incurred prior to November 2005, a year after the election. The expenses for activity between the election and November 2005 may be winding down costs. If the Audit Division believes they are not, the auditors should more fully explain why these expenses are not winding down costs.