



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

RECEIVED
FEDERAL ELECTION
COMMISSION
SECRETARIAT

2015 JUN -4 P 4: 37

June 4, 2015

AGENDA ITEM

For Meeting of 6-18-15

MEMORANDUM

To: The Commission

Through: Alec Palmer *EWL for*
Staff Director

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

Thomas E. Hintermister *by MLF*
Assistant Staff Director
Audit Division

Martin L. Favin *MLF*
Audit Manager

By: Camilla Reminsky *CR*
Lead Auditor

Subject: Audit Division Recommendation Memorandum on Gary Johnson 2012, Inc

Pursuant to Commission Directive No. 70 (FEC Directive on Processing Audit Reports), the Audit staff presents its recommendations below and discusses the findings in the attached Draft Final Audit Report (DFAR). The Office of General Counsel (OGC) has reviewed this memorandum and concurs with the recommendations.

Please note that pursuant to 11 CFR § 9038.2(a)(2) the notification of repayment must be delivered via the Final Audit Report to Gary Johnson 2012, Inc (GJ2012) no later than three years after the candidate's Date of Ineligibility (DOI), which in this case is May 5, 2015. GJ2012 has entered into several tolling agreements in order to extend the time for notification of repayment, and the current deadline is **July 8, 2015**. Therefore, the Audit Division and Office of General Counsel (OGC) have developed a plan to expedite processing of the audit report.

Finding 1. Net Outstanding Campaign Obligations

In response to the Preliminary Audit Report (PAR), Gary Johnson 2012, Inc (GJ2012) provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the PAR. In response to the DFAR, GJ2012 accepted the Audit staff's Net Outstanding Campaign Obligations calculations that show that Gary Johnson did not receive matching fund payments in excess of his entitlement.

The Audit staff recommends that the Commission find that the Candidate did not receive matching fund payments in excess of his entitlement.¹

Finding 2. Amounts Owed to the U.S. Treasury

In response to the PAR, GJ2012 provided additional information, and disputed the Audit staff's conclusion. In response to the DFAR, GJ2012 disputed the premise² for the Audit staff's calculation of amounts owed to the U.S. Treasury and stated that GJ2012 acted in good faith. GJ2012 also agreed with the Audit staff's calculation of matching funds received based on contributions ineligible to be submitted, and stated that they would repay this amount to the U.S. Treasury.

Directive 70 provides a committee with an opportunity for an audit hearing to address violations of the FECA (Title 52 audit findings). If the Commission makes a determination that matching funds are repayable to the U.S. Treasury, then the Candidate may request a hearing on violations of the Matching Funds Act through the administrative review process (11 C.F.R. § 9038.2(c)). Nevertheless, GJ2012's legal counsel (Counsel) requested leeway to address the part of this finding that he believed is separate and apart from the repayment issue so that GJ2012 may address this later if the Commission determines that repayment is necessary. Counsel stated that if it were not for the failure to update the disclaimer on GJ2012's website, GJ2012 would have been compliant with the Matching Fund Act. Counsel stated that GJ2012 acted as it thought it was allowed to, allocating the first \$250 from each contributor to the primary election and getting that amount matched, and allocating all subsequent amounts from each contributor to the general election.

Counsel presented a chart that showed that funds post-DOI were deposited first to the general election account, then the first \$250 from each contributor was transferred to the primary election account, thus keeping matchable and non-matchable contributions separate. He further stated that he sees the Audit staff's calculations, based on commingled accounts, as an overbroad interpretation of the Kennedy case (*Kennedy for President Committee v. Federal Election Commission* (D.C. Cir. 1984)). Counsel explained that the accounts were separate, with all

¹ The Audit staff notes that in the response to the PAR and the DFAR, GJ2012 alluded to assets which have not yet been valued, and the possibility of debt settlement. The addition of assets and/or reduction of debt on the NOCO could result in the Candidate having received matching fund payments in excess of his entitlement.

² OGC has addressed GJ2012's arguments in its legal analyses on the DFAR and this recommendation memorandum.

matching funds and primary contributions kept in one account, and all general contributions kept in another account. He stated that every expense that primary funds were used for was a qualified expense, and that the activity is clearly separated. Counsel further stated that the repayment ratio formula did not need to be applied in this case because the activity can clearly be seen, and that using the repayment ratio does not meet the purpose of the statute.

Counsel's argument for leniency is based on the premise that GJ2012 intended to change its disclaimer after the primary election, but the fact remains that the disclaimer was not changed, and in keeping with the disclaimer actually used, the first \$2,500 from each contributor was properly designated by Audit staff to the primary election and all subsequent donations from each contributor were designated to the general election. Counsel's argument is also based on the premise that if the disclaimer had been changed, GJ2012 would not have spent private funds allocated to the primary election on non-qualified (general election) expenses. The Audit staff notes that after DOI, GJ2012 deposited \$158,125 in private donations directly in the primary account and \$1,267,858 in the general election account. GJ2012 only transferred \$2,200 from the general election account to the primary election account. The Audit staff's rough estimate of contributions aggregating \$250 or less received after DOI is more than several hundred thousand dollars. The Audit staff has seen no evidence from bank statements or similar documentation that any more than \$160,325 (\$158,125 in private donations directly deposited in the primary account + \$2,200 in transfers from the general account to the primary account) was deposited into the primary account. If funds designated to the primary election were kept in the general election account, then primary and general election funds were still commingled, regardless of which disclaimer GJ2012 was following.

A supplemental response submitted by GJ2012 after the audit hearing addressed the legal premise for the method of calculation of repayment, and is addressed in the attached memo from the Office of General Counsel.

The Audit staff recommends that the Commission make a determination that \$333,441 is payable to the United States Treasury.

Finding 3. Use of General Election Contributions for Primary Election Expenses

In response to the PAR, GJ2012 stated that the Committee used an acceptable method of accounting to separate general and primary election receipts, and that the use of general election contributions for primary election expenses was an advance against anticipated matching funds. In response to the DFAR, GJ2012 requested that the arguments made in response to the PAR be reconsidered and requested an audit hearing to present GJ2012's arguments.

During the audit hearing, Counsel agreed that GJ2012 did use general election contributions for primary election expenses. However, Counsel stated that these were only to cover short term gaps in cash flow and it would have been a burden to seek outside funds for such short term matters. Counsel stated that the finding

lacks context, and that it seems unreasonable and not the intent of the Act to force committees to engage in commercial transactions in order to cover such short term cash flow issues. Counsel emphasized that these were short-term loans only, and stated that he thought that it would be easy to tell if any committee was abusing this leeway.

After considering Counsel's presentation during the audit hearing, the Audit staff maintains that GJ2012 was not permitted to use general election contributions for primary election expenses prior to the primary election date. The Audit staff notes that GJ2012 did have negative bank balances according to the bank's daily balance calculations on five occasions before the primary election date, presumably using an overdraft allowance in the bank account. These negative balances lasted at most for two days. However, if the general election funds had not been kept in the bank account, it would have been negative thirty-nine days, at an average of six days at a time. The longest time that GJ2012's balance would have been negative had general election contributions not been in the account was the sixteen days preceding the primary election date. The Audit staff contends that the general election funds should have been either deposited in the general election account when received, or transferred to that account immediately after GJ2012 discovered that general election funds were in the primary election account, and should not have been available to cover overages instead of the bank overdraft that GJ2012 used on occasion.

During the audit hearing, Counsel said that in the DFAR, the Audit staff stated that it took into account that time elapsed between the date a contribution was received and the date it was deposited to the bank, then contradicted itself and did not actually take that into account while calculating the amount of general election funds used for primary election expenses. Counsel's interpretation of the Audit staff's actions is incorrect. The Audit staff used the contribution date provided by GJ2012 rather than the bank deposit date. The Audit staff notes that by using the contribution dates in its calculations, Audit staff used the date that GJ2012 considered contributions to be in its accounts rather than using the bank deposit date, which could be days later. Thus, the Audit staff calculated funds available to GJ2012 at the earliest possible date, and in fact, the date that GJ2012's accounting staff considered those funds to be at its disposal. The Audit staff used GJ2012's contribution dates in order to provide the most beneficial outcome for GJ2012.

The Audit staff recommends that the Commission find that GJ2012 used \$12,936 in general election contributions for primary election expenses prior to the general election.

Finding 4. Reporting of Debts and Obligations

In response to the PAR, GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P. In response to the DFAR, GJ2012 discussed its method of accounting, in which GJ2012 "re-allocated payments" in December of 2014 to pay off \$171,000 of the \$300,000 win bonus within the 30-day regulatory requirement, so that the \$171,000 would be

considered a qualified expense.³ The Audit staff notes that while GJ2012 may amend its reports to reflect corrections to reporting or apply a different accounting method at any time, the win bonus was not actually paid within the time frame, as required. As this bonus was not paid within 30 days after the Candidate's DOI, the Audit staff does not consider any portion of the bonus to be a qualified campaign expense.

In response to the DFAR, GJ2012 requested an audit hearing during which Counsel stated that GJ2012 had amended its reports to correctly report debts and obligations, and that there were no further substantive comments regarding this finding.

The Audit staff recommends that the Commission find that GJ2012 did not disclose debts to nine vendors totaling \$447,567, as required.

Finding 5. Extension of Credit by a Commercial Vendor

In response to the PAR, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. In response to the DFAR, GJ2012 stated that NSON should not be forced to reveal the names of its clients, and that it is in the normal course of business for an entity to be late in billing. GJ2012 further stated that it could not value the assets referred to in their response to the PAR at this time, and that it will not pursue debt settlement until after the audit is completed. In its response to the DFAR, GJ2012 also requested an audit hearing to present the Committee's arguments.

During the audit hearing, Counsel stated that GJ2012 does not believe that there was any extension of credit by NSON outside the normal course of business. Counsel stated that the language of the contract stated that NSON *may* assess interest charges, not that the company *must* assess those charges. Counsel further stated that vendors regularly use the threat of interest charges as leverage and do not always assess those charges. In addition, Counsel stated that there is nothing that says a vendor must sue in order to get paid. In fact, it would not be in the vendor's best interest to litigate, as it might damage its reputation and may lead to a difficulty in finding or keeping other clients. Counsel stated that any vendor would work with their client in order to seek payment without litigation, and stated that there have been conversations between NSON and GJ2012 in order to resolve the outstanding payments. Counsel also stated that part of the attempt to settle the outstanding debts hinges on intangible assets for which GJ2012 does not yet have a value. Counsel stated that GJ2012 could not value the assets until after the audit and repayment process is over, because over time, the assets lose value, and they may also lose value if GJ2012 must make a large repayment to the U. S. Treasury.

Counsel addressed the Audit staff's assertion in the DFAR that it is unable to determine whether the contracts between NSON and other clients indicate that

³ This argument pertains to the calculations in Finding 2 of non-qualified expenses, not to the substance of Finding 4.

NSON contracted with other political and non-political clients in the same manner, because the client names have been redacted. Counsel stated that the fact that these contracts are all substantially similar shows that NSON contracted in the same manner with all its clients. Counsel further stated that it would not be reasonable to breach confidentiality with those clients to reveal their names so that the Audit staff can verify that the provided contracts are with both political and non-political clients.

The Audit staff recommends that the Commission find that NSON made a prohibited contribution to GJ2012 by extending credit beyond the normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered.

If this recommendation memorandum is approved, a Proposed Final Audit Report will be prepared as soon as possible after the Commission's vote, due to the impending notification of repayment deadline.

This recommendation memorandum is being circulated on a 72-hour tally basis. In case of an objection, Directive No. 70 states that the Audit Division Recommendation Memorandum will be placed on the next regularly scheduled open session agenda.

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

Attachments:

- Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc
- Office of General Counsel Legal Comments on the Audit Division Recommendation Memorandum on Gary Johnson 2012, Inc (LRA #905)

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc

(April 1, 2011 – November 30, 2014)

Why the Audit Was Done

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

Future Action

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

About the Campaign (p. 3)

Gary Johnson 2012, Inc is the principal campaign committee for Gary Johnson, a candidate for the Libertarian Party nomination for the office of President of the United States. The Committee is headquartered in Salt Lake City, Utah. For more information, see the chart on the Campaign Organization, p. 3.

Financial Activity (p. 4)

• Receipts	
○ Contributions from Individuals	\$ 2,249,318
○ Matching Funds Received	510,261
Total Receipts	\$ 2,759,579
• Disbursements	
○ Operating Expenditures	\$ 2,534,497
○ Fundraising Disbursements	153,019
○ Exempt Legal and Accounting Disbursements	28,130
Total Disbursements	\$ 2,715,646

Findings and Recommendations (p. 5)

- Net Outstanding Campaign Obligations (Finding 1)
- Amounts Owed to the U.S. Treasury (Finding 2)
- Use of General Election Contributions for Primary Election Expenses (Finding 3)
- Reporting of Debts and Obligations (Finding 4)
- Extension of Credit by a Commercial Vendor (Finding 5)

¹ 26 U.S.C. §9038(a).

Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc

(April 1, 2011 – November 30, 2014)



Table of Contents

	Page
Part I. Background	
Authority for Audit	1
Scope of Audit	1
Inventory of Campaign Records	1
Committee Structure	1
Part II. Overview of Campaign	
Campaign Organization	3
Overview of Financial Activity	4
Part III. Summaries	
Findings and Recommendations	5
Amounts Owed to the United States Treasury	7
Part IV. Findings and Recommendations	
Finding 1. Net Outstanding Campaign Obligations	8
Finding 2. Amounts Owed to the U.S. Treasury	11
Finding 3. Use of General Election Contributions for Primary Election Expenses	18
Finding 4. Reporting of Debts and Obligations	20
Finding 5. Extension of Credit by a Commercial Vendor	22

Part I

Background

Authority for Audit

This report is based on an audit of Gary Johnson 2012, Inc (GJ2012), undertaken by the Audit Division of the Federal Election Commission (the Commission) as mandated by Section 9038(a) of Title 26 of the United States Code. That section states, "After each matching payment period, the Commission shall conduct a thorough examination and audit of the qualified campaign expenses of every candidate and his authorized committees who received [matching] payments under section 9037." Also, Section 9039(b) of the United States Code and Section 9038.1(a)(2) of the Commission's Regulations state that the Commission may conduct other examinations and audits from time to time as it deems necessary.

Scope of Audit

This audit examined original and amended reports filed by GJ2012 before the audit notification letter was sent on December 3, 2012². The audit also examined the original filings of the 2012 30 Day Post-General and Year-End reports. The following areas were covered by this audit:

1. the campaign's compliance with limitations for contributions and loans;
2. the campaign's compliance with the limitations for candidate contributions and loans;
3. the campaign's compliance with the prohibition on accepting prohibited contributions;
4. the disclosure of contributions received;
5. the disclosure of disbursements, debts and obligations;
6. the consistency between reported figures and bank records;
7. the accuracy of the Statement of Net Outstanding Campaign Obligations;
8. the campaign's compliance with spending limits;
9. the completeness of records; and
10. other campaign operations necessary to the review.

Inventory of Campaign Records

The Audit staff routinely conducts an inventory of campaign records before it begins audit fieldwork. GJ2012's records were materially complete and fieldwork commenced immediately.

Committee Structure

GJ2012 was the only campaign committee authorized by Gary Johnson, the Candidate, for the 2012 Presidential election. This committee conducted both primary and general election activity for the Candidate. GJ2012 opened two bank accounts: a primary account and a general account. In practice, GJ2012 deposited nearly all contributions

² Amendments filed after December 3, 2012, were given a limited review to determine if issues noted in the Preliminary Audit Report were corrected by GJ2012.

received before the Candidate's nomination in the primary account, and most contributions received after the nomination in the general account. GJ2012 received matching funds for the primary campaign and this audit covered committee activity and information obtained to determine whether or not expenses were qualified campaign expenses defrayed in connection with the primary election.

Part II

Overview of Campaign

Campaign Organization

Important Dates	
• Date of Registration	April 22, 2011
• Date of Ineligibility ³	May 5, 2012
• Audit Coverage	April 1, 2011 - November 30, 2014 ⁴
Headquarters	Salt Lake City, Utah
Bank Information	
• Bank Depositories	One
• Bank Accounts	One primary checking account and one general checking account
Treasurer	
• Treasurer When Audit Was Conducted	Chet Goodwin
• Treasurer During Period Covered by Audit	Elizabeth Hepworth (4/22/11 – 1/4/12) Chet Goodwin (1/5/12 – Present)
Management Information	
• Attended Commission Campaign Finance Seminar	No
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

³ A threshold submission was submitted on April 26, 2012, and the Commission certified the Candidate as eligible to receive matching funds on May 24, 2012. The period during which the Candidate was eligible for matching funds ended on May 5, 2012, his date of ineligibility (DOI). However, GJ2012 submitted contributions for matching funds it had received before DOI. Due to the campaign's outstanding debt, GJ2012 was able to submit primary election contributions received after DOI for matching as well.

⁴ The Audit staff conducted limited reviews of receipts and expenditures after December 31, 2012 to determine whether the Candidate was eligible to receive additional matching funds.

Overview of Financial Activity (Audited Amounts)

Cash-on-hand @ April 1, 2011	\$ 0
Receipts	
○ Contributions from Individuals ⁵	2,249,318
○ Matching Funds Received ⁶	510,261
Total Receipts	\$ 2,759,579
Disbursements	
○ Operating Expenditures	2,534,497
○ Fundraising Disbursements	153,019
○ Exempt Legal and Accounting Disbursements	28,130
Total Disbursements	\$ 2,715,646
Cash-on-hand @ December 31, 2012	\$ 43,933

⁵ GJ2012 received approximately 24,500 contributions from more than 1,400 individuals.

⁶ As of the Candidate's DOI (May 5, 2012), GJ2012 had received no matching funds. GJ2012 received 6 payments totaling \$632,017 as of January 8, 2013.

Part III

Summaries

Findings and Recommendations

Finding 1. Net Outstanding Campaign Obligations

The Audit staff's review of GJ2012's financial activity through November 30, 2014, and estimated winding down costs indicated that the Candidate did not receive matching fund payments in excess of his entitlement.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the Preliminary Audit Report. (For more detail, see p. 8.)

Finding 2. Amounts Owed to the U.S. Treasury

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements determined that primary election funds were spent on non-qualified campaign expenses and that matching funds were received for contributions that were not eligible to be matched.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information, and disputed the Audit staff's conclusion. Audit staff does not find GJ2012's arguments compelling, and recommends that the Commission make a determination that \$333,441 is payable to the United States Treasury. (For more detail, see p. 11.)

Finding 3. Use of General Election Contributions for Primary Election Expenses

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements during the pre-DOI period indicated that GJ2012 spent \$12,396 in general election receipts on primary election expenses prior to the Candidate's DOI.

In response to the Preliminary Audit Report, GJ2012 stated that the use of general election receipts for primary election expenses was an advance against anticipated matching funds. The Audit staff notes that short-term advances against matching funds must come from a qualified financial institution, and be secured by certified matching funds amounts. (For more detail, see p. 18.)

Finding 4. Reporting of Debts and Obligations

During audit fieldwork, the Audit staff's review of GJ2012's disbursements indicated that debts from seven vendors totaling \$407,455 were not disclosed on Schedule D-P (Debts and Obligations), as required.

In response to the Preliminary Audit Report, GJ2012 submitted additional invoices for debts to two vendors that were not previously disclosed to Audit staff. This resulted in a total of \$447,567 in debts owed to nine vendors that were not disclosed on Schedule D-P as required. GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P. (For more detail, see p. 20.)

Finding 5. Extension of Credit by a Commercial Vendor

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON⁷ made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered.

In response to the Preliminary Audit Report, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. However, neither GJ2012 nor the vendor presented any documentation to demonstrate that other clients were subject to the same billing practices, or that GJ2012 was regularly and timely billed for services rendered. (For more detail, see p. 22.)

⁷ NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

Summary of Amounts Owed to the United States Treasury

• Finding 2.A. (p. 13)	Payment of Non-Qualified Expenses with Primary Election Funds	\$ 332,191
• Finding 2.B. (p. 15)	Receipt of Matching Funds Based on Ineligible Contributions	1,250
Total Due U.S. Treasury		\$ 333,441

Part IV

Findings and Recommendations

Finding 1. Net Outstanding Campaign Obligations

Summary

The Audit staff's review of GJ2012's financial activity through November 30, 2014, and estimated winding down costs indicated that the Candidate did not receive matching fund payments in excess of his entitlement.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the Preliminary Audit Report.

Legal Standard

A. Net Outstanding Campaign Obligations (NOCO). Within 15 days after the candidate's date of ineligibility (see definition below), the candidate must submit a statement of "net outstanding campaign obligations." This statement must contain, among other things:

- The total of all committee assets including cash on hand, amounts owed to the committee and capital assets listed at their fair market value;
- The total of all outstanding obligations for qualified campaign expenses; and
- An estimate of necessary winding-down costs. 11 CFR §9034.5(a).

B. Date of Ineligibility. The date of ineligibility is whichever of the following dates occurs first:

- The day on which the candidate ceases to be active in more than one state;
- The 30th day following the second consecutive primary in which the candidate receives less than 10 percent of the popular vote;
- The end of the matching payment period, which is generally the day when the party nominates its candidate for the general election; or
- In the case of a candidate whose party does not make its selection at a national convention, the last day of the last national convention held by a major party in the calendar year. 11 CFR §§9032.6 and 9033.5.

C. Definition of Non-Qualified Campaign Expense. A non-qualified campaign expense is any expense that is not included in the definition of a qualified campaign expense (see below).

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

- An expense that is:

- Incurred by or on behalf of the candidate (or his or her campaign) during the period beginning on the day the individual becomes a candidate and continuing through the last day of the candidate's eligibility under 11 CFR §9033.5;
- Made in connection with the candidate's campaign for nomination; and
- Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9032.9.
- An expense incurred for the purpose of determining whether an individual should become a candidate, if that individual subsequently becomes a candidate, regardless of when that expense is paid. 11 CFR §9034.4.
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).

E. Entitlement to Matching Payments after Date of Ineligibility. If, on the date of ineligibility (see above), a candidate has net outstanding campaign obligations as defined under 11 CFR §9034.5, that candidate may continue to receive matching payments for matchable contributions received and deposited on or before December 31st of the Presidential election year provided that he or she still has net outstanding campaign debts on the day when the matching payments are made. 11 CFR §9034.1(b).

F. Winding Down Costs. A primary election candidate who does not run in the general election may receive and use matching funds after notifying the Commission in writing of the candidate's withdrawal from the campaign for nomination or after the date of the party's nominating convention, if the candidate has not withdrawn before the convention. A primary election candidate who runs in the general election must wait until 31 days after the general election before using any matching funds for winding down costs, regardless of whether the candidate receives public funds for the general election. 11 CFR §9034.11(d).

Facts and Analysis

A. Facts

The Candidate's date of ineligibility (DOI) was May 5, 2012. The Audit staff reviewed GJ2012's financial activity through November 30, 2014, analyzed estimated winding down costs and prepared the Statement of Net Outstanding Campaign Obligations that appears on the following page.

Gary Johnson 2012, Inc
Statement of Net Outstanding Campaign Obligations
As of May 5, 2012
Prepared February 10, 2015

Assets

Cash in bank	\$ (10,856) ⁸	
Total Assets		\$ (10,856)

Liabilities

Accounts Payable (AP) for Qualified Campaign Expenses as of 5/5/12	\$ (1,268,352)	
AP (Primary Account) Billed Post-DOI	(713,952)	
Winding Down (WD) Costs (5/5/12 – 12/6/12)	0	
Actual WD Costs (12/7/12 - 11/30/14) [a]	(22,899)	
Estimated WD Costs (12/1/14 - 6/30/15) [b]	(112,268)	
Total Liabilities		\$(2,117,471)

**Net Outstanding Campaign Obligations
(Deficit) as of May 5, 2012** **\$(2,128,327)**

Footnotes to NOCO Statement:

- [a] The General election was held on November 6, 2012. The winding down period began 31 days after the General election on December 7, 2012.
- [b] Estimated winding down costs will be compared to actual winding down costs and adjusted accordingly.

Shown below are adjustments for funds received after the Candidate's DOI on May 5, 2012 through January 8, 2013, the date GJ2012 received its last matching fund payment.

Net Outstanding Campaign Obligations (Deficit) as of May 5, 2012	\$(2,128,327)
Less: Contributions Received (May 6, 2012 to January 8, 2013)	1,216,661
Less: Matching Funds Received through January 8, 2013	632,017
Remaining Net Outstanding Campaign Obligations (Deficit) as of January 8, 2013⁹	\$ (279,649)

As presented above, the Candidate has not received matching funds in excess of his entitlement.

⁸ The primary election campaign's May 5, 2012 cash balance was negative due to short term use of funds from the general election account. (see Finding 3 on page 16 for more detail).

⁹ GJ2012 and its major vendor, NSON, are discussing the possibility of waiving the interest on debts not repaid. If this debt is forgiven, the NOCO will require an adjustment. See Finding 5 for additional detail.

B. Preliminary Audit Report Recommendation

The Audit staff presented a preliminary NOCO statement and related work papers to GJ2012 representatives at the exit conference. The preliminary NOCO statement showed that GJ2012 was in a surplus position and GJ2012 would be required to repay some matching funds received to the U.S. Treasury¹⁰. Audit staff requested that GJ2012 provide additional documentation after the exit conference to enable the Audit staff to update the NOCO statement as necessary. On January 24, 2014, and June 18, 2014, GJ2012 submitted additional invoices in support of debts incurred for primary election expenses. These additional invoices were mostly for interest owed on debts incurred in relation to the primary election that had not been paid, and one invoice previously not provided to the Audit staff for a debt incurred for fundraising activity in relation to the primary election. The Audit staff reviewed this documentation and revised the NOCO accordingly. As a result of this additional documentation, the revised NOCO indicated that the Candidate did not receive matching funds in excess of his entitlement.

The Audit staff recommended that GJ2012 demonstrate any adjustments it believes are required in connection with any part of the NOCO statement or provide any other additional comments.

C. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 did not dispute the NOCO calculations contained on the Preliminary Audit Report, however, provided additional bank statements and invoices to show actual and additional estimated winding down costs as well as additional accounts payable for qualified campaign expenses. These expenses have been incorporated into the revised NOCO that reflects a deficit of \$279,649 as of November 30, 2014. The revised NOCO indicates that the Candidate did not receive matching funds in excess of his entitlement¹¹.

Finding 2. Amounts Owed to the U.S. Treasury

Summary

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements determined that primary election funds were spent on non-qualified campaign expenses and that matching funds were received for contributions that were not eligible to be matched.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information, and disputed the Audit staff's conclusion. Audit staff does not

¹⁰ This NOCO was prepared on December 12, 2013, and contains the same figures as the NOCO prepared on May 8, 2013. The May 8, 2013 NOCO was included in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.

¹¹ GJ2012 and its major vendor, NSON, are discussing the possibility of waiving the interest on debts not repaid. If this debt is forgiven, the NOCO will require an adjustment. See Finding 5 for additional detail.

find GJ2012's arguments compelling, and recommends that the Commission make a determination that \$333,441 is payable to the United States Treasury.

Legal Standard

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

- An expense that is:
 - Incurred by or on behalf of the candidate (or his or her campaign) during the period beginning on the day the individual becomes a candidate and continuing through the last day of the candidate's eligibility under 11 CFR §9033.5;
 - Made in connection with the candidate's campaign for nomination; and
 - Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9032.9.
- An expense incurred for the purpose of determining whether an individual should become a candidate, if that individual subsequently becomes a candidate, regardless of when that expense is paid. 11 CFR §9034.4.
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).

B. Definition of Non-Qualified Campaign Expense. A non-qualified campaign expense is any expense that is not included in the definition of a qualified campaign expense (see above). These include, for example, but are not limited to:

- Excessive expenditures. An expenditure which is in excess of any of the limitations under 11 CFR §9035 shall not be considered a qualified campaign expense.
- General election and post-ineligibility expenditures. Except for winding down costs pursuant to 11 CFR §9034.4(a)(3) and certain convention expenses described in 11 CFR §9034.4(a)(6), any expenses incurred after a candidate's date of ineligibility, as determined under 11 CFR §9033.5, are not qualified campaign expenses. In addition, any expenses incurred before the candidate's date of ineligibility for goods and services to be received after the candidate's date of ineligibility, or for property, services, or facilities used to benefit the candidate's general election campaign, are not qualified campaign expenses.
- Civil or criminal penalties. Civil or criminal penalties paid pursuant to the Federal Election Campaign Act are not qualified campaign expenses and cannot be defrayed from contributions or matching payments. Any amounts received or expended to pay such penalties shall not be considered contributions or expenditures but all amounts so received shall be subject to the prohibitions of the Act.
- Payments to candidate. Payments made to the candidate by his or her committee, other than to reimburse funds advanced by the candidate for qualified campaign expenses, are not qualified campaign expenses.
- Lost, misplaced, or stolen items. The cost of lost, misplaced, or stolen items may be considered a nonqualified campaign expense. Factors considered by the Commission in making this determination shall include, but not be limited to,

whether the committee demonstrates that it made conscientious efforts to safeguard the missing equipment; whether the committee sought or obtained insurance on the items; whether the committee filed a police report; the type of equipment involved; and the number and value of items that were lost. 11 CFR §9034.4(b).

C. Matching Funds Used for Non-Qualified Campaign Expenses. If the Commission determines that a campaign used matching funds for non-qualified campaign expenses, the candidate must repay the Secretary of the United States Treasury an amount equal to the amount of matching funds used for the non-qualified campaign expenses. 26 U.S.C. §9038(b)(2)(A).

D. Seeking Repayment for Non-Qualified Campaign Expenses. In seeking repayment for non-qualified campaign expenses from committees that have received matching fund payments after the candidate's date of ineligibility, the Commission will review committee expenditures to determine at what point committee accounts no longer contain matching funds. In doing this, the Commission will review committee expenditures from the date of the last matching funds payment to which the candidate was entitled, using the assumption that the last payment has been expended on a last-in, first-out basis. 11 CFR §9038.2(b)(2)(iii)(B).

E. Primary Winding Down Costs During the General Election Period. A primary election candidate who runs in the general election, regardless of whether the candidate receives public funds for the general election, must wait until 31 days after the general election before using any matching funds for winding down costs related to the primary election. No expenses incurred by a primary election candidate who runs in the general election prior to 31 days after the general election shall be considered primary winding down costs. 11 CFR §9034.11(d).

F. How to Determine Repayment Amount for Non-Qualified Campaign Expenses When Candidate in Surplus Position. If a candidate must make a repayment to the United States Treasury because his or her campaign used matching funds to pay for non-qualified campaign expenses, the amount of the repayment must equal that portion of the surplus that bears the same ratio to the total surplus that the total amount received by the candidate from the matching payment account bears to the total deposits made to the candidate's accounts. 11 CFR §9038.2(b)(2)(iii).

G. Bases for Repayment. The Commission may determine that certain portions of the payments made to a candidate from the matching payment account were in excess of the aggregate amount of payments to which such candidate was entitled. Examples of such excessive payments include, but are not limited to, the following:

- Payments or portions of payments made on the basis of matched contributions later determined to have been non-matchable 11 CFR §9038.2(b)(1)(iii).

H. Notification of Repayment Obligation. The Commission will notify a candidate of any repayment determinations as soon as possible, but no later than three years after the

close of the matching payment period. The Commission's issuance of the audit report to the candidate (under 11 CFR §9038.1(d)) will constitute notification for purposes of this section. 11 CFR §9038.2(a)(2).

Facts and Analysis

A. Payment of Non-Qualified Expenses with Primary Election Funds

1. Facts

During an examination of disbursement records, the Audit staff identified \$1,199,701¹² in disbursements for general election expenses paid with primary election funds. Of this amount, disbursements totaling \$1,192,400 occurred during the period between the Candidate's DOI, May 5, 2012, and 31 days after the general election, December 7, 2012. During this period, expenses incurred are not considered primary winding down costs. Since these expenses are not related to the primary election of the Candidate, they are considered non-qualified campaign expenses.

In the post-election wind-down period, when wind-down expenses must be allocated between the primary and general election campaigns, \$7,301 was spent¹³. Since these amounts were not allocated between campaigns, these are also non-qualified expenses. Additionally, the accounting staff for GJ2012 stated that expenses identified by themselves, or by NSON, as general election expenses were paid from the general account, and expenses identified as primary expenses were paid from the primary account. Of the expenses identified by Audit staff as non-qualified expenses, expenses totaling \$1,191,856 were paid out of the general account.

After the Candidate's DOI, GJ2012 continued to raise funds to pay off the debt incurred during the primary election, as permitted by law. Approximately \$1.2 million in private contributions designated for the primary election were deposited into GJ2012's general election account, and were used to pay general election expenses. Audit staff determined the private contributions designated for the primary election using the same calculations as in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.

To determine which general election expenses were paid using the contributions designated for the primary election, Audit staff followed the following procedures:

1. Used the list of primary and general contributions calculated for the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.
2. Used GJ2012's disbursement database of disbursements from the primary election account. The dates from GJ2012's database were the check dates

¹² The initial amount of non-qualified expenses was subsequently reduced to \$1,194,425 after the Audit staff calculated the matching funds cut-off date earlier (December 20, 2012) than had been previously calculated.

¹³ The amount using an end date of December 20, 2012 (as explained in the previous footnote) is \$2,025.

rather than the dates that the checks cleared the bank account. Any disbursements from the bank statements that were not in GJ2012's database were also included by Audit staff in this review. The same procedure was followed for the review of the general election account.

3. For each day analyzed, Audit staff first summed the three different types of receipts separately (primary contributions, general contributions and receipts of matching funds from the U.S. Treasury). Contributions were considered spent on a first-in, first-out (FIFO) basis. If multiple types of contributions were received on the same day, the contributions were applied to disbursements in the following order: primary, general, matching funds.
4. The last day that any primary election contributions submitted for matching funds were still in the general election account was December 20, 2012. Therefore, the calculation of non-qualified campaign expenses from that account ended on that date.

Following these procedures resulted in the most favorable repayment calculation for GJ2012.

Pursuant to 11 CFR §9038.2(b)(2)(iii)(B), calculation of non-qualified expenses from all of GJ2012's accounts would continue until no matching funds were left in any of the accounts. This "zero-out date" occurred on February 20, 2014. In order to completely and accurately calculate whether non-qualified expenses were paid with matching funds, Audit staff needed information from GJ2012 about contributions received so that the amounts received for the primary and general elections could be accurately recorded. Although this information was requested, GJ2012 provided no contribution detail dated after December 31, 2012. In addition, although Audit staff requested bank statements, no bank statements for the general account were received after the November 2013 statement. This type of information is regularly requested from committees that have received federal matching funds. Without these bank statements, Audit staff does not know what expenditures have been made and cannot determine if these expenditures were for the primary or general election. Given the lack of documentation, Audit staff was unable to verify the receipts or expenditures after December 31, 2012. However, the Audit staff was able to verify the date the last contribution submitted for matching funds was deposited to the general account. Thus, the Audit staff used December 20, 2012, as the cutoff date for examining the both accounts for non-qualified expenses.¹⁴

In accordance with 11 CFR §9038.2(b)(2)(iii), the ratio of repayment was calculated at 27.9053%.¹⁵ This ratio applied to the non-qualified expenses equals a repayment amount of \$334,780¹⁶.

¹⁴ Audit staff's estimate of the additional amount of possible non-qualified expenses is \$16,000, which would result in an additional repayment amount of about \$4,450. The \$16,000 estimate is based on the provided bank statements through November 2014, and assumes that all the expenses were paid using contributions to the primary election.

¹⁵ Matching funds certified as of 90 days post-DOI divided by deposits for the Primary election as of 90 days post-DOI ($\$303,751/\$1,088,509=.279053$).

2. Preliminary Audit Report Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference along with schedules detailing the finding. GJ2012 representatives did not comment on this finding. The Audit staff recommended that GJ2012 demonstrate it did not make non-qualified expenses or provide any other additional comments it deemed necessary. It was further recommended that, absent such evidence, the Audit staff would recommend that the Commission determine that \$334,780¹⁷ is repayable to the U.S. Treasury.

3. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report, GJ2012 counsel stated that since qualified campaign expenses exceeded the amount of matching funds received by \$95,585, "...no matching funds were used to pay for non-qualifying campaign expenses..." In addition, GJ2012 claims that certain non-qualified campaign expenses totaling \$1,220 identified by the Audit staff were paid solely with available general election funds. GJ2012 also states that expenses totaling \$7,301 identified as being unallocated between primary and general activities were not paid with matching funds but solely with general election funds.

In each of the instances noted above, GJ2012's calculation fails to apply the amount of private contributions received and applied towards remaining net outstanding campaign obligations after the Candidate's DOI. Pursuant to 11 CFR §9034.4, "...all contributions received by an individual from the date he or she becomes a candidate and all matching payments received by the candidate shall be used only to defray qualified campaign expenses..." Therefore, the Audit staff maintains that both the amount of private contributions and the amount of matching funds are applied to qualified campaign expenses. According to the Audit staff, this calculation continues to indicate that matching funds were part of GJ2012's account balance until February 20, 2014 and prior to that time the identified non-qualified campaign expenses for the general election were paid, in part, with primary election matching funds and are subject to repayment.

GJ2012's response also references newly discovered debts and other debts related to the Primary activity, including a \$300,000¹⁸ win bonus owed to NSON, and states that these debts should be included in the calculation. In doing so, GJ2012 asserts that this would move up the date on which Federal matching funds were no longer in

¹⁶ The ratio applied to the Audit staff's revised non-qualified expenses using an end calculation date of December 20, 2012 (as explained in footnote 12) is \$333,307.

¹⁷ See footnote 16.

¹⁸ GJ2012 further states that the bonus is a qualified campaign expense, however, pursuant to 11 CFR §9034.4(a)(5)(ii), monetary bonuses must be paid no later than thirty days after the date of ineligibility to be considered qualified campaign expenses. These bonuses have not been paid, therefore, the \$300,000 bonus owed to NSON is a non-qualified campaign expense, and as such, is not reflected in the NOCO (Finding 1).

the account, thereby reducing the repayment amount.¹⁹ The Audit staff notes that debts are not part of the calculation of non-qualified expenses. Expenditures considered in a repayment determination under 11 CFR 9038.2(b)(2)(ii) and (3) include all non-qualified and undocumented expenditures incurred and **paid** between the campaign's date of inception, and the date on which the candidate's accounts no longer contain any matching funds. Outstanding debts and newly discovered debts are not included in the repayment calculation.

Finally, GJ2012's response noted an expense incorrectly classified by Audit staff as a general election expense instead of a primary election expense. The amount of identified non-qualified campaign expense has been adjusted to be considered as a qualified campaign expense and accordingly, the Audit staff has reduced the total repayment amount by \$1,116 (\$4,000 x 27.9053%).

The Audit staff recommends that the Commission make a determination that \$332,191 is repayable to the U.S. Treasury.

B. Receipt of Matching Funds Based on Ineligible Contributions

1. Facts

During an examination of receipts in audit fieldwork, the Audit staff identified five contributions designated to the general election totaling \$8,000 that were submitted for matching funds. These contributions were ineligible to be matched for primary election funds. The amount of matching funds awarded for these ineligible contributions was \$1,250.

2. Preliminary Audit Report Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference along with schedules detailing the finding. GJ2012 representatives did not comment on this finding. The Audit staff recommended that GJ2012 show that the contributions were not general election contributions or provide any other additional comments it deemed necessary. It was further recommended that, absent such evidence, the Audit staff would make a recommendation that the Commission make a determination that \$1,250 is repayable to the U.S. Treasury.

3. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 stated that it was investigating whether or not these contributions were "...accidentally attributed to the wrong spouse." If the Committee's investigation determines that the contributions were, in fact, ineligible, Counsel states that GJ2012 would refund the appropriate amount to the U.S. Treasury.

¹⁹ Non-qualified expenses paid after the candidate's accounts are presumed to have been purged of all matching funds are not subject to repayment since the candidate's accounts contained no matching funds.

The Audit staff recommends that the Commission make a determination that \$1,250 is repayable to the U.S. Treasury.

Finding 3. Use of General Election Contributions for Primary Election Expenses

Summary

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements during the pre-DOI period indicated that GJ2012 spent \$12,396 in general election receipts on primary election expenses prior to the Candidate's DOI.

In response to the Preliminary Audit Report, GJ2012 stated that the use of general election receipts for primary election expenses was an advance against anticipated matching funds. The Audit staff notes that short-term advances against matching funds must come from a qualified financial institution, and be secured by certified matching funds amounts.

Legal Standard

Receipt of General Election contributions before the date of the Primary Election.

(1) If the candidate, or his or her authorized committee(s), receives contributions that are designated for use in connection with the general election pursuant to 11 CFR §110.1(b) prior to the date of the primary election, such candidate or such committee(s) shall use an acceptable accounting method to distinguish between contributions received for the primary election and contributions received for the general election. Acceptable accounting methods include, but are not limited to:

- (i) The designation of separate accounts for each election, caucus or convention; or
- (ii) The establishment of separate books and records for each election.

(2) Regardless of the method used under paragraph (e)(1) of this section, an authorized committee's records must demonstrate that, prior to the primary election, recorded cash-on-hand was at all times equal to or in excess of the sum of general election contributions received less the sum of general election disbursements made. 11 CFR §102.9(e).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff reviewed available receipt and disbursement records to determine what contributions, if any, were designated per contributor solicitation devices to the general election and then spent by GJ2012 on primary election expenses prior to the primary election date (May 5, 2012). Committees are not permitted to spend funds designated to the general election for primary election expenses prior to the primary election date. If general election funds are held in the primary election account, the general election funds should be held in reserve and not spent for primary election purposes.

Prior to the primary election, GJ2012 received a total of \$22,396 designated to the general election that was deposited in the primary election account. The Audit staff determined the private contributions designated for the general election using the same calculations as were employed in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013. Of this amount, a total of \$10,000 was deposited to the general election account by September 6, 2011. Beginning on February 21, 2012, GJ2012 did not maintain enough contributions designated to the primary election to pay for all of its primary expenditures, and used contributions designated to the general election to make up the difference. The Audit staff's review identified \$12,396 in contributions designated to the general election that were spent on primary election expenses prior to the primary election date. These expenditures were identified as primary election expenses as they were bank fees incurred prior to the Candidate's DOI and payments on invoices submitted for various services incurred in connection with the Candidate's campaign for nomination. In addition, no invoices for any services rendered in conjunction with the general election were received prior to the payment of these expenses.

B. Preliminary Audit Report & Audit Division Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the payments made using general election funds for primary election expenses prior to the candidate's DOI for the audited cycle. GJ2012 representatives did not comment on this finding.

The Audit staff recommended that GJ2012 provide documentation to demonstrate that general election contributions were not used to fund primary election activity. In accordance with 11 CFR §102.9, documentation should demonstrate that an acceptable accounting method was used. Absent such a demonstration, GJ2012 was to provide any additional comments it considered necessary with respect to this matter.

C. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 stated that the \$12,396 was treated as an advance against anticipated matching funds from the general election contributions to the primary election.

To the extent that GJ2012 is characterizing the advance of general election funds as a loan to the primary account, it is noted that regulations specify that such loans or advances must come from a qualified financial institution, which the general account is not. It is also noted that short term loans to Presidential primary committees were obtained in the past, however, these loans were secured by matching fund amounts certified and expected to be received by the committees and occurred only when the Presidential Campaign fund was in a shortfall position. Matching funds for GJ2012 were not certified until May 25, 2012 and the Presidential Campaign fund was not in a shortfall position in 2012. In no instances were general election contributions permitted to be used for primary election expenditures.

GJ2012 stated that they "...used an acceptable accounting method in accordance with 11 CFR §102.9," and that there were separate accounts for primary and general election

contributions. As explained in the “Committee Structure” section on pages 1 and 2 of this report, in practice, GJ2012 deposited nearly all receipts before DOI in its designated primary account and nearly all receipts after DOI in its designated general account. GJ2012 further stated that Audit staff based its calculation on cash on hand and did not take into account the delay in deposits collected through credit card processors. These would be considered received, but would not be in GJ2012’s bank account immediately.

In fact, as this is a common occurrence with campaign committees, the Audit staff took this deposit delay into account. The Audit staff used GJ2012’s contributions database for this calculation, which uses the date of contribution rather than the date of deposit.

Finding 4. Reporting of Debts and Obligations

Summary

During audit fieldwork, the Audit staff’s review of GJ2012’s disbursements indicated that debts from seven vendors totaling \$407,455 were not disclosed on Schedule D-P (Debts and Obligations), as required.

In response to the Preliminary Audit Report, GJ2012 submitted additional invoices for debts to two vendors that were not previously disclosed to Audit staff. This resulted in a total of \$447,567 in debts owed to nine vendors that were not disclosed on Schedule D-P as required. GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P.

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.

52 U.S.C. §30104(b)(8) (formerly 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 and to the committee 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.

- Once it has been outstanding 60 days from the date incurred, a debt of \$500 or less must be reported 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, except reoccurring administrative expenses (such as rent) shall not be reported as a debt before the payment due date.

11 CFR §104.11(b).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff used available disbursement records to reconcile the accounts²⁰ of GJ2012's vendors²¹. These vendors provided GJ2012 with various campaign management services such as fundraising, accounting, clerical and administrative staff, and travel arrangements.

The Audit staff identified debts to seven of GJ2012's vendors totaling \$407,455 that were not reported on Schedule D-P as required. Of these debts, \$300,000 was owed to NSON for a bonus after the Candidate received the nomination as the Libertarian Party candidate for the Presidential general election. This bonus was incurred, per contract, as of the date of nomination, May 4, 2012, and should have been reported on the 2012 June Monthly report, covering the time period from May 1, 2012 through May 31, 2012.

It should be noted that GJ2012 was invoiced for half of this debt (\$150,000) on December 21, 2012, and reported it on the 2012 Year-End report. However, the Audit staff maintains the debts should have been reported as debt for the entire amount based on the date and terms of the contract. The remaining reportable debts of \$107,455 were for smaller amounts to all six vendors identified by the Audit staff.

B. Preliminary Audit Report & Audit Division Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the unreported debts for each reporting period covered by the audit. In response to the exit conference, GJ2012 submitted one additional invoice for the other half of the bonus referenced in the "Facts" section above. This invoice was dated January 1, 2013. As of the date the Preliminary Audit Report was sent to GJ2012, this \$150,000 had not been disclosed on any reports filed with the Commission.

The Audit staff recommended that GJ2012 provide documentation demonstrating that these expenditures did not require reporting on Schedule D-P. Absent such documentation, the Audit staff recommended that GJ2012 amend its reports to disclose the outstanding debts.

C. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 amended its reports and submitted additional invoices and documentation for other previously undisclosed debts. Adjustments made by the Audit staff based on the additional documentation provided reduced the original determination of debts and obligations not timely reported amount by \$7,758.

²⁰ The reconciliation consisted of calculating invoiced and paid amounts for individual reporting periods in the 2011-2012 campaign cycle. The Audit staff then determined whether any outstanding debts were correctly disclosed on Schedule D-P. Each debt amount was counted once, even if it required disclosure over multiple reporting periods.

²¹ Audit staff restricted this review to only primary campaign debts, as per the scope of this Audit.

GJ2012 submitted additional invoices from two new vendors that were not previously provided to the Audit staff, nor disclosed on Schedule D-P, for debts incurred within the audit period totaling \$47,870. In combination with the seven vendors noted in the Preliminary Audit Report, the Audit staff has thus identified nine vendors that GJ2012 owed \$447,567 that was not reported on Schedule D-P as required. GJ2012 filed amendments that materially corrected these omissions.

In its initial response to the PAR, GJ2012 disputed that the \$300,000 owed to NSON for a bonus was not timely reported. GJ2012 states that the NSON contract "...specifically states that invoices are due and payable upon receipt," and that the vendor not invoicing timely does not create a reportable debt, since the campaign would not be able to base the debt reporting on an invoice.

Pursuant to 11 CFR §104.11(b), "[a] debt or obligation, including a loan, written contract, written promise or written agreement to make an expenditure...shall be reported as of the date on which the debt or obligation is incurred..." GJ2012 made a written agreement on October 14, 2011, that NSON would be owed a bonus of "\$300,000 for receiving any party nomination as either VP or President." Thus, this debt was incurred on the date of the Candidate's nomination by the Libertarian Party at its convention on May 5, 2012, and should have been reported as a debt or obligation on Schedule D-P on the June Monthly Report that covered May 1, 2012 through May 31, 2012, regardless of when it was invoiced.

In a supplemental response to the PAR, GJ2012 stated that it has deferred to Audit staff's judgment that the \$300,000 win bonus should be reported as of the date of the Candidate's nomination, despite not having been invoiced²². GJ2012 filed amendments to its reports to report this obligation as of May 2012.

Finding 5. Extension of Credit by a Commercial Vendor

Summary

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON²³ made a prohibited contribution to GJ2012 by extending credit beyond its

²² GJ2012 further stated that they, "in conjunction with NSON, reallocated prior payments to NSON to this earlier Primary expenditure to ensure that payments were made on a First in-First out basis." The Audit staff believes that GJ2012 cannot reallocate these payments in such a manner. It appears that GJ2012 has decided to apply this procedure in an attempt to reduce the amount of repayment to the U.S. Treasury as detailed in Finding 2. However, this "re-allocation" of payments would still not result in the win bonus being paid within the statutory 30 day period (see footnote 13 for additional detail), so this remains a non-qualified expense regardless of the accounting convention used. In fact, to alter the accounting method to pay this debt off would result in additional non-qualified expenses paid using matching funds, which would actually result in an even larger repayment to the U.S. Treasury.

²³ NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered.

In response to the Preliminary Audit Report, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. However, neither GJ2012 nor the vendor presented any documentation to demonstrate that other clients were subject to the same billing practices, or that GJ2012 was regularly and timely billed for services rendered.

Legal Standard

A. Contribution defined. A gift, subscription, loan (except when made in accordance with 11 CFR §100.72 and §100.73), advance, or deposit of money or anything of value made by a person for the purpose of influencing any election for Federal office is a contribution. The term "anything of value" includes all in-kind contributions.

The usual and normal charge for a service is the commercially reasonable rate that one would expect to pay at the time the services were rendered.

The provision of services at a charge less than the usual and normal charge results in an in-kind contribution. The value of such a contribution would be the difference between the usual and normal charge for the services and the amount the political committee was billed and paid. 11 CFR §100.52(a) and (d).

B. Corporate Contributions Impermissible. A corporation is prohibited from making any contribution in connection with a federal election. 52 U.S.C. §30118(a) (formerly 2 U.S.C. 441b(a)).

C. 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).

D. 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 (see below); 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).

E. Definition of Ordinary Course of Business. In determining whether credit was extended in the ordinary course of business, the Commission will consider whether:

- The commercial vendor followed its established procedures and its past practice in approving the extension of credit;
- The commercial vendor received prompt, full payment if it previously extended credit to the same candidate or political committee; and
- The extension of credit conformed to the usual and normal practice in the commercial vendor's industry or trade. 11 CFR §116.3(c).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered relating to the primary election²⁴.

On October 14, 2011, GJ2012 entered into a contract with NSON to manage the campaign. NSON handled fundraising, press and media relations, creative advertising, and all administrative functions of the primary election campaign. Disbursements to NSON totaled 86% of the total of all disbursements by GJ2012, and accounted for 89% of GJ2012's outstanding debt as of December 31, 2012 was owed to NSON. From April 21, 2011 through December 21, 2012, NSON invoiced GJ2012 \$2,198,204 for campaign management expenses, including fundraising, clerical work, and travel arrangements. As of March 31, 2013, \$1,752,032 had been outstanding more than 120 days, and \$936,247 remains outstanding. To date, GJ2012 has only made payments of \$1,261,957 for the \$2,198,204 invoiced by NSON.

The terms of the contract between GJ2012 and NSON stated that:

NSON may assess a carrying charge of eighteen percent (18%) per annum on payments not made within thirty (30) days of the date of the invoice. NSON may, at its sole discretion and without notice, suspend its services hereunder should Client not pay in full any amount invoiced. NSON further reserves the right, at its sole discretion to withhold from Client any instruments of NSON's services pending payment on Client's account.

NSON had not assessed any interest charges as of March 31, 2013. Audit staff also did not locate any documentation of attempts by NSON to collect on the outstanding debt in the records provided by GJ2012.

B. Preliminary Audit Report & Audit Division Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the extensions of credit for primary election expenses. Audit staff requested that GJ2012 provide evidence that NSON made commercially reasonable attempts to collect the outstanding amount. In response to the exit conference, on January 17, 2014, GJ2012 submitted an accounts receivable aging schedule for other

²⁴ Audit staff restricted this review to only primary campaign services, as per the scope of this Audit.

clients of NSON to show that credit was extended on similar terms to other committees, a copy of a lawsuit filed by NSON in the state of Utah against another client, and a bill dated December 31, 2013, for \$245,527 in interest on the outstanding debts from GJ2012 to show that NSON was attempting to collect on the outstanding debt. The aging schedule detailed the outstanding amounts from nine clients, including another political committee also associated with the Candidate. Six of these clients had debt outstanding more than 300 days, and 84% of the total debt outstanding on the aging schedule was owed by the political committee.

GJ2012 quoted an NSON response to a query the Committee had made to this vendor,

Ongoing attempts have been made and continue to be made to collect the outstanding debt owed from the Gary Johnson 2012 campaign. These include support and help with continued solicitation for donations. Any and all other legal remedies are and will be considered to satisfy the obligation.

The Audit staff reviewed the documentation submitted in response to the exit conference. Although GJ2012 provided an internally generated aging schedule and a copy of a lawsuit filed, GJ2012 did not provide any contracts with, or invoices to, other clients of NSON. As such, the Audit staff cannot verify with a reasonable certainty that NSON's contract with GJ2012 was offered on the same terms or pursued in the same manner as other NSON clients, political or non-political.

In addition, on June 18, 2014, GJ2012 submitted several new invoices for interest charged by NSON on debts outstanding from January 2014 through June 2014.

The Audit staff recommended that GJ2012 provide documentation, to include statements from this vendor that demonstrates the credit extended was in the normal course of business and did not represent an excessive in-kind contribution by the vendor. The information provided may include examples of other non-political customers/clients of similar size and risk for which similar services were provided and similar billing arrangements were used. Also, GJ2012 should provide information concerning the presence of safeguards such as billing policies for similar non-political clients and work, advance payment policies, and debt collection policies and practices to show that this was normal business practice for NSON or provide additional explanation about the situation.

C. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information about the business practices of NSON. In an affidavit, Ron Nielson, the proprietor of NSON, stated that his company did not extend credit to GJ2012 that it would not have extended to a similar non-political campaign. Mr. Nielson stated that NSON exercises discretion in the assessing and collecting of finance charges in order to collect on the principal, and that NSON has previously waived finance charges in favor of collecting on the principal. In addition, Mr. Nielson stated that NSON has engaged in discussions with GJ2012 to accept campaign assets in lieu of payment.

GJ2012 also submitted redacted contracts that NSON used for other political and non-political campaigns. The non-redacted portions of these contracts are substantially similar to the one signed by GJ2012. Counsel for GJ2012 further states that NSON acted according to normal and usual practice in the industry, and that NSON and its competitors frequently extend credit to clients seeking similar services in anticipation that doing so would enable the clients to raise funds.

In addition, Counsel for GJ2012 stated that NSON and GJ2012 were negotiating for the acceptance of campaign assets in lieu of payments owed, and that NSON may waive interest fees “as is routine in such matters.”²⁵

The NSON contracts provided by GJ2012 are redacted to the extent that the Audit staff cannot verify whether or not the clients are political or non-political. Since the nature of these entities cannot be verified, the Audit staff does not find these contracts to be adequate evidence that credit was extended to GJ2012 in the same way as other political and non-political clients.

Furthermore, documentation provided by GJ2012 to show that NSON attempted to collect on outstanding debts did not show that “NSON regularly invoiced GJ2012 for all services...” In fact, GJ2012 was not invoiced for services in some cases until months or even more than a year after the services were performed. NSON did not submit invoices for interest due on amounts owed until December 31, 2013, more than a year after the Candidate’s date of ineligibility, for invoices that had been outstanding for thirteen (13) to twenty-two (22) months. In addition, no documentation such as invoices to other non-political clients has been presented to show that NSON has also treated the collection of amounts due by non-political clients in the same manner.

Pursuant to 11 CFR §9034.5(c), Presidential campaigns are required to report on the NOCO all capital assets whose purchase price exceeded \$2,000, and other assets whose value exceeds \$5,000, and maintain a list of these items. GJ2012 did not disclose any assets on the NOCO statements submitted when applying for matching funds, nor were any lists provided to the Audit staff during fieldwork. The Audit staff requests that GJ2012 submit documentation for any assets owned and not previously disclosed to the Commission.

The Audit staff notes that NSON had billed GJ2012 \$345,333 in interest as of October 15, 2014, and the Audit staff has estimated that \$85,893 in additional interest will be billed by NSON to GJ2012 by June 30, 2015. Both of these amounts are reflected in the NOCO in Finding 1 of this report.

If GJ2012 and NSON come to a mutual agreement on debts less than the amounts owed and the debt settlement plan is reviewed and approved by the Commission, then the lower amount owed would necessarily reduce the total liabilities on the NOCO statement and

²⁵ If GJ2012 and NSON come to an agreement to settle the Committee’s debts for less than has been billed, GJ2012 will need to file a debt settlement plan and seek Commission review of this settlement, pursuant to 11 CFR §116.7.

likely result in the receipt of matching funds in excess of the Candidate's entitlement. Further repayment may also result if GJ2012 discloses newly-discovered assets.²⁶

²⁶ Also note the repayment amount for non-qualified expenses identified in Finding 2 would also require adjustment.



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

MEMORANDUM

JUN 03 2015

TO: Patricia C. Orrock
Chief Compliance Officer

Thomas E. Hintermister
Assistant Staff Director
Audit Division

FROM: Lisa J. Stevenson *LJS*
Deputy General Counsel - Law

Lorenzo Holloway *JB for LH*
Assistant General Counsel
Compliance Advice

Joshua Blume *JB*
Attorney

SUBJECT: Audit Division Recommendation Memorandum on Gary Johnson 2012, Inc.
(LRA # 905)

I. INTRODUCTION

The Office of the General Counsel (“OGC”) has reviewed the Audit Division Recommendation Memorandum (“ADRM”) on Gary Johnson 2012, Inc. (“the Committee”). The ADRM also includes the Draft Final Audit Report (“DFAR”) on the Committee, which was sent to the Committee on March 26, 2015, and to which the Committee responded on April 14, 2015. The Committee requested, and the Commission granted, an audit hearing, which was held on May 13, 2015. Following the hearing, the Committee requested, and the Commission granted, leave to file supplemental comments on Finding 2 of the DFAR, concerning the Committee’s repayment obligation. We received these supplemental comments on May 22, 2015. See Gary Johnson 2012, Inc. Audit Hearing Supplementary Information, dated May 22, 2015 (“Supplemental Comments”). We concur with the ADRM, and offer supplemental comments on issues raised by the Committee in its written response to the DFAR, during the audit hearing,¹ and in the supplemental comments.

¹ In its response to the DFAR, the Committee requested and was granted an opportunity to comment on Finding 2 during the audit hearing. We note that the Commission’s *Procedural Rules for Audit Hearings* provide audited committees with an opportunity for a hearing when the audit report finds violations of the Federal Election

II. FINDING 2 - AMOUNTS OWED TO THE U.S. TREASURY

Finding 2 recommends that the Committee repay a total of \$333,141 to the United States Treasury. Approximately 99.7 percent of this total amount, or \$332,191, represents a repayment ratio of the total amount of funds spent by the Committee on non-qualified campaign expenses.² See 11 C.F.R. § 9038.2(b)(2)(iii) (setting forth formula for computing amount to be repaid) (“repayment ratio”).

The Committee argues in its response to the DFAR, and in its supplemental comments, that the Commission’s use of the repayment ratio to calculate the Committee’s required repayment amount is not a reasonable method for determining the extent to which public funds were used to pay non-qualified campaign expenses. *Committee Response to DFAR*, dated April 14, 2015; Supplemental Comments. See *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558, 1563 (D.C. Cir. 1984). The Committee contends that it maintained two separate accounts dedicated to the primary election and to the general election, respectively. The Committee contends it deposited all of the public funds it received into its primary account; however all of the spending on non-qualified campaign expenses analyzed by the Commission in Finding 2 was disbursed from the Committee’s general account, which contained private contributions for the primary election.

The Committee’s argument again raises the issue of whether private primary contributions maintained in an account that is separate from the account used to hold the public funds must be included in the formula to determine the ratio repayment calculation. We conclude that the private funds maintained in a separate account must be included in the repayment ratio.

First, the Commission’s regulations are clear on this point. The repayment ratio must include “total deposits.” 11 C.F.R. § 9038.2(b)(2)(iii). “Total deposits” is defined as “all deposits to *all candidate accounts* minus transfers between accounts, refunds, rebates, reimbursements, checks returned for insufficient funds, proceeds of loans and other similar

Campaign Act of 1971 (“FECA”), as amended, or Commission regulations. See *Procedural Rules for Audit Hearings*, 74 Fed. Reg. 33140, 33142 (July 10, 2009). A repayment determination under title 26 of the United States Code is not, however, a statement of a violation of the FECA. See *Reagan Bush Committee, et al. v. Federal Election Commission*, 525 F. Supp. 1330, 1337-1339 (D.D.C. 1981) (distinguishing repayment determinations made pursuant to an audit under Presidential Election Campaign Fund Act (“PECFA”), 26 U.S.C. § 9007, from title 52 enforcement process for addressing alleged violations of the FECA or the PECFA). The Committee will, if it chooses, have the opportunity to request an oral hearing on the repayment determination once the Commission has notified the Committee of that determination in the Final Audit Report. See 11 C.F.R. § 9038.2(c)(2)(ii).

² A “qualified campaign expense” is defined as a purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value incurred by or on behalf of a publicly-financed candidate or his or her authorized committee through the candidate’s date of ineligibility (“DOI”) that is made in connection with the campaign for nomination and is not made in violation of Federal or State law. 11 C.F.R. § 9032.9. See also 26 U.S.C. § 9032(9).

amounts.” 11 C.F.R. § 9038.3(c)(2) (emphasis added). There is no exception here for a separate account that solely holds private contributions.³

Second, the Commission’s decision to include “all deposits to all candidate accounts” (11 C.F.R. § 9038.3(c)(2)) is consistent with the court of appeals decision in *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558 (D.C. Cir. 1984). The *Kennedy* decision vacated an earlier Commission regulation which presumed that 100 percent of a committee’s spending on non-qualified campaign expenses was made with public funds. *Kennedy v. Federal Election Commission*, 734 F.2d at 1559-1560 (“The Commission’s regulation, however, on its face and as applied to the Kennedy for President Committee in this case, indulges the unreasonable presumption that *all* unqualified expenditures are paid out of federal matching funds.”) (emphasis in original). The *Kennedy* decision held that this approach was *ultra vires* because the controlling statute limits the repayment determination to the amount of public funds so spent. *See Kennedy*, at 1561; *see also* 26 U.S.C. § 9038(b)(2) (Commission repayment determination limited to “any amount of any payment made to a candidate from the matching payment account”). Thus, the Court held that the Commission is required under the Act to make a reasonable determination that the repayment sum reflects the public funds used for non-qualified purposes. *See Kennedy*, at 1562.

At the same time, because public funds and private funds “are commingled in the candidate’s coffers,” the *Kennedy* court acknowledged that the repayment determination may never be perfectly accurate. *Id.* The court noted that 26 U.S.C. §9038(b)(2) delegates to the Commission the task of estimating the proportion of total spending for non-qualified purposes that is attributable to the use of public funds, but does not specify a particular method for doing so. Thus, the Commission has discretion to design an approach that will enable it to adhere to the statutory mandate as the *Kennedy* court conceived it. *Id.* at 1563.

That approach is embodied in the repayment ratio at 11 C.F.R. § 9038.2(b)(2)(iii). The Explanation and Justification for the Final Rule promulgating this regulation, shortly after the *Kennedy* decision, explicitly refers to the *Kennedy* decision as the basis for the new regulation, and it is the Commission’s adoption of the method that must be used to determine the amount of public funds used for non qualified campaign expenses. *See Explanation and Justification for Final Rule on Repayments by Publicly Financed Presidential Candidates*, 50 Fed. Reg. 9421 (Mar. 8, 1985) (“The use of such formulas is consistent with the court’s opinion, which does not require a mathematically precise determination of the amount of the Federal funds spent improperly but only a reasonable determination of the amount of Federal matching funds so used.”). Section 9038.2(b)(2)(iii) contains a general formula that the Commission is to use in all cases in which it seeks repayment for non-qualified campaign spending. *See* 11 C.F.R. § 9038.2(b)(2)(iii) (repayment ratio to be used to determine amount of “any repayment sought”).

³ This regulatory language, as well as the Commission’s application of that language in other regulatory contexts and in previous audit reports, discussed below, demonstrates that the Commission has continuously considered a publicly-funded committee’s public and private funds to be commingled as a matter of law under the authority of the *Kennedy* decision.

Third, the Commission has reiterated the principle of considering “all deposits to all candidate accounts” in calculating the repayment ratio in several contexts. In promulgating the regulations, the Commission has stated that it considers all funds in a publicly funded committee’s accounts to be commingled. *See Final Rule and Explanation and Justification Regarding Public Financing of Presidential Primary and General Election Candidates*, 56 Fed. Reg. 35898, 35905 (July 29, 1991) (citing *Kennedy for President Committee*, 734 F.2d 1558, 1565 n.11).⁴

The Commission maintained this principle when it revised the regulations. In revising section 9038.2(b)(2), the Commission could have segregated the private contributions received after the candidate’s DOI and not applied the repayment ratio to those private contributions. *Explanation and Justification for Final Rule on Public Financing of Presidential Primary and General Election Candidates*, 60 Fed. Reg. 31854, 31870 (June 16, 1995). The Commission, instead however, revised section 9038.2(b)(2) to capture the private contributions received after the candidate’s DOI and to “more accurately reflect[] the mix of public funds and private contributions received during the campaign, particularly for a candidate who receives significant amounts of private contributions after his or her date of ineligibility. By taking private contributions received within 90 days of DOI into account when determining a candidate’s repayment ratio, the new rule will likely reduce the ratio, thereby reducing the amount of the candidate’s repayment.”⁵ *Explanation and Justification for Final Rule on Public Financing of Presidential Primary and General Election Candidates*, 60 Fed. Reg. 31854, 31870 (June 16, 1995) (emphasis added).

The Commission has also maintained the “all deposits to all candidate accounts” principle in audits. In previous audits, the Commission has stated that a committee’s public

⁴ The Committee incorrectly states that the Audit Division’s calculated repayment ratio includes total deposits into both the general and the primary accounts. Supplemental Comments, at 5. However, the Audit Division’s calculation excludes contributions designated for the general election and deposited into the Committee’s general election account from the repayment ratio calculation. The Audit Division included only the contributions designated for the primary election that were deposited into the general election account. We agree with this approach because only an analysis of the total funds a committee has available to spend on a primary election, as opposed to a general election, is relevant to a determination relating to matching funds. *See* OGC Comments on Preliminary Audit Report on Gary Johnson 2012, Inc. at 6-7 (Oct. 24, 2014).

⁵ A similar situation, in which the Commission could have opted to separate public funds and private contributions based on the accounts holding those funds relates to repayments in the general election financing system. In the general election financing system, publicly funded presidential candidates are not allowed to raise private contributions. 26 U.S.C. § 9003(b)(2). However, there are two exceptions to this rule. First, major party candidates receiving public funds may raise private contributions to the extent necessary to compensate for a deficiency in the government fund used to disburse public funds to the candidate. 11 C.F.R. § 9003.3(b)(1). Second, minor and new party presidential candidates may supplement their receipt of public funds with private contributions to defray qualified campaign expenses exceeding the amount of public funds disbursed by the government fund. 11 C.F.R. § 9003.3(c). In both cases, candidates receiving both public and private funds may opt to deposit them into separate accounts, or may deposit both types of fund into the same account. 11 C.F.R. §§ 9003.3(b)(2), (c)(3), 9005.2(c). Although both regulations explicitly allow for the possibility that a publicly-funded committee will physically segregate its public from its private funds, the repayment ratio still applies to all of the accounts. *See* 11 C.F.R. § 9007.2(b)(2)(iii).

funds and private primary contributions are commingled even if a committee has more than one account and the public funds are held separate from the private primary contributions.⁶ See Final Report of the Audit Division on LaRouche Democratic Campaign (approved May 17, 1990), at 8 (rejecting committee argument that no repayment required because segregated federal funds account not used); Final Report of the Audit Division on Albert Gore, Jr. for President Committee, Inc. (approved July 13, 1989), at 11 (separate bank account for deposit of matching funds would still require repayment); Final Report of the Audit Division on The Tsongas Committee, Inc. (approved Dec. 16, 1994), at 65-66 (rejecting argument that *Kennedy* decision disallows repayment determination where specific account used did not contain matching funds);⁷ Statement of Reasons, Senator Robert Dole and the Dole for President Committee, Inc.

⁶ In 1987, the Commission voted to decline to seek repayment, and to exempt from the operation of the "mixed pool" principle, the private funds used in connection with a candidate's continued campaign after becoming ineligible to receive public funds because of a failure to receive 10 percent or more of the vote in two consecutive primary elections. See *Proposed Statement of Reasons In the Matter of Lyndon H. LaRouche; The LaRouche Campaign*, at 17; *Certification In the Matter of Final Repayment Determination and Draft Statement of Reasons – The LaRouche Campaign, Agenda Document # 87-87* (Aug. 20, 1987) (approving Draft Statement of Reasons by vote of 5-0). See also 11 C.F.R. § 9033.5(b) (failure to obtain 10 percent of vote in two consecutive primary elections renders candidate ineligible). The Commission specifically addressed this issue and cited *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558, 1563 (D.C. Cir. 1984) when it revised its regulations to allow candidates to use private funds to continue to campaign after the candidate's DOI. See *Explanation and Justification for Final Rule on Public Financing of Presidential Primary and General Election Candidates*, 56 Fed. Reg. 35898, 35905 (July 29, 1991). 11 C.F.R. § 9034.4(a)(3)(ii). This is consistent with the Commission's mixed pool theory because a candidate that continues to campaign after DOI is no longer eligible for public funds for the purpose of campaigning. Those candidates, therefore, can only receive and use private contributions for that purpose. 11 C.F.R. § 9034.4(a)(3)(ii).

⁷ In the Tsongas audit, the Commission ultimately declined to seek repayment with respect to amounts disbursed from a separate account, known as the Andover account, opened by a principal fundraiser, Mr. Nicholas Rizzo, without the committee's knowledge. See *Certification In the Matter of The Tsongas Committee, Inc. – Report of the Audit Division, Agenda Document # 94-128* (Dec. 8, 1994) (voting to revise repayment recommendation "relating to the amounts raised and spent by Mr. Rizzo"). See also Final Report of the Audit Division on The Tsongas Committee, Inc. (approved Dec. 16, 1994), at 66 ("However, after considering the circumstances surrounding this matter, on December 8, 1994, the Commission decided not to seek a repayment."). Net deposits to the Andover account totaled approximately \$720,000, and most of this sum was converted to Mr. Rizzo's personal use. See Executive Summary of Final Report of the Audit Division on The Tsongas Committee, Inc. (approved Dec. 16, 1994), at 2. The Commission's discussion of the audit indicates that it deemed the audit to present a unique situation warranting departure from the application of the mixed pool theory, but was not a rejection of the theory itself. Specifically, Mr. Rizzo had embezzled the committee's funds; the benefit of the disbursements from the Andover account had accrued solely to Mr. Rizzo and not to the committee; and the Andover account did not contain public funds, nor were the funds in the account used to obtain public funds. See, e.g., Audio Recording: Commission Open Meeting on the Matter of The Tsongas Committee, Inc. – Report of the Audit Division, Agenda Doc. # 94-128 (Dec. 8, 1994) ("Audio Recording"), Audio File # 2, at 1:26:11-1:26:35 (statement of Commissioner Thomas opining existence of consensus to not require repayment for disbursements made for personal use with embezzled money); at 37:45-42:10 (statement of Commissioner McGarry opining repayment inequitable where committee funds embezzled by trusted confidant and funds used for Mr. Rizzo's benefit rather than campaign's; small amount used for campaign's benefit appropriate subject of repayment, however); at 49:14-54:34 (statement of Commissioner Thomas, noting very unique circumstances of case because Mr. Rizzo not acting within scope of committee authority in using funds to pay gambling debts; ratio repayment not appropriate in this circumstance).

at 24-25 (approved Feb. 6, 1992) (rejecting argument that expenditures of third party on behalf of committee causing committee to exceed spending limitations not subject to repayment because third party never received public funds, and stating “[o]rdinarily, federal matching funds and private contributions are commingled in a committee’s accounts”).

Finally, if the Commission did not consider “all deposits to all candidate accounts” for the purpose of the repayment ratio, then a committee would be able to avoid the application of the theory of a “commingled pool of federal and private monies” and a possible repayment obligation simply by depositing its public funds and its private contributions into separate accounts. Committees that did so would be able to claim that they spent only their private primary contributions, and not their public funds, on non-qualified campaign expenses.

This is exactly what the Committee is claiming in this case. The *Kennedy* court, however, rejected the theory that one type of fund (private in that particular case) takes priority over another type in determining which funds were used to pay non-qualified campaign expenses.⁸ *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558 (D.C. Cir. 1984). The Commission’s regulations follow this approach by making it clear that neither private contributions nor public funds may be used to defray non-qualified campaign expenses. 11 C.F.R. § 9034.4(a)(1).

III. FINDING 4 - REPORTING OF DEBTS AND OBLIGATIONS

In its response to the DFAR, the Committee raises the issue of the proper treatment of a \$300,000 “win bonus” included as a term in the Committee’s contract with its principal campaign consultant, NSON, also known as Political Advisors. The contract provided that this amount would be due to NSON from the Committee in the event that Mr. Johnson received his party’s nomination as either Vice President or President – a condition that was fulfilled. *Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc.*, at 21 (March 26, 2015).

The DFAR concluded that the win bonus was an outstanding debt that was incurred as of the candidate’s DOI – the date that triggered the requirement under the contract to pay the bonus by virtue of Mr. Johnson’s receiving his party’s nomination for President at that time. *Id.* As a consequence, the Audit Division concluded that the Committee should have reported the bonus as a debt as of the DOI and continuously thereafter until it was paid. *Id.*, at 22.

⁸ The Committee also states that but for its inadvertent oversight in failing to change the disclaimer on its internet-based contribution solicitation pages to reflect its intent to change the allocation of contributions between the primary and the general election, the factual grounds for the repayment determination would not have been present. It also quotes the *Kennedy* court’s observation that “the violation of campaign spending limitations is often, if not usually, inadvertent,” *Kennedy v. Federal Election Commission*, 734 F.2d 1558, 1560 n.1 (D.C. Cir. 1984). It is not clear whether the Committee is arguing that the Commission ought to consider what the Committee intended the disclaimer to be rather than what the disclaimer actually was when evaluating the propriety of the repayment determination. Regardless of whether the error was “inadvertent,” the Commission must look to the language of the actual disclaimer in place at the time the contributions were made in determining allocation, as the Audit staff has done here.

In response to the DFAR, the Committee characterizes this finding as concluding that the win bonus was a primary expense and that it should have been paid from primary funds.⁹ *Committee Response to DFAR*, at 3 (dated April 14, 2015). The Committee states that it “reallocated” payments of \$171,200 that it made to NSON during the thirty-day period immediately following the date of ineligibility [“DOI”] to “what would have been the earlier invoices based on the reasonable preference of the time-limited win bonus over other pre-DOI expenses.”¹⁰ *Id.* It appears that the Committee may have chosen, in light of its understanding of the audit finding, to recharacterize past payments in the amount of \$171,200 that it made to NSON for other services as, instead, a partial payment of the win bonus.

The Committee’s retroactive accounting, to treat a portion of the outstanding debt as having been paid in the past, may be due to the Audit Division’s observation in the DFAR that Commission regulations, in pertinent part, do not allow the payment of bonuses to be considered qualified campaign expenses unless they are paid within 30 days of the DOI. *See* 11 C.F.R. § 9034.4(a)(5)(i)(B). Nothing in section 9034.4(a)(5) warrants treating the sum of \$171,200 as a proper bonus and therefore a qualified campaign expense. A plain reading of the regulation requires that the bonus actually be paid within 30 days of the DOI. The Commission has explained that it promulgated the bonus provision in reaction to a publicly funded campaign paying large monetary bonuses after the election upon discovery of excess public funds. *See Explanation and Justification of Final Rules on Public Financing of Presidential Candidates and Nominating Conventions*, 68 Fed. Reg. 47386, 47390 (Aug. 8, 2003).¹¹ The requirements that a bonus be memorialized in an advance written contract and that it be paid within a specific and restricted period of time must therefore be seen as necessary means to the fulfillment of this purpose. Allowing the Committee’s retrospective accounting long after the expiration of the time period provided for in the regulation to substitute for actual, contemporaneous payment would create too much leeway for publicly-funded committees to thwart that purpose.¹²

⁹ As discussed below, the Audit Division’s finding is actually that the win bonus is not a qualified campaign expense because it was not paid within thirty days of the DOI. Further, it is unclear whether, apart from the Committee’s retroactive accounting methodology, any part of this debt has in fact been paid.

¹⁰ The Committee notes that the remaining balance of the total bonus amount of \$300,000, which would be \$128,800, would not be a qualified campaign expense, and will be addressed through its negotiations with NSON to settle its debts. This suggests that the Committee regards \$171,200 of the bonus as having been paid and the remainder as having not yet been paid, and therefore remaining as outstanding debt.

¹¹ The Commission’s explanation provided here is of the modification of 11 C.F.R. § 9004.4(a)(6), which is the provision governing payments of gifts and bonuses by committees receiving public funds for the general election. However, elsewhere in the Explanation and Justification, the Commission notes that it has modified 11 C.F.R. § 9034.4(a)(5), the parallel provision pertaining to publicly funded candidates for the primary election, for the same reasons as for the general election provision. *See Explanation and Justification of Final Rules on Public Financing of Presidential Candidates and Nominating Conventions*, 68 Fed. Reg. 47386, 47406 (Aug. 8, 2003) (“For the reasons explained above in the explanation and justification for newly redesignated 11 C.F.R. § 9004.4(a)(6), the Commission has decided to make a similar change to 11 C.F.R. § 9034.4(a)(5).”).

¹² Also, 11 C.F.R. § 9034.4(a)(5)(ii) permits only a maximum of \$150 in bonus payments per individual and a total maximum payment of \$20,000. The records are not clear as to whether the entire bonus was payable to NSON

IV. FINDING 5 - EXTENSION OF CREDIT BY A COMMERCIAL VENDOR

Finding 5 concludes that NSON made a prohibited corporate contribution to the Committee by extending credit to the Committee outside of its normal course of business and by not making commercially reasonable attempts to collect approximately \$1.75 million in debt owed by the Committee for services rendered.

The DFAR concluded that because copies of contracts between NSON and other clients submitted by the Committee redacted the clients' identities, they did not suffice to show that NSON's contractual terms with the Committee were part of its normal course of business. *See Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc.*, at 26 (March 26, 2015). The DFAR stated that because of the redactions, the Commission could not verify the Committee's representations as to the political or non-political nature of the clients. *Id.* In response, the Committee argues that nothing in the applicable laws or regulations requires NSON to disclose the identities of its clients to the Audit staff. *Committee Response to DFAR*, at 4 (dated April 14, 2015). Further, the Committee contends that requiring this disclosure would violate relevant contract terms or trade customs. *Id.* The Committee argues that the similarity of the terms of the proffered contracts to its own contract with NSON suffices to show that NSON pursued its normal course of business with the Committee. *Id.*

In the context of debt settlement plan review, the Commission has accepted similar evidence such as a chart from a debtor committee identifying a creditor's other clients using letters of the alphabet without requiring independent verification. *See Memorandum to Commission on Withdrawal and Resubmission of Debt Settlement Plan # 11-02, Stouffer for Congress*, at 5-6 (Aug. 10, 2012). However, the context of reviewing debt settlement plans differs from that of conducting a mandatory audit of a publicly-financed political committee pursuant to 26 U.S.C. § 9038. In the latter context, committees agree as a condition of receiving public funds that they will provide evidence of qualified campaign expenses, and records, books, and other information requested. 26 U.S.C. § 9038(a)(1)-(2). In the public funding area, the United States Court of Appeals for the District of Columbia has concluded that the Commission was not required to accept at face value, without supporting documentation or evidence, the statement of an accountant for an audited committee that putative mark-up charges were reasonable for the market. *LaRouche's Committee for a New Bretton Woods*, 439 F.3d 733, 738-39 (D.C. Cir. 2006). In that case, however, there was apparently no documentation or evidence to support the accountant's unsubstantiated conclusion at all, whereas here there is evidence of similar contract terms.¹³

or to NSON's chief executive officer as an individual, but in either case these maxima would be exceeded in a payment of \$171,200.

¹³ We note also that a similar issue involving the sufficiency of contract evidence was raised in the Final Audit Report on the Rightmarch.com PAC Inc. political committee. *See Final Audit Report of the Commission on RIGHTMARCH.COM PAC INC*, at 12 (dated February 26, 2013). Rightmarch offered contracts made by similar vendors in the industry, but did not offer contracts its specific creditor made with other political and non-political clients. *Id.* The Commission was not able to approve the finding in which this discussion is located by four affirmative votes, however, and the finding is in the "Additional Issues" section under Directive 70. *Id.*, at 13.