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**MEMORANDUM**

**AGENDA ITEM**

To: The Commission

Through:  Alec Palmer  
Staff Director

From:  Patricia C. Orrock  
Chief Compliance Officer

Thomas E. Hintermister   
Assistant Staff Director  
Audit Division

Kendrick Smith   
Audit Manager

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By: Brenda Wheeler   
Lead Auditor

Subject: Proposed Final Audit Report on the California Republican Party/V8 (A09-15)

For Meeting of 6-13-13

Attached for your approval is the subject report. The report has been written in accordance with Directive 70. Documents related to this audit report can be viewed in the Voting Ballot Matters folder.

This report is being circulated on a 72 hour no objection basis. Should an objection be received, it is recommended that the report be considered at the next regularly scheduled open session. If you have any questions, please contact Brenda Wheeler or Kendrick Smith at 694-1200.

Attachment:  
Proposed Final Audit Report on the California Republican Party/V8



# Proposed Final Audit Report on the California Republican Party/V8

January 1, 2007 – December 31, 2008

## Why the Audit Was Done

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

## Future Action

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

## About the Committee (p. 2)

The California Republican Party/V8 is a state party committee headquartered in Burbank, California. For more information, see the chart on the Committee Organization, p. 2.

## Financial Activity (p. 2)

• <b>Receipts</b>	
○ Contributions from Individuals	\$ 6,367,753
○ Contributions from Other Political Committees	87,646
○ Transfers from Affiliated Party Committees	7,557,282
○ Transfers from Non-federal and Levin Accounts	3,389,660
○ Other Receipts	188,928
<b>Total Receipts</b>	<b>\$ 17,591,269</b>
• <b>Disbursements</b>	
○ Operating Expenditures	\$ 11,110,199
○ Transfers to Affiliated/Other Party Committees	3,968,892
○ Contributions to Federal Candidates	30,000
○ Coordinated Party Expenditures	41,660
○ Federal Election Activity	2,392,956
○ Contribution Refunds	33,688
<b>Total Disbursements</b>	<b>\$ 17,577,395</b>
• <b>Levin Receipts</b>	<b>\$ 620,349</b>
• <b>Levin Disbursements</b>	<b>\$ 624,378</b>

## Commission Finding (p. 3)

- Misstatement of Levin Financial Activity

## Additional Issues (p. 3)

- Reporting of Debts & Obligations (Issue 1)
- Extension of Credit by a Commercial Vendor (Issue 2)

<sup>1</sup> 2 U.S.C. §438(b).

# **Proposed Final Audit Report on the California Republican Party/V8**

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January 1, 2007 – December 31, 2008



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# **Part I**

## **Background**

### **Authority for Audit**

This report is based on an audit of the California Republican Party/V8 (CRP), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine whether the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 2 U.S.C. §438(b).

### **Scope of Audit**

Following Commission-approved procedures, the Audit staff evaluated various risk factors and as a result, this audit examined:

1. the disclosure of individual contributors' occupation and name of employer;
2. the disclosure of disbursements, debts and obligations;
3. the disclosure of expenses allocated between federal, non-federal, and Levin accounts;
4. the consistency between reported figures and bank records;
5. the completeness of records; and
6. other committee operations necessary to the review.

### **Audit Hearing**

CRP declined the opportunity for an audit hearing before the Commission on matters presented in this report.

## Part II

### Overview of Committee

#### Committee Organization

<b>Important Dates</b>	
• Date of Registration	March 5, 1981 <sup>2</sup>
• Audit Coverage	January 1, 2007 – December 31, 2008
<b>Headquarters</b>	
Burbank, California	
<b>Bank Information</b>	
• Bank Depositories	One
• Bank Accounts	Four Federal, Two Levin & Ten Non-federal Accounts
<b>Treasurer</b>	
• Treasurer When Audit Was Conducted	Keith Carlson
• Treasurer During Period Covered by Audit	Keith Carlson
<b>Management Information</b>	
• Attended Commission Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

#### Overview of Financial Activity (Audited Amounts)

<b>Cash-on-hand @ January 1, 2007</b>	<b>\$ 66,827</b>
○ Contributions from Individuals	6,367,753
○ Contributions from Other Political Committees	87,646
○ Transfers from Affiliated Party Committees	7,557,282
○ Transfers from Non-federal and Levin Accounts	3,389,660
○ Other Receipts	188,928
<b>Total Receipts</b>	<b>\$ 17,591,269</b>
○ Operating Expenditures	11,110,199
○ Transfers to Affiliated/Other Party Committees	3,968,892
○ Contributions to Federal Candidates	30,000
○ Coordinated Party Expenditures	41,660
○ Federal Election Activity	2,392,956
○ Contribution Refunds	33,688
<b>Total Disbursements</b>	<b>\$ 17,577,395</b>
<b>Cash-on-hand @ December 31, 2008</b>	<b>\$ 80,701</b>
<b>Levin Cash-on-hand @ January 1, 2007</b>	<b>\$ 11,321</b>
<b>Total Levin Receipts</b>	<b>\$ 620,349</b>
<b>Total Levin Disbursements</b>	<b>\$ 624,378</b>
<b>Levin Cash-on-hand @ December 31, 2008</b>	<b>\$ 7,292</b>

<sup>2</sup> CRP originally registered with the Secretary of the Senate on August 7, 1974, as the Republican State Central Committee of California Federal Election Account, under a different identification number. This previous committee terminated on August 5, 1981, shortly after the formation of the current Committee. On April 8, 2011, CRP filed an amended Statement of Organization changing its name to the California Republican Party.

## **Part III**

# **Summaries**

### **Commission Finding**

#### **Misstatement of Levin Financial Activity**

During audit fieldwork, a comparison of CRP's reported Levin activity with bank records revealed a material misstatement of receipts and disbursements in 2008. CRP understated receipts and disbursements by \$50,071 and \$54,000, respectively. In response to the Interim Audit Report recommendation, CRP filed amended reports to correct the misstatements.

The Commission approved the finding that CRP misstated its Levin fund activity for calendar year 2008. (For more detail, see p. 4.)

### **Additional Issues**

#### **Issue 1. Reporting of Debts & Obligations**

Audit fieldwork indicated that CRP did not accurately disclose debts and obligations for 28 vendors totaling \$2,188,950 on Schedule D (Debts and Obligations) of those reports reviewed during the audit. In response to the Interim Audit Report recommendation, CRP filed amended disclosure reports to correct the debt reporting.

The Commission did not approve, by the required four votes, the Audit staff's recommendation that CRP did not accurately disclose debts and obligations for 28 vendors totaling \$2,188,950. Pursuant to Commission Directive 70,<sup>3</sup> this matter is discussed in the "Additional Issues" section. (For more detail, see p. 6.)

#### **Issue 2. Extension of Credit by a Commercial Vendor**

The Audit staff noted that an incorporated vendor appeared to have made a prohibited contribution to CRP by extending credit beyond its normal course of business and by not making commercially reasonable attempts to collect \$1,171,002 for services rendered. In response to the Interim Audit Report and Draft Final Audit Report recommendations, CRP and the vendor presented a detailed analysis of the circumstances that led to the incurred debt, their attempts to devise payment plans to resolve the debt, and why the extension of credit was beneficial to both parties.

The Commission could not reach consensus on whether CRP had demonstrated that the vendor terms were in its normal course of business or whether the vendor had made commercially reasonable attempts to collect the CRP debt. Thus, the Commission did not approve, by the required four votes, the Audit staff's recommendation that CRP accepted a prohibited contribution from the vendor. Pursuant to Commission Directive 70, this matter is discussed in the "Additional Issues" section. (For more detail, see p. 8.)

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<sup>3</sup> Available at [http://www.fec.gov/directives/directive\\_70.pdf](http://www.fec.gov/directives/directive_70.pdf).

## Part IV

# Commission Finding

### Misstatement of Levin Financial Activity

#### Summary

During audit fieldwork, a comparison of CRP's reported Levin activity with bank records revealed a material misstatement of receipts and disbursements in 2008. CRP understated receipts and disbursements by \$50,071 and \$54,000, respectively. In response to the Interim Audit Report recommendation, CRP filed amended reports to correct the misstatements.

The Commission approved the finding that CRP misstated its Levin fund activity for calendar year 2008.

#### Legal Standard

**A. Reporting.** If a state, district or local party committee's combined annual receipts and disbursements for federal election activity (FEA) are \$5,000 or more during the calendar year, then it must disclose receipts and disbursements of federal funds and Levin funds used for FEA. 11 CFR §300.36(b)(2).

**B. Contents of Levin Reports.** Each report must disclose:

- The amount of cash-on-hand for Levin funds at the beginning and end of the reporting period;
- The total amount of Levin fund receipts and disbursements (including allocation transfers) for the reporting period and for the calendar year; and
- Certain transactions that require itemization on Schedule L-A (Itemized Receipts of Levin Funds) or Schedule L-B (Itemized Disbursements of Levin Funds).  
11 CFR §300.36(b)(2)(B).

#### Facts and Analysis

##### A. Facts

As part of fieldwork, the Audit staff reconciled CRP's reported Levin activity with bank records for 2008. The following chart outlines the discrepancies concerning the beginning cash-on-hand balance, receipts, disbursements and the ending cash-on-hand balance. The succeeding paragraph addresses the reasons for the misstatements.

<b>2008 Committee Activity</b>			
	<b>Reported</b>	<b>Bank Records</b>	<b>Discrepancy</b>
Beginning Cash-on-Hand Balance @ January 1, 2008	\$14,988	\$14,443	\$545 Overstated
Receipts	\$556,470	\$606,541	\$50,071 Understated
Disbursements	\$559,692	\$613,692	\$54,000 Understated
Ending Cash-on-Hand Balance @ December 31, 2008	\$11,766	\$7,292	\$4,474 Overstated

CRP overstated the beginning cash-on-hand balance by \$545. CRP did not explain the reason for the overstatement but it likely resulted from prior-period discrepancies. The \$50,071 understatement of receipts resulted mostly from contributions from individuals that CRP did not report; the understatement of disbursements by \$54,000 resulted from a vendor payment that CRP did not report, and the \$4,474 overstatement of the ending cash-on-hand balance was the result of the misstatements previously described.

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

The Audit staff discussed the reporting errors and presented relevant work papers to the CRP representative at the exit conference. The representative stated that he would review the matter.

The Interim Audit Report recommended that CRP amend its reports to correct the misstatement for 2008 and amend its most recently filed report to correct the cash-on-hand balance with an explanation that the change resulted from a prior-period audit adjustment. Further, CRP should have reconciled the cash balance of its most recent report to identify any subsequent discrepancies that may have had an impact on the \$4,474 adjustment recommended.

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

In response to the Interim Audit Report recommendation, CRP amended its reports to correct the misstatements. Specifically, CRP amended Schedule A to disclose receipt of \$50,000 from five individuals and payment to a vendor on Schedule B for \$54,000. Prior to the issuance of this report, CRP transferred the remaining funds in its Levin account to a non-federal account, resolving the remaining discrepancies.

#### **D. Draft Final Audit Report**

In the Draft Final Audit Report, Audit staff acknowledged that CRP filed amended disclosure reports that corrected the misstatements. CRP did not address this matter in its response to the Draft Final Audit Report.

#### **Commission Conclusion**

On April 11, 2013, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended that the Commission adopt a finding that CRP misstated its Levin fund activity for calendar year 2008. The Commission approved the Audit staff's recommendation.

# Part V

## Additional Issues

### Issue 1. Reporting of Debts & Obligations

#### Summary

Audit fieldwork indicated that CRP did not accurately disclose debts and obligations for 28 vendors totaling \$2,188,950 on Schedule D (Debts and Obligations) of those reports reviewed during the audit. In response to the Interim Audit Report recommendation, CRP filed amended disclosure reports to correct the debt reporting.

The Commission did not approve, by the required four votes, the Audit staff's recommendation that CRP did not accurately disclose debts and obligations for 28 vendors totaling \$2,188,950. Pursuant to Commission Directive 70, this matter is discussed in the "Additional Issues" section.

#### Legal Standard

**A. Continuous Reporting Required.** A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished.

2 U.S.C §434(b)(8) and 11 CFR §§104.3(d) and 104.11(a).

**B. Separate Schedules.** A political committee must file separate schedules for debts owed by the committee and debts owed to the committee, together with a statement explaining the circumstances and conditions under which each debt and obligation was incurred or extinguished. 11 CFR §104.11(a).

#### C. Itemizing Debts and Obligations.

- A debt of \$500 or less must be reported once it has been outstanding 60 days from the date incurred (the date of the transaction); the committee reports it on the next regularly scheduled report.
- A debt exceeding \$500 must be disclosed in the report that covers the date on which the debt was incurred. 11 CFR §104.11(b).

#### Facts and Analysis

##### A. Facts

During fieldwork, the Audit staff reviewed disbursement records and disclosure reports for proper reporting of debts and obligations. This review identified debts owed to 28 vendors totaling \$2,188,950 that required disclosure. Most of the identified debts were greater than \$500, and all remained outstanding during the reporting period in which they were incurred.

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

At the exit conference, the Audit staff discussed these debts with a CRP representative and provided relevant work papers. The representative stated that he would review the matter.

The Interim Audit Report recommended that CRP amend its reports to disclose these debts and obligations on Schedule D.

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

In response to the Interim Audit Report, Counsel for the CRP commented, "...Finding No. 2 does not conclude that the CRP failed to report debts and obligations; rather that the reported debts and obligations by period were inaccurate. Some of these debts and obligations were reported on a later monthly report than the one the FEC auditor found it should have been reported." Counsel for the CRP also commented, "We would like to point out that CRP's largest vendor (Strategic Fundraising (SFI)) was disclosed properly every month."

Commission regulations require continuous reporting of debt and obligations until the debt is extinguished. The review by the Audit staff concluded that CRP did not continuously disclose several obligations as required on Schedule D, while CRP never disclosed other obligations on Schedule D. The Audit staff agrees that SFI was not one of the vendors cited in this review.

In response to the Interim Audit Report recommendation, CRP amended its reports to correct the disclosure of debts and obligations on Schedule D.

### **D. Draft Final Audit Report**

In the Draft Final Audit Report, Audit staff acknowledged that CRP amended its reports to correct the disclosure of debts and obligations on Schedule D.

### **Commission Conclusion**

On April 11, 2013, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended that the Commission adopt a finding that CRP failed to disclose debts and obligations totaling \$2,188,950 on Schedule D of its reports.

The Commission could not reach a consensus on whether CRP had failed to disclose these debts and obligations. Some Commissioners voted to approve the recommended finding. Other Commissioners determined that this matter should not remain a finding since CRP complied with the Interim Audit Report recommendation by filing amended disclosure reports that included the debts and obligations. The Commission did not approve the Audit staff's recommended finding by the required four votes.

Pursuant to Commission Directive 70, matters not approved by the required four votes are discussed in the "Additional Issues" section.

## **Issue 2. Extension of Credit by a Commercial Vendor**

### **Summary**

The Audit staff noted that an incorporated vendor appeared to have made a prohibited contribution to CRP by extending credit beyond its normal course of business and by not making commercially reasonable attempts to collect \$1,171,002 for services rendered. In response to the Interim Audit Report and Draft Final Audit Report recommendations, CRP and the vendor presented a detailed analysis of the circumstances that led to the incurred debt, their attempts to devise payment plans to resolve the debt, and why the extension of credit was beneficial to both parties.

The Commission could not reach consensus on whether CRP had demonstrated that the vendor terms were in its normal course of business or whether the vendor had made commercially reasonable attempts to collect the CRP debt. Thus, the Commission did not approve, by the required four votes, the Audit staff's recommendation that CRP accepted a prohibited contribution from the vendor. Pursuant to Commission Directive 70, this matter is discussed in the "Additional Issues" section.

### **Legal Standard**

**A. Corporate Contributions Impermissible.** A corporation is prohibited from making any contribution in connection with a federal election. 2 U.S.C. §441b(a).

**B. Definition of Commercial Vendor.** A commercial vendor is any person who provides goods or services to a candidate or political committee and whose usual and normal business involves the sale, rental, lease or provision of those goods or services. 11 CFR §116.1(c).

**C. Extension of Credit by Commercial Vendor.** A commercial vendor, whether or not it is a corporation, may extend credit to a candidate or political committee provided that:

- The credit is extended in the vendor's ordinary course of business; and
- The terms of the credit are similar to the terms the vendor observes when extending a similar amount of credit to a nonpolitical client of similar risk.

11 CFR §116.3(a) and (b).

### **Facts and Analysis**

#### **A. Facts**

During fieldwork, the Audit staff identified an incorporated vendor that appeared to have made a prohibited contribution to CRP by impermissibly extending credit beyond its normal course of business and by not providing documentation demonstrating that the vendor made commercially reasonable attempts to collect the debts. The vendor, Strategic Fundraising, Inc. (SFI), performed voter/donor file prospecting and telephone fundraising services for CRP. There are 297 invoices, totaling \$1,171,002, which were outstanding between 121 and 757 days. Several of these invoices, dated between October and December 2006, were outstanding for services rendered during the 2006 election cycle. CRP paid all invoices between March and October 2007 and also in November 2008. Other than the initial invoices, CRP made no other documentation available to demonstrate that SFI made further attempts to collect these debts.

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

At the exit conference, the Audit staff discussed this matter with a CRP representative and provided relevant work papers for review. The representative stated that he would review the matter.

The Audit staff had questions regarding SFI's billing and payment practices; therefore, a copy of the SFI vendor contract was requested. In response, CRP provided the contract and a letter from SFI addressing the extension of credit. The contract contained the following pertinent provisions:

- While SFI was responsible for planning, preparing, managing and conducting all telephone fundraising efforts directed at both previous and prospective donors, CRP was responsible for collecting, depositing and recording all contributions generated by SFI and providing SFI with regular reports "identifying all individuals who contributed to the Committee as a result of SFI's efforts, along with the amount and date of each contribution."
- SFI was to invoice CRP weekly, and CRP was to pay all invoices within 30 days of the invoice date and pay all prospecting invoices upon receipt.
- Outstanding balances 30 days past due were to accrue interest of 1 ½ % compounded monthly.
- The prospective donor fundraising section included a "Break-Even Guarantee," whereby in exchange for the right to be CRP's exclusive telephone fundraising firm, SFI agreed to cover the costs of all calls to prospective contributors. As such, CRP was not expected to pay more for prospecting calls than the sum of all actual contributions generated by those calls. The guarantee included a provision in which the parties acknowledged that SFI was "accepting significant business risk" by extending the guarantee to CRP and provided partial mitigation of the risk by granting SFI the exclusive right to conduct CRP's fundraising programs over the course of an entire year.
- SFI would be paid for its prospecting services at "an amount equal to the gross receipts generated by each prospecting project." In addition, if the "cumulative gross proceeds from all Prospecting campaigns performed in a calendar year exceeded the total of all prospecting calls...the positive difference [would] be credited to the Committee."

The letter from SFI stated that credit was extended to CRP because it, along with many other Republican Party clients of SFI, was unable to engage in sustainable new donor acquisition, renewal and reactivation of old donors as a result of the external political climate at the time. SFI further stated that it believed at all times that this extension of credit would further CRP's receipt of new funding, and that at no time did it intend to make a contribution by virtue of its extension of credit. SFI contended that the extension of credit was in its ordinary course of business, and that it followed its established procedures and its past practice with other telephone fundraising clients in the political arena in approving the extension of credit. SFI further added that CRP and SFI negotiated a resolution of disputed billing items by devising a payment plan that involved its continued telephone fundraising for CRP and retention against the outstanding but unpaid balances of receipts until the obligation was satisfied in 2009. SFI contended that it received reasonable, prompt payment in full from CRP based on this extension of credit.

After consideration of all the aspects of this matter, the Audit staff suggested that there were two separate and distinct issues to be considered. First, CRP should have established that SFI's extension of credit was in its ordinary course of business. Second, if the first provision was met, CRP should have demonstrated that SFI made commercially reasonable attempts to collect the debts. If CRP did not establish either provision, a prohibited contribution would have resulted.

#### Ordinary Course of Business

In determining whether an extension of credit was in the ordinary course of business, the Commission considers whether the vendor followed established procedures and past practices, whether the vendor received prompt payment in full for previous extensions of credit, and whether the extension of credit conformed to the usual and normal practice in the industry (11 CFR §116.3(c)).

In considering similar fundraising agreements, the Commission has sought to determine whether an extension of credit was in a vendor's ordinary course of business by considering the presence of adequate vendor safeguards. The Commission has required committees to have safeguards in place to ensure that committees, in fact, pay for all the costs of the fundraising programs. See MUR 5635 (Conservative Leadership PAC); AO 1991-18 (New York State Democratic Committee); AO 1976-36 (Committee for Fautroy). Safeguards proposed by the Commission have included requiring advance deposits by a committee to reimburse vendors for potential shortfalls, limiting the term of the contract, or allowing vendors to terminate the contract early and demand full payment as a result of poor fundraising performance.

The terms of the "Break Even Guarantee" and the exclusivity clause in the contract raise the question of whether SFI's extension of credit to CRP was in its ordinary course of business. The guarantee appears very similar to the type of "no-risk" or "limited-risk" provisions that, in previous matters, the Commission has found could constitute in-kind contributions in the absence of safeguards ensuring that (1) the committee would pay for all of the costs of the fundraising programs and (2) the vendor would bear all of the financial risk of programs not paying for themselves (MUR 5635; AO 1991-18; AO 1979-36). However, unlike the previous cases, SFI was not responsible for the "caging" of contributions resulting from its fundraising activity. The contract outlines that contributions were to be sent to CRP, which was supposed to deposit them in its own account and then pay the invoiced amounts to SFI. This provision, in combination with the guarantee, raises questions as to whether the arrangement between CRP and SFI was one in which "the committee retain[ed] contribution proceeds while giving up little, or assum[ing] little to no risk with the vendor bearing all, or nearly all the risk." See AO 1991-18 (New York State Democratic Party). It appears that the exclusivity clause was included to offset any risk that prospecting calls would not generate contributions sufficient to cover SFI's costs in making them. This raises a question regarding whether this clause provided sufficient financial value to SFI such that it negated SFI's assumption of the risk that it would lose money on the prospecting calls. However, without additional information showing that the value of the exclusivity clause was comparable to SFI's financial risk or that "no-risk" or "limited-risk" agreements such as the guarantee between CRP and SFI conform to the usual and normal practices in the

telemarketing industry, the Audit staff concluded that SFI did not extend credit to CRP in its ordinary course of business.

#### Commercially Reasonable Debt Collection

Even where an extension of credit by a commercial vendor is legally permissible when made, it may evolve into a contribution over time through the lack of commercially reasonable attempts on the part of the vendor to collect the resulting debt. The Commission has determined that these attempts are commercially reasonable if the vendor has pursued its remedies as vigorously as it would have pursued its remedies against a non-political debtor in similar circumstances (11 CFR §116.4(d)(3)). In this matter, it appeared that the parties did not fulfill many of the debt collection provisions outlined in their contract.

- As previously mentioned, other than initial invoices, CRP made no other documentation available to demonstrate that CRP was billed weekly or that SFI had made any further attempts to collect these debts.
- CRP did not present documentation to the Audit staff to demonstrate that CRP was billed the 1 ½ % interest, compounded monthly, for its debts outstanding more than 30 days.

In regard to the letter submitted by SFI, SFI admitted that credit was extended to CRP and other political clients. It also mentioned a negotiated repayment plan; however, CRP has never discussed this plan with the Audit staff or presented it to the Audit staff for review.

The Interim Audit Report recommended that CRP provide documentation or any other comments to demonstrate that SFI had extended credit to CRP in its ordinary course of business. The documentation should have included, but not been limited to, evidence that (1) the “Break Even Guarantee” within the SFI contract is common industry practice, (2) verification that the value of the exclusivity clause provided sufficient financial value to SFI such that it negated SFI’s assumption of the risk that it would lose money on the prospecting calls, and (3) confirmation that the terms of the credit are similar to the terms SFI observes when extending a similar amount of credit to a nonpolitical client of similar risk.

In addition, the Interim Audit Report recommended that CRP provide documentation or any other comments to demonstrate that SFI had made commercially reasonable attempts to collect these debts. The documentation should have included, but not been limited to, evidence supporting the negotiated payment plan and examples of other SFI customers or clients of similar risk for which similar services had been provided and similar billing arrangements had been used. CRP also should have provided documentation concerning SFI’s billing policies for similar clients and work, advance payment policies, debt collection policies, and billing cycles.

Absent such a demonstration, the Audit staff would consider the \$1,171,002 an impermissible contribution from SFI.

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

In response to the Interim Audit Report recommendation, CRP and the Chief Financial Officer of SFI (CFO) disputed that the extension of credit by SFI resulted in a corporate contribution.

CRP discussed the many factors that led to its incurrence of the debts to SFI. CRP's specific explanations follow.

1. Fundraising is Cyclical - CRP stated that it had incurred most of its SFI debt during its traditional drought period, the off-election year (2007). CRP stated that "the CRP's traditional fundraising cycle has peaks and valleys, and the valley in 2007 after the big California gubernatorial election of 2006 and the decline of national Republican fortunes in the 2006 Congressional elections, was especially large and problematic."
2. CRP Organizational Changes and the Decline in Direct Mail and Tele-Fundraising Rates – CRP stated that like many organizations that engage in direct mail and tele-fundraising efforts, it had suffered a decline in fundraising receipts from these activities. CRP also discussed the turnover in key upper management positions (Chairman and Chief Operating Officer) and how this affected its ability to resolve some of its debt issues.
3. National and State Decline in Republican Fortunes – CRP stated, "Like other Republican organizations that engage in direct mail and tele-fundraising, the CRP also suffered a loss of brand identification and support that was related to the declining popularity of the national administration and special conditions in California, where in 2006, Republicans had suffered a loss of all but two statewide Republican officeholders." CRP added further, "the CRP suffered a loss of larger dollar donors in part because its major statewide officeholder, Governor Schwarzenegger, had declared after his re-election in 2006 that he no longer considered himself as a partisan Republican governor, and he described his party as a damaged brand." CRP stated that, beginning in early 2007, Governor Schwarzenegger stopped helping CRP in fundraising.

CRP contended that SFI had made commercially reasonable efforts to collect the CRP debt. As evidence of these attempts, CRP stated that it engaged in good-faith discussions and negotiations to resolve the debt to SFI. CRP added that many of its officers and key employees were in constant, regular communications with SFI. In addition, CRP's Board of Directors received regular briefings at each board meeting regarding the growing debt, and key CRP staff visited SFI offices in Minnesota to negotiate a strategy to resolve the debt.

As further evidence that SFI had made commercially reasonable efforts to collect the CRP debt, CRP stated that SFI billed it monthly on all telemarketing and direct mail matters, that it had hundreds of separate communications by telephone, email and face-to-face with SFI representatives relating to the debt matter, and that SFI's invoices included finance charges.

Counsel for the CRP said that an agreement negotiated with SFI in July 2008, "(1) resolved disputes about billing items; (2) negotiated a set aside of SFI-generated tele-

fundraising receipts that were dedicated and credited to pay-down of the CRP debt; and (3) extended the SFI-CRP fundraising agreement into 2009-2010.”

CRP contended that the fundraising agreement was in SFI’s ordinary course of business. In response to the concern that the agreement with SFI did not provide for it to cage and sequester funds necessary to pay its bills, CRP stated that it chose to separate caging functions from all its fundraising vendors and that it had a separate caging vendor and agreement. CRP points out two critical facts. First, CRP was one of the largest, if not the largest, of SFI’s clients. CRP stated that this better ensured compliance with FEC and non-federal campaign reporting requirements. Second, CRP’s financial situation during 2007 and 2008 resulted in delayed payments to vendors. The separate caging agreement allowed for it to balance payments to vendors with “keeping its doors open.”

To supplement its Interim Audit Report response, CRP provided comments from the CFO to address its contention that SFI extended credit in the normal course of business. The CFO contended that extending credit was in the best interest of CRP from a prospecting and fundraising perspective, and in the best interest of SFI from the perspective of helping a valued, long-term client by working out a mutually beneficial payment plan. The CFO stated that SFI believed that by continuing to prospect and fundraise for CRP, in spite of the debt, not only would CRP eventually realize its fundraising goals but its donor base also would not decline or lose value and CRP would possibly acquire new donors. The CFO stated that the result of extending credit to CRP would be CRP gaining new or lapsed donors and SFI eventually being paid. Therefore, SFI extended credit to CRP. The CFO noted that at no time had SFI intended to make a contribution to the CRP by virtue of an extension of credit.

Regarding the “Break Even Guarantee” and the exclusivity provision within the CRP and SFI agreement, the CFO stated, “Without disclosing too much of the details of our business model or explaining how fundraising works, SFI will stress that our standard fundraising agreements with all political clients call for exclusivity. As a company, we understand the need to acquire new donors for the long-term health of our partners like the CRP and we have a 20 year history which allows us to mitigate our internal 'risk'. All other tele-fundraising firms offer the exact or similar 'break-even guarantee'. As pointed out above, we issue credit to non-political clients as well in the exact same fashion.”

Regarding SFI’s commercially reasonable attempts to collect the CRP debt, the CFO contended that besides its normal weekly invoices, SFI also sends out via an e-mail link bi-weekly summaries and open invoice reports which contain the ‘aging’ for each client. He added that this was done for all SFI clients, political and non-profit. As further evidence, the CFO stated, “SFI requested and was presented with several informal payment plans in the fall/winter of 2007. They would be adhered to for a while, and then the CRP would be unable to keep up with the payments...” The CFO concurred with Counsel that a new agreement was created in 2008 that resulted in the debt being paid off in early 2009.

#### Assessment by the Audit Staff

After reviewing the responses submitted by CRP and the CFO, the Audit staff made the following observations regarding CRP’s adherence to the Interim Audit Report recommendation.

1. Other than providing written comments, CRP did not submit any documentation to demonstrate that SFI had extended credit to CRP in its ordinary course of business. The CFO stated that the “Break Even Guarantee” and the exclusivity clause within the SFI contract is common industry practice, but neither CRP nor the CFO provided any examples of other client contracts or supporting documentation to validate this statement. The CFO cited confidentiality clauses in contracts with its non-profit clients that do not fall under the purview of the Commission. In addition, neither CRP nor the CFO provided confirmation that the terms of the credit issued to CRP are similar to the terms SFI observed when extending a similar amount of credit to a nonpolitical client of similar risk.

Further research by the Audit staff indicated the “Break Even Guarantee” and the exclusivity clause were not unusual in the fundraising industry. SFI did not “cage” the contributions resulting from the fundraising activity. Under its contract, contributions were to be sent directly to CRP, which was to deposit the contributions in its own account and then pay the invoiced amounts to SFI. This provision, in combination with the Guarantee, raised questions as to whether the arrangement between CRP and SFI was one in which CRP retained contribution proceeds while giving up little, or assuming little to no risk with the SFI bearing all or nearly all the risk. The Audit staff’s research also indicated this provision is not unusual.

CRP did not provide documentation to demonstrate any particular financial value of the exclusivity clause. If the exclusivity clause provided value to SFI sufficient to negate SFI’s assumption of the risk that it would lose money on the prospecting calls, the extension of credit would result in no contribution. Further research by the Audit staff indicated that when a contract contained an exclusivity clause as a safeguard against losses by the vendor; it was not the only safeguard, as it was in CRP’s contract with SFI.

2. CRP and the CFO both detailed SFI’s attempts to collect the CRP debt. However, neither provided any evidence to support the various negotiated payment plans, the bi-weekly summaries or open invoice reports, the meetings between CRP and SFI officials, the hundreds of communications between the two parties, etc. In addition, neither CRP nor the CFO provided any examples of other SFI customers or clients of similar risk for which similar services had been provided and similar billing arrangements had been utilized.

SFI’s effort to convince the CRP to resume the fundraising program and SFI’s continued provision of services when CRP had repeatedly failed to pay raised the question of whether SFI’s debt collection efforts were commercially reasonable. Among the debt collection practices that might have been regarded as evidence of commercial reasonableness was the withholding of additional services until overdue debts were satisfied. Here, it appeared that the opposite happened: CRP, concerned about the level of debt it had accumulated, sought to suspend delivery of services from SFI, and it was SFI that convinced CRP that the only viable way for CRP to get out of debt to SFI was for it to continue the fundraising program. If this is correct, it may be that SFI’s decision to give CRP additional time to pay

and SFI's decision to continue providing services was commercially reasonable. However, the Audit staff believed that additional information was necessary to reach this conclusion. SFI asserted in its response that, as part of its effort to convince the CRP, it met with CRP and presented a detailed house file analysis that included details on historical fundraising trends and renewal rates. In addition, SFI contended that this meeting led to a better understanding of the need to prospect and fundraise to help CRP out of the situation it found itself in. Information supporting this contention by SFI would be precisely the type of information that would have demonstrated the commercial reasonableness of SFI's course. In addition, the specifics of the negotiated payment plans and how the plans compare to the terms SFI had provided to similarly situated nonpolitical clients may have also demonstrated the commercial reasonableness and reasonable debt collection efforts by SFI. However, while both CRP and SFI said that SFI provided such information to CRP in 2008, neither provided a copy of the detailed house file analysis or the specifics of the negotiated payment plans to the Audit staff.

After review of the responses to the Interim Audit Report submitted by CRP and the CFO, the Audit staff concluded that CRP had not demonstrated that SFI had extended credit within its ordinary course of business or made commercially reasonable attempts to collect the CRP debt. Pending CRP's provision of further documentation, the Audit staff still considered this matter an impermissible contribution of \$1,171,002 to CRP.

#### **D. Draft Final Audit Report**

In response to the DFAR, Counsel for CRP (Counsel) and the CFO submitted letters disputing the Audit staff's contention that CRP has not demonstrated that SFI extended credit within its ordinary course of business or made commercially reasonable attempts to collect the CRP debt.

#### CRP Response to DFAR

In CRP's response, Counsel responded to some questions raised by the Audit staff in the DFAR and the Office of General Counsel (OGC) in its DFAR legal analysis. Counsel stated that:

1. "...the CRP believes that SFI did not suffer actual financial losses from the 'no risk guarantee' " and "...SFI was paid nearly in full for the amounts it had initially billed for services."
2. "Based upon its additional submission, SFI believes that it made a profit, and continues to make a profit on its fundraising relationship with the CRP." Counsel wrote further that the best evidence of this is that the relationship between CRP and SFI has continued for another four years.

In addition, Counsel suggested that the Commission should consider revising its debt settlement provisions for ongoing committees such as CRP since its debt situations are so different than those for terminating committees. Counsel contended that, unlike a candidate committee, a party committee is an ongoing entity that must fundraise to remain in existence, and often external conditions affect its ability to fundraise. As such, party committees must enter into contractual obligations with fundraising entities in a manner that will ensure their existence.

Counsel also included a memorandum to SFI (dated July 3, 2008) that discussed a partial payment of \$250,000 to SFI "...on a currently unresolved account payable..." The memorandum also stated that CRP is currently undertaking a comprehensive review of the SFI bills, from an accuracy and performance standpoint. In addition, the memorandum stated, "[the enclosed payment] should be viewed solely as a good faith effort on CRP's part to reduce the outstanding balances subject to the completion of the comprehensive review and a determination of what is the appropriate amount due under these contracts."

Counsel provided more details of the 2008 negotiated settlement between SFI and CRP. In one of the provisions, which the Audit staff had not seen previously, SFI agreed to waive accrued interest on unpaid balances if CRP agreed to meet its obligations to pay the balance of amounts outstanding or that which would be accrued in the fundraising efforts that SFI and CRP undertook from the late summer of 2008 through the beginning of 2009 to extinguish the past debt. In addition, CRP and SFI were to negotiate an extension of the fundraising agreement for the 2009-2010 cycle. CRP and SFI also made payment agreements for future fundraising. However, CRP did not present the formal agreements to the Audit staff.

#### Information Provided by SFI

Counsel also provided the information below from the CFO.

1. Regarding some of the safeguards proposed by the Commission, the CFO stated that "[t]he CRP has bylaws that forbid it from entering into agreements that span across two board terms essentially limiting the contract to approximately two years." The CFO also contended that all of its contracts, with both political and non-profit clients, contain a termination clause that either party can execute for any reason.
2. Regarding the caging of contributions by CRP, the CFO stated that SFI has control over "risk" in all of its fundraising agreements. The CFO contended that, as part of the fundraising agreement with CRP, SFI routinely audits the "caged" data to verify every donation is being accurately and timely reported to SFI. The CFO also added that "[w]hile some fundraising/donor acquisition is low margin work, it goes without saying that through our 20 years of experience we are able to avoid 'losing money.'" The CFO stated that the fact that CRP was able to fundraise out of the financial situation and pay off its balance owed to SFI contradicts the DFAR conclusion and demonstrates it is without basis.
3. Regarding its commercially reasonable debt collection efforts, the CFO stated that SFI has had other clients that found themselves in similar debt situations, which were resolved under similar verbal agreements. In addition, the CFO stated that "[o]ther documentation to demonstrate SFI's full efforts to collect the debt is difficult to come by as this occurred 4-5 years ago, the CRP staff and treasurer involved have moved on and our CEO at the time has since retired."

The CFO maintained that the debt settlement agreement “worked as planned” and “...that the CRP paid off the debt and is a continued partner of SFI’s to this day.” The CFO further stated that “[o]ur experience tells us that ‘withholding of additional services until overdue debts are satisfied’ doesn’t work. I have been made aware of several state parties having their vendors stop doing work for them only to 1) not get paid, 2) get paid more slowly or 3) end the relationship permanently. We sought a win-win solution and achieved it.” The CFO expressed a concern regarding the provision of additional documentation to the Audit staff. He stated that “[i]t does not seem appropriate however to disclose private (to the CRP) and proprietary (to SFI) information that could/would end up on the public record. Sharing LifeTime Value data, inception donor counts, renewal rates, fundraising plans, etc [sic] does not appear to be in the purview of the Commission.”

In response to the memorandum sent to SFI by CRP (previously discussed on p. 17), the CFO sent a letter to Counsel dated July 9, 2008. The letter indicated that CRP had nearly a \$900,000 balance that had accrued over the last 12-14 months. The CFO also wrote that communication between CRP and SFI never mentioned any “unresolved payables” and that during a meeting held in Minnesota between CRP and SFI, there was no mention of CRP undertaking a comprehensive review from an accuracy and performance standpoint. However, the CFO did indicate that CRP was going to provide a list of questions regarding small billing issues but that the CFO never received the list.

The Audit staff concluded that CRP received a prohibited contribution from SFI. The Audit staff believed that SFI’s initial extension of credit to CRP was not in its ordinary course of business and that SFI did not engage in commercially reasonable debt collection efforts in seeking repayment from CRP.

### **Commission Conclusion**

On April 11, 2013, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended that the Commission adopt a finding that CRP accepted a prohibited contribution from SFI totaling \$1,171,002 as SFI’s initial extension of credit to CRP was not in its ordinary course of business and SFI did not engage in commercially reasonable debt collection efforts in seeking repayment from CRP.

The Commission did not approve the Audit staff’s recommended finding by the required four votes. Some Commissioners voted to approve the recommendation of the Audit staff. Other Commissioners believed that SFI had adequate safeguards in place to ensure its repayment and expressed concerns with the Audit staff’s requests for SFI to provide additional documentation from SFI clients detailing services and billing arrangements. Pursuant to Commission Directive 70, this matter is discussed in the “Additional Issues” section.