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

I. INTRODUCTION.

Kerry-Edwards 2004, Inc. (the "Committee") and Kerry-Edwards 2004, Inc. General Election Legal and Accounting Compliance Fund ("GELAC") file this response to the Audit staff's findings and recommendations as set forth in the Preliminary Audit Report (the "PAR").

In general, this response follows the numerical order of the PAR. With some exceptions (noted below) the Committee believes that the recommended findings are without substantial support in fact or in law. The PAR attempts to find fault with the Committee actions by applying novel legal theories to facts and by making conclusory allegations unsupported by the facts. For example:

- The Audit staff urges the Commission to attribute $41,000 in interest earned by its media vendor to the Committee even though 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, nor used for the Committee's benefit.
- The Audit staff attributes to the Committee, rather than GELAC, a $100,000 payment to Riverfront Media, which was for the purpose of compliance and consulting in connection with the audit. It does so without separately breaking out this sum for Commission review and without any acknowledgement in the PAR that the Committee disputed this treatment of a GELAC expense.
- The Audit staff advances the novel theory -- for the first time that we can find -- that labor and engineering costs must be included in the Commission's

definition of capital assets. To do so it relies not on Commission regulations or any other Commission authority, but rather on Federal accounting standards that explicitly do not apply to a non-governmental entity such as the Committee. Even then, it selectively applies portions of the standard without regard to other sections of the same standard.

- The Audit staff urges the Commission to set aside its promulgated bright line rule for non-capital assets with respect to airplane decals. It makes this suggestion through an unsustainable analogy to the Commission's travel regulations.

- The Audit staff ignores a direct statement provided by a phone vendor as to the cost of the monthly phone leased from that vendor, claiming additional information beyond the phone vendor's clarification of his own contract is required.

- The Audit staff turns an approximately 99.58% rate of invoice/affidavit collection into a record keeping finding.

Many of the disagreements, detailed further below, stem from a fundamental difference in approach between the Committee and the Audit staff. The Audit staff seems bothered by the idea that the rules adopted by the Commission, and submitted to Congress for review, can be applied on their face to yield what the auditors view to be an "unjust" result in some circumstances. Thus, as discussed below, the Audit staff eschews the "bright line rule" contained in the regulations when they believe the result would be too favorable for the Committee. They apply an inapposite accounting standard when they conclude that the current regulations do not properly account for certain expenses as capital asset costs.

The Committee will not defend Title 26 or the related Commission regulations as "fair and balanced." Sometimes, as with the bright-line rule for primary and general election expenses, the regulations result in an outcome more favorable to the Committee.

In other circumstances, they do not. Senator Kerry, for example, faced a 12-week general election during which to spend his public grant, while the regulations permitted President Bush to spend unlimited private funds during four of those weeks, and then spend his public grant during an 8-week period. As the response below details, Senator Kerry had to contend with the Commission's rules regarding leased airplane travel, while President Bush was entitled to fly on Air Force One at a fraction of the actual operating cost. Sometimes the rules help a committee and sometimes they hinder it. The Audit staff may not, however, pick and choose the least attractive presentation of the facts and application of the law to suit their objective.

Finally, during its review of the PAR it has become clear to the Committee that embedded in the summary totals contained in the PAR are numerous legal and factual assumptions for which no explanation or itemization is offered. In some instances, these assumptions relate to issues about which the Committee had raised prior objections, but yet were left unaddressed in the PAR itself. In other instances, the PAR reflects calculations that square with neither the Committee's own records provided to the auditors nor with the figures presented by the auditors to the Committee at the Exit Conference. The Committee is concerned that the Commission fully understand all of the information and arguments presented in the audit -- and not just those that are described by the Audit staff.

To aid the Commission, the Committee is attempting to present each of these issues in a complete fashion, attaching back-up documentation when possible. However,

the Committee remains concerned that yet additional summary calculations and/or arguments may again be presented to the Commission by the Audit staff, without a full opportunity for those arguments and/or calculations to be reviewed by the Committee. As a result, the Committee respectfully requests that if any additional issues or new calculations are presented to the Commission as part of the remaining audit process, the Committee receive notice and an opportunity to review those calculations or arguments and have an additional right of response. The Committee strongly believes that the Commission should, as part of its due process obligations, provide such an opportunity.

II. FINDINGS AND RECOMMENDATIONS.

A. FINDINGS FOR WHICH AN ADDITIONAL RESPONSE IS REQUIRED

1. The Committee did not benefit from the interest earned by its media vendor.

Finding 1 relates to interest earned, without the Committee's knowledge, by its Committee's media buyer. The Commission's regulations state:

> If the Commission determines that a candidate *received* any income as a result of an investment or other use of payments from the fund pursuant to 11 CFR 9004.5, it shall so notify the candidate, and such candidate shall pay to the United Treasury an amount equal to the amount determined to be income, less any Federal, State or local taxes on such income.

11 C.F.R. § 9007.2(b)(4) (emphasis added). Relying on this regulation, the PAR concludes that the Committee must repay $41,277 that the Audit staff claims was earned by the Committee's outside media buyer. As described in further detail below, the Committee received no benefit from the interest earned by its media buyer, and there is therefore no factual basis for treating the interest earned by the Committee's media buyer

as being subject to section 9007.2.

During the general election, the Committee received media services through a contract with Victory 2004 LLC, a D.C. limited liability company whose members include Riverfront Media SMLLC, Squier, Knapp & Dunn Communications, Inc., and Shrum, Devine, & Donilon, Inc. *See* Exhibit A. Riverfront Media SMLLC, which provided the media purchasing services, is a wholly owned subsidiary of GMMB Inc., which in turn is a wholly-owned subsidiary of Fleishman-Hillard Inc. and an indirect subsidiary of Omnicom Group Inc., a publicly-traded company.

As explained in an affidavit provided by Riverfront Media and attached as Exhibit B (the "Riverfront Affidavit"),

> Monies were received into Riverfront Media's bank account from John Kerry for President, Kerry-Edwards 2004, and the Democratic National Committee. These receipts contained monies to be paid to media outlets for ads placed by Riverfront Media as well as the agreed-upon media commission . . . . As is industry standard practice, all monies housed in Riverfront Media's bank account were subject to earn interest and be assessed bank fees. This is consistent with other business units within GMMB, and the same interest rates and bank charges applied across the board. Due to campaign and media timelines, the vast majority of all monies received (net dollars for vendors) were immediately paid back out to media outlets. Interest was earned primarily on Riverfront's media commissions, which are housed in the account until needed to pay operating expenses. Again, GMMB and its affiliates, including Riverfront Media, follow industry standard practice by putting all funds received from clients in interest-bearing operating accounts. The interest earned by Riverfront Media did not affect the financial terms offered Kerry-Edwards 2004.

Riverfront Affidavit, ¶¶ 8-9.

During the field work for this audit, the Audit staff requested and received from

Riverfront Media all of its bank records relating to its work on behalf of the Committee. Prior to the Audit staff's request for these bank statements from Riverfront Media in spring of 2005, however, the Committee was unaware of Riverfront Media's interest earnings, and never received any benefit from the interest Riverfront Media earned in connection with its parent companies. *See* Affidavit of the Committee's Chief Executive Officer, attached as Exhibit C.

Neither the PAR nor the auditors have suggested that the Committee knew that its vendor was earning interest. Similarly, there is no evidence or suggestion that any interest to be earned by the media buyer factored into the negotiations between the parties. Nevertheless, the PAR contains several conclusory statements about the interest earned by Riverfront Media, as part of the Audit staff's effort to shoehorn Riverfront Media's interest earnings into section 9007.2: "It appears that the interest earned was used to pay for media buys and/or to offset amounts owed to Riverfront" and "This potential repayment exists because the funds were actually used for campaign purposes and, therefore, triggered the regulation involving receipt of income." PAR, pp. 8-9. Such statements are simply not supported by the facts.

During a meeting between Committee representatives and the staff about the PAR, the auditors acknowledged that they could not point to any particular invoice or expense paid for by the interest. Instead, they simply stated that there was the "potential" that the interest was used to defray Committee costs. In contrast to this speculation, the Committee offers sworn affidavits from both Riverfront Media and the Committee's chief

executive officer, which state unequivocally that the Committee had no knowledge of these interest payments until the Audit staff's request for Riverfront Media's bank records in the spring of 2005.[1]

In sum, in the PAR the Audit staff "recommends that the General Committee provide evidence that demonstrates 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." PAR, p. 8. The Committee's CEO's affidavit, and Riverfront Media's affidavit and interest calculation, amply demonstrate "that the General Committee did not benefit from the interest earned" by Riverfront Media. This Finding is without merit and should be rejected.

2. The Committee disagrees with the Audit staff's calculation of expenditures subject to the expenditure limitation as of June 30, 2005.

The Committee disagrees with a number of the Audit staff's conclusions in Finding 2, which relates to the 2004 general election expenditure limitation for presidential candidates. During the 2004 general election, the Committee's expenditure limitation was $74,620,000, and the expenditure report period for the Committee was from July 30, 2004 to December 2, 2004. The PAR contains a series of numbers that purport to support the Audit staff's conclusion about the calculation of the Committee's expenditures that are subject to this expenditure limitation. Frustratingly, many of the

[1] Even if the Committee had somehow "received" the interest at issue – which it did not – the information that Riverfront Media provided to the Committee in response to this audit shows that the proper interest calculation is $6,663.81, not $41,277. *See* Exhibit D.

numbers lack an explanation of their subtotals or how they were derived, or why they differ from the Expenditure Limitation Calculation provided by the Committee over one year ago. *See* Kerry-Edwards 2004, Inc. Schedule of Expenditures Subject to the Limitation as of June 30, 2005, dated October 27, 2005, attached at Exhibit E (the "October 2005 KE04 Expenditure Limitation Calculation"). It has taken the Committee significant time and resources to piece together many of the differences that are not apparent from the face of the PAR. The Committee is concerned that the Commission may have approved the PAR without a full presentation of these figures and thus without a complete understanding of the assumptions contain within them. The Committee wishes to highlight the disagreements below in greater detail, so that the Commission will have a more complete record upon which to consider these issues.

a. GELAC Fund Reimbursement for Shared Overhead (Line 2).

The PAR refers to $36,950 of "Excess Compliance Fund Reimbursement for Shared Overhead," but there is no explanation in the PAR of which expenses this amount encompasses. The Committee's previous submission calculated this amount at $19,656.31, consisting of $18,956.31 in rent and $700 in computer expenses. *See* October 2005 KE04 Expenditure Limitation Calculation at Line 10, worksheet B, cell K17. Based on additional spreadsheets obtained from the Audit staff after the issuance of the PAR, the Committee surmises that the disputed amount relates to GELAC's reimbursement of accounting software and computer rentals for compliance staff under the 85% formula applicable to the Committee's accounting office.

Under the Commission's General Election Supplement to the Financial Control and Compliance Manual (last updated April 2000) (the "General Election Manual"), GELAC may reimburse 85% of the Committee's costs associated with its accounting office:

> A committee may allocate 85 percent of payroll, payroll taxes, overhead, and other costs which relate to the operations of the accounting office and 50 percent of computer expense as exempt compliance. The accounting office is defined as the cost center responsible for performing the following functions: expenditure processing, payroll, budget tracking, general ledger maintenance, cash receipt and disbursement journal maintenance, Federal and State Tax filings, review of documentation and payment of expenses, tracking of limitations, and preparation of disclosure reports.
>
> The accounting office shall not include the legal department, fundraising, administration, State or regional offices, press, research, etc. Computer costs charged to the accounting office must not include costs related to fundraising or general campaign management. Overhead may be charged to the accounting cost center based on relative payroll dollars charged to the accounting office vs. total payroll dollars for the national headquarters staff.

General Election Manual, p. 19.

In treating the accounting department's computer rentals and accounting software as subject to the 85% allocation rule applicable to other accounting costs, the Committee relied on the General Election Manual's statement that "[c]omputer costs charged to the accounting office must not include costs related to fundraising or general campaign management." *Id.* It makes no sense for the General Election Manual to caution against charging non-accounting-related computer costs to the accounting office, if no computer costs can be charged to the accounting office at all, as appears to be the Audit staff's position. The Audit staff's apparent position that computer costs for the accounting office

must be allocated at 50% is not supported by the instructions in the General Election Manual, and should not be adopted by the Commission. The Committee continues to believe that its interpretation of the General Election Manual is reasonable, and the accounting office's computer costs are properly subject to the accounting office's 85% allocation formula.

b. Unreimbursed Costs Incurred for Providing Transportation to USSS

During the general election, members of the United States Secret Service ("USSS") traveled with Senator Kerry, Senator Edwards, and their family members. Commission regulations provide that the cost of USSS travel on behalf of a campaign does not count towards a committee's expenditure limitation. The costs of such travel may be reimbursed by the USSS, and any USSS travel that is not reimbursed by the USSS may be reimbursed by GELAC. *See* 11 C.F.R. §§ 9003.3(a)(2)(i)(H), 9004.6(a).

The PAR states that the amount of unreimbursed USSS costs as of June 30, 2005 was $632,551.18, and it provides a cursory explanation of the underlying calculation:

> 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.

PAR, p. 12. However, in the October 2005 KE04 Expenditure Limitation Calculation, this amount is presented as $644,440.85 [$2,297,274.39-$1,325,693.67-$327,139.87]. *See* October 2005 KE04 Expenditure Limitation

Calculation, attached as Exhibit E, at Line 11, worksheet J, cell C9; Line 12, worksheet H, cell J30; and worksheet J, cell D14. The Committee provided comprehensive documentation for its USSS reimbursement calculations during the course of the audit, and the PAR presents no analysis or explanation to dispute those figures. The Committee received additional information about these figures from the Audit staff on December 22, 2006, the deadline for this response, but in the interest in meeting its filing deadline with the Commission, the Committee has not had a chance to incorporate that information into this response.

c. Amount Due to the Primary (Line 5).

During the general election, Senator Kerry and Senator Edwards did most of their campaign traveling on airplanes leased by the Committee (the "JK-757" and "JRE-727," respectively). These airplanes were originally used during the primary, and the leases for these airplanes were subsequently assigned to the Committee. As part of the reconfiguration of the airplanes during the primary, the primary committee purchased assets for use on the airplanes, and those assets were subsequently sold to the Committee in accordance with the Commission's Title 26 regulations pertaining to the sale of capital assets between a primary committee and a general committee. *See* 11 C.F.R. §§ 9003.5(d) and 9004.9(d). As explained below, the Committee strongly objects to the Audit staff's attempts to import a novel set of legal theories in order to artificially expand the Committee's share of costs for these leased airplanes.

(i) Valuation of Capital Assets Pursuant to Commission Regulations

The Commission's regulations for publicly funded presidential general election campaigns have specific rules that govern capital assets. Under 11 C.F.R. § 9003.5(d), "[t]he candidate or committee shall maintain a list of all capital assets whose purchase price exceeded $2000 when acquired by the campaign . . . . For purposes of this section, 'capital asset' shall be defined in accordance with 11 C.F.R. 9004.9(d)(1)(i)." That section, in turn, states: "For purposes of this section, the term *capital asset* means any property used in the operation of the campaign whose purchase price exceeded $2000 when acquired by the committee." 11 C.F.R. § 9004.9(d)(1)(i). Examples of "property" that must be included as capital assets if they meet the $2000 threshold are "office equipment, furniture, vehicles and fixtures acquired for use in the operation of the candidate's campaign," as well as "items such as computer systems and telecommunications systems, if the equipment is used together and if the total cost of all components that are used together exceeds $2000." *Id.*

In its regulations, the Commission has established a uniform calculation for the purchase price of capital assets transferred from a presidential candidate's primary committee to the general committee: "If capital assets are obtained from the candidate's primary election committee, the purchase price shall be considered to be 60% of the original cost of such assets to the candidate's primary election committee." 11 C.F.R. § 9004.9(d)(1)(ii).

By explicitly adopting the 60% valuation rule in 11 C.F.R. § 9004.9(d), the Commission has moved away from the time-consuming inquiries into the useful life of assets that could tie up Commission resources for years. The Commission's shift to a more streamlined approach was, in no small part, out of recognition of the costs of complexity. As this 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 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.

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 or engineering.

In addition to property owned by the primary committee, however, the Audit staff selected labor and engineering as two types of primary committee costs that should be sold to the Committee and "depreciated" to 40% of the original cost of those services performed during the primary. Since no Commission regulations or other Commission authority set forth this rule, the Audit staff relied instead on a set of standards that do not, on their face, apply to the Committee, and which have never been formally adopted by this agency in order to support their position. As stated in the PAR:

> 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). 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.

PAR, p. 15.

The Committee has several objections to the use of this standard in this context. First, omitted from the PAR, but included in the paragraph of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment) which appears to have been cited by the

Audit staff, are the following costs:

- transportation charges to the point of initial use;

- handling and storage costs;

- acquisition and preparation costs of buildings and other facilities;

- an appropriate share of the cost of the equipment and facilities used in construction work;

- fixed equipment and related installation costs required for activities in a building or facility;

- direct costs of inspection, supervision, and administration of construction contracts and construction work;

- legal and recording fees and damage claims;

- fair value of facilities and equipment donated to the government; and

- material amounts of interest costs paid.

Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment), Chapter 2, section 26.

All committees undoubtedly incur some of these other costs in connection with many capital assets. For example, committees pay legal fees in connection with the negotiation of the lease agreements and the purchase of capital assets. Has the Commission ever required a committee to have separated out those legal costs and, in accordance with Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment), Chapter 2, section 26, incorporated them into the "purchase price" of the asset?

If the Commission adopts these standards, "handling and storage costs" and "direct

costs of inspection, supervision, and administration of construction contracts and construction work" in connection with assets that meet the Commission's $2,000 threshold for a "capital asset" would presumably also need to be tracked and included in the cost of the asset. If labor and engineering services were required to be included, but these other types of expenses were not, how was the Committee to know which parts of Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment) it must follow, if one part of Chapter 2, section 26 applies but another does not? What Commission rule would alert a committee to this requirement? Undoubtedly, widespread complexity and uncertainty would be added to the capital asset valuation process by introducing these factors into the equation.

What makes this proposed application of this new standard even more inappropriate is the fact that it explicitly does not apply to the Committee and its assets. According to the standards' Introduction, "[t]he purpose of this statement is to provide accounting standards for Federally owned property." As explained in the standards' Executive Summary, "[t]he diversity among Federal PP&E creates a need for meaningful categories of PP&E *with different accounting standards for each category.*" Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment) (emphasis added). If different types of federally owned property have different accounting standards, then how might a committee with no federally owned property know which of the standards should apply?

Even if one were to assume that the category of Federally owned property most analogous is "general PP&E" (as opposed to Federal mission PP&E, heritage assets, or stewardship land, the other three options listed), the accounting board itself cautions against comparing Federal and non-Federal assets: "The Board is not making a recommendation that cost comparisons actually be made. Nor is it suggesting that costs can be easily compared for a Federal and non-Federal entity." Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment), Chapter 1, Note 28.

Not surprisingly, the underlying purpose of these accounting standards appears to differ from that of Commission regulations. The "Board seeks to provide accounting standards that will result in:

> - relevant and reliable cost information for decision-making by internal users (e.g., program managers, budget examiners and officials),
>
> - comprehensive, comparable cost information for decision-making and program evaluation by Congress and the public, and
>
> - information to help assess the efficiency and effectiveness of asset management (e.g., condition of assets including deferred maintenance)."

Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment). While it might be commendable for the Commission to "help assess the efficiency and effectiveness of asset management" by presidential committees, these objectives do not appear to fit squarely within the purposes of Commission regulations, suggesting that perhaps the Federal Accounting Standards Advisory Board's Statement of Federal

Financial Accounting Standards were promulgated for a different purpose.

Given the myriad of uncertainties that arise when applying the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment) in a context for which it was not intended, it is not surprising that the Commission has never adopted this as its own rule, nor even cross-referenced it in any of its regulations. And were the Commission to decide, improbably, that it thought these rules should apply to a campaign committee, it would need to make that decision on a prospective basis, through the rulemaking process. *See* 11 C.F.R. § 112.4(e) ("Any rule of law which is not stated in the Act or in chapters 95 or 96 of the Internal Revenue Code of 1954, or in a regulation duly prescribed by the Commission, may be initially proposed only as a rule or regulation pursuant to procedures established in 2 USC § 438(d) or 26 USC 9009(c) and 9039(c) as applicable").

As noted earlier, Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6 (Accounting for Property, Plant, and Equipment) contains accounting standards for "Federally owned" property, plant, and equipment (PP&E). The Committee's leased airplanes were not, of course, "Federally owned" property. However, if the standard for "Federally owned" property is the standard to which the Committee is to be held, there is a regulation that governs airplanes that are "Federally owned" that is actually within the Commission's jurisdiction. It is 11 C.F.R. § 100.93(e), entitled "Government conveyances." It requires a campaign that uses

an airplane provided by the Federal government to merely pay the equivalent of first class airplane in most cases. It does not, however, require the campaign to pay for any reconfiguration costs. *Id.* Thus, under the most analogous rule for Federally owned property that is contained in the Commission's own regulations, the reconfiguration costs transferred from the primary committee to the Committee would be zero.

If the airplanes leased by the primary committee and the Committee are to be treated as the equivalent of "Federally owned" airplanes, as the Audit staff advocates, the Committee respectfully questions why the rules for Federally owned airplanes found in 11 C.F.R. § 100.93 would be overlooked, in favor of standards that were established outside the Commission's jurisdiction.

In sum, there is no connection between the Audit staff's position and the Commission's regulations. If the Commission wishes to adopt the Audit staff's new definition of capital assets, thereby introducing greater complexity into the publicly funded presidential campaign audit process and moving even further away from a level playing field between challengers and incumbents, then 11 C.F.R. § 112.4(e) requires it to do so in the context of a rulemaking, and not in an effort to extract a larger repayment from a particular presidential nominee. The Committee believes that its purchase price of $260,798 (60% of $434,663) for assets used on a leased airplane is in accordance with 11 C.F.R. § 9004.4(d), and strongly disagrees with the position advocated by the Audit staff that labor and engineering should be treated as within the definition of 11 C.F.R. § 9003.5(d) in order to raise the purchase price to $555,598.

(ii) Leased phone and fax equipment.

The Committee leased, but did not purchase, phone and fax systems for the JK-757. In the contract with the vendor, which was originally entered into with the primary committee, the vendor did not separate out the monthly cost of renting the phone and fax systems, but instead gave an amount that included the monthly rental charge, as well as labor and engineering fees incurred during the primary. *See* Exhibit F. When, during the course of the audit, the Committee sought clarification from the vendor as to what the monthly charge was, he stated in writing that the monthly rental charge was $13,250. *See* Exhibit G. It is undisputed that the Committee leased, but never purchased, the phone and fax system from this vendor, and that the system was installed in the spring of 2004. The Committee again objects to the Audit staff's effort to require the Committee to treat as general election expenses the cost of labor and engineering services performed for a leased phone system during the primary.

The Committee furthermore disagrees with the Audit staff's characterization of this issue in the PAR:

> 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.

PAR, p. 13.

The explanation provided in the Committee's Response to the Exit Conference Memorandum, dated October 27, 2005, seems to provide a more than an adequate explanation of why the monthly lease charge from the vendor is separate from the one-time charge for services performed during the primary:

> The Committee agrees that it should reimburse the primary committee for the portion of the lease between the primary committee and Commercial Jet, Inc. that took place during the expenditure report period. According to Vincent R. Quinn, Director of Marketing & Sales for Commercial Jet, Inc. and signatory to the contract, the monthly amount of the phone system lease was not broken out in sufficient detail in the Workscope Authorization Agreement, dated April 9, 2004, between the primary committee and Commercial Jet, Inc. He has stated to the Committee, in writing, that the correct monthly payment for the lease is $13,250. See Exhibit E. The Committee agrees to reimburse the primary committee for half of the eight-month lease.

Response to the Exit Conference Memorandum, pp. 11-12.

Given the information provided thus far, the Committee is uncertain what "additional information" the Audit staff is referring to in the PAR. The Committee believes the underlying dispute is whether or not there is a legal basis for requiring the Committee to pay the primary committee's labor and engineering costs.

The more fundamental issue, of course, presented by this and many of the other calculations, is whether the Committee must pay for every direct or indirect benefit it derived from the primary committee. It is no secret that the Committee benefited from assuming responsibility for electing Senator Kerry and Senator Edwards from a fully-functioning primary committee. The primary committee

saved the Committee expenses in all sorts of ways – it did not need to start from scratch in its hiring process, it did not need to ferret out a new building lease, new leased equipment, new vendors, etc. However much it may disturb the Audit staff that not all benefits transferred from the primary committee to the Committee are monetized, the Commission was well aware of this tradeoff when it adopted its bright-line regulation for primary and general election expenses, with some clearly enumerated exceptions. As the Commission's Explanation & Justification for 11 § C.F.R. 9034.4(e) states:

> Questions have arisen in recent election cycles as to whether certain expenses charged to primary committees were in fact used to benefit the general election . . . .
>
> Most of the commentators who addressed this issue favored a "bright-line" cut-off date between primary and general election expenses, which would give committees clear guidance as to which expenses will be attributed to the primary election and which to the general election. Some suggested that this date be set as the candidate's date of ineligibility. Moreover, most comments opposed any guidelines or presumptions that would require a "case-by-case" determination of how certain expenditures should be characterized.
>
> The Commission recognizes that it can be difficult to select a single "bright line" date appropriate for all campaigns under all circumstances. Also, the adoption of "bright line" rules could in certain instances result in the primary committee's subsidizing the general election committee, or vice versa. Nevertheless, the Commission believes this approach is appropriate with regard to certain specific types of expenditures that may benefit both the primary and the general election. These include expenditures for polling; state or national offices; campaign materials; media production costs; campaign communications; and campaign-related travel costs (*see also* 11 CFR 9034.5, depreciation of capital assets, discussed below.)
>
> *The Commission recognizes that there could be situations in which this approach does not accurately reflect the relative impact of particular expenditures. However, these differences should balance themselves out*

> *over the course of a lengthy campaign. In addition, a major factor in the Commission's decision is the desire to complete the audits more quickly and using fewer agency resources. It can be extremely time-consuming and labor-intensive for both the Committee and the committees to examine thousands of individual expenditures, especially where, as here, both the timing and the purpose of each expenditure is at issue. Accordingly, the Commission is adding a new paragraph (e) to this section partially [to] deal with this situation.*

Explanation and Justification, 60 *Fed. Reg.* 31854, 31866-67 (June 16, 1995) (emphasis added).

Unless the current Commission intends to abandon section 9034.4(e) without the benefit of a rulemaking, the Committee fails to see how the costs of goods and services used by the primary committee during the primary are the legal obligation of the Committee, unless the costs fit within one the regulations' enumerated exceptions.

(iii) JK-757 Exterior Decals.

Although this issue was not highlighted in the Exit Conference Memorandum, the PAR focuses on some exterior decal work done on the JK-757 during the primary:

> 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. 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. 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.

PAR, p. 13.

The Committee disagrees that the bright-line rule of 11 C.F.R. 9034.4(e) can be expanded beyond its enumerated exceptions, as the Audit staff seeks to do. Nor is the Audit staff's creative interpretation of section 9034.4(e)(7) appropriate in this context. Section 9034.4(e)(7) provides a general rule that travel shall be attributed according to when the travel occurs, with some exceptions: (1) travel to and from the convention shall be attributed to the primary election (even though post-convention travel occurs during the general election, of course), and (2) "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 C.F.R. § 9034.4(e)(7). Put simply, decals have no relationship to "travel by a person who is working exclusively on general election campaign preparations." This provision quite clearly applies to advance staff that were traveling ahead during the primary to make preparations for general election campaign rallies in particular cities. Their travel costs were treated by the Committee as general election expenses pursuant to 11 C.F.R. § 9034.4(e)(7). It would be bizarre for the Commission to conclude that this travel rule encompasses decals applied to a leased plane during the primary.

(iv) JRE-727

Senator Edwards was publicly identified as Senator Kerry's choice for running mate in early July 2004, and Senator Edwards traveled on behalf of Senator Kerry and the primary committee prior to Senator Kerry's nomination at the DNC convention in late July 2004. The PAR, somewhat misleadingly, states that "[t]he General Committee leased a Boeing 727 for Senator Edward's travel for the period August 1, 2004, through November 2, 2004," when in fact it is undisputed that Senator Edwards flew on the primary committee's leased 727 airplane prior to the DNC convention, as the flight records previously provided to the Audit staff demonstrate. PAR, p. 12. According to the PAR, the remaining disputes about the JRE-727 appear to relate to installation work and external decals installed on the JRE-727 between July 11-18, 2004, prior to Senator Edwards' use of the plane between July 19-27, 2004, the period before his attendance at the DNC nominating convention. *Id.*

The Committee disagrees that labor and engineering costs associated with installing leased phone equipment on a leased airplane during the primary are attributable to the Committee under the Commission's regulations.

Similarly, the treatment of exterior decal work performed on a leased airplane as a "capital asset" does not appear to be consistent with the Commission's definition of "capital asset". The Committee might just as well be required to treat a fresh coat of paint as a "capital asset" to be purchased by the general committee. As discussed above in the context of the JK-757 leased phone system, section 9034.4(e) has created a bright-line test for primary and general election expenses, and the fact that the Committee may

derive a benefit from a cost incurred by the primary committee does not, in and of itself, provide a legal justification for placing responsibility for some or all of the cost on the Committee. The Commission's Explanation & Justification for 11 § C.F.R. 9034.4(e) bears repeating:

> Questions have arisen in recent election cycles as to whether certain expenses charged to primary committees were in fact used to benefit the general election . . . .
>
> Most of the commentators who addressed this issue favored a "bright-line" cut-off date between primary and general election expenses, which would give committees clear guidance as to which expenses will be attributed to the primary election and which to the general election. Some suggested that this date be set as the candidate's date of ineligibility. Moreover, most comments opposed any guidelines or presumptions that would require a "case-by-case" determination of how certain expenditures should be characterized.
>
> The Commission recognizes that it can be difficult to select a single "bright line" date appropriate for all campaigns under all circumstances. Also, the adoption of "bright line" rules could in certain instances result in the primary committee's subsidizing the general election committee, or vice versa. Nevertheless, the Commission believes this approach is appropriate with regard to certain specific types of expenditures that may benefit both the primary and the general election. These include expenditures for polling; state or national offices; campaign materials; media production costs; campaign communications; and campaign-related travel costs (*see also* 11 CFR 9034.5, depreciation of capital assets, discussed below.)
>
> *The Commission recognizes that there could be situations in which this approach does not accurately reflect the relative impact of particular expenditures. However, these differences should balance themselves out over the course of a lengthy campaign. In addition, a major factor in the Commission's decision is the desire to complete the audits more quickly and using fewer agency resources. It can be extremely time-consuming and labor-intensive for both the Commission and the committees to examine thousands of individual expenditures, especially where, as here, both the timing and the purpose of each expenditure is at issue. Accordingly, the Commission is adding a new paragraph (e) to this section partially [to] deal with this situation.*

Explanation and Justification, 60 *Fed. Reg.* 31854, 31866-67 (June 16, 1995) (emphasis added). There is no legal basis for treating the decal work done during the primary as a general election expense under section 9034.4(e) or any other Commission regulation.

c. Amount Due to Riverfront Media (Line 6)

The PAR states that "it is the opinion of the Audit staff that the General Committee owes [Riverfront Media] $944,768." PAR, p.17. 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 Committee believes that the records also reflect an overpayment by the DNC and thus this amount is attributable to the DNC as an additional 441a(d) expenditure, well within the remaining $124,989 in 441a(d) spending authority the DNC has retained from the 2004 presidential election.

As support for the Audit staff's position that Riverfront Media is owed more money, the PAR states that "[t]he Audit staff agrees that the General Committee paid the invoices it received. However, neither the General Committee nor the media vendor can

associate these paid invoices with specific buy(s); apparently due to problems with Riverfront's accounting system." PAR, p. 17. The Audit staff simply misapprehends the manner in which campaigns transfer funds and account for media buys.

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, both of which have been provided previously to the Audit staff (the most recent version of the Campaign Master Spreadsheet is included in this response as Exhibit H). The reason there is no precise match between each Riverfront Media invoice and particular media buys is that when the Committee paid a media buy invoice from Riverfront Media, it would do so based on a projected media plan. That plan would eventually change, due to cancellations, placement adjustments or last-minute strategy changes. As a result, there would often remain surplus funds in the media vendor's account. As the campaign progressed, the Committee would then direct Riverfront Media to apply the surplus funds to its next media buy rather than sending the Committee back a refund, therefore creating a daisy chain from one invoice to the next, the end result being that the net amount owed for media buys was a lower number than the amount invoiced. There was nothing unusual about this "recycling" of Committee funds for future media buys, rather than Riverfront Media issuing the Committee a refund every time the actual media buy differed from the amount that had been initially invoiced. Indeed, it is the customary way virtually all Democratic campaigns at all levels process media buys. Riverfront Media's total invoices, cancelled

checks, refunds, media buy spreadsheet, Campaign Master Spreadsheet, station affidavits, and the Riverfront Affidavit should provide more than sufficient detail, without the massive undertaking of adding yet another column to the Campaign Master Spreadsheet.

The Committee also notes that the Audit staff's assertion that Riverfront Media was unable to accommodate the Audit staff's request because of "problems with Riverfront's accounting system" is without merit. As stated in the Riverfront Affidavit,

> Monies were received into Riverfront Media's bank account from John Kerry for President, Kerry-Edwards 2004, and the Democratic National Committee. These receipts contained monies to be paid to media outlets for ads placed by Riverfront Media as well as the agreed-upon media commission. Separate project numbers in our job-costing system were set up to track receipts from these entities as well as all disbursements made on behalf of these entities to media outlets. Refunds that were received from media outlets were allocated back to the appropriate entity based on the original disbursements made. Separate media buys made with 441a(d) funds were identified and executed by our media buying department to insure that the funds were handled separately from non-441a(d) hybrid funds.
>
> ***
>
> Riverfront Media maintains a full-cycle integrated accounting system utilizing PeopleSoft financial software, which contains a job costing system. Financial spreadsheets are also utilized to further analyze and manage financial data. An on-site accounting team of nine full-time employees at GMMB manages all facets of the accounting cycle including accounts receivable, accounts payable, billing and general ledger through the financial statements.
>
> Within the PeopleSoft system, unique project numbers are assigned to all clients, allowing for expenses to be tracked on a job-cost basis. Unique activity codes within each project number allow us to capture data on specific tasks within each client project. For the Kerry campaign, we maintained completely separate project codes to capture activity for each entity involved.

A purchase order system within PeopleSoft ensures the proper handling of all expenditures. Approvals from account/firm managers are required prior to payment of vendors. Purchase orders are coded to specific client projects and tasks to ensure the proper recording of expenses. The accounting department also reviews these expenditures for correct application to projects and accounts.

All documents that have been processed through the PeopleSoft system are stored electronically in the firm's database. This allows for quick and accurate collection of documents for backup and other evidentiary purposes.

Riverfront Media continuously reviews and tests its accounting processes and internal controls to ensure we are in compliance with all statutory and regulatory guidelines including the Sarbanes-Oxley Act. Our firm performs quarterly testing of our policies & procedures to meet rigorous Sarbanes-Oxley standards. Our records are also subject to random testing by the Internal Audit division of Omnicom Group Inc as well as testing by external auditors selected by management of Fleishman-Hillard and Omnicom. Riverfront Media's financial statements are audited on a consolidated basis in conjunction with the audit of Fleishman-Hillard.

Our Accounting Department has policies and procedures in place to facilitate the review of management reports on a regular basis. These analyses ensure that accounts are fairly stated and can identify amounts that require further review. Senior management of the firm, including the General Manager, Managing Partner, and Chief Financial Officer, are routinely engaged in reviewing client-related management reports.

Riverfront Affidavit, ¶¶ 8, 13-18.

d. Accounts Payable as of June 30, 2005 (Line 7)

The PAR refers to $217,221 in accounts payable for the Committee as of June 30, 2005, but contains no explanation of which expenses are included in this amount. Based on information subsequently obtained from the Audit staff, $100,000 of this $217,221 is a payment to Riverfront for post-election audit-related expenses. Those expenses fall within the category of winding down expenses, which may be paid by either the

Committee or GELAC. *See* 11 C.F.R. §§ 9003.3(a)(2)(I) and 9004.11. GELAC has paid this expense.

The Committee objected to this same issue in its response to the Exit Conference Memorandum, stating:

> $100,000 for Riverfront reconciliation and recordkeeping
>
> It is the Committee's view that these expenses are wind-down expenses, which are qualified campaign expenses that may be paid by GELAC. See 11 C.F.R. § 9003.3(a)(2)(i)(I). Section 2.3 of the Media Services Agreement, dated as of July 30, 2004, by and among Kerry-Edwards 2004, Inc. ("Campaign"), and Victory 2004 LLC ("Consultant"), and each of Shrum, Devine, & Donilon, Inc., Riverfront Media SMLLC and Squier, Knapp & Dunn Communications, Inc., states that "Campaign shall be responsible for insuring that a maximum of $100,000 is available to reimburse Consultant for the costs, reasonably documented, incurred by Consultant to complete the required reconciliation and other related recordkeeping requirements set forth in Section 10.3(b),(d) and (e) by November 2, 2005. Consultant shall be responsible for any costs in excess of $100,000 in the aggregate."
>
> The obligations set forth in Section 10.3(b),(d) and (e) are as follows:
>
> (b) 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.
>
> (d) Files on a per-spot basis, including, but not limited to, station affidavits or other documents sufficient to demonstrate usage of that spot in its unaltered condition, and documents contained in segregated files sufficient to demonstrate usage for spots which are altered versions of other spots, including station affidavits or other sufficient records of the time at which each spot is run on a station.
>
> (e) A complete record of all refunds for cancelled Bookings, including documentation to demonstrate the spot to which each refund applied.

> Section 2.6 states that "Consultant agrees and acknowledges that its current intention is to divide the fees paid by Campaign to Consultant as follows . . . Reconciliation/Recordkeeping Payment in Section 2.3: entire $100,000 to Riverfront, on or before November 2, 2005.
>
> On October 20, 2005, the Committee provided the auditors with documentation provided by Riverfront for over $200,000 worth of expenses incurred after the expenditure report period by Riverfront (over $100,000 of staff time and over $100,000 of temporary labor costs, respectively) to complete Riverfront's obligations under Section 10.3(b),(d) and (e) for purposes of the audit. As of the date of this response, Riverfront continues to expend resources on these matters.

Response to Exit Conference Memorandum, dated October 27, 2005, pp. 17-18.

Despite the Committee's written objection to this issue after the Exit Conference, the PAR contained no acknowledgement that it even remained an issue in dispute. Indeed, the $100,000 was not even separately presented in the PAR. Instead, it was simply combined with other expenses. The Committee again objects to the inclusion of this GELAC expense in the calculation of the Committee's accounts payable and respectfully requests that the Commission to consider this issue directly.

The Committee also disagrees with another component of the $221,221 total set forth on Line 7. Although there is no explanation of this issue in the PAR, based on information subsequently provided by the Audit staff it appears that the $221,221.37 includes $65,682.86 which was previously reported as debt to the vendor Production Support Services. A significant portion of this Production Support Services debt was paid by the DNC as a 441a(d) expenditure, as evidenced on the DNC's 2005 October Quarterly Report. (*See* payment of $39,825.50 on 8/4/05, and $23,884.00 on 9/12/05).

As a result, this amount does not belong in the Committee's expenditure limitation calculation.

e. Refund of expenditures subject to the limitation received after June 30, 2005

There are several updates to the Audit staff's calculations of refunds received after June 30, 2005. As reflected on the Committee's FEC reports, the Committee has received $586,310.61 in refunds since that date. *See* Exhibit I. The Committee can also provide its bank records relating to these refunds, if needed.

To summarize, the Committee's calculation of Expenditures Subject to the Limitation as of June 30, 2005, updated from the October 2005 KE04 Expenditure Limitation Calculation (attached as Exhibit E) with the information contained in this response to Finding 2, is set forth on the following page:

Line		
1	Reported Expenditures Subject to Limitations at June 30, 2005	$74,788,655
2	Excess Compliance Fund Reimbursements for Shared Overhead	19,656
3	Less: Unreimbursed Costs Incurred for Providing Transportation to the U.S. Secret Service	(644,441)
4	Adjusted Reported Expenditures Subject to Limitation at June 30, 2005	74,163,870
5	Add: Due to the Primary Committee	807,723
	Accounts Payable as of June 30, 2005	53,512
	Less: Refunds of Expenditures Subject to the Limitation Received after June 30, 2005	(586,310)
10	Total Expenditures Incurred Chargeable to the Limitation at September 30, 2005	74,438,794
11	Expenditure Limitation	74,620,000
12	Amount in Excess of Limitation	(181,206)
	Less: Expenditures that May be Reimbursed by GELAC	(6,585)
13.	Amount in Excess of Limitation	(187,791)

3. The Committee has satisfied its recordkeeping responsibilities under 11 C.F.R. § 9003.5.

Finding 3 relates to the Audit staff's request for additional station affidavits from two of the Committee's media vendors, Riverfront Media and Chambers Lopez & Gaitan. The PAR states:

> 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 affidavits pertaining to media buys made by Chambers which have been considered in the above analysis. No additional affidavits were provided pertaining to the missing Riverfront affidavits.

PAR, pp. 19-20.

In response to the PAR, the Committee is submitting additional documentation from its media vendors which it believes will materially satisfy its recordkeeping obligations under Commission regulations.

The Committee's recordkeeping obligations are set forth in 11 C.F.R. §§ 9003.5(b) and 102.9(b), and contain an array of categories of documentation that may satisfy the Committee's burden to show that its funds disbursed to Riverfront Media and Chambers, Lopez & Gaitan were, indeed, spent for media:

> (b) *Documentation required.* (1) For disbursements in excess of $200 to a payee, the candidate shall present a canceled check negotiated by the payee and either:
>
> (i) A receipted bill from the payee that states that purpose of the disbursement; or
>
> (ii) If such a receipt is not available,

(A) One of the following documents generated by the payee: a bill, invoice, or voucher that states the purpose of the disbursement; or

(B) Where the documents specified in paragraph (b)(1)(ii)(A) of this section are not available, a voucher or contemporaneous memorandum from the candidate or the committee that states the purpose of the disbursement; or

(iii) Where the supporting documentation required in paragraphs (b)(1)(i) or (ii) of this section is not available, the candidate or committee may present collateral evidence to document the qualified campaign expense. Such collateral evidence may include, but is not limited to:

(A) Evidence demonstrating that the expenditure is part of an identifiable program or project which is otherwise sufficiently documented such as a disbursement which is one of a number of documented disbursements relating to a campaign mailing or to the operation of a campaign office; or

(B) Evidence that the disbursement is covered by a pre-established written campaign committee policy, such as a dairy [sic] travel expense policy.

(iv) If the purpose of the disbursement is not stated in the accompanying documentation, it must be indicated on the canceled check negotiated by the payee.

(2) For all other disbursements, the candidate shall present:

(i) A record disclosing the full name and mailing address of the payee, the amount, date, and purpose of the disbursement, if made from a petty cash fund; or

(ii) A canceled check negotiated by the payee that states the full name and mailing address of the payee, and the amount, date and purpose of the disbursement.

(3) For purposes of this section:

(i) *Payee* means the person who provides the goods or services to the candidate or committee in return for the disbursement; except that an individual will be considered a payee under this section if he or she receives $1000 or less advanced for travel and/or subsistence and if the individual is the recipient of the goods or services purchased.

(ii) *Purpose* means the full name and mailing address of the payee, the date and amount of the disbursement, and a brief description of the goods or services purchased. Examples of acceptable and unacceptable descriptions of goods and services purchased are listed at 11 CFR 104.3(b)(3)(i)(B).

(4) The documentation requirements of 11 CFR 102.9(b) shall also apply to disbursements.

11 C.F.R. § 9003.5(b).

Section 102.9(b), in turn, provides that:

(b)(1) An account shall be kept of all disbursements made by or on behalf of the political committee. Such account shall consist of a record of:

(i) The name and address of every person to whom any disbursement is made;

(ii) The date, amount, and purpose of the disbursement; and

(iii) If the disbursement is made for a candidate, the name and office (including State and congressional district, if any) sought by that candidate.

(iv) For purposes of 11 CFR 102.9(b)(1), *purpose* has the same meaning given the term at 11 CFR 104.3(b)(3)(i)(A).

(2) In addition to the account to be kept under 11 CFR 102.9(b)(1), a receipt or invoice from the payee or a cancelled check to the payee shall be obtained and kept for each disbursement in excess of $200 by or on behalf of, the committee, except that credit card transactions, shall be documented in accordance with 11 CFR 102.9(b)(2)(ii) and disbursements by share draft or check drawn on a credit union account shall be documented in accordance with 11 CFR 102.9(b)(2)(iii).

(i)(A) For purposes of 11 CFR 102.9(b)(2), *payee* means the person who provides the goods or services to the committee or agent thereof in return for payment, except for an advance of $500 or less for travel and subsistence to an individual who will be the recipient of the goods and services.

(B) For any advance of $500 or less an individual for travel and subsistence, the expense voucher or other expense account documentation and a cancelled check to the recipient of the advance shall be obtained and kept.

(ii) For any credit card transaction, documentation shall include a monthly billing statement or customer receipt for each transaction and the cancelled check used to pay the credit card account.

(iii) For purposes of 11 CFR 102.9(b)(2), a carbon copy of a share draft or check drawn on a credit union account may be used as a duplicate record of such draft or check provided that the monthly account statement showing that the share draft or check was paid by the credit union is also retained.

11 C.F.R. § 102.9(b).

As explained in the Commission's Explanation & Justification for section 9003.5:

> The candidate's burden of proof with regard to qualified campaign expenses consists of two elements – the candidate must show (1) that the expenditure was made, and (2) that the goods or services purchased were in connection with the campaign. These two elements are derived from the statutory definition of the term qualified campaign expense – an expense "incurred by [a] candidate *** or by [the candidate's] authorized committee[s] to further the election of *** such candidate [ ] ***" 26 U.S.C. 9002(11).
>
> The first element of the candidate's burden of proof – showing that the expenditure was made – is directed at proving that the expenditure was actually incurred. The second element of proof – that the goods or services purchased were in connection with the campaign – is directed at showing that the expenditure was made to further the candidate's election.
>
> Subsections (a)(1) through (4) set forth the minimum documentation necessary to show that the expenditure was incurred. For disbursements in excess of $200, the preferred documentation is by receipted bill from the payee. *If there is no receipted bill, documentation may be by cancelled check to the payee plus a bill, invoice, voucher or memorandum from either the payee or the candidate. If such documentation is not available, the minimum documentation permissible is a cancelled check.*

Explanation and Justification on Public Financing of Presidential General Election Campaigns, 45 *Fed. Reg.* 43371, 43375 (June 27, 1980) (emphasis added).

During its 1995 amendments to section 9003.5, the Commission revised this rule to treat canceled checks with even greater significance. While noting that "as in the past, the revised rules require that documentation in addition to the committee's check be provided for disbursements exceeding $200," the Commission made canceled checks the one mandatory component of the documentation requirement for which no alternative documentation would be accepted:

> The revised rules in this section require committees to provide canceled checks negotiated by the payees for all disbursements over $200 . . . . [T]his change will assist the Commission's Audit staff in verifying that public funds are spent on qualified campaign expenses.

Explanation and Justification on Public Financing of Presidential Primary and General Election Campaigns, 60 *Fed. Reg.* 31854, 31857 (June 16, 1995).

Consistent with the mandate, each of these media vendors has provided the Audit staff with cancelled checks showing all of their media expenditures on the Committee's behalf. In addition, these two media vendors provided bank statements, check registers, copies of ads, internal spreadsheets, new spreadsheets created to make the auditors' job easier, and the station affidavits for the vast majority of their media buys. They also answered every question the auditors gave them to the best of their ability. There is no dispute that the funds paid to the Committee's media vendors were, indeed, used for the intended purpose. The only question remaining, then, is whether any television or radio stations kept the payments made for media buys without actually running the Committee's ads or providing the Committee with a refund. Both media vendors have spent countless hours since the 2004 election hounding television and radio stations to produce additional documentation for the very small percentage of media buys for which they did not have station affidavits. A more detailed description of each of the media vendors' documentation is provided below.

a. Riverfront Media

The vast majority of the Committee's media buys were handled by Riverfront Media pursuant to the Media Services Agreement, attached as Exhibit A. Riverfront

Media is a wholly-owned subsidiary of GMMB, Inc. As explained in the Riverfront Affidavit, Riverfront Media was created solely to accommodate the record-keeping related to the 2004 Democratic presidential campaign. No other business was transacted by this entity, enabling Riverfront Media to keep separate records and ensure the proper tracking of receipts and disbursements. A separate bank account, with its own check stock, was created for this purpose as well. Riverfront Media enjoyed all of the benefits and expertise of GMMB, including its strong financial management. Riverfront Affidavit, ¶ 7.

Founded in 1983, GMMB is a well-respected full service advertising and communications agency with dozens of past and current political clients – including Governors, Senators, and former Presidents. GMMB's media planning and buying department has been named the "best spot buying team" in the country by MediaWeek. Annually, GMMB places between $100 and $225 million in media for its clients. Riverfront Affidavit, ¶¶ 2, 5.

During the course of the general election, Riverfront Media cut more than 6,800 checks to more than 500 vendors. Riverfront Affidavit, ¶20. As indicated earlier, these cancelled checks were all made available to the Audit staff, and there has been no assertion from the Audit staff that Riverfront Media's production of its cancelled checks was in any way incomplete.

To properly execute the reconciliation on behalf of the Committee, Riverfront

Media dedicated a team of experienced accountants who spent months identifying invoices/affidavits from media outlets, matching these documents against disbursements issued to the outlets, matching these documents against disbursements issued to the outlets, and balancing the results vendor-by-vendor. The reconciliation team has contacted every vendor to which a disbursement was made during the general election, and continued to contact those for which Riverfront Media did not have the appropriate documentation for the disbursements it recorded. Many of these vendors required repeated follow-up – sometimes requiring as many as ten calls. Riverfront kept separate files for each vendor to track its progress on retrieving the necessary documentation. Even after repeated attempts, a certain segment of this vendor population simply refused to comply with documentation requests. Riverfront Affidavit, ¶ 19.

Riverfront Media received over 8,000 station invoice/affidavits from those vendors. Riverfront Affidavit, ¶20. Riverfront Media has reconciled approximately 99.58% of these station invoice/affidavits, with just 0.42% remaining. *Id.* Riverfront Media has provided a Campaign Master Spreadsheet, included as Exhibit H to this response, which reconciles the station invoice/affidavits with the amounts paid to each station, identifying refunds where appropriate. *Id.*

Riverfront Media's 8,000+ station affidavits are organized in folders that are contained in 6 large boxes with which the Audit staff is familiar. The Audit staff has requested that affidavits received after it last reviewed these boxes be segregated; unfortunately, River Media was unable to accommodate this request. In order to try to

accommodate the Audit staff, the Committee is arranging for all of the 8,000+ invoices/affidavits to be available to the Audit staff in electronic, searchable format. Although the Committee's vendor working on this project was unable to complete this enormous task before the holidays, the Committee expects to have this electronic version of the Riverfront Media invoices/affidavits to the Audit staff before year's end, along with the boxed originals.

The Committee strongly disagrees that any additional steps are necessary to satisfy its recordkeeping burden.

b. Chambers, Lopez & Gaitan

As the Audit staff is aware, Chambers, Lopez & Gaitan is a small media firm, specializing in Hispanic media. Its partners have worked diligently to comply with every request from the Audit staff, despite requests that appeared to go beyond what the Commission's regulations require. Chambers, Lopez & Gaitan produced every cancelled check and bank record requested by the Audit staff. One of its partners spent many hours during 2005 preparing detailed spreadsheets to make the auditors' review of its documentation more convenient. She also spent countless hours contacting each and every media entity, of varying degrees of size and sophistication, in the pursuit of additional documentation requested by the Audit staff. Chambers, Lopez & Gaitan's inventory of invoices/affidavits is materially complete. Since the issuance of the PAR, which identified a recordkeeping finding of $35,333, Chambers, Lopez & Gaitan has obtained additional station affidavits and confirmations of cancelled orders, which are

attached as Exhibit J. Chambers, Lopez & Gaitan has gone above and beyond the call of duty in their efforts to please the Audit staff. There is no material omission in the records produced by Chambers, Lopez & Gaitan, and no plausible basis for concluding that the funds disbursed to Chambers, Lopez & Gaitan were not disbursed for their intended purpose.

4. The Committee agrees to amend its Schedule Ds, although it does not concede that it is necessary to do so.

In response to the Audit staff's debt schedule provided after the Exit Conference, the Committee agreed that $383,023.10 of expenses should have been reported as debt earlier, and agreed to amend its Schedule Ds. *See* Exhibit K. The PAR, however, mischaracterizes the Committee's response and gives the impression that the Committee agreed with the Audit staff about all aspects of this finding, before it even saw the Audit staff's list of alleged debt issues. *See* PAR, p. 21 ("The matter was discussed at the exit conference. General Committee representatives were provided schedules and agreed to amend their reports").

For the reasons set forth in its response to the Exit Conference, the Committee continues to disagree with the Audit staff as to whether certain items that were disclosed as debt were reported early enough, or, in other cases, whether the items were required to be disclosed as debt at all (e.g., recurring expenses). *See* 11 C.F.R. § 104.11(b).

Despite these disagreements, the Committee agrees to make additional amendments to its Schedule Ds in accordance with the Audit staff's recommendation.

5. Stale-dated checks.

The Committee has provided an update on the items identified in the Audit staff's stale-dated check spreadsheet. *See* Exhibit L.

B. FINDINGS AND ADDITIONAL ISSUES FOR WHICH NO ADDITIONAL RESPONSE IS REQUIRED.

The Committee agrees with the Commission's conclusion regarding Finding 6: that the cost of the biographical film used at the convention was reasonably allocated. *See* PAR, p. 5. It is the Committee's understanding that no open issues remain for Finding 7 and Additional Issues 1-3. *See* PAR, pp. 5-6.

C. GELAC RESPONSE TO THE AUDIT STAFF'S FINDINGS AND RECOMMENDATIONS.

1. GELAC has additional documentation for most of the presumptive redesignations in question.

The PAR identified 160 contributions, presumptively redesignated from the primary committee to GELAC, for which additional documentation was requested. Included with this response are copies of the presumptive redesignation letters sent to those contributors. The Committee is providing hard copies of either letters sent or letters received from the contributors identified in the Audit staff's spreadsheet provided after issuance of the PAR, for whom additional documentation was requested. *See* Exhibit M. The Committee is also providing a modified version of the Audit staff's spreadsheet to isolate the specific transactions for which additional documentation is being provided. *See* Exhibit N, worksheet 1. The remaining three worksheets in Exhibit N use the Audit staff's data as a base with additional information included to ensure that

all of the items identified by the Audit staff have been addressed. Note that the Committee has been unable to locate the contributors' addresses for 9 of the transactions, totaling $10,550. Considering that this represents less than 1/200 of the $2,218,314 in presumptive redesignations, involving a total of approximately 2700 contributors, GELAC has substantially complied with its recordkeeping obligations for the presumptive redesignations it received from the primary committee.

2. GELAC has paid $13,800 to the U.S. Treasury for stale-dated checks.

On December 6, 2005, GELAC sent the U.S. Treasury a disgorgement check in the amount of $13,800. *See* Exhibit O. In a spreadsheet provided to GELAC subsequent to the PAR, the Audit staff identified the following checks drawn on GELAC as stale-dated:

1012	*06/20/2004*	*William Bumpers*	*$*	*2,000.00*
1020	*06/20/2004*	*Robert Grunewald*	*$*	*2,000.00*
1022	*06/20/2004*	*Henry Lord*	*$*	*500.00*
1032	*06/20/2004*	*Andrew Tsao*	*$*	*1,000.00*
1060	*07/24/2004*	*Joseph Rosenblatt*	*$*	*250.00*
1062	*07/24/2004*	*Mark Stein*	*$*	*1,000.00*
1143	*09/23/2004*	*John Mattar*	*$*	*1,000.00*
1144	*09/23/2004*	*Lawrence Melinker*	*$*	*2,000.00*
1155	*09/23/2004*	*Carlyn Ring*	*$*	*1,000.00*
1161	*09/23/2004*	*Randolph Snell*	*$*	*2,000.00*
1162	*09/23/2004*	*Jeremiah Spires*	*$*	*200.00*
1223	*10/19/2004*	*Edward Jaycox*	*$*	*100.00*
1253	*10/19/2004*	*Jane Cooney-Waterhouse*	*$*	*750.00*
1357	*11/18/2004*	*Herbert Hofmann*	*$*	*1,000.00*
			$	*14,800.00*

All of the identified transactions are refunds of contributions. With the exception of Check #1223 (Jaycox - $100) and Check #1253 (Cooney-Waterhouse - $750), the refunds were issued at the request of the contributor and not due to any impermissibility of funds.

Of those identified in the FEC audit report as outstanding/stale, GELAC's supporting documentation for its disgorgement of funds to the US Treasury identifies all of the above-referenced checks except for Check #1143 (Mattar - $1000), Check #1155 (Ring - $1000) and Check #1357 (Hofmann - $1000); the supporting documentation indicates that those checks, each issued in response to a contributor's request, were voided in the second quarter of 2005. GELAC's supporting documentation for its disgorgement indicates that Check #1382 (a contribution refund to Louise Arnold - $2000) was included in the committee's disgorgement calculation. It was subsequently discovered that Check #1382 cleared the committee's bank account in May 2005.

The difference between GELAC's disgorgement and the PAR, therefore, is one of the three checks that were not included in GELAC's documentation for disgorgement (i.e., #1143, #1155, #1357).

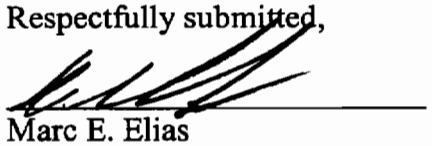
It is noted that only $850 of the total amount disgorged required disgorgement due to the impermissibility of funds; other checks that were stale-dated and disgorged did not represent impermissible or defective contributions, nor did they represent payments for goods or services received by the committee. No further disgorgement from GELAC is necessary.

III. CONCLUSION.

In sum, the Committee believes that it acted in full compliance with Title 26 and applicable Commission regulations and urges the Commission to adopt a final audit report that reflects that fact.

December 22, 2006

Respectfully submitted,



Marc E. Elias
Perkins Coie, LLP
607 14th St. NW
Washington, DC 20005

General Counsel to
Kerry-Edwards 2004, Inc. and
Kerry-Edwards 2004, Inc. GELAC

List of Exhibits to the PAR (provided in electronic form)

A. Media Services Agreement among the Committee, Riverfront Media, et al.

B. Riverfront Affidavit

C. Affidavit of Karen Hancox, the Committee's Chief Executive Officer

D. Riverfront Media Interest Calculation

E. October 2005 KE04 Expenditure Limitation Calculation

F. Letter Agreement, dated April 9, 2004, between John Kerry for President, Inc. and Commercial Jet, Inc.

G. Email from Commercial Jet, Inc.

H. Campaign Master Spreadsheet

I. Committee Offsets received after June 30, 2005

J. Chambers Lopez & Gaitan Invoices/Affidavits and Cancelled Orders

K. Committee's 2005 Response to Debt Schedule Finding

L. Update on Committee State-Dated Checks

M. Additional Presumptive Redesignation Documentation

N. Presumption Redesignation Spreadsheet

O. GELAC Disgorgement for Stale-Dated Checks Finding