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August 16, 2012

**AGENDA ITEM**

**MEMORANDUM**

To: The Commission

For Audit Hearing of 8/23/12

Through: Alec Palmer *AP*  
Staff Director

From: Patricia C. Orrock *PCO*  
Chief Compliance Officer

Tom Hintermister *TH*  
Assistant Staff Director  
Audit Division

Marty Kuest *MK by [signature]*  
Audit Manager

By: Rickida Morcomb *RM*  
Lead Auditor

Subject: Audit Hearing for McCain-Palin 2008, Inc. (General Committee) and  
McCain-Palin Compliance Fund, Inc. (Compliance Fund)

Attached for your information is a copy of the Draft Final Audit Report (DFAR) and Office of General Counsel legal analysis that was mailed to McCain-Palin 2008, Inc. and McCain-Palin Compliance Fund, Inc. (the Committees) on May 23, 2012. The Committees requested a hearing before the Commission to present its case on June 7, 2012, and formally responded to the report on July 7, 2012. The hearing was granted on June 25, 2012, and has been scheduled for August 23, 2012.

Prior to the receipt of the DFAR, the Committees received the Preliminary Audit Report (PAR) that contained the same findings presented in the DFAR. In response to the PAR, the Committees provided a narrative response to address the two findings.

With respect to the finding pertaining to the General Committee on Campaign Travel Billing for Press, the Committees stated that “(1) the Primary Committee [John McCain 2008, Inc] and the General Committee used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the General Committee and the Primary Committee”; “(2) to the extent a misallocation of

Press reimbursements between the committees still exists, the General Committee may correct the imbalance through a payment to the Primary Committee.”.

For the finding pertaining to the Compliance Fund on the Failure to File 48-Hour Notices, the Committees stated that “the Compliance Fund experienced a one-time data management error with an outside vendor relating to the 48-hour notice requirement and measures have been taken to ensure the unintentional oversight was corrected.”

In its response to the DFAR, the Committees restated its points submitted in response to the PAR concerning the Campaign Travel Billing for Press finding. The Committees questioned whether its calculation of travel billing was reasonable and whether there was a legal violation of the Act. The Committees again supported its position by stating that its travel billing calculation was:

- more consistent with Audit precedent from the Commission, specifically stating “the Dole-Kemp Audit staff’s methodology for determining a travel segment’s hourly rate for a fixed-rate contract was to divide the total amount of payments made under the aircraft lease by the total number of actual flight hours;”
- more consistent with Generally Accepted Accounting Principles (GAAP), specifically stating “the Primary Committee and the General Committee used a GAAP-compliant accrual-basis accounting to calculate the fixed-expense share of each travel segment”, which, “...required that the Swift Air contract expenses (and offsets to those expenses in the form of Press reimbursements) were recognized as actual flight hours were used;” and
- more consistent with the “benefit derived” principle, which is a new explanation offered by the Committees.

According to the Committees, under the “benefit derived” principle a committee derives benefit from an aircraft only when it uses an aircraft. Therefore, citing 11 CFR §106.1(a)(1), the Committees believe it correctly determined “use” of the aircraft by using a “rolling basis by continually adjusting each new travel segment’s hourly cost based on the evolving total of estimated hours to be flown under the Swift Air contract.” The Committees also argued that the Audit staff ignored the aircraft usage altogether and only focused on the timing of the payments.

The Committees questioned if “Commission rules and precedents prohibit the General Committee from correcting a Press reimbursement misallocation through a payment to the Primary Committee.” The Committees supported its position again with the following:

- “...these primary-election Press reimbursements, which offset an initial outlay of privately raised funds by the Primary Committee, are simply not comparable to public funds received by the General Committee as a general-election grant under Part 9005. They are therefore not subject to the “qualified campaign expense” restriction;”
- the General Committee and Primary Committee are affiliated and therefore the transfer of any misallocated Press reimbursement would not be an expense;

- the General Committee would not actually incur any “primary-related expenses” due to the fact that the 2008 election was four years ago and the transfer is to correct a “misdeposit of primary-election Press reimbursements into a General Committee account;”
- “...the transfer would not be a “non-qualified expense” because the Commission has in the past repeatedly permitted transfers from publicly funded general-election committees to their affiliated primary-election committees to correct misallocations and similar issues;” and
- “...a General-to-Primary transfer should not be prevented under the Audit Division’s “non-qualified expense’ rationale because the only reason for this misallocation issue is the Commission’s failure to provide guidance on how to prospectively calculate the fixed-cost portion of a particular travel segment’s “total actual cost of ...transportation.” The Primary Committee and the General Committee had no notice that they were not using the Commission’s preferred calculation method.”

The Audit staff maintains the focus of the audit is the General Committee. As in Dole-Kemp, the Audit staff used only the general election operating cost and the actual weekly hours flown by the General Committee when calculating the billable cost to the Press. The Audit staff’s method did not conflict with GAAP in that the revenue recognition principle recognizes revenue in the period in which it is earned. Since the period and activity audited was the general election period, the Audit staff applied the cost for the general election portion of the Swift Air contract and related expenses. In addition, the Audit staff’s method is supported by 11 CFR §9034.4(e)(7), which states in part that expenditures for campaign-related transportation shall be attributed according to when the travel occurs.

Furthermore, with respect to the Committees position concerning the “benefit derived”, the Audit staff maintains that 11 CFR §106.1(a)(1) states in part that expenditures made on behalf of more than one clearly identified Federal candidate shall be attributed to the benefit reasonably expected to be derived. In this case both the primary and general campaigns paid its share of the contract and billed the Press accordingly. The primary campaign billed the Press for reimbursements at a lower hourly rate than actual cost would have suggested during the primary period and the General Committee billed at a higher rate in the general period. Historically, transfers were sometimes permitted between the primary and general committees in Presidential campaigns when it has been shown in the course of an audit that funds or obligations belonging to a primary or general committee were in the possession of the other. This is not the case in this instance.

The Audit staff contends that the issue is not one of methodology but rather of results. Committees are limited in the amount they may seek as reimbursement for travel provided to the Press. Once they establish administrative costs of ten percent of the total, they may receive reimbursement for no more than 110 percent of actual costs. The General Committee received reimbursements in total that exceeded 110 percent. The amount the Press was overcharged is the difference between the maximum amount the Audit staff calculated as appropriately billable and the reimbursements actually received in the general election period.

In the DFAR, the Audit staff maintains that the travel billing reimbursement from Press during the general election campaign period exceeded the maximum 110 percent allowed and that \$344,892 should be returned on a pro rata basis to the Press representatives. Disgorgement to the U.S. Treasury, however, may be acceptable if the General Committee is unable to reconstruct the precise amount owed to each Press representative.

The response to the DFAR regarding the Failure to File 48-Hour Notices finding stated “the 48-Hour Notices were already discussed thoroughly” in its response to the PAR. In the DFAR, the Audit staff acknowledged that the majority of 48-hour notices not filed were the result of a data management error as indicated by the Compliance Fund. The DFAR also states that none of the contributions identified by the Audit staff were redesignated contributions, as purported by the Compliance Fund.

Documents related to this audit report can be viewed in the Voting Ballot Matters folder. Should you have any questions, please contact Rickida Morcomb or Marty Kuest at 694-1200.

Attachments:

- Draft Final Audit Report
- Office of General Counsel Legal Analysis of Draft Final Audit Report
- The Committees Response to the Draft Final Audit Report/Request for Hearing

cc: Office of General Counsel



## Draft Final Audit Report of the Audit Division on McCain-Palin 2008 Inc. and McCain-Palin Compliance Fund, Inc.

March 24, 2008 - December 31, 2008

### Why the Audit Was Done

Federal law requires the Commission to audit every political committee established by a Presidential candidate who receives general funds for the general campaign.<sup>1</sup> The audit determines 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 General Committee

McCain-Palin 2008 Inc. (General Committee) is the principal campaign committee for Senator John S. McCain, the Republican Party's nominee for the office of President of the United States. The General Committee is currently headquartered in Washington, DC. For more information, see the campaign Campaign Organization, p. 2.

### Financial Activity of the General Committee

• Receipts	
○ Federal Funds Received	\$ 84,103,800
○ Payments to Operating Expenditures	9,318,570
○ Loans Received	17,076,880
○ Other Receipts	1,154,733
○ Total Receipts	\$ 111,653,983
Disbursements	
○ Operating Expenditures	\$ 92,083,836
○ Loan Repayments	17,076,880
○ Other Disbursements	1,491,107
○ Total Disbursements	\$ 110,651,823

### Finding and Recommendation for the General Committee (p. 5)

- Campaign Travel Billing for Press

<sup>1</sup> 26 U.S.C. §9007(a).

## About the Compliance Fund

The McCain-Palin Compliance Fund, Inc. (Compliance Fund) was established pursuant to 11 CFR §9003.3(a)(1)(i). The Compliance Fund accepts contributions to be used solely for legal and accounting services to ensure compliance with the Federal Election Campaign Act (the Act). These contributions include the Compliance Fund's share of contributions from affiliated joint fundraising committees. The Compliance Fund is currently headquartered in Washington, DC. An overview of financial activity for the Compliance Fund is presented below.

## Financial Activity of the Compliance Fund

• <b>Receipts</b>	
○ Contributions	\$ 2,79,490
○ From Other Authorized Committees	25,000,453
○ Offsets to Operating Expenditures	1,131,000
○ Other Receipts	12,471,780
○ <b>Total Receipts</b>	<b>\$ 48,328,864</b>
• <b>Disbursements</b>	
○ Operating Expenditures	\$ 11,675,642
○ All Other Disbursements	13,112,237
○ <b>Total Disbursements</b>	<b>\$ 24,787,879</b>

## Finding and Recommendation for the Compliance Fund (p. 5)

- Failure to Post Hour Notices

## About Joint Fundraising Committees

This audit included seven joint fundraising committees. Each of the joint fundraising committees is headquartered in Alexandria, Virginia and was an authorized committee of the candidates, John McCain and Sarah Palin. The combined financial activity of these joint fundraising committees is presented below and the financial activity of each of these committees is presented on page 4.

## Financial Activity of the Joint Fundraising Committees

• <b>Receipts</b>	
○ Contributions	\$ 207,620,125
○ From Other Authorized Committees	812,325
○ Offsets to Operating Expenditures	159,926
○ <b>Total Receipts</b>	<b>\$ 208,592,376</b>
• <b>Disbursements</b>	
○ Operating Expenditures	\$ 30,374,003
○ All Other Disbursements	167,116,292
○ <b>Total Disbursements</b>	<b>\$ 197,491,195</b>

## Finding and Recommendation for the Joint Fundraising Committees (p. 5)

Based on the limited examination of the reports and statements filed and the records presented by the seven joint fundraising committees, the Audit staff did not discover any material non-compliance.

**Draft Final Audit Report of the  
Audit Division on  
McCain-Palin 2008 Inc. and  
McCain-Palin Compliance Fund,  
Inc.**

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March 24, 2008 – December 31, 2008

**DRAFT**



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# Part I

## Background

### Authority for Audit

This report is based on audits of McCain-Palin 2008 Inc. (General Committee), McCain-Palin Compliance Fund, Inc. (Compliance Fund), and seven joint fundraising committees affiliated with the 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 "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." This includes joint fundraising committees authorized by the candidates. 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 Audit

The audits of the General Committee and Compliance Fund 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, debts and obligations;
6. the recordkeeping process and completeness of records;
7. the consistency between reported figures and bank records;
8. the accuracy of the Statement of Net Outstanding Qualified Campaign Expenses;
9. the campaigns' compliance with spending limitations; and
10. other campaign operations necessary to the review.

The audits of the seven joint fundraising committees affiliated with the Compliance Fund examined:

1. the receipt of excessive contributions and loans;
2. the proper allocation of contributions among joint fundraising participants;
3. the proper allocation of expenses and net amounts transferred to the Compliance Fund; and
4. the consistency between reported figures and bank records.

### Inventory of Records

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

## Part II Overview of Campaign

### Campaign Organization

	General Committee	Compliance Fund
<b>Important Dates</b>		
• Date of Registration	08/12/08	02/25/08
• Audit Coverage Dates	09/01/08 thru 12/31/08	03/21/08 thru 12/31/08
<b>Headquarters</b>	Washington, DC	Washington, DC
<b>Bank Information</b>		
• Bank Depositories	Three	Four
• Bank Accounts	Eight Bank Accounts	Eight Bank Accounts
<b>Treasurer</b>	Salvatore A. Pupura (08/12/08 – 08/18/08), Joseph Schmuckler (08/19/08 – Present)	Salvatore A. Pupura (02/25/08 – 03/20/08); Joseph Schmuckler (03/21/08 – Present)

### Joint Fundraising Committees

Of the seven joint fundraising committees, four registered with the Federal Election Commission in April 2008 and three registered in August 2008. These committees are headquartered in Alexandria, Virginia and Lisa Mosker is the Treasurer for each committee. Each of six joint fundraising committees maintained a single bank account, and the seventh joint fundraising committee maintained two bank accounts.

## Overview of Financial Activity

(Audited Amounts)

	General Committee	Compliance Fund
<b>Opening Cash Balance-</b>	\$0	\$0
<b>Receipts</b>		
• Contributions		\$9,679,490
• Federal Funds Received	\$84,103,800	
• From Other Authorized Committees		25,046,453
• Offsets to Operating Expenditures	9,318,500	1,131,139
• Loans Received	17,076,880	
• Other Receipts	1,154,733	471,782
<b>Total Receipts</b>	<b>\$111,653,983</b>	<b>\$48,328,864</b>
<b>Disbursements</b>		
• Operating Expenditures	2,083,006	\$11,675,042
• Transfers to Other Authorized Committees		222,502
• Loan Repayments	17,076,880	
• Refunds to Contributors		551,599
• Other Disbursements	491,107	12,338,136
<b>Total Disbursements</b>	<b>\$110,651,823</b>	<b>\$24,787,879</b>
<b>Closing Cash Balance @ 12/31/2008</b>	<b>\$1,002,160</b>	<b>\$23,540,985</b>

## Overview of Financial Activity

(Audited Amounts)

<u>Joint Fundraising Committees</u>	McCain Victory 2008	McCain-Palin Victory 2008	McCain Victory Ohio	McCain Victory California	McCain Victory California	McCain-Palin Victory California	McCain Victory Florida
<b>Opening Cash Balance</b>	\$0	\$0	\$0	\$0	\$0	\$0	\$0
<b>Receipts</b>							
• Individual Contributions	\$76,290,438	\$100,038,158	\$1,790,913	\$15,194,747	\$15,194,747	\$5,175,926	\$3,128,210
• Political Committee Contributions	\$603,884	\$529,183	\$42,000		\$200,795	\$49,581	\$31,000
• Transfers from Other Authorized Committees	\$366,165	\$1,310	\$0		\$77,350	\$40,800	\$22,400
• Offsets	\$14,000	\$1,077	\$0		\$41,983	\$270	\$1,094
<b>Total Receipts</b>	<b>\$77,274,889</b>	<b>\$100,999,729</b>	<b>\$1,832,913</b>	<b>\$15,514,875</b>	<b>\$15,514,875</b>	<b>\$5,266,576</b>	<b>\$3,182,704</b>
<b>Disbursements</b>							
• Operating Expenditures	\$7,400,000	\$18,000,527	\$283,642	\$1,705,448	\$1,705,448	\$895,640	\$606,800
• Transfers to Other Authorized Committees	\$6,642,154	\$4,097,552	\$1,418,627	\$13,154,796	\$13,154,796	\$3,871,179	\$2,326,750
• Refunds to Contributors	\$103,974	\$611,376	\$21,200	\$350,951	\$350,951	\$379,600	\$120,900
• Other Disbursements	\$500	\$0	\$0	\$0	\$0	\$0	\$0
<b>Total Disbursements</b>	<b>\$74,474,006</b>	<b>\$93,692,155</b>	<b>\$1,723,469</b>	<b>\$15,211,195</b>	<b>\$15,211,195</b>	<b>\$5,146,419</b>	<b>\$3,054,450</b>
<b>Closing Cash Balance @12/31/2008</b>	<b>\$2,800,183</b>	<b>\$7,278,574</b>	<b>\$109,444</b>	<b>\$303,680</b>	<b>\$303,680</b>	<b>\$120,157</b>	<b>\$128,255</b>

## **Part III**

### **Summaries**

#### **General Committee**

##### **Campaign Travel Billing for Press**

The General Committee received reimbursements totaling \$344,892 from the Press for campaign travel, which was above the maximum amount billable to the Press. The Commission's regulations provide that a 10 percent markup on the actual cost of transportation and services may be billed to the Press. The General Committee stated that the excess reimbursement from the Press for travel was a misallocation of billing proceeds, requiring the General Committee to pay John McCain 2008, Inc. (the Primary Committee) for the excess funds collected.

In response to the Preliminary Audit Report, the General Committee maintained that it used a reasonable process for the allocation of Press reimbursements between the two committees that is consistent with Commission precedent as well as Generally Accepted Accounting Principles (GAAP). The General Committee also explained its contention that any apparent excess of Press reimbursements collected during the term of the contract could be corrected by making a payment to the Primary Committee. The General Committee requested that the Commission permit a transfer from the General Committee to the Primary Committee to resolve the matter. In the event that the Commission does not permit the transfer, the General Committee requests that it be allowed to disgorge the excessive Press reimbursements to the U.S. Treasury. The General Committee believes that the Commission should find that the Press reimbursements were correctly calculated resulting in no violation of the Act, and that the General Committee may terminate immediately. (For more detail, see p. 6.)

#### **Compliance Fund**

##### **Failure to File 48-Hour Notices**

The Compliance Fund failed to file 48-hour notices for 169 contributions totaling \$240,700 that were received prior to the general election. In response to the Preliminary Audit Report, the Compliance Fund explained that it had experienced a one-time data-management error with an outside vendor relating to the 48-hour notice requirement. The Compliance Fund has taken measures to ensure that this unintentional oversight was corrected. The Compliance Fund believes that the Commission should find there was no violation of the 48-hour notice requirement and that the Compliance Fund should be able to terminate immediately. (For more detail, see p. 19.)

#### **Joint Fundraising Committees**

Based upon the limited examination of the reports and statements filed, and the records presented by seven joint fundraising committees, the Audit staff discovered no material non-compliance. (For more detail, see p. 21.)

## Part IV

# Finding and Recommendation for the General Committee

### Campaign Travel Billing for Press

#### Summary

The General Committee received reimbursements totaling \$344,892 from the Press for campaign travel, which was above the maximum amount billable to the Press. The Commission's regulations provide that a 10 percent markup of the actual cost of transportation and services may be billed to the Press. The General Committee stated that the excess reimbursement from the Press for travel was a misallocation of billing proceeds, requiring the General Committee to pay John McCain 2008, Inc. (the Primary Committee) for the excess funds collected.

In response to the Preliminary Audit Report, the General Committee maintained that it used a reasonable process for the allocation of Press reimbursements between the two committees that is consistent with Commission precedents as well as Generally Accepted Accounting Principles (GAAP). The General Committee also explained its contention that any apparent excess of Press reimbursements collected during the term of the contract could be corrected by making a payment to the Primary Committee. The General Committee requested that the Commission permit a transfer from the General Committee to the Primary Committee to resolve the matter. In the event that the Commission does not permit the transfer, the General Committee requests that it be allowed to disgorge the excessive Press reimbursements to the U.S. Treasury. The General Committee believes that the Commission should find that the Press reimbursements were correctly calculated, resulting in no violation of the Act, and that the General Committee should terminate immediately.

#### Legal Standard

**A. Expenditures for Transportation and Services Made Available to Media Personnel and Secret Service.** Expenditures by an authorized committee for transportation, ground services or facilities (including air travel, ground transportation, housing, meals, telephone service and computers) provided to media personnel, Secret Service personnel or national security staff will be considered qualified campaign expenses, and, except for costs relating to Secret Service personnel or national security staff, will be subject to the overall expenditure limitations of 11 CFR 9003.2(a)(1) and (b)(1). 11 CFR §9004.6.

**B. Billing Media Personnel for Transportation and Services.** The committee shall provide each media representative, no later than 60 days from the campaign travel or event, an itemized bill that specifies the amounts charged for air and ground transportation for each segment of the trip, meals and other billable items specified in the White House Press Corps Travel Policies and Procedures issued by the White House Travel Office. 11 CFR §9004.6(b)(3).

**C. Reimbursement Limits for Transportation and Services of Media Personnel.**

The amount of reimbursement sought from media personnel shall not exceed 110 percent of the media representative pro rata share (or a reasonable estimate of the media representative's pro rata share) of the actual cost of transportation and services made available. Any reimbursement received in excess of this amount shall be returned to the media representative. 11 CFR §9004.6(b) and (d)(1).

**D. Pro Rata Share Definition.** A media representative's pro rata share shall be calculated by dividing the total actual cost of the transportation and services provided by the total number of individuals to whom transportation and services were made available (to include committee staff, media personnel, Secret Service staff). 11 CFR §9004.6(b)(2).

**E. Administrative Costs for Transportation and Services of Media Personnel.** The committee may deduct from the amount of expenditures subject to the overall limitation the reimbursements paid by media representatives for transportation and services, up to the actual cost of the transportation and services provided to the media representatives. The committee may deduct an additional amount of the reimbursements received from media representatives, representing the incurred administrative costs of 3 percent. The committee may deduct an amount in excess of 3 percent representing the administrative costs actually incurred by the committee in providing services to the media, provided that the committee is able to document the total amount of administrative costs actually incurred.

For the purposes of the above paragraph, administrative costs include all costs incurred by the committee in making travel arrangements and seeking reimbursement, whether these services are performed by committee staff or independent contractors. 11 CFR §9004.6(c).

**F. Attribution of Travel Costs.** Expenditures for campaign-related transportation, food and lodging by any individual, including a candidate, shall be attributed according to where 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).

**G. Travel Support Documentation.** For each trip, an itinerary shall be prepared and made available by the committee for Commission inspection. The itinerary shall show the time of arrival and departure and the type of events held.

For trips by government conveyance or by charter, a list of all passengers, along with a designation of which passengers are and which are not campaign-related, shall be made available for Commission inspection. When required to be created, a copy of the government's or charter company's official manifest shall also be maintained and made available by the committee. 11 CFR §9004.7(b)(3) and (4).

**H. Assets Purchased from the Primary Election Committee.** If capital assets are obtained from the candidate's primary election committee, the purchase price shall be considered to be 60 percent of the original cost of such assets to the candidate's primary election committee. 11 CFR §9004.9(d)(1)(ii).

## **Facts and Analysis**

### **A. Facts**

In 2008, the Press covering the campaign of the Presidential candidate (John McCain) and the Vice Presidential candidate (Sarah Palin) travelled predominately on two aircraft chartered by the campaign. The aircraft for the Presidential candidate was the same aircraft used by John McCain 2008, Inc. (the Primary Committee) and was chartered through Swift Air, LLC (Swift Air). The aircraft for the Vice Presidential candidate was chartered through JetBlue Airways Corporation shortly before the Republican National Convention. The Press also occasionally travelled on aircraft chartered by the General Committee through CSI Aviation Services (CSI) and via ground transportation throughout the campaign.

As cited above, the amount of reimbursement sought from media personnel shall not exceed 110 percent of the media representative's pro rata share (or a reasonable estimate of the media representative's pro rata share) of the actual cost of transportation and services made available. Any reimbursement received in excess of this amount shall be returned to the media representative. 11 CFR §9004.6(b) and (d)(1).

The General Committee contends that it did not receive Press travel reimbursement above the 110 percent allowed by the regulations. The General Committee calculated total transportation costs for the Press to be \$4,501,658, equaling 106 percent of the cost calculated by the General Committee. The General Committee actually received \$4,476,728 from the Press as reimbursement for travel.

During field office audits, Audit staff calculated that the General Committee received Press travel reimbursement in excess of the 110 percent allowed by the regulations. The Audit staff calculated the total pro rata transportation cost for the Press to be \$3,756,215 and a maximum amount billable to the Press (110 percent of cost) of \$4,131,836.<sup>2</sup> Based on the Audit staff's calculation of transportation costs, the General Committee is required to refund to the Press \$344,897 (\$4,476,728 - \$4,131,836).

The main difference between the General Committee's figure and the Audit staff's figure is the calculation for total transportation costs. The General Committee disagreed with the Audit staff's cost calculation methods with respect to charter flights associated with the aircraft used by the Presidential candidate. The General Committee also did not agree with the Audit staff's initial application of aircraft reconfiguration costs.

<sup>2</sup> The General Committee billed at 106 percent, but was able to document administrative costs to allow billing up to 110 percent for all modes of transportation. In determining the amount billable to the Press, the Audit staff credited the General Committee for any under billing of the Press associated with any one aircraft or mode of transportation. In other words, any under billing of the Press for travel on the aircraft for the Vice Presidential candidate, CSI chartered aircraft, and ground transportation was applied to any overbilling of the Press that may have occurred for travel on the Presidential aircraft.

The Audit staff calculated transportation costs based on actual hours used only by the General Committee during the general campaign. The General Committee, in contrast, calculated transportation costs based on the life of the charter contract, which covered both the primary and general campaign periods.

***Applying Cost on Aircraft for Presidential Candidate***

The Primary Committee and the General Committee chartered a Boeing 737-400 from Swift Air for use by the Presidential candidate. The Swift Air contract covered the period from June 30, 2008 through November 15, 2008. The contract stipulated payments totaling \$6,384,000 to be paid in 19 weekly installments of \$336,000. The contract covered nine weeks for the Primary Committee and ten weeks for the General Committee. The contract also required the General Committee and Primary Committee to pay costs for fuel, catering, passenger taxes, and ground handling fees. There was also an aircraft reconfiguration cost of \$650,000 that was paid initially by the Primary Committee. The General Committee correctly reimbursed the Primary Committee \$390,000 (\$650,000 less 40 percent depreciation) for these aircraft reconfiguration costs.

The contract allowed 22.4 flight hours per week for a total of 425.6 flight hours for the life of the contract. If the full flight hours per week were not flown, the hours rolled over to subsequent week(s). If the contracted 22.4 flight hours per week were exceeded and no accumulated unused hours were available, there was a charge of \$15,000 per additional hour. Neither the Primary nor General Committee ever exceeded the 22.4 flight hours in a week. The General Committee used 140.3 flight hours and the Primary Committee used 111.8 flight hours during the contract.

The General Committee made its first weekly installment payment of \$336,000 on August 29, 2008, and made total payments of \$4,047,402 to Swift Air. This amount included charges for fuel, catering, passenger taxes, and ground handling fees.

For the first week of the campaign, the General Committee used the total cost of the contract (primary and general) and divided it by the remaining number of hours available under the contract, including unused hours paid for by the Primary Committee. Later weeks were calculated using the amount yet to be paid on the contract and dividing it by the estimated flight hours that would be used in the future, based on weekly averages. The calculation included reconfiguration costs. This method caused a fluctuation of the hourly charter rate calculated from as low as \$11,569 to as high as \$39,715. Using this rate, the segment cost was calculated and divided by the number of passengers.

The Audit staff calculated the charter rate per flight hour for Swift Air by taking the contract weekly installment (\$336,000) and dividing that by the actual weekly hours flown. The costs of fuel, catering, passenger taxes, ground handling, and certain reconfiguration costs were then added to determine the total segment cost. The cost per passenger was then calculated by dividing the total segment cost by the total number of passengers on the segment.

***Applying Reconfiguration Costs***

The Audit staff and the General Committee did not initially agree on the amount of aircraft reconfiguration costs billable to the Press. Historically, the Commission has allowed the Press to be billed only for the aircraft reconfiguration costs that could

reasonably considered as having benefited the Press. The General Committee believes all costs for reconfiguring an aircraft at the beginning and at the end of the campaign should be considered when calculating the billable amount for the Press. The General Committee also stated that part of the aircraft reconfiguration cost was to bring the aircraft into compliance with Federal Aviation Administration safety standards that ultimately benefited the safety of all passengers including the Press.

## **B. Preliminary Audit Report & Audit Division Recommendation**

The issue of press travel reimbursement was presented at the exit conference. In response, the General Committee submitted the following points for the Commission's consideration.

### *Cost Calculation*

The General Committee made a comparison between the Swift Air contract, which spanned both the primary and general election periods, and similar aircraft contracts that were analyzed during previous presidential audits: Dole-Kemp in 1996, Bush-Cheney in 2000, and Kerry-Edwards in 2004. The General Committee specifically referenced the Audit staff's calculation of the hourly rate for each aircraft from the 1996 Dole-Kemp audit, which accumulated all operating costs and divided that total by the actual number of hours flown by each aircraft. By applying the same calculation to the entire amount of the Swift Air contract (\$6,384,000 divided by 252.1 hours flown), the General Committee contends that its cost calculations used for billing the Press were accurate.

The Audit staff agrees that if the General Committee was using the *total* Swift Air contract amount for both, the primary and general election periods, as well as the full aircraft reconfiguration cost, it did not receive travel reimbursement from the Press that exceeded the maximum allowed by the regulations. However, as in Dole-Kemp only those costs attributable to the General Committee should be used in determining the travel cost that the General Committee may bill to the Press. This conclusion is consistent with travel cost calculations from past presidential audits and is supported by 11 CFR §903.11(e), which states, in part, that expenditures for campaign-related transportation shall be allocated according to when the travel occurs. As in Dole-Kemp, the Audit staff used only the general election operating cost (\$4,047,402) and the actual weekly hours flown by the General Committee when calculating the billable cost to the Press. This is a more appropriate method when calculating costs and billing for campaign travel during the general election period.

The General Committee provided a spreadsheet that spanned the primary and general election periods and relied on adjusting the per-hour billing rates on a segment-by-segment basis due to using fewer flight hours than available in the Swift Air contract. The General Committee made the spreadsheet available to demonstrate that the Primary and General Committees' billing allocation was based on total costs (\$6,354,859) that were lower than the contract amount (\$6,384,000). The General Committee contends that no overbilling of the Press could have occurred since the difference (\$29,141) was never billed to the Press by the Primary committee during week eight. However, it appears that the General Committee did bill this difference to the Press<sup>3</sup>. Therefore, the

<sup>3</sup> During the second week of the general campaign, the General Committee calculated Press billing by using the total cost of the contract (\$6,384,000) and subtracting the amount of the contract already billed (\$2,140,752) to arrive at the remaining balance of the contract. The helicopter cost (\$29,141) was included

General Committee included the total contract amount in calculating the billing allocation.

The Audit staff used the weekly \$336,000 installment divided by the actual hours flown weekly during the general election period for billing calculations (plus the fuel, catering, taxes, and ground handling fees). The General Committee explained that the Audit staff's calculations had the benefit of hindsight because, due to the fast pace of the election campaign, the actual flying hours were unknown at the time of billing. Therefore, estimates of pro rata share had to be used in order to be in compliance with the regulations to bill media representatives within 60 days of travel. The General Committee believes that the Audit staff's methodology would be in conflict with 11 CFR §9004.6(b)(3), which says, in part, that media representatives should be given a bill that specifies amounts charged for air and ground for each segment.

The Audit staff's methodology does not conflict with 11 CFR §9004.6(b)(3), given that the actual flight hours are known soon after flights occur and thereby fall within the required 60 days to provide the Press with an itemized bill that specifies the amounts charged for air transportation for each segment of the trip. It appears the General Committee invoiced the Press on average 12 days after completion of each travel week, allowing time to use the actual flight hours for the week. Other billable travel costs known at the time of billing also could have been added to determine the cost per passenger. This method would incorporate adjusting for weekly flight hours.

The General Committee also referenced the 2000 Bush-Cheney audit and explained that it used the same billing methodology and personnel for that audit, which did not include an adverse audit finding or informal advice from the Audit staff suggesting that a correction to the accounting methods was necessary. The Audit staff acknowledges that the same billing methodology was used in 2000 Bush-Cheney; however, the amount of the overbilling of the Press was not material. Furthermore, there is no indication that the 2000 Bush-Cheney General Committee included costs associated with the Bush Primary Committee in the calculation of travel costs.

#### ***Generally Accepted Accounting Principles (GAAP)***

The General Committee explained several accounting principles and standards under GAAP to support its methodology for billing the Press. The General Committee believes that the Audit staff did not apply the appropriate accounting basis in its analysis. Specifically, the General Committee believes that the Audit staff incorrectly applied a cash-basis of accounting instead of an accrual-basis in its analysis of Press billing. Under cash-basis accounting, revenue is recorded when cash is received and an expense is recorded when cash is paid. In accrual-basis accounting, revenue is recognized when it is earned (or when services are performed) and expenses are recognized when they are incurred.<sup>4</sup> The General Committee contends that under accrual-basis accounting, the objective is to ensure that events that change an entity's financial statements are recorded in the periods in which the events occur, rather than only in the periods during which the entity receives or pays cash. The General Committee also contends that the matching

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in the \$2,140,752 already billed. The remaining balance of the contract was then divided by the average estimated flight hours remaining on the contract to determine the adjusted charter rate for the week.

<sup>4</sup> "Accounting Principles 7<sup>th</sup> Edition", Jerry J. Weygandt PhD, CPA, Donald E. Kieso PhD, CPA, Paul D. Kimmel PhD, CPA, page 90.

principle under GAAP dictates that expenses are recognized when the revenue is recognized, and therefore that the entire cost of the contract should be used when calculating billing for travel.

The Audit staff agrees that the matching principle dictates that expenses be recognized when the revenue is recognized. In turn, the revenue recognition principle recognizes revenue in the *period* in which it is earned. Since the *period* and activity audited was the general election period, the Audit staff correctly applied the \$4,047,402 cost for the general election portion of the Swift Air contract and related expenses.

The issue is not whether the cash or accrual-basis of accounting is applied to the transportation costs and revenue generated from billing the Press for travel; nor is there a question of the matching principle under GAAP. At issue is whether the activity of a separate reporting and corporate entity (the Primary Committee) should be recognized by the General Committee and by this audit. An underlying assumption in GAAP is that every entity is separate and, therefore, the revenues and expenses of each entity should be recognized as such. As previously noted, recognizing the activity of the two entities separately is further supported by 11 CFR §903.4(e)(7), which states in part that expenditures for campaign-related transportation shall be attributed according to when the travel occurs. Therefore, the General Committee should recognize only those transportation costs from September 1, 2008, through November 4, 2008, in the calculation for billing the Press.

#### ***Reconfiguration***

The General Committee believes that aircraft reconfiguration costs are a part of placing the asset in service and therefore reconfiguration costs were included in the value of the asset when it was purchased from the Primary Committee. Therefore, the General Committee contends that all reconfiguration costs could be billed to the Press pro rata since the Press used the asset.

In response to the Joint Conference and after discussions with the Audit staff, the General Committee stated that reconfiguration costs incurred, with the exception of decals and any items that benefited only campaign staff, such as divider-curtain expenses, should be included in the billable amount. After considering the General Committee's response, the Audit staff revised its calculation of aircraft reconfiguration costs billable to the Press. The Audit staff did not include costs for painting and applying logos totaling \$161,386 or the cost for a divider-curtain totaling \$1,167 in the calculation for billable reconfiguration costs since the General Committee indicated that these items benefited only the campaign. As a result, the Audit staff calculated \$487,447 (\$650,000 – \$161,386 – \$1,167) in reconfiguration costs billable to all travelers for both the primary and general periods. After subtracting 60 percent of the accepted reconfiguration cost because the asset was purchased from the Primary Committee, the Audit staff calculated \$292,468 (\$487,447 x 60%) of aircraft reconfiguration costs as billable during the general period. The Audit staff divided this amount by the total 140.3 flight hours flown by the General Committee to determine the amount of aircraft reconfiguration costs attributed to each segment.

### ***Other Considerations***

The General Committee stated that the Audit staff and the Commission have allowed for transfers and repayments between primary and general election presidential committees with respect to other types of vendors. The General Committee believes that any excess funds from the Press for travel are no different than deposits related to other vendors such as those for telephone contracts, media placement refunds, or lease agreements, for which repayments sometimes are necessary to ensure that a primary committee does not subsidize a general committee.

The General Committee also contends that it would not be reasonable to force campaigns to renegotiate and redraft every legal contract that exists to separate primary and general activity. To refund the Press would involve more than 700 separate billing transactions and it would "go against many of the internal ethics policies of the various news organizations...who are not allowed to receive passage and discounted rates on campaign transportation so as to not unduly influence their coverage of the candidates."

The Audit staff acknowledges the administrative burden that may be involved with refunding the Press. Historically, the Commission has allowed refunds to the Press to be made on a pro rata basis, such as in the 1996 Dole-Kemp audit, rather than recalculating each billing to the Press. The General Committee's alternative suggestion, refunding the Primary Committee, would be considered a non-qualified campaign expense subject to repayment. The regulations state that a general election committee cannot incur primary-related expenses because these expenses are not in furtherance of the general election. 11 CFR §9002.11(a).

The General Committee received reimbursements from the Press for campaign travel that were above the maximum amount billable to the Press. The Primary Committee appears to have billed an amount that was less than its cost. The Primary and General Committee each paid its share of the cost of the contract awarded to the Press and Secret Service accordingly. Although the regulation limits how much can be billed, there is no requirement that any billing be made. Thus, the travel could be provided at no cost.

The General Committee is correct that there are transactions between the Primary and General Committees in many Presidential campaigns in which either the primary or general election is publicly funded. Assets, ranging from office equipment to service deposits to, as in this case, aircraft configuration, often are purchased. In each case, value is transferred between the two committees. For example, if the General Committee purchases security deposits, it gives cash for the right to continue the service and recover the deposit after the campaign. No such exchange is involved in the proposed transfer to the Primary Committee in this case.

The General Committee does not dispute that it received more reimbursements from the Press during the general election period, but the General Committee believes a more appropriate term is misallocation of Press travel reimbursement received between the General Committee and the Primary Committee. The General Committee's methodology may accurately reflect the comparative actual use of the aircraft between the Primary (111.8 flight hours) and General Committees (140.3 flight hours), but it does not reflect the comparative actual costs paid by each committee. The General Committee did not

exceed the overall expenditure limitation, even with the excessive Press reimbursements. However, the purpose is to match the cost of the campaign to the proper election and spending limit. For these reasons and those noted above, the reimbursements totaling \$344,892 that the General Committee received from the press were above the maximum amount billable under the regulations.

The Preliminary Audit Report recommended that the General Committee demonstrate it did not receive reimbursements from the Press for campaign travel that were above the maximum amount billable. Absent such evidence, the General Committee was to return, on a pro rata basis, \$344,892 to Press representatives and provide documentation to support the refunds.

### **C. Committee Response to Preliminary Audit Report**

The General Committee submitted a response to the Preliminary Audit Report on December 20, 2011, which addressed the finding concerning Press reimbursement for travel. The General Committee argued that there was no "overbilling" because "the Primary Committee and the General Committee used a reasonable process to predict the allocation of Press reimbursements between the committees" that is "consistent with the Commission precedent as well as Generally Accepted Accounting Principles." The General Committee also argued that if there was a misallocation of Press reimbursement between the two committees, a payment to the Primary Committee can correct it.

The General Committee discussed the details of its approach to press billing. The General Committee maintained that because the contract with Swift Air for air travel spanned nine weeks of the Primary and ten weeks of the General campaigns, it was necessary to bill based on the entire cost of the contract. The General Committee also asserted that the Primary Committee and the General Committee "used a reasonable process to predict the eventual, proper allocation of press reimbursements between the General Committee and the Primary Committee." The General Committee described in some detail the difficulty encountered in the billing process due to the fact that while they knew what the total costs were for the combined period, they would not know how to apply the fixed costs until the contract was completed and the actual number of hours flown was known. Accordingly, the Primary Committee began billing at the rate of \$15,000 per flight hour, which would have been the actual contract price per hour had it flown all the hours provided for in the contract. By the time the billing began in the general election period, the General Committee had to face the fact that the total price of the contract less the total for flight hours billed to date required that the remaining hours to be flown would have to be valued at a higher rate in order to account for the remaining outstanding balance of the contract.

The General Committee stated the following:

"The Audit Division acknowledges that the Committees' method for predicting the proper allocation of Press reimbursements between the General Committee and the Primary Committee 'reflect[s] the comparative actual use of the aircraft between the Primary and General Committees...' The Audit Division nonetheless advocates a new, never-before-announced technique for calculating a travel segment's hourly rate, and by extension, the proper allocation of Press reimbursements: divide each weekly installment of the

\$6,384,000 Swift Air payment 'divided by the actual weekly hours flown during the general election period...'"

"The Audit Division's method is conveniently simple. But this simplicity is wrought by ignoring important realities about the Swift Air contract. For one, the Swift Air contract was jointly held by the Primary Committee and the General Committee. It spanned four months, straddling the divide between primary and general-election periods. The Committees and Swift Air intended this exact structure. A four-month contract held by two entities is manifestly different than a two-month contract held by one. The Audit Division, however, wants to now artificially bisect the Swift Air contract without even considering whether the parties would have structured two separate two-month contracts another way. For instance, the amount and frequency of the weekly installment payments might have been different, and the costs certainly would have been greater since a key factor in the cost of securing a dedicated aircraft is the lease's duration. The Audit Division cannot disregard a contract's fundamental elements without its analysis spinning into the realm of fiction."

"The Audit Division also ignores that the Swift Air transaction was a fixed \$6,384,000 fee in exchange for up to 425.6 flight hours. The payment and the hours were divided into equal weekly installments, but a particular week's fixed installment payment was not in exchange for that week's flight hours. Dividing a week's installment payment by the week's actual flight hours therefore does not reflect what a traveler segment's hourly rate and "total actual cost" were. Yet the Audit Division does that anyway, presumably to simplify the hourly rate calculations since one uses only a week's actual flight hours rather than wait until the end of the contract to determine how many actual flight hours over which to spread the \$6,384,000 fixed fee. Simplicity is indeed attractive. It interferes with accurately calculating each travel segment's "total actual cost" though."

"The Committees' calculation method for a travel segment's hourly rate, on the other hand, does not rely on counterfactuals. It recognizes the Swift Air contract as it is, and in doing so, is more consistent with Commission precedent and with Generally Accepted Accounting Principles. The Primary Committee and the General Committee therefore used a reasonable process to predict the eventual proper allocation of Press reimbursements between the Committees."

The General Committee then asserted that the calculation method used by the Committees is more consistent with Commission precedent. It defined Commission precedent by citing the methods used by three other campaigns, Dole – Kemp 1996, Kerry – Edwards 2004, and Bush – Cheney 2000, and maintaining that its method coincided closely with those of the campaigns cited. The General Committee contends that the Kerry-Edwards 2004 charter "straddled the primary- and general-election periods," like the Swift Air contract. The General Committee also maintains that its methodology is more consistent with GAAP.

Further, the General Committee states that the Audit staff "relied on non-GAAP cash-basis accounting to estimate the fixed-expense share of each travel segment's total actual

cost of the transportation” and points out, “The Commission has endorsed GAAP’s use in presidential campaign audits and cited GAAP to make an adverse audit finding against the Kerry-Edwards Campaign.”

The General Committee goes on to state:

“The Primary Committee and the General Committee used GAAP-compliant accrual-basis accounting to calculate the fixed-expense share of each travel segment’s “total actual cost of the transportation.” Accrual-basis accounting required that the Swift Air contract expenses (and offsets to those expenses in the form of Press reimbursements) were recognized as actual flight hours were used. A portion of the Swift Air contract’s fixed cost was assigned to each travel segment using a depreciation technique called the “units of production” method, which is expressed as  $\text{Cost} / \text{Estimated Units} = \text{Depreciation Per Unit Produced}$  (i.e.  $\$6,384,000 / \text{Estimated Flight Hours} = \text{Aircraft Hourly Rate}$ ). The “units of production” method was most appropriate here because the actual flight hours, and thus the actual contract costs, were not incurred ratably over the individual weeks of the contract.”

“By contrast, the Audit Division relied on non-GAAP cash-basis accounting to estimate the fixed-expense share of each travel segment’s “total actual cost of the transportation. The Audit staff used the weekly \$336,000 installment as the trigger for recording expenses (and offsets to those expenses in the form of Press reimbursements). Like all cash-basis accounting, this simplifies the hourly rate calculations since one uses only a week’s actual flight hours rather than waiting until the end of the contract to determine how many actual flight hours over which to spread the \$6,384,000 fixed fee. But again, like all cash-basis accounting, this does not offer a fully accurate picture of the transaction here because a week’s installment payment was *not* paid to Swift Air in exchange for that week’s installment of flight hours.”

The General Committee summarized its position on GAAP by stating, “...the calculation method used by the Primary Committee and the General Committee is more consistent with GAAP. The two committees therefore used a reasonable process to predict the eventual proper allocation of Press reimbursements between the Committees.”

In the conclusion of its response, the General Committee offered its rationale in opposing the Audit staff’s position that a payment to the Primary Committee to correct the imbalance would constitute an impermissible use of public funding resulting in a non-qualified campaign expense subject to repayment. The General Committee makes four arguments.

1. Funds received under circumstances outside Part 9005 (concerning the general election public grant), such as Press reimbursements, are not similarly restricted and therefore their use is not restricted.
2. Because the primary campaign is long over, the General Committee will not actually incur any primary-related expenses. The transfer is simply to correct what the Audit Division views as the original “misdeposit”(sic) of Press reimbursements.

3. The transfer would not be a “non-qualified expense” because in the past, the Commission has repeatedly permitted transfers from publicly funded general-election committees to their affiliated primary-election committees to correct misallocation and similar issues.
4. Finally, a General-to-Primary Committee transfer should not be prevented under the Audit Division’s “non-qualified expense” rationale because the only reason for this misallocation issue is the Commission’s failure to provide guidance on how to prospectively calculate the fixed-cost portion of a particular travel segment’s “total actual cost of ... transportation.” The Primary Committee and the General Committee had no notice that they were not using the Commission’s preferred calculation method.

The Audit staff notes that the General Committee’s response to the Preliminary Audit Report concedes that an imbalance existed between the reimbursements it sought from the Press during the primary portion of the Swift Air contract and those sought during the period attributable to general election. The imbalance resulted from the Primary Committee billing the Press for reimbursements at a lower hourly rate than the actual cost would have suggested during the primary period. The Audit staff maintains that the amount represented by what the General Committee calls an “imbalance” actually represents the amount the General Committee overcharged the traveling Press during the general election period.

The Audit staff concedes that the General Committee’s explanation of the origin of the imbalance is accurate. It explains how the Primary Committee billed significantly less in the primary period, and the General Committee billed at a higher rate in the general period; this is essentially the problem. The General Committee over billed the Press during the general election by exceeding 110 percent of the actual reimbursable cost incurred for transportation.

The General Committee described the contract as a “fixed \$6,384,000 fee in exchange for up to 427.6 flight hours.” The duration of the contract was 19 weeks with nine weeks falling in the primary period and the last ten weeks in the general period. There were additional terms in the contract. The General Committee could fly up to 22.4 hours of flight time per week. Any additional hours flown would be billed at \$15,000 per hour. Should the General Committee use the entire allotment of 22.4 hours in a given week, it would be entitled to draw on any hours not used in a successive week. This issue never arose because neither campaign ever exceeded the weekly allotment of 22.4 hours.

The General Committee objected to the Audit staff’s calculation of fixed costs based only on the portion of the contract that applied solely to the general election period. The Audit staff notes that the only portion of the Swift Air contract for which the General Committee was responsible was the final ten weeks. The General Committee seemed to have understood that it was liable for the portion of the contract beginning in the contract’s tenth week because that is how the contract obligation was paid. The Primary Committee was not permitted to pay for any of the contract beyond its obligation because, in so doing, the Primary Committee would have made a contribution to the General Committee. This would not have helped the General Committee since it was

limited to the federal grant. The Audit staff necessarily focused on the fixed cost incurred and paid during the general election period.

The General Committee also objected to the Audit staff calculation of weekly fixed costs based on payments each week divided by the hours flown that week. The General Committee contention that “the payment and the hours were divided into equal weekly installments, but a particular week’s fixed installment payment was *not* in exchange for that week’s flight hours” does not square with the facts. Swift Air did intend that it be paid weekly for services provided under the contract, and it limited the services to be provided on a weekly basis to a maximum of 22.4 of flight hours. Swift Air charged the General Committee weekly for its services and monitored total use weekly to determine whether it had provided services beyond the number of hours prescribed in the contract. As a consequence, the Audit staff believes that its method of dividing the fixed payment by the number of hours flown provides a reasonable calculation of fixed weekly costs. Moreover, this method will associate the correct weekly hourly costs based on the campaign’s use each week.

The General Committee makes a case for its methodology being consistent with the past campaigns of Dole-Kemp 1996, Bush-Cheney 2000 and Kerry-Edwards 2004. The Audit staff notes that Dole-Kemp 1996 had a distinct contract for the general election and is not comparable to the problems of a contract spanning two elections as laid out by the General Committee. The audit of Bush-Cheney 2000 indicates that this committee did not materially overcharge the Press for campaign related travel. Finally, the General Committee cited the audit of Kerry-Edwards 2004<sup>5</sup> which found that the general campaign had received bankable flight hours that had been earned by the primary campaign. In this instance, the Commission determined that the general campaign should reimburse the primary campaign for these flight hours. The reimbursement was required to avoid a prohibited contribution from the primary campaign to the general campaign. Further, the Audit staff notes that the issue is not of methodology but of results. Committees are limited in the amount they may seek as reimbursement for travel provided to the Press. Once they establish administrative costs of ten percent of the total, they may receive reimbursement for no more than 110 percent of actual costs. The General Committee received reimbursements in total that exceeded 110 percent.

The General Committee objected to the Audit staff calculations based on the period of the contract that coincided with the general election. It maintained that by using these calculations, the Audit staff is resorting to (non-GAAP) cash-basis accounting. As outlined above, the focus of the review was necessarily the general election period. Within the general election period, the Audit staff matched, on a weekly basis, the services received with the contract cost paid. In summary, the amount the Press was overcharged is the difference between the maximum amount the Audit staff calculated as

<sup>5</sup> The audit of Kerry-Edwards 2004 found no material non-compliance with press billing. Apart from the fact that the Kerry-Edwards 2004 charter contract spanned the primary and general election, there is little similarity between the two campaigns. The repayment of banked hours was unrelated to press billing in Kerry-Edwards 2004. Indeed, Kerry-Edwards 2004 recognized that the banked hours were appropriately an asset of the primary campaign and had calculated a repayment equal to 99 percent of the amount identified in the audit; this amount eventually was repaid.

appropriately billable and the reimbursements actually received in the general election period.

The General Committee made arguments for allowing a transfer to the Primary Committee to correct the imbalance. The Audit staff acknowledges that transfers were sometimes permitted between the primary and general committees in Presidential campaigns when it has been shown in the course of an audit that funds or obligations belonging to a primary or general committee were in the possession of the other. This is not the case in this instance.

The General Committee believes that the Commission should find that the Press reimbursements were calculated correctly, resulting in no violation of the Act, and that the General Committee may terminate immediately.

In the final analysis, the focus of the audit is the General Committee. As such, the Audit staff maintains that the General Committee received Press reimbursements during the general election campaign period, which in the aggregate exceeded the maximum allowed, and that the General Committee should return, on a pro rata basis, \$344,892 to Press representatives and provide documentation to support the refunds. Disbursement to the U.S. Treasury, however, may be acceptable if the General Committee is unable to reconstruct the precise amounts owed to Press representatives.

## **Part V Finding and Recommendation for the Compliance Fund**

### **Failure to File 48-Hour Notices**

#### **Summary**

The Compliance Fund failed to file 48-hour notices for 169 contributions totaling \$240,700 that were received prior to the general election. In response to the Preliminary Audit Report, the Compliance Fund explained that it had experienced a one-time data-management error with an outside vendor relating to the 48-hour notice requirement. The Compliance Fund has taken measures to ensure that this unintentional oversight was corrected. The Compliance Fund believes that the Commission should find there was no violation of the 48-hour notice requirement and that the Compliance Fund should be able to terminate immediately.

#### **Legal Standard**

**48-Hour Notification of Contributions.** An authorized committee of a candidate must file special notices regarding contributions of \$1,000 or more received less than 20 days but more than 48 hours before any election in which the candidate is running. This rule applies to all types of contributions to any authorized committee of the candidate. 11 CFR §104.5(f).

## Facts and Analysis

### A. Facts

The general election was held on November 4, 2008. Contributions of \$1,000 or more received by the Compliance Fund between October 16, 2008, and November 1, 2008, required the filing of 48-hour notices (FEC Form 6 – 48-Hour Notice of Contributions/Loans Received). The Audit staff isolated 589 contributions, totaling \$871,260, which required the filing of these 48-hour notices. A review of these records identified 169 contributions, totaling \$240,700, for which the Compliance Fund failed to file the 48-hour notices.

### B. Preliminary Audit Report & Audit Division Recommendation

The Audit staff discussed this matter with Compliance Fund representatives at the exit conference and provided a schedule of the contributions requiring 48-hour notice filings. In response, Compliance Fund representatives stated that the matter had been addressed previously in a letter to the Reports Analysis Division and reiterated that “48-hour notices were not required for many of the identified contributions, as they were merely redesignations or reattributions that took place during the 48-hour notice reporting period.” Compliance Fund representatives also stated that the Compliance Fund’s normal practice of filing a 48-hour notice was not followed for a remaining group of contributions, due to data-management errors made by an outside vendor. To elaborate, the Compliance Fund’s outside data-management vendor ‘tagged’ this group of contributions with an incorrect date in its database and consequently failed to locate the group in a subsequent, computerized search for contributions requiring a 48-Hour Notice. The Compliance Fund has now taken measures with the outside vendor to ensure that this unintentional oversight is corrected, and Compliance Fund staff believes that this was a one-time occurrence.

Additionally, Compliance Fund representatives emphasized that “48-Hour Notices are intended to bring to light any last-minute contributions that a candidate might deploy for campaign-related activities, such as advertising and get-out-the-vote efforts, during an election’s final days. Contributions of the Compliance Fund, however, may not be used for any candidate’s election and may only support legal and accounting services to ensure compliance with Federal law. It should also be noted that the Compliance Fund today maintains a balance of over \$20 million, meaning that these funds received shortly before the 2008 general election still have not been spent for any purpose. The Compliance Fund was therefore not in material violation of the 48-hour notice requirement when its reliance on an outside vendor caused it to delay disclosure of donations that would only fund lawyers’ and accountants’ legal compliance activities. For these same reasons, the Compliance Fund should not be fined for this vendor failure even if the Commission somehow finds that a technical infringement of the 48-hour notice requirement occurred.”

The Preliminary Audit Report recommended that the Compliance Fund provide:

- documentation to demonstrate that the contributions in question were included properly in 48-hour notices; or
- documentation establishing that the contributions were not subject to 48-hour notification; and/or
- any further written comments it considered relevant.

### C. Committee Response to the Preliminary Audit Report

In response to the Preliminary Audit Report, the Compliance Fund reiterated the arguments mentioned above concerning the filing of 48-hour notices. Specifically, the Compliance Fund maintained that the Commission incorrectly identified contributions that were redesignated during the 48-hour notice reporting period or refunded immediately following receipt. For other contributions, the Compliance Fund stated that it did not follow the normal practice of filing 48-hour notices due to data-management errors by its outside vendor. Furthermore, the Compliance Fund again stated that the funds received shortly before the 2008 general election still have not been spent for any purpose, and it reiterated its belief that 48-hour notices are intended to disclose any last-minute contributions that can be used for campaign-related activities and not for donations to the legal and accounting activities of the Compliance Fund.

The Audit staff acknowledges that the majority of 48-hour notices not filed were the result of a data management error as indicated by the Compliance Fund. It also noted, however, that none of the contributions it had identified were redesignated contributions.<sup>6</sup> Also, the contributions that the Compliance Fund identified in its response to the Preliminary Audit Report, at footnote 56, actually were received during the 48-hour notice period but refunded after the notice period (after November 1, 2008). As such, these contributions required a 48-hour notice.

## Part VI Finding and Recommendation for the Joint Fundraising Committees

Based upon the limited examination of the reports and statements filed and the records presented by the seven joint fundraising committees, the Audit staff discovered no material non-compliance.

<sup>6</sup> The Compliance Fund's response to the Preliminary Audit Report mistakenly includes the example, at footnote 55, of a redesignated contribution from Eileen Kamerick on 10/23/08. This contribution, totaling \$1,500, was reported as a memo entry redesignation from the primary on the Compliance Fund's Post-General 2008 disclosure report and not included in the Audit staff's review of 48-hour notices. A subsequent credit card contribution made on the committee's website from Eileen Kamerick totaling \$1,000 on 10/29/08 was also reported on the Compliance Fund's Post-General 2008 disclosure report and was included in this review.

## Part VII Attachment

**McCain-Palin 2008 Inc.**  
**Statement of Net Outstanding Qualified Campaign Expenses**  
**As of December 4, 2008**  
**As Determined on December 31, 2011**

**Assets**

Cash in Bank		\$3,693,508	
Accounts Receivable:			
Due from the Compliance Fund	\$2,661,175		(a)
Due from the Primary Committee	\$339,056		
Due from Other Vendors	\$424,755		(b)
		<u>\$7,234,922</u>	
<b>TOTAL ASSETS</b>			<b>\$10,928,434</b>

**Obligations**

Accounts Payable:			
For Qualified Campaign Expenses		\$8,448,103	
Due to the Compliance Fund		\$100,107	
Due to the Primary Committee		\$167,828	
Payment to Press for Campaign Travel		\$344,892	(c)
Amount Due U.S. Treasury:			
Disbursement of Interest Earned		\$58,319	(d)
Disbursement of Stale-Dated Checks		\$2,882	(e)
Winding Down Costs:			
Actual: December 5, 2008 to December 31, 2011		<u>\$1,806,303</u>	(f)
<b>TOTAL OBLIGATIONS</b>			<b>\$10,928,434</b>
<b>NET OUTSTANDING QUALIFIED CAMPAIGN EXPENSES (DEFICIT)</b>			<b><u>(\$0)</u></b>

- (a) This amount represents repayments for expenditures paid by General, \$87,217 for Secret Service shortfall for campaign travel, \$76,841 for transfers, and \$2,399,908 for 5 percent allocable portion of media costs. A receivable for \$97,149 is due for compliance-related winding-down costs.
- (b) This amount represents Press and Secret Service receipts, media refunds through June 30, 2011, interest earned, capital assets sold, and capital assets in-house to be sold.
- (c) This amount represents payment due to Press as discussed in the Campaign Travel Billing for Press finding on page 7.
- (d) This amount represents a disbursement made on Jan. 2, 2009 for interest.
- (e) This amount represents a disbursement made on Jan. 2, 2010 for stale-dated checks.
- (f) The General Committee has not exceeded the winding-down cost limitation at 11 CFR §9004.11(b).



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

April 11, 2012

**MEMORANDUM**

**TO:** Patricia Carmona  
Chief Compliance Officer

Thomas Hintermister  
Assistant Staff Director  
Audit Division

**FROM:** Christopher Hughey *pch*  
Deputy General Counsel

Lawrence L. Calvert, Jr. *LLC*  
Associate General Counsel

Lorenzo Holloway *LH*  
Assistant General Counsel  
For Public Finance and Audit Advice

Delanie DeWitt Painter *DDP for DDP*  
Attorney

**SUBJECT:** Draft Final Audit Report for McCain-Palin 2008, Inc. and McCain-Palin Compliance Fund, Inc. (LRA 759)

**I. INTRODUCTION**

The Office of the General Counsel has reviewed the proposed Draft Final Audit Report ("DFAR") for McCain-Palin 2008, Inc. (the "General Committee") and McCain-Palin Compliance Fund (the "GELAC"). We generally concur with the findings in the DFAR and specifically comment on Finding 1: Campaign Travel Billing for Press. If you have any questions, please contact Delanie DeWitt Painter, the attorney assigned to this audit.

**II. CAMPAIGN TRAVEL BILLING FOR PRESS – BACKGROUND**

The auditors reviewed travel billing and press reimbursements and concluded that the General Committee must refund \$344,892 to the press for excessive reimbursements.

The press traveled with the presidential candidate on a plane chartered through Swift Air LLC ("Swift Air"). John McCain 2008, Inc. ("Primary Committee") had used the same chartered airplane during the latter part of the primary campaign. The auditors calculated the total actual transportation cost to the press as \$3,756,215. They determined that the maximum that the General Committee could bill the press was 110% of this actual cost, \$4,131,836. The General Committee billed the press \$4,503,658 and, in response to those bills, received reimbursements of \$4,476,728. Thus, the auditors conclude that the General Committee must refund the excessive amount of \$344,982 (\$4,476,728 -- \$4,131,836) to the press. The excessive reimbursements were primarily caused by the Committee's method of calculating the actual travel costs on the leased airplane from Swift Air.

In response to the Preliminary Audit Report ("PAR"), the General Committee contends that it used a "reasonable process" to "predict the eventual, proper allocation" of press reimbursements between the General Committee and the Primary Committee. PAR Response at 3-5. It argues that its calculation method is more consistent with past Commission audits. *Id.* at 6-9. Further, it asserts that its calculation is more consistent with Generally Accepted Accounting Principles ("GAAP"). *Id.* at 9-11. Finally, the General Committee argues that to the extent a misallocation of press reimbursements between the committees still exists, the General Committee may correct the imbalance by making a payment to the Primary Committee. *Id.* at 11-13. The General Committee's arguments are discussed in more detail below. We do not find the General Committee's arguments persuasive.

The Swift Air charter contract for the leased aircraft covered a portion of the primary campaign and the entire general campaign and ran between June 30, 2008 and November 15, 2008. The contract was signed on behalf of the Primary Committee, but the General Committee appears to have assumed the payments and terms of the contract and made weekly payments to Swift Air during the general election period. The total contract cost was \$6,384,000, to be paid in 19 weekly payments of \$336,000. The contract entitled the campaign to 22.4 flight hours per week for a total of 425.6 flight hours for the entire contract. Flight hours in excess of 22.4 hours per week were to incur additional charges and unused hours could be rolled over to later weeks. The Primary Committee and General Committee remained liable for the total contract cost of \$6,384,000 even if fewer than 425.6 hours were flown by the end of the contract, and were entitled to no refund or rebate for flight hours that remained unused at the end of the contract. Neither the Primary Committee nor the General Committee used up the flight hours that they were entitled to use; the Primary Committee used 111.8 flight hours and the General Committee used 140.3 flight hours. The Primary Committee paid Swift Air \$336,000 per week each week for nine weeks and the General Committee paid the same weekly amount each week for ten weeks during the general election period. Over the ten weeks it had the aircraft, the General Committee paid Swift Air a total of \$4,047,402, which included the contract cost of \$3,360,000 plus \$687,402 for fuel, catering, passenger taxes and ground handling fees as required by the contract.

To determine the amount that the General Committee could receive in press reimbursements, the General Committee had to calculate the pro rata share of the actual cost of travel for each passenger. The General Committee and the Audit Division used two different methods to calculate this pro rata share.

The General Committee's calculation was based on the cost over the entire life of the contract and included the entire amount that the General Committee paid as well as a portion of the amount that the Primary Committee paid on the contract. Specifically, the General Committee's calculation is based on the combined actual flight hours that both committees used during the campaign and the total contract cost. The committees estimated the flight hours and adjusted the estimate on a segment-by-segment basis. Using this method of calculating the actual travel cost, the General Committee claims that it received press reimbursement of only 106% of the actual cost – less than the regulatory maximum of 110%.

The General Committee asserts that it was not easy to determine the actual cost of travel in advance because the Swift Air travel cost could be calculated only at the end of the contract, when the committees would know how many hours had been flown and could then divide the total contract cost. PAR Response at 3. It argues that because the committees could only “predict the proper hourly rate,” they continually adjusted each new travel segment “based on the evolving total of estimated hours to be flown” under the contract. *Id.* at 4. The committees realized that the contract straddled the primary and general election periods and anticipated that they would need to later “rebalance” the press reimbursements between them when the actual hourly rates were known, after the 2008 election. *Id.* The Committee argues that “a particular week’s fixed installment payment was *not* in exchange for that week’s flight hours.” *Id.* at 5.

The Audit Division took a different approach to calculate the pro rata share of the actual cost of travel and concludes that the General Committee received reimbursements in excess of the maximum 110%. It looked only at the actual cost paid by the General Committee to Swift Air for travel during the general election portion of the contract, not the entire cost of the contract over its entire life during both the primary and general campaigns. The auditors’ calculation was based on the \$336,000 weekly payments to Swift Air, as well as costs for fuel, catering, passenger taxes and ground costs and some reconfiguration costs. The Audit Division concluded that the Primary Committee billed press travelers less than their pro rata share of the total amount the Primary Committee actually paid on the Swift Air contract, leaving an amount that the Primary Committee had paid on the contract but did not bill. Consequently, the General Committee billed press travelers *more* than 110% of their pro rata share of the amount the *General Committee* actually paid on the contract because the General Committee’s calculation included a portion of the entire contract that had been paid by the Primary Committee.

### **III. EXCESSIVE MEDIA REIMBURSEMENTS ARE DETERMINED BY CALCULATING ACTUAL TRAVEL COST**

#### **A. The General Committee and The Audit Division Disagree on How to Calculate Actual Travel Cost**

The crux of the disagreement between the General Committee and the Audit Division is which accounting method should be used to calculate the “actual costs” portion of the calculation of passengers’ pro rata share of actual travel costs under 11 C.F.R. § 9004.6(a). The General Committee argues its accounting method, in combining the contract cost of both committees, was more reasonable than the auditors’ accounting method given that the contract price was not directly proportional to the actual use of the aircraft over the period of the contract. While the auditors’ method relied on the cost that each committee paid under the contract, the General Committee argues that the cost that the committees were paying for the contract was not directly reflective of the flight hours that they were using as they proceeded through the campaign.

As a legal matter, however, we question whether the Commission should apply the General Committee’s approach because it requires the Commission to combine the contract cost and use of both the Primary Committee and the General Committee. The problem with the General Committee’s argument is that its method may accurately reflect the comparative actual use of the aircraft between the two committees but it is out of proportion to the comparative actual costs paid by the two committees. And because, of the two committees, the General Committee is the only one that is publicly financed and the only one that is the subject of this audit, it is the “actual cost,” 11 C.F.R. § 9004.6(a), to the General Committee with which we are concerned here.

The public financing rules allow general election committees to seek limited reimbursements from the media for travel expenses. *See* 11 C.F.R. § 9004.6(a)(2) and (3). “The amount of reimbursement sought from a media representative . . . shall not exceed 110% of the media representative’s pro rata share (or a reasonable estimate of the media representative’s pro rata share) of the actual cost of the transportation and services made available.” 11 C.F.R. § 9004.6(b)(1). The pro rata share is calculated by “dividing the total actual cost of the transportation and services provided by the total number of individuals to whom such transportation and services are made available.”<sup>1</sup> 11 C.F.R. § 9004.6(b)(2). While we can apply this regulation to the travel expenses of one committee operating in one election, neither the regulation itself, nor its Explanation and Justification provide a formula for calculating the actual cost of air travel on a chartered airplane used by two committees in two different elections (primary and general).

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<sup>1</sup> The travel reimbursement rule at section 9004.6 has changed in some ways over the years, but the Commission has consistently stated that committees should determine the media representative’s pro rata share of the “actual cost” of the transportation. *See, e.g.,* Explanation and Justifications for 11 C.F.R. § 9004.6, 45 Fed. Reg. 43,376 (June 27, 1980); 56 Fed. Reg. 35903 (Jul. 29, 1991), 60 Fed. Reg. 31,858-59 (June 16, 1995), 64 Fed. Reg. 42,581 (Aug. 5, 1999).

The auditors' calculation of the actual cost of the Swift Air contract and related costs is simple. The auditors determined that the actual cost was the amount paid by the General Committee to Swift Air for travel during the general election period. The calculation was based on the weekly installment payment of \$336,000 and additional costs, the weekly flight hours, and the number of passengers. The Audit Division's method indicates that the General Committee billed the press and received reimbursements from the press, not only for the amounts the General Committee paid to Swift Air during the general election period, but also for a portion of the travel costs that the Primary Committee paid to Swift Air for primary campaign transportation attributable to the primary campaign.

The Audit staff's calculation is appropriate because the cost of the Swift Air contract paid for and used by both the primary and general campaigns should be divided based on the amount each committee actually paid for travel during the primary or general campaign. The regulatory history provides no guidance about how to determine the "actual cost" in a case like this one, where a candidate's primary and general committees shared a contract for use of the same leased *airplane*. But the Commission has noted, in addressing what types of costs could be charged to the media as the "actual cost" of *ground* transportation and facilities, that "campaigns should already be well aware that each media representative may only be charged his or her own pro rata share of costs" and "committees may not force the traveling press to absorb the costs" of services "used or consumed" by others. Explanation and Justification for 11 C.F.R. § 9004.6, 64 Fed. Reg. 42,581-2 (Aug. 5, 1999). *Id.* at 42,582. This reasoning would support the conclusion that media traveling with a candidate's general election campaign should pay only for general election period travel and not be forced to absorb air travel costs more properly viewed as attributable to the candidate's primary campaign, and specifically to the media who traveled with that campaign.

**B. The General Committee's Actual Cost Should Be Based On The Travel Cost Paid By The General Committee**

The General Committee's press billing and reimbursement calculation should be based only on the General Committee's payments for travel in furtherance of the general election campaign during the general election period. The General Committee cannot incur primary-related travel expenses because they are not in furtherance of the general election campaign. *See* 26 U.S.C. § 9002(11); 11 C.F.R. § 9002.11. As the General Committee cannot incur expenses for primary-related travel, it should not be able to effectively bill the press for those costs either. The publicly-funded General Committee and McCain's non-publicly funded Primary Committee should keep their expenses separate because the two campaigns operated under different rules, requirements and limitations. Senator McCain agreed to use only public funds for his general election campaign; to take no contributions; and to keep his spending within the general election expenditure limitation, which equals the amount of public funds he received. *See* 26 U.S.C. §§ 9002(11), 9003(b); 2 U.S.C. §§ 441a(b)(1) and (c); 11 C.F.R. § 9002.11. By

contrast, Senator McCain opted not to participate in the primary matching payment program; his primary campaign was entirely privately funded.

Because primary and general election campaign expenditures must remain separate, the Commission created “bright line” rules for attributing expenses between the primary and general expenditure limitations after issues arose in prior election cycles about how to divide expenses that benefitted both campaigns between publicly funded primary and general committees. 11 C.F.R. § 9034.4(e); *see* Explanation and Justification for 11 C.F.R. § 9034.4(e), 60 Fed. Reg. 31,854 at 31,866-68 (Jun. 16, 1995). These rules were later revised to also apply to this situation, where the candidate received public funds in only one election. *Id.* Many of these bright line rules are based on timing. Under the bright line attribution rules, travel costs are attributed based on when the travel occurs. 11 C.F.R. § 9034.4(e)(7). If the travel occurs before the date of the nomination, the cost is a primary expense, unless the travel is by a person working exclusively on general election campaign preparations. *Id.* While these bright line rules are normally applied to situations to determine the attribution of travel costs to a primary and general campaign sharing expenses, we believe that it is appropriate for the Commission to use these same rules to determine the attribution of the travel costs between these committees and how much these committees should bill the press for travel costs.

Under the bright line attribution rules, the General Committee’s weekly payments to Swift Air were for general expenses and the Primary Committee’s weekly payments were for primary expenses because the weekly payments appear to be related to the weekly use of the leased plane. Although the General Committee contends that each weekly installment payment was not in exchange for that week’s flight hours, PAR Response at 5, it has not provided any documentation or explanation demonstrating that there was no connection between the weekly payments and the weekly flight hours. To the extent that the payments and the amounts billed to the press were related to travel occurring at the same time as the payments were made, those amounts were attributable to the Primary Committee prior to the date of the candidate’s nomination and to the General Committee after the date of the candidate’s nomination. *See* 11 C.F.R. § 9034.4(e)(7).

The regulations also allow a limited exception for qualified campaign expenses incurred prior to the general election expenditure report period for property, goods or services to be used during the expenditure report period in connection with the general election campaign. 11 C.F.R. § 9002.11(a)(2), 9003.4, 9004.4. The Commission explained that this exception is “designed to permit a candidate to set up a basic campaign organization before the expenditure report period begins.” Explanation and Justification for 11 C.F.R. § 9003.4, 45 Fed. Reg. 43375 (Jun. 27, 1980). The rule lists examples of expenses such as establishing financial accounting systems and organizational planning. 11 C.F.R. § 9003.4(a).

The General Committee has not demonstrated that the Primary Committee's weekly lease payments were related to travel after the date of nomination or that travel during the primary period was by persons who were working exclusively to prepare for the general election. *See* 11 C.F.R. § 9034.4(e)(7). Nor has it demonstrated that the Primary Committee was somehow pre-paying for the General Committee's use of the leased plane during the general election period. *See* 11 C.F.R. § 9003.4(a). Both campaigns paid the same weekly amount for the leased plane and both campaigns used the leased plane. Although unused hours rolled over from week to week, neither committee used all of the flight hours they could have used under the contract.<sup>2</sup>

In addition, the separate reporting of expenditures by these separate committees supports the conclusion that General Committee and Primary Committee travel expenditures must remain separate. The General Committee and the Primary Committee file separate reports and are separate committees.<sup>3</sup> Publicly funded authorized committees shall report all expenditures to further the candidate's general election campaign in reports separate from reports of any other expenditures made by those committees with respect to other elections. 11 C.F.R. § 9006.1.

#### **IV. PAST COMMISSION AUDITS DO NOT SUPPORT THE GENERAL COMMITTEE'S ARGUMENTS**

The draft DFAR addresses the General Committee's argument that its calculation method is more consistent with the General Committee's interpretation of previous audits including Kerry-Edwards 2004, Dole-Kemp 1996, and Bush-Cheney 2000.<sup>4</sup> We agree with the discussion of these audits in the draft DFAR, but we suggest that the Audit Division slightly expand the discussion of the General Committee's argument concerning the Kerry-Edwards 2004 audit.

The Committee contends, and it is correct, that the Kerry-Edwards air charter lease "straddled the primary- and general-election periods," like the Swift Air contract. PAR Response at 7. The Committee, however, is incorrect in assuming that there must have been similar issues in calculating the costs for press reimbursements where the Kerry Edwards general committee reimbursed the primary committee for "banked" flight

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<sup>2</sup> If the General Committee is able to demonstrate that some portion of the Primary Committee's contract payments was to further the general election and should have been paid for by the General Committee, its actual cost of travel and the amount it may bill the press might increase. We recommend that the Audit Division specifically note this issue in the DFAR.

<sup>3</sup> Generally, publicly funded general election candidates set up a separate authorized committee for the general election, which they authorize to incur expenses on their behalf, as well as a separate legal and compliance fund. *See* 26 U.S.C. §§ 9002(1); 11 C.F.R. §§ 9002.1, 9002.2, 9003.3.

<sup>4</sup> The draft DFAR also addresses the General Committee's arguments based on GAAP accounting principles. We defer to the Audit Division's expertise in analyzing the correct application of accounting and auditing principles and procedures.

hours used by the general committee, *id.* at 8, because, according to the Audit Division, the Kerry-Edwards general committee did not use the plane in question to transport the press.<sup>5</sup> To assist the Commission, we recommend that you include this information about the Kerry-Edwards audit in the DFAR's discussion of past Commission audits.

The General Committee also cites several audits that it had relied upon in prior responses, Dole-Kemp 1996 and Bush-Cheney 2000. The General Committee argues that its calculation method was structured to match past Commission audits and that it used the same method the auditors used in the Dole-Kemp audit, dividing the total amount of payments made under the lease by the number of actual flight hours, to predict the travel costs attributable to the General Committee. PAR Response at 5-6. The Committee asserts that it does not matter that the Dole-Kemp contract only covered the general election period. *Id.* The Committee states that Bush-Cheney 2000's lease covered the primary and general election periods and was structured in a nearly identical way to the Swift Air contract, and the Bush-Cheney campaign used the same billing methodology as the General Committee did for the Swift Air contract. *Id.* at 8. It argues that there was no press finding in the Bush-Cheney 2000 Final Audit Report, and the Audit Division did not "even communicate informally any objection over calculation methodology." *Id.* It contends that even if the overbilling of the press in that audit was not material, the "Audit Division still should have given notice of methodology errors" and the "Commission's acquiescence in a recordkeeping practice has precedential value because silence is reasonably construed by the audited party as approval." *Id.*

We concur with the Audit Division's discussion of these past Commission audits in the draft DFAR. The General Committee seeks to apply the hourly calculation used in the Dole-Kemp 1996 audit to the total Swift Air costs over the life of the entire contract for both the General Committee and Primary Committee, and not, as in Dole-Kemp 1996, to a general election committee's portion of the costs for travel during the general election campaign. The Bush-Cheney 2000 committee may have used a similar billing methodology to the General Committee, but that method did not result in any material overbilling of the press or audit finding in that audit. The absence of a finding in that audit does not indicate the approach or billings by the Bush-Cheney 2000 committee were correct. It merely indicates that the difference between the committee's and auditors' calculations in that audit was not large enough to raise an issue of material noncompliance.

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<sup>5</sup> Moreover, in contrast to this audit, where both committees used less than the flight hours they paid for, the Kerry-Edwards general committee actually paid the Kerry primary committee for the "banked" flight hours used by the general committee (i.e., hours originally paid by the Kerry primary committee, but not used by it). We presume that if the Kerry-Edwards general committee had used the plane to transport the press, the Audit Division would have included these payments to the Kerry primary committee in the Kerry-Edwards general committee's "actual cost." 11 C.F.R. § 9004.6(b)(1). Please advise us if this is not the case.

However, you may wish to address whether this issue arose in any prior audits in such a way that the General Committee would have been on notice that its choice of accounting method might have negative consequences.

#### **V. PROPOSED TRANSFER TO PRIMARY COMMITTEE WOULD NOT RESOLVE ISSUE**

The General Committee's final argument is that if there is a "misallocation" of press reimbursements, it should not have to make any refunds to press entities, but instead may correct the imbalance with a transfer from the General Committee to the Primary Committee. PAR Response at 11-13. The General Committee argues that such a payment would not result in qualified campaign expenses. *Id.* It contends that the Commission has previously permitted transfers from publicly funded general committees to primary committees to correct similar misallocation issues and cites Kerry-Edwards 2004 as an example of the payment by the general committee to the primary committee for a misallocation of joint reconfiguration costs and banked flight hours. *Id.* at 12-13. It asserts that the transfer itself would not be any type of expense because the Committees are affiliated and may make unlimited transfers. *Id.* at 12. The General Committee also contends that the restriction limiting its spending to qualified campaign expenses applies only to the public funds it received, and not to funds it received from other sources, such as press reimbursements. *Id.* It contends that the transfer will not result in the General Committee incurring non-qualified primary expenses because three years have passed and any funds transferred are unlikely to be used to defray any primary activity, and the Primary Committee already paid for press travel without recouping its full travel costs. *Id.* Last, the General Committee argues that the Commission should permit a transfer because the issue was caused by the Commission's failure to provide advance guidance on press reimbursement calculations. *Id.* at 13. Alternatively, the Committee requests permission to disgorge the press reimbursements to the Treasury. *Id.*

The General Committee's proposed transfer of funds to the Primary Committee will not resolve the issue that the General Committee received reimbursements from the press in excess of its actual travel cost. The amount of excess press reimbursements the General Committee received should be returned to the media representatives. 11 C.F.R. § 9004.6(d)(1). The fact that the General Committee overbilled the press and the Primary Committee could have billed the press more than it did does not mean that the General Committee owes the excess press reimbursements it received to the Primary Committee. Moreover, as previously noted, the General Committee has not demonstrated that the Primary Committee paid Swift Air more than its share of the contract costs to cover travel costs used by the General Committee during the general election period. In previous Commission audits where a general committee reimbursed a primary committee, such as the payment for banked hours in Kerry-Edwards, the Commission required the reimbursements because one committee had paid for goods or services that were actually used by the other committee. But here, the General Committee does not owe any reimbursement to the Primary Committee.

Moreover, if the General Committee's public funds are transferred to the Primary Committee and used to pay for any primary campaign expenses, the payments would be non-qualified campaign expenses that may be subject to repayment because they would not be made to further McCain's campaign for the general election. *See* 26 U.S.C. §§ 9002(11), 9007(b)(4); 11 C.F.R. §§ 9002.11, 9004.4, 9007.2(b)(2). While the General Committee might be able to transfer funds to the Primary Committee, the Primary Committee could not then use the funds for any primary expenses such as debts without causing the General Committee to make a non-qualified campaign expense. All of the General Committee's funds must be used only for qualified campaign expenses; there is no exception for press reimbursements received.<sup>6</sup> *See* 11 C.F.R. §§ 9002.11, 9004.4. Because press payments reimburse campaigns for some of the public funds spent on travel costs, reimbursements retain their character as public funds. Whether or not the Commission provided advance guidance on press reimbursement calculations, the proposed transfer would not resolve this issue.

The General Committee should pay the excess reimbursements to the press. The regulations require committees to return reimbursements in excess of 110% to the media representative. 11 C.F.R. § 9004.6(d). Only amounts that are less than 110% but exceed the actual cost of travel plus a percentage for administrative costs should be paid to the Treasury. *Id.* In other contexts, the regulations provide for payment to the Treasury for stale-dated checks, 11 C.F.R. § 9007.6, and disgorgement payments for the amount of prohibited and excessive contributions identified by a sampling method in an audit. 11 C.F.R. § 9007.1(f). Payment to the Treasury is appropriate in those instances because of the difficulty of resolving situations where payees have not cashed committee checks or the audit sample does not identify specific contributors for refunds. Similarly, disgorgement to the Treasury might be appropriate here if the General Committee is unable to reconstruct the precise amounts owed to each individual press entity, or if the payees cannot now be located.

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<sup>6</sup> Fully publicly funded general election candidates must agree not to accept any private contributions, 11 C.F.R. § 9003.2(a)(2); thus, their expenditures are equal to the public funds received. The only funds that are not subject to the public funding use restrictions are private contributions in a general election legal and accounting compliance fund. *See* 11 C.F.R. § 9003.3.



July 7, 2012

**VIA ELECTRONIC AND CERTIFIED MAIL**

Thomas E. Hintermister  
Assistant Staff Director  
Audit Division  
Federal Election Commission  
999 E Street, NW  
Washington, DC 20463

**Re: McCain Presidential Committees' Response to the Draft Final Audit Report**

Dear Mr. Hintermister:

McCain-Palin 2008, Inc. and McCain-Palin Compliance Fund, Inc. have endeavored to comply strictly with Commission rules. Their success in doing so is demonstrated by the fact that the Audit Division's nearly four-year audit of McCain-Palin 2008, McCain-Palin Compliance Fund, and their seven affiliated joint fundraising committees has identified only two outstanding issues: (1) Press reimbursement calculation methods that the Audit Division concedes did not result in "the General Committee ... receiv[ing] travel reimbursements from the Press that exceeded the maximum allowed by the regulations";<sup>1</sup> and (2) certain 48-Hour Notices that were not filed due to an outside vendor's data-management error and concerned contributions only used for compliance purposes.

This Response focuses its analysis exclusively on the first of these issues—Press reimbursement—in addressing comments by the Audit Division and the Office of General Counsel that were included in the Draft Final Audit Report ("Draft FAR") materials. The 48-Hour Notices were already discussed thoroughly in Section II of the "Response to the Preliminary Audit Report," which was previously submitted to the Commission.<sup>2</sup>

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<sup>1</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>2</sup> Preliminary Audit Report Response of McCain Presidential Committees at 14-15 (Dec. 20, 2011).

## I. ANALYSIS

The Press covering Senator John McCain's participation in the 2008 presidential campaign travelled predominantly on an aircraft chartered by the McCain Campaign through a contract with Swift Air, LLC. John McCain 2008 (the "Primary Committee") and McCain-Palin 2008 (the "General Committee") agreed to pay Swift Air \$6,384,000 in exchange for 425.6 total flight hours from June 30th to November 15th.<sup>3</sup> The total fee paid by the Primary Committee and the General Committee was fixed, in that \$6,384,000 was still due even if fewer than 425.6 hours were ultimately flown.<sup>4</sup> This is relevant because the two Committees, in fact, only used 252.1 of the 425.6 contracted flight hours (111.8 hours were used by the Primary Committee, 140.3 hours by the General Committee).

The Primary Committee and the General Committee were legally authorized to seek reimbursement from travelling Press entities for up to 110 percent of the \$6,384,000 fixed-payment total and other travel expenses.<sup>5</sup> The Audit Division does not allege that any ineligible expenses were billed to the Press for reimbursement.<sup>6</sup> And significantly, the Audit Division concedes that the Primary Committee and the General Committee collected the proper total from the Press:

The Audit staff agrees that when using the *total* Swift Air LLC contract amount for both the primary and general election periods ... the General Committee did not receive travel reimbursement from the Press that exceeded the maximum allowed by the regulations.<sup>7</sup>

The total amount billed and received by the Primary Committee and the General Committee was, by the Audit Division's statement, a legally proper amount. Despite the Audit Division's puzzling insistence on clinging to the term "overbilling," the Division is, at bottom, only arguing that the two Committees should have better "match[ed] the cost of the campaign to the proper election."<sup>8</sup> Put differently, the Audit Division thinks that, although the two Committees together collected the proper total from the Press, the General Committee received too much of the total and the Primary Committee received too little.<sup>9</sup>

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<sup>3</sup> The contract permitted a maximum number of 22.4 flight hours flown in a week. If the maximum weekly hours were not flown, the leftover hours "rolled over" for use in subsequent weeks. If the contracted 22.4 weekly flight hours were exceeded and no "rolled over" hours were available, Swift Air charged \$15,000 per additional hour. The maximum weekly flight hours were never exceeded.

<sup>4</sup> The fee excluded aircraft reconfiguration costs and variable costs (e.g. fuel, baggage fees). Reconfiguration costs and variable costs are not at issue in the Draft FAR, so they are not discussed in this Response. See Fed. Election Comm'n, Preliminary Audit Report at 9 (Sept. 30, 2011) ("The General Committee correctly reimbursed the Primary Committee \$390,000 ... for these aircraft configuration costs.").

<sup>5</sup> See 11 C.F.R. § 9004.6.

<sup>6</sup> 11 C.F.R. § 9004.6(a)(1).

<sup>7</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011) (emphasis in original).

<sup>8</sup> Fed. Election Comm'n, Preliminary Audit Report at 13 (Sept. 30, 2011).

<sup>9</sup> Fed. Election Comm'n, Preliminary Audit Report at 13 (Sept. 30, 2011) ("The General Committee received reimbursements from the Press for campaign travel that were above the maximum amount billable to the Press. The Primary Committee appears to have billed an amount that was less than its cost.").

The General Committee, which is named in the Draft FAR, does not dispute that Press reimbursements could be rebalanced between the two Committees, now with the benefit of hindsight. The General Committee, however, argues that: (A) the Primary Committee and the General Committee used a reasonable process in the first instance to predict the eventual, proper allocation of Press reimbursements between the Committees; and (B) to the extent a misallocation of Press reimbursements between the two Committees still exists, it may correct the imbalance through a payment to the Primary Committee.

**A. The Primary Committee and the General Committee Used a Reasonable Process to Predict the Eventual, Proper Allocation of Press Reimbursements between the General Committee and the Primary Committee**

Commission rules require an authorized committee seeking reimbursement from Press entities to present an itemized invoice within 60 days of a campaign trip or event.<sup>10</sup> The invoice must reasonably estimate a Press entity's pro rata share for the air transportation of "each segment of the trip," which is calculated by "dividing the total actual cost of the transportation and services provided by the total number of individuals to whom such transportation and services are made available."<sup>11</sup>

A travel segment's "total actual cost of the transportation" is comprised of both variable and fixed expenses. Variable expenses, such as fuel, catering, passenger taxes, and ground handling fees, are easily attributed to a particular travel segment since they are that same segment's direct costs. Fixed expenses are different. They are not the result of any particular travel segment and would exist even if a travel segment did not occur. What is the proper method for assigning a portion of a fixed cost to a particular travel segment?

The Commission has never issued a rule or express guidance that specifically answers this question, as was acknowledged in the Draft FAR materials: "neither the regulations itself, nor its Explanation and Justification provide a formula for calculating the actual cost of air travel on a chartered airplane used by two committees in two different elections."<sup>12</sup> To calculate the fixed-expense share of a travel segment's "total actual cost of the transportation," then, one must devise a reasonable method to assign some portion of the overall fixed cost to that single travel segment.

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<sup>10</sup> 11 C.F.R. § 9004.6(b)(3). *See also* 52 Fed. Reg. at 20886 (June 3, 1987)(stating that the rules permit an estimate of a media entity's costs because it "eases the burden of accounting precisely for such costs in the heat of the campaign. In addition, this allowance permits reimbursements received from some media organizations to compensate for those that do not pay in full.").

<sup>11</sup> 11 C.F.R. § 9004.6(b)(2)-(3).

<sup>12</sup> Fed. Election Comm'n, Off. of General Counsel Memo. to Thomas Hintermister at 4 (Apr. 11, 2012). *See also* Fed. Election Comm'n, Off. of General Counsel Memo. to Thomas Hintermister at 5 (Apr. 11, 2012) ("The regulatory history provides no guidance about how to determine the 'actual cost' in a case like this one, where a candidate's primary and general committees shared a contract for use of the same leased *airplane*." ) (emphasis in original).

Here, the Primary Committee and the General Committee presented itemized invoices that, as required, listed a reasonable estimate of each Press entity's pro rata share for air transportation, calculated by dividing the "total actual cost of the transportation" by the total number of individuals to whom the transportation was made available. Variable costs were easily attributed to each travel segment. To determine each travel segment's "total actual cost of the transportation," though, the two Committees still needed to devise a method to assign a portion of their fixed costs to each travel segment.

This was not easily done in advance with the two Committees' largest fixed transportation-related cost, the \$6,384,000 fee for 425.6 flight hours paid to Swift Air. (Again, this \$6,384,000 fee was a fixed expense, because it was still due in full even if fewer than the maximum 425.6 hours were ultimately flown.) The Committees knew the total fee (\$6,384,000), the total number of flight hours to which they were entitled (425.6 hours), and, therefore, the baseline hourly rate ( $\$6,384,000 / 425.6 = \$15,000/\text{flight hour}$ ). But the final hourly rate for the Swift Air contract could be calculated only at the end of the contract, when the Committees would know exactly how many flight hours over which to spread the \$6,384,000 fixed fee. While an hourly rate for a travel segment could be predicted, the ultimate hourly rate for that travel segment would fluctuate based on subsequent use or disuse of the plane. For example, the Press could be billed a pro rata share using a \$15,000 per-hour estimate for a July travel segment, but the ultimate hourly rate for that segment would go up if plane use was less than anticipated in August through November, or go down if the plane was flown more than expected in the post-July period. The Committees' calculations were therefore not hampered by "the fast pace of the election campaign," as the Audit Division surmised.<sup>13</sup> The Committees could not "calculate" here. At best, they could predict the proper hourly rate for a travel segment, knowing that the actual hourly rate would, in the end, depend on future, unknowable events.<sup>14</sup>

Facing this situation without the benefit of Commission rules or express guidance, the two Committees could have arbitrarily applied a calculation method or an hourly rate. Instead, the Committees undertook an effort to continually adjust each new travel segment's hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract.<sup>15</sup> Press reimbursement billings were then sent out and collected using these estimated hourly costs. Realizing that the Swift Air contract straddled the primary- and general-election periods, the two Committees fully anticipated that they could need to later "rebalance" the Press reimbursements between them when the actual hourly rates for all travel segments became known (and knowable) after the 2008 election.

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<sup>13</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>14</sup> Because the actual hours flown were far less than the hours to which the Campaign was "entitled" by the contract (252.1 hrs v. 425.6 hrs), the actual per hour cost was much greater (\$25,208 per hour using the Campaign's methodology and \$27,350 per hour using the Audit Division's methodology) than the per hour cost envisioned by the contract ( $\$6,384,000 / 425.6 \text{ hours} = \$15,000 \text{ per hour}$ ).

<sup>15</sup> As the Audit Division noted, "The General Committee ... relied on adjusting the per hour billing rates on a segment-by-segment basis due to using fewer flight hours than available in the Swift Air contract." Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

The Audit Division acknowledges that the Committees' method for predicting the proper allocation of Press reimbursements between the General Committee and the Primary Committee "reflect[s] the comparative actual use of the aircraft between the Primary ... and General Committees..."<sup>16</sup> The Audit Division nonetheless advocates a new, never-before-announced technique for calculating a travel segment's hourly rate, and by extension, the proper allocation of Press reimbursements: divide each weekly installment of the \$6,384,000 Swift Air payment "by the actual weekly hours flown during the general election period..."<sup>17</sup>

The Audit Division's method is conveniently simple. But this simplicity is wrought by ignoring important realities about the Swift Air contract. For one, the Swift Air contract was jointly held by the Primary Committee and the General Committee. It spanned four months, straddling the divide between primary- and general-election periods. The Committees and Swift Air intended this exact structure. A four-month contract held by two entities is manifestly different than a two-month contract held by one. The Audit Division, however, wants to now artificially bisect the Swift Air contract without even considering whether the parties would have structured two separate two-month contracts another way. For instance, the amount and frequency of the weekly installment payments might have been different, and the costs certainly would have been greater since a key factor in the cost of securing a dedicated aircraft is the lease's duration.<sup>18</sup> The Audit Division cannot disregard a contract's fundamental elements without its analysis spinning into the realm of fiction.

The Audit Division also ignores the fact that the Swift Air transaction was a fixed \$6,384,000 fee in exchange for 425.6 flight hours. The Committees were required to pay "a total of" of \$6,384,000 in exchange for "425.6 hours over the Term" of the contract, which lasted until November 15, 2008.<sup>19</sup> The total payment and the total hours were divided into equal weekly portions as a scheduling mechanism, but a particular week's payment was *not* in exchange for that week's flight hours, as the Audit Division supposes. General contract law principles,<sup>20</sup> and

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<sup>16</sup> Fed. Election Comm'n, Preliminary Audit Report at 13 (Sept. 30, 2011). *See also* Fed. Election Comm'n, Off. of General Counsel Memo. to Thomas Hintermister at 4 (Apr. 11, 2012) (remarking that the General Committee's "method may accurately reflect the comparative actual use of the aircraft").

<sup>17</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>18</sup> Regardless of whether the contract is for two months or four months, the aircraft operator/owner is required to place the aircraft through Federal Aviation Administration inspection and thereby remove the aircraft from regular commercial service. The cost of setup and servicing the aircraft for the inspection is relatively static. This allows the lessor of the aircraft to factor that cost throughout the duration of the contract adding to the weekly operating fee. Timing for the complex reconfiguration and then its return to an original state after use are also factors in determining the time the aircraft would be out of service for other commercial rentals. Therefore, the contract would naturally be cheaper based on the longer duration. Several outside experts on aircraft lease pricing confirmed this conclusion, that a four-month lease would be 5 percent to 20 percent less expensive than a two-month lease. The statements of those experts can be provided to the Commission upon request.

<sup>19</sup> Swift Air, LLC Charter Agreement at Attach. A to Cover Sheet at 1 (May 30, 2008).

<sup>20</sup> 15 Williston on Contracts § 45:4 (4th ed.). *See also* 15 Williston on Contracts § 45:3 (4th ed.) ("It may be assumed that if the promises constitute a single contract, there is a general dependency between all the promises on one side and all the promises on the other. This means that all the promised performances on both sides must be regarded as the agreed exchange for each other.")

Arizona law,<sup>21</sup> which governed the Swift Air transaction, presume that a contract is not divisible in this manner unless divisibility is the contracting parties' unambiguous intent. And the intent of the Committees and Swift Air, as expressed through the lease's structure and plain language, was clear:

- If the Committees breached or cancelled the lease, they were required to pay "all past charges for *actual hours flown* and related expenses to the date of termination."<sup>22</sup> The portion of the total 425.6 hours that had been used, not the number of weeks that had passed, served as the basis for calculating the breach or cancellation payment. This is consistent with a \$6.38-million-for-425.6-hours agreement rather than a contract divisible into 19 weekly segments.
- The contract is for a term of months, and not a term of weeks.<sup>23</sup>
- The contract featured no maximum or minimum number of weekly flight hours. The Committees would have paid a fee to compensate Swift Air for employee overtime and other costs if weekly usage exceeded 22.4 hours. The Audit Division misreads this provision to mean that Swift Air "limited the services to be provided on a weekly basis to a maximum of 22.4 of flight hours."<sup>24</sup> This interpretation is plainly incorrect. That same contractual provision specifically declares: "[t]here shall be no maximum amount of hours allowed." The Committees were also permitted to, without penalty, "roll ... unused hours over to the next week or weeks." In fact, the contract expresses relative indifference as to the number of hours flown in a week, "so long as by the end of the Term, Charterer has paid for at least 425 hours of flying."<sup>25</sup> Thus, the flight time to which the Committees were entitled was nowhere limited on a weekly basis. Rather, the structure contemplated the hours over the agreement's entire term. This indifference to weekly usage undermines the Audit Division's claim that a weekly fixed payment was actually in exchange for that week's flight hours.
- The Committees and Swift Air anticipated that flight hours would increase as the 2008 general election neared. If the contracting parties had intended one week's payment to be in exchange for one week's flight hours, then, the payments would have been in graduated amounts so that the hourly rate remained roughly constant as usage also increased. Instead, the payments were divided equally, demonstrating that the parties intended the weekly payments and the weekly hours simply as a timetable.

Dividing a week's installment payment by the week's actual flight hours therefore does not reflect what a travel segment's hourly rate and "total actual cost" were. Yet the Audit Division does that very thing, presumably to simplify the hourly rate calculations since one uses only a week's actual flight hours rather than waiting until the end of the contract to determine how

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<sup>21</sup> See, e.g., *Olliver/Pilcher Ins., Inc. v. Daniels*, 148 Ariz. 530, 533, 715 P.2d 1218, 1221 (1986) ("Where the severability of the agreement is not evident from the contract itself, the court cannot create a new agreement for the parties to uphold the contract.").

<sup>22</sup> Swift Air, LLC Charter Agreement at Attach. A to Cover Sheet at 8, 15 (May 30, 2008) (emphasis added).

<sup>23</sup> Swift Air, LLC Charter Agreement at Attach. A to Cover Sheet at 2 (May 30, 2008).

<sup>24</sup> Fed. Election Comm'n, Draft Final Audit Report at 18 (May 23, 2012).

<sup>25</sup> Swift Air, LLC Charter Agreement at Attach. A to Cover Sheet at 1 (May 30, 2008).

many actual flight hours over which to spread the \$6,384,000 fixed fee.<sup>26</sup> Simplicity is indeed attractive. It interferes with accurately calculating each travel segment's "total actual cost" here, though.

The Committees' calculation method for a travel segment's hourly rate, on the other hand, does not rely on counterfactuals. It recognizes the Swift Air contract as it is, and in doing so, is more consistent with the "benefit derived" principle, with Commission audit precedent, and with Generally Accepted Accounting Principles. The Primary Committee and the General Committee therefore used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the Committees.

### **1. The Committees' Calculation Method is More Consistent with the "Benefit Derived" Principle**

The Committees' calculation method to determine a travel segment's hourly rate coheres with the "benefit derived" principle. The Commission has favored the concept that shared expenses between committees should, unless otherwise specified, be allocated "according to the benefit reasonably expected to be derived."<sup>27</sup> For example, to allocate shared expenses between primary-election and general-election presidential committees that are both publicly funded, the Commission's rules state:

Any expenditure for goods or services that are *used* for the primary election campaign ... shall be attributed to the [primary-election spending] limits set forth at 11 CFR 9035.1. Any expenditure for goods or services that are *used* for the general election campaign ... shall be attributed to the [general-election spending] limits set forth at 11 CFR 110.8(a)(2)...<sup>28</sup>

Usage is central to allocation.<sup>29</sup> And it is here as well because a committee derives benefit from an aircraft only when it "uses" an aircraft.<sup>30</sup>

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<sup>26</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011) (stating that under the Audit Division's method "the actual flight hours are known soon after flights occur...")

<sup>27</sup> See, e.g., 11 C.F.R. § 106.1(a)(1). See also Fed. Election Comm'n, Report of the Audit Division on Bush-Cheney '04, Inc. and the Bush-Cheney '04 Compliance Committee, Inc., Statement by Mason and Von Spakovsky 2 (2007) ("The basic principle behind two entities sharing the cost of a mutually beneficial, single communication is express in 11 CFR § 106.1, which states that '[e]xpenditures, including in-kind contributions, independent expenditures, and coordinated expenditures made on behalf of more than one clearly identified Federal candidate shall be attributed to each such candidate according to the benefit reasonably expected to be derived."); Fed. Election Comm'n, Report of the Audit Division on Bush-Cheney '04, Inc. and the Bush-Cheney '04 Compliance Committee, Inc., Statement of Weintraub 3 (2007) ("The only justification permitting cost-splitting between Federal candidate and the party is that other candidates in the party are going to benefit from the generic reference to the party.").

<sup>28</sup> 11 C.F.R. § 9034.4(e)(1) (emphasis added).

<sup>29</sup> See 60 Fed. Reg. at 31,867 (June 16, 1995) (stating that the Rules in 9034.4(e) are bright-line rules meant to "give committees clear guidance as to which expenses will be attributed to the primary election and which to the general election.").

As mentioned, the Committees undertook an effort to determine how much of the fixed \$6.38 million payment to Swift Air each Committee was “using” on a rolling basis by continually adjusting each new travel segment’s hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract.<sup>31</sup>

Importantly, the Audit Division concedes that the Committees’ method for predicting the proper allocation of Press reimbursements between the General Committee and the Primary Committee “reflect[s] the comparative actual use of the aircraft between the Primary ... and General Committees....”<sup>32</sup> The Office of General Counsel seems to agree.<sup>33</sup> Because measuring “use” of an aircraft is the method to determine “benefit derived,” the Audit Division and Office of General Counsel recognize that the Committees’ method allocated the Swift Air aircraft costs (and resulting Press reimbursements) according to the benefit reasonably expected to be derived.

The Audit Division advocates an abandonment of the “benefit derived” principle, though. The Office of General Counsel concludes: “[t]he auditors determined that the actual cost was the amount paid by the General Committee to Swift Air...”<sup>34</sup> The Office then restates the correct standard— “travel costs are attributed based on when travel occurs”—but somehow fails to point out that the Audit Division is ignoring aircraft usage altogether and only focusing on the timing of *payments*. Under the Division’s preferred method, the final 10 weeks of the 19-week contract occurred during the general-election period, and the final 10 weekly payments are therefore, by that fact alone, the General Committee’s “share” of the Swift Air fixed fee and resulting Press reimbursements.<sup>35</sup> Use is irrelevant. “Actual cost” equals actual payment *per se*. Allocation is determined solely by how committees choose to divide a shared expense. This approach meaningfully departs from past Commission practice. The Audit Division would commit the Commission to deferring entirely to political committees’ chosen allocations. Assume, for instance, the Committees had front-loaded the weekly payments so that two-thirds of the \$6.83

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<sup>30</sup> See 11 C.F.R. § 9034.4(e)(7) (stating that travel expenses “shall be attributed according to when the travel occurs.”).

<sup>31</sup> As the Audit Division noted, “The General Committee ... relied on adjusting the per hour billing rates on a segment-by-segment basis due to using fewer flight hours than available in the Swift Air contract.” Fed. Election Comm’n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>32</sup> Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011).

<sup>33</sup> See also Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 4 (Apr. 11, 2012) (remarking that the General Committee’s “method may accurately reflect the comparative actual use of the aircraft between the two committees.”).

<sup>34</sup> Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 5 (Apr. 11, 2012).

<sup>35</sup> Fed. Election Comm’n, Draft Final Audit Report at 17 (May 23, 2012) (“The Audit staff notes that the only portion of the Swift Air contract for which the General Committee was responsible was the final ten weeks. The General Committee seemed to have understood that it was liable for the portion of the contract beginning in the contract’s tenth week because that is how the contract obligation was paid... The Audit staff necessarily focused on the fixed cost incurred and paid during the general election period.”). See also Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 5 (Apr. 11, 2012) (“The Audit staff’s calculation is appropriate because the cost of the Swift Air contract paid for and used by both the primary and general campaigns should be divided based on the amount each committee actually paid...”).

million total was paid in the first nine weeks. If the Audit Division applied its approach to this hypothetical arrangement, the General Committee's "share" would be just one-third, regardless of the General Committee's comparative use of the aircraft because "the actual cost [to the General Committee] was the amount paid by the General Committee to Swift Air." One might think of other potential scenarios. For example, assume that the Swift Air contract payment schedule and amounts were left as-is, but the Primary Committee used only one hour of flight time. The Audit Division would still permit the Primary Committee to defray over \$3 million of the Swift Air payment because the Primary Committee's actual cost "was the amount paid ... to Swift Air." These absurd results, which would permit a committee to subsidize another's activities, show that while the timing of travel is relevant to reaching a proper allocation in this instance, the timing of payments is not. The "benefit derived" principle is a more accurate allocation approach, and the Audit Division should not have discarded it.

Unlike the Audit Division, the two Committees used a process that was consistent with the "benefit derived" principle to predict the eventual, proper allocation of Press reimbursements. That process was therefore reasonable.

## **2. The Committees' Calculation Method is More Consistent with Audit Precedent from the Commission.**

Though the Committees could not look to a Commission rule or express announcement, they structured their calculation method for determining a travel segment's hourly rate to match Commission precedent found in previous audits. That precedent is embodied in this instructive statement from the Dole-Kemp Final Audit Report, which discusses the proper method for prospectively estimating the hourly cost of a fixed-rate contract:

The contracts for these aircraft contained a fixed price and specified the maximum number of hours that could be flown at that price. This required [Dole-Kemp] to estimate not only the variable costs (such as fuel, landing fees, catering, etc.) related to operating the aircraft, but also estimate the total number of hours to be flown by each aircraft. These estimates were revised several times during the campaign. The estimated hourly rate used by [Dole-Kemp] increased as the campaign progressed and then dropped slightly prior to the campaign's conclusion. The Audit staff determined the hourly rate for each aircraft by accumulating all operating costs and dividing that total by the actual number of hours flown by each aircraft. That calculation resulted in a significantly lower average hourly cost for the aircraft used by Senator Dole and Secretary Kemp than used by [Dole-Kemp] to bill the Press and Secret Service.<sup>36</sup>

The Dole-Kemp Audit staff's methodology for determining a travel segment's hourly rate for a fixed-rate contract was to divide the total amount of payments made under the aircraft lease by the total number of actual flight hours.

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<sup>36</sup> Fed. Election Comm'n, Final Audit Report on Dole for President Committee, et al. at 2 (2007) (emphasis added).

The Primary Committee and the General Committee assigned a portion of their \$6,384,000 fixed Swift Air payment to each travel segment using the methods employed by the Dole-Kemp Audit staff. They initially undertook an effort to continually adjust each new travel segment's hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract. Press reimbursement billings were then sent out and collected using these estimated hourly costs, realizing that the actual rate would differ from the estimate when the actual hourly rates for all travel segments became known (and knowable) after the 2008 election.

The Audit Division rejects the Committees' method because "only those costs attributable to the General Committee should be used in determining the travel cost the General Committee may bill to the Press"<sup>37</sup> and because "the General Committee should recognize only those transportation costs from September 1, 2008 through November 4, 2008 in the calculation for billing the Press."<sup>38</sup> The Audit Division is only setting up "straw men" here so that it can knock them down. The Committees do not disagree with the Audit Division's truisms—certainly only Press reimbursements for general-election travel should be billed and kept by the General Committee. The real issues here are how should the Committees have predicted the amount of "those costs attributable to the General Committee"? And what was the proper method for prospectively calculating the "transportation costs from September 1, 2008 through November 4, 2008"? The Committees' point is that they used the Dole-Kemp method to calculate in advance each travel segment's hourly rate, and thereby used a reasonable method to predict the amount of Swift Air-related fixed "costs [that would be] attributable to the General Committee."

The Audit Division also cites the Dole-Kemp Audit, but they tacitly suggest that the Dole-Kemp Audit prevents the Division from recognizing that the Swift Air contract extended back into the primary-election period. This is not the case. The Dole-Kemp Audit did indeed deal only with general-election activity, but that was because it was examining a general-election-only aircraft lease.<sup>39</sup> The Dole-Kemp Audit's scope was limited by the underlying facts, not by any legal considerations. The Dole-Kemp Audit should therefore not be seen as precedent that the Audit Division may not recognize that the Swift Air contract extended back into the primary-election period. (Again, the Dole-Kemp Audit is cited by the General Committee for

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<sup>37</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>38</sup> Fed. Election Comm'n, Preliminary Audit Report at 12 (Sept. 30, 2011).

<sup>39</sup> Based on research of the news media from that time period and the Dole for President Committee reports filed with the Commission, it seems that the Dole Primary Committee had run out of room to spend money on normal operating expenses by May 1996, and therefore would not have had the opportunity, as our Campaign did, Bush-Cheney 2000 did, and Kerry-Edwards 2004 did, to sign a contract for and implement reconfiguration costs related to a large air charter for a period of time that crosses the Primary/General periods. Research from the Commission reports shows that the Dole campaign's main air charter vendor was named "AV Atlantic." While we found millions of dollars in expenditures to that firm in September and October 1996, we could find no payments in June 1996 and only one payment to the firm in July 1996 during the end of the primary-election period. It would seem on its face, then, that the Dole Campaign's arrangement with its air charter vendor was vastly different than the type of contract setup the McCain Campaign used. We also note that a *New York Times* article during June 1996 validates the conclusion that the Dole Primary Committee did not have sufficient funds available to enter into the same type of agreement as our Campaign did. *New York Times*, "Democrats Charge Dole Violated Rules on Spending," 6/12/96 ("At the end of April, his campaign reported having spent all but \$177,000 of that sum...").

the proposition that the proper methodology here is to divide the total amount of payments made under an aircraft lease by the total number of actual flight hours.)

Commission precedent is also valuable here. While only general-election committees are subject to mandatory audit,<sup>40</sup> the Audit Division has conducted limited inquiries into primary-election committees concerning jointly held assets and other items. For example, the Kerry-Edwards 2004 and Bush-Cheney 2000 campaigns held air charter leases that, like the Swift Air contract, straddled the primary- and general-election periods.

The Kerry-Edwards 2004 Final Audit Report states that the campaign leased an aircraft for a period of seven months (April to November 2004).<sup>41</sup> This time frame clearly demonstrates a contract that crossed election periods and therefore is also potentially a reasonable comparison to the Committees' circumstance if the Audit records do indeed show a similar contract and payment structure. Additionally, the Kerry-Edwards 2004 air charter lease allowed unused flying hours to be "banked" each month and moved forward, as needed, without changing the overall cost of the contract. A total of 10.4 hours were banked from the Kerry-Edwards 2004 primary-election committee and used by their general-election committee instead. According to the post-election Final Audit Report, the general-election committee owed the primary-election committee a total of \$205,067 for these banked and transferred hours.<sup>42</sup> The Audit Division claims that the "repayment of banked hours was unrelated to press billing in Kerry-Edwards 2004."<sup>43</sup> This seems unlikely. While Press reimbursement is not specifically mentioned in the Kerry-Edwards 2004 Final Audit Report, if unused "primary" banked hours were later used by their general-election committee and a reimbursement from the general committee to the primary committee was required after the fact to pay for those hours, there must also have been a misallocation of deposited offsets to those expenditures from the Press by both committees. Press travel reimbursements could not have been properly reconciled by the Kerry-Edwards general committee if the Audit Division did not make them account for the 10.4 primary banked hours that were rolled forward to the general committee until after the audit was completed. Yet, again, the Kerry-Edwards Final Audit Report does not include any comments or findings as to how Press reimbursements should have been handled in that type of "cross-election" scenario.

As for Bush-Cheney 2000, it held an aircraft lease with Miami Air International, Inc. that was structured in a manner nearly identical to the Swift Air contract. The Miami Air International contract straddled the primary- and general-election periods, from August 1, 2000 to November 7, 2000, and entitled Bush-Cheney 2000 to a maximum number of flight hours for a fixed payment of \$3,444,312.88. The Bush-Cheney 2000 compliance staff used the same billing methodology for travel under this contract as the Committees did in 2008 with the Swift Air contract. However, the Bush-Cheney 2000 Final Audit Report did not contain an adverse audit finding related to Press travel reimbursements. And the Audit Division did not even

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<sup>40</sup> 11 C.F.R. § 9007.1(a).

<sup>41</sup> Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 13 (2007).

<sup>42</sup> Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 21 (2007).

<sup>43</sup> Fed. Election Comm'n, Draft Final Audit Report at 18 n. 5 (May 23, 2012).

communicate informally any objection over calculation methodology to Bush-Cheney 2000 compliance staff, many of whom are now involved in the McCain Campaign audit. As the Audit Division put it:

The General Committee also referenced the 2000 Bush-Cheney audit and explained that it used the same billing methodology and personnel in that audit, which did not include an adverse audit finding or any informal advice from the Audit Division suggesting a correction to the accounting methods was necessary. The Audit Division acknowledges that the same billing methodology was used in 2000 Bush-Cheney...<sup>44</sup>

The Division excuses its silence during the Bush-Cheney 2000 audit now by claiming that “the amount of the overbilling of the Press was not material.”<sup>45</sup> Although the regulated community might well appreciate the Commission saying on the record that a \$40,000 error is immaterial, this statement is highly questionable. The Press reimbursements were hardly minimal—over \$40,000 was sought under the Miami Air International contract during the primary election and the Bush-Cheney campaign incurred over \$200,000 in travel expenses during that same period. Putting aside the amount, though, the Audit Division still should have given notice of methodology errors, even if the Division now somehow considers the amount involved as “not material.” In the context of an audit, the Commission’s acquiescence in a recordkeeping practice has precedential value because silence is reasonably construed by the audited party as approval. This is particularly the case where, as here, the Commission has otherwise failed to issue general guidance concerning a particular recordkeeping practice. Indeed, “if an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.”<sup>46</sup>

The Audit Division should not be allowed to “swerve” from prior precedent here. The Primary Committee and the General Committee followed the Commission-audited campaigns’ proven path. Particularly, the Bush-Cheney 2000 method for a fixed-rate contract that straddled primary- and general-election periods was replicated exactly because, again, the same compliance consultants and personnel were involved in the two campaigns. The calculation method used by the Primary Committee and the General Committee is clearly more consistent with the Commission’s audit precedent than the Audit Division’s favored method. The two Committees therefore used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the Committees.

## **2. The Committees’ Calculation Method Is More Consistent with Generally Accepted Accounting Principles**

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<sup>44</sup> Fed. Election Comm’n, Preliminary Audit Report at 11 (Sept. 30, 2011).

<sup>45</sup> Fed. Election Comm’n, Preliminary Audit Report at 11 (Sept. 30, 2011). *See also* Fed. Election Comm’n, Draft Final Audit Report at 18 (May 23, 2012); Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 8 (Apr. 11, 2012).

<sup>46</sup> *Bush-Quayle '92 Primary Comm., Inc. v. Fed. Election Comm'n*, 104 F.3d 448, 453 (D.C. Cir. 1997) (citing *Greater Boston Tel. Corp. v. FCC*, 444 F.2d 841, 852 (D.C.Cir.).

The Committees' calculation method is based on rules and standards adopted by the accounting profession called Generally Accepted Accounting Principles ("GAAP") that are used to prepare, present, and report financial statements.<sup>47</sup> The Commission has endorsed GAAP's use in presidential campaign audits and cited GAAP to make an adverse audit finding against the Kerry-Edwards Campaign.<sup>48</sup>

GAAP dictates the use of accrual-basis accounting in nearly all circumstances.<sup>49</sup> In accrual-basis accounting, revenue is recognized when it is earned and expenses are recognized when incurred. This is in contrast to cash-basis accounting, a non-GAAP method, which records revenue when cash is received and an expense when cash is paid.<sup>50</sup> Why is accrual-basis accounting a GAAP method and cash-basis accounting not? Because "[i]n many instances, the cash basis just does not present fully enough the financial picture..."<sup>51</sup> After all, the timing of cash receipts and payments may be detached from a transaction's underlying substance.

The Primary Committee and the General Committee used GAAP-compliant accrual-basis accounting to calculate the fixed-expense share of each travel segment's "total actual cost of the transportation." Accrual-basis accounting required that the Swift Air contract expenses (and offsets to those expenses in the form of Press reimbursements) were recognized as actual flight hours were used. A portion of the Swift Air contract's fixed cost was assigned to each travel segment using a depreciation technique called the "units of production" method, which is expressed as  $\text{Cost} / \text{Estimated Units} = \text{Depreciation Per Unit Produced}$  (i.e.  $\$6,384,000 / \text{Estimated Flight Hours} = \text{Aircraft Hourly Rate}$ ).<sup>52</sup> The "units of production" method was most appropriate here because the actual flight hours, and thus the actual contract costs, were not incurred ratably over the individual weeks of the contract.<sup>53</sup>

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<sup>47</sup> BARRY J. EPSTEIN, RALPH NACH & STEVEN M. BRAGG, WILEY GAAP: 2010 INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 2-4 (2010).

<sup>48</sup> Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 13-14 (2007).

<sup>49</sup> RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 9, 17 (2011) ("For financial reporting in accordance with generally accepted accounting principles, the accrual basis of accounting must be used.").

<sup>50</sup> DONALD E. KIESO, JERRY J. WEYGANDT & JERRY D. WARFIELD, INTERMEDIATE ACCOUNTING: PROBLEM SOLVING SURVIVAL GUIDE 3-4 (2011).

<sup>51</sup> RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 14 (2011).

<sup>52</sup> Depreciation is not a matter of valuation, but a means of cost allocation. The method of depreciation chosen must result in the systematic and rational allocation of the cost of the asset (less its residual value) over the asset's expected useful life. See RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 239 (2011).

<sup>53</sup> RICHARD F. LARKIN & MARIE DiTOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 240 (2011).

By contrast, the Audit Division relied on non-GAAP cash-basis accounting to estimate the fixed-expense share of each travel segment's "total actual cost of the transportation." The "Audit staff used the weekly \$336,000 installment" as the trigger for recording expenses (and offsets to those expenses in the form of Press reimbursements).<sup>54</sup> Like all cash-basis accounting, this simplifies the hourly rate calculations since one uses only a week's actual flight hours rather than waiting until the end of the contract to determine how many actual flight hours over which to spread the \$6,384,000 fixed fee. But again, like all cash-basis accounting, this does not offer a fully accurate picture of the transaction here because a week's installment payment was *not* paid to Swift Air in exchange for that week's installment of flight hours.

The Audit Division declares, all too conveniently, that "cash or accrual-basis accounting" is not "[t]he issue."<sup>55</sup> GAAP-compliant methods, in the Audit Division's view, are "[t]he issue" only when candidates fail to use them.<sup>56</sup> The Audit Division then artfully changes the subject rather than confess that it used non-GAAP accounting:

At issue is whether the activity of a separate reporting and corporate entity (the Primary Committee) should be recognized by the General Committee and by this audit. An underlying assumption to GAAP is that every entity is separate and, therefore, the revenue and expenses of each entity should be recognized as such.<sup>57</sup>

Again, this "corporate separateness" statement does not validate the Audit Division's reliance on cash-basis accounting—just because one treats corporations as separate entities does not mean one should arbitrarily use weekly installment payments as the basis for calculating a travel segment's "total actual cost."

The Audit Division's point about corporate separateness instead seems to be that the Division must bisect the Swift Air contract and entirely disregard its primary-election portion.<sup>58</sup> This is, again, counterfactual. The Primary Committee and the General Committee are separate for Commission reporting purposes and only the General Committee is subject to mandatory audit, but they are otherwise tightly integrated entities, having shared a candidate, staff members,

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<sup>54</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>55</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>56</sup> See Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 13-14 (2007).

<sup>57</sup> Fed. Election Comm'n, Preliminary Audit Report at 10 (Sept. 30, 2011).

<sup>58</sup> Interestingly, in the Kerry-Edwards Final Audit Report, the Audit Division quotes the Wiley GAAP 2007 Interpretation and Application of Generally Accepted Accounting Principles textbook stating, "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." The reason the Audit Division includes this section is to later make its point that part of the reconfiguration costs paid by the Primary Committee are really owed by the General Committee. The General Committee notes this passage because the Audit Division states that it is permissible to bridge committees and use GAAP principles in an instance when reconfiguration costs for travel purposes are a capital asset that must be calculated and paid for by the General Committee, even though the checks were originally written during the Primary Committee. Having interpreted GAAP previously as requiring a "cross-election" inquiry, it is puzzling how the Audit Division now makes the opposite claim. Fed. Election Comm'n, Final Audit Report on Kerry-Edwards 2004, et al. at 13-19 (2007).

consultants, the Swift Air contract, and other resources.<sup>59</sup> The Audit Division suggests GAAP mandates its proposed suspension of reality, but that suggestion is incorrect. In fact, GAAP provides for separate commonly controlled organizations that share an economic interest, like the Primary Committee and the General Committee, to issue consolidated financial figures.<sup>60</sup> And GAAP's "matching principle" counsels against bisecting the Swift Air contract, as it requires the cost of a long-lived asset to be allocated over all of the accounting periods during which the asset is used (i.e. the entire contract period).<sup>61</sup>

In sum, the calculation method used by the Primary Committee and the General Committee is more consistent with GAAP. The two Committees therefore used a reasonable process to predict the eventual, proper allocation of Press reimbursements between the Committees.

**B. To the Extent a Misallocation of Press Reimbursements between the Committees Still Exists, the General Committee May Correct the Imbalance through a Payment to the Primary Committee**

The General Committee believes that, to the extent a misallocation of Press reimbursements between the General Committee and the Primary Committee still exists, the General Committee may correct the imbalance through a payment to the Primary Committee.

Materials included with the Draft FAR miscast the issue as whether "the General Committee owes the excess press reimbursements it received to the Primary Committee."<sup>62</sup> This is inaccurate. The actual issue is more general in nature: do Commission rules and precedents prohibit the General Committee from correcting a Press reimbursement misallocation through a payment to the Primary Committee?

As an initial matter, it is worth noting that the Audit Division is making two inconsistent arguments. On one hand, the Division states that the Press reimbursements received by the General Committee are excessive because the travel costs and associated receipts are attributable to the primary election:

The Audit Division's method indicates that the General Committee billed the press and received reimbursements from the press ... for a portion of the travel costs that the

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<sup>59</sup> 11 C.F.R. § 9007.1(a).

<sup>60</sup> RICHARD F. LARKIN & MARIE DITOMMASO, WILEY 2011 NOT-FOR-PROFIT GAAP: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS 160 (2011).

<sup>61</sup> See PATRICK R. DELANEY, RALPH NACH, BARRY J. EPSTEIN & SUSAN W. BUDAK, WILEY GAAP 2003: INTERPRETATION AND APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 66 (2003).

<sup>62</sup> Fed. Election Comm'n, Off. of General Counsel Memo. to Thomas Hintermister at 9-10 (Apr. 11, 2012).

Primary Committee paid to Swift Air for primary campaign transportation attributable to the primary campaign.<sup>63</sup>

On the other hand, the Audit Division asserts that these primary-election Press reimbursements cannot be given now to the Primary Committee because they have also become general-election Press reimbursements and disbursing them to “the Primary Committee ... would be considered a non-qualified campaign expense subject to repayment.”<sup>64</sup> It is not apparent how a single set of Press reimbursements can simultaneously be both primary- and general-election reimbursements. The Audit Division’s argument is not just self-contradictory, though. The Audit Division is wrong for several other reasons.

First, the Audit Division cites the “qualified campaign expense” definition for the proposition that “regulations state that a general election committee cannot incur primary-related expenses because they are not in furtherance of the general election.”<sup>65</sup> This is a misstatement of the law. Primary-election expenses do indeed fall outside the “qualified campaign expense” definition. But not all funds received by a general-election candidate committee must be spent only for a “qualified campaign expense.” Commission rules are precise: “An eligible candidate shall use payments received under 11 CFR part 9005 only ... [t]o defray qualified campaign expenses...”<sup>66</sup> Funds not “received under” Part 9005 (concerning the general-election public grant) are not similarly constrained. It may be that the use of general-election Press reimbursements are restricted, since they offset the initial outlay of fund “received under” Part 9005.<sup>67</sup> But the Audit Division makes no attempt to explain how Press reimbursements “attributable to the *primary* campaign,” as described in the Draft FAR materials, are “received under 11 CFR part 9005.” Indeed, these primary-election Press reimbursements, which offset an initial outlay of privately raised funds by the Primary Committee, are simply not comparable to public funds received by the General Committee as a general-election grant under Part 9005. They are therefore not subject to the “qualified campaign expense” restriction.

Second, the Audit Division never explains how the General Committee’s transfer to the Primary Committee would be an “expense” at all—qualified or non-qualified. The General Committee and the Primary Committee are “affiliated.”<sup>68</sup> For contribution limit purposes, affiliated committees are “considered ... a single political committee” and transfers between them are unlimited by typical restraints on movement of funds.<sup>69</sup> The General-to-Primary transfer itself would therefore not be an “expense.” Now, the Audit Division may counter that

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<sup>63</sup> Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 5 (Apr. 11, 2012).

<sup>64</sup> Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011).

<sup>65</sup> Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011).

<sup>66</sup> 11 C.F.R. § 9004.4(a)(1).

<sup>67</sup> Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 10 (Apr. 11, 2012) (“Because press payments reimburse campaigns for some of the public funds spent on travel costs, reimbursements retain their character as public funds.”).

<sup>68</sup> 11 C.F.R. § 100.5(g).

<sup>69</sup> 11 C.F.R. § 110.3(a)(1), (c).

the “expense” refers to the Primary Committee’s outlay for Press travel. This is also incorrect. The Primary Committee, according to the Audit Division, already paid for Press travel without recouping its full costs.<sup>70</sup> Given that it is nearly four years after the 2008 election, funds transferred to the Primary Committee will likely sit in the Primary Committee’s bank account without actually defraying *any* primary-election activity’s costs. In other words, the General Committee will not actually incur any primary-related expenses. The transfer is simply to correct what should be seen as the original “misdeposit” of primary-election Press reimbursements into a General Committee account.

Third, the transfer would not be a “non-qualified expense” because the Commission has in the past repeatedly permitted transfers from publicly funded general-election committees to their affiliated primary-election committees to correct misallocations and similar issues. For example, the Commission required the Kerry-Edwards Campaign’s general-election committee to pay the Campaign’s primary-election committee to fix a misallocation of joint reconfiguration costs and banked flight hours.<sup>71</sup> The Audit Division admits these types of payments have been relatively common:

The Audit staff acknowledges that transfers were sometimes permitted between the primary and general committees in Presidential campaign when it has been shown in the course of an audit that funds or obligations belonging to a primary or general committee were in the possession of the other. This is not the case in this instance.<sup>72</sup>

The Audit Division never explains why it “is not the case in this instance,” offering only a bald declaration. But if the standard is, as the Audit Division states, that transfers are permitted “when it has been shown ... that funds or obligations belonging to a primary or general committee were in the possession of the other,” those circumstances are certainly present here. The Draft FAR materials, in fact, conclude that the General Committee “received reimbursements from the press ... for a portion of the travel costs that the Primary Committee paid to Swift Air for primary campaign transportation...”<sup>73</sup> Said differently, funds “belonging to [the Primary Committee] ... were in the possession of the” General Committee. The General Committee is, according to the Audit Division, receiving another “free ride” at the Primary Committee’s expense. The Primary Committee’s Press cost-to-reimbursement balance is negative, while the General Committee’s is positive. The General Committee should be allowed, as other committees have been, to transfer funds to reach a cost-benefit equilibrium for both Committees because this situation meets the very standard articulated by the Audit Division.

And finally, a General-to-Primary transfer should not be prevented under the Audit Division’s “non-qualified expense” rationale because the only reason for this misallocation issue is the Commission’s failure to provide guidance on how to prospectively calculate the fixed-cost

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<sup>70</sup> Fed. Election Comm’n, Preliminary Audit Report at 13 (Sept. 30, 2011) (“The Primary Committee appears to have billed an amount that was less than its cost.”)

<sup>71</sup> Fed. Election Comm’n, Final Audit Report on Kerry-Edwards 2004, et al. at 19-22 (2007).

<sup>72</sup> Fed. Election Comm’n, Draft Final Audit Report at 19 (May 23, 2012).

<sup>73</sup> Fed. Election Comm’n, Off. of General Counsel Memo. to Thomas Hintermister at 5 (Apr. 11, 2012).

portion of a particular travel segment's "total actual cost of ... transportation." The Primary Committee and the General Committee had no notice that they were not using the Commission's preferred calculation method. In fact, the Commission's past acquiescence during the 2000 election cycle led directly to the Primary Committee and the General Committee using the cost calculation method that they did, adjusting each new travel segment's hourly costs based on the evolving total of estimated hours to be flown under the Swift Air contract. This was a reasonable method in light of the Commission's silence and apparently misleading acquiescence, and the General Committee should not be penalized through a forced refund to Press entities. The Commission should permit the transfer here, even if it decides not to do so for future committees, who now understand the Commission's preferred calculation method under these circumstances.

In sum, the General Committee asserts that to the extent a misallocation of Press reimbursements between the General Committee and the Primary Committee still exists, the General Committee may correct the imbalance through a payment to the Primary Committee. The Audit Division claims this is legally prohibited because the transfer would be a "non-qualified campaign expense." The Audit Division's claim is undermined, however, by the text of Commission rules, the "affiliated" status of the General and Primary Committees, the Commission's practice of allowing transfers to correct misallocation-like issues, and the Commission's failure to provide advance guidance on Press reimbursement calculations. We respectfully request that the Commission permit the transfer from the General Committee to the Primary Committee to resolve any lingering misallocation of Press reimbursements between them.

In the event the Commission somehow does not permit the transfer, the General Committee asks that it be allowed to disgorge the Press reimbursements to the U.S. Treasury, as has been permitted previously.<sup>74</sup> Over 200 travel segments involving 700 press entities occurred during the primary- and general-election periods. Reconstructing the proper refund amounts for each Press representative would be exceedingly burdensome. And the General Committee would be compelled to remain open for an inordinate amount of time to await the clearance of any stale-dated refund checks.

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<sup>74</sup> Fed. Election Comm'n, Final Audit Report on the Mondale-Ferraro Committee at 23 (1987) ("The Interim Audit Report included an amount for accounts payable due the Press of \$32,381.36 which represented amounts collected from the Press for air charters and incidentals which were in excess of amounts billed. The figure was as of March 31, 1985. The General Fund's response, verified by follow-up fieldwork, indicates that after March 31, 1985 an additional \$927.40 was received. Therefore, accounts payable due the Press has been increased to \$33,308.76. General Fund officials intend to research these prior to making any refunds. A review of the General Fund's disclosure reports through September 30, 1986 show that none of these refunds have been made. *If it is determined that the refunds will not be made, the amount of the surplus repayment* [to the US Treasury assumed to be also for other items and their receipt of the federal grant] *should be adjusted accordingly.*") (emphasis added).

**II. CONCLUSION**

For all the foregoing reasons, McCain-Palin 2008 and McCain-Palin Compliance Fund believe the Final Audit Report should state that the Commission found no legal violations and that the two committees may terminate their registrations with the Commission immediately.

Respectfully Submitted,

(signed)  
Salvatore A. Purpura  
Assistant Treasurer  
McCain-Palin 2008 and McCain-Palin Compliance Fund

**From:** [Matthew Sanderson](#)  
**To:** [mkuest@fec.gov](mailto:mkuest@fec.gov); [rlmorcomb@fec.gov](mailto:rlmorcomb@fec.gov)  
**Subject:** FW: Request for Audit Hearing and for Response Extension  
**Date:** 06/07/2012 06:35 PM  
**Importance:** High

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Marty and Rickida:

I should have cc-ed you on the original email, but did not. Please see below.

Matt

(202) 862-5046 (direct)  
[msanderson@capdale.com](mailto:msanderson@capdale.com)

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**From:** Matthew Sanderson  
**Sent:** Thursday, June 07, 2012 2:23 PM  
**To:** [thintermister@fec.gov](mailto:thintermister@fec.gov)  
**Cc:** Trevor Potter  
**Subject:** Request for Audit Hearing and for Response Extension  
**Importance:** High

Mr. Hintermister:

McCain Palin-2008 and McCain-Palin Compliance Fund request an audit hearing to discuss the matters raised in the Draft Final Audit Report.

In addition, the Committees request additional time to respond in writing to the Draft Final Audit Report (and the attached Office of General Counsel memorandum). This written response is currently due on June 11, 2012. More time is needed to prepare a full response to the issues raised. The Committees also need an extension because they no longer retain full-time staff members and must rely on independent contractors who have other responsibilities. The Committees therefore respectfully ask for an extension so that their written response will be due on or before Monday, July 9, 2012.

Please let me know if you have any questions.

Best,

Matt  
Matthew T. Sanderson

Caplin & Drysdale, Chartered  
(202) 862-5046 (direct)  
One Thomas Circle, NW  
Washington, DC 20005  
[msanderson@capdale.com](mailto:msanderson@capdale.com)  
[www.capdale.com/msanderson/](http://www.capdale.com/msanderson/)

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