



Draft Final Audit Report of the Audit Division on the California Republican Party/V8 January 1, 2007 – December 31, 2008

Why the Audit Was Done

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

Future Action

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

About the Committee (p. 2)

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

Financial Activity (p. 2)

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

Findings and Recommendations (p. 3)

- Misstatement of Levin Financial Activity (Finding 1)
- Reporting of Debts & Obligations (Finding 2)
- Extension of Credit by a Commercial Vendor (Finding 3)

¹ 2 U.S.C. §438(b).

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Part I Background

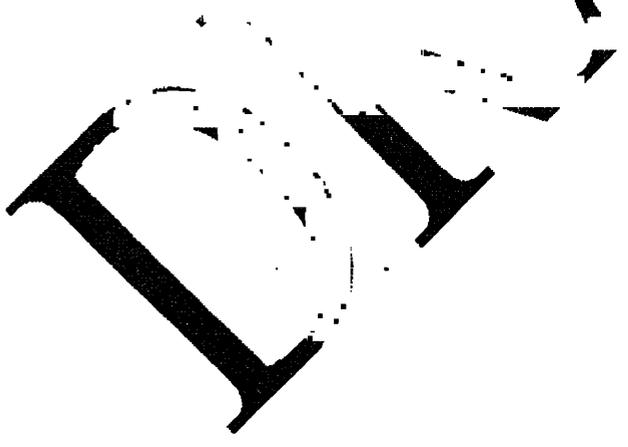
Authority for Audit

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

Scope of Audit

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

1. the disclosure of individual contributors' occupational name of employer;
2. the disclosure of disbursements, assets, and obligations;
3. the disclosure of expenses allocated to federal, non-federal, and Levin accounts;
4. the consistency between reported figures and actual figures;
5. the completeness of reports and
6. other committee information necessary to the review.



Part II Overview of Committee

Committee Organization

Important Dates	
• Date of Registration	March 5, 1981 ²
• Audit Coverage	January 1, 2007 – December 31, 2008
Headquarters	
Burbank, California	
Bank Information	
• Bank Depositories	One
• Bank Accounts	Four Federal, State, and Ten Non-federal Accounts
Treasurer	
• Treasurer When Audit Was Conducted	Keith Carlson
• Treasurer During Period Covered by Audit	Keith Carlson
Management Information	
• Attended Commission Campaign Finance Seminar	
• Who Handled Accounting and Recordkeeping Tasks	P. S. [unclear]

Overview of Financial Activity (Audited Amounts)

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

² CRP originally registered with the Secretary of the Senate on August 7, 1974, as the Republican State Central Committee of California Federal Election Account, under a different identification number. This previous committee terminated on August 5, 1981, shortly after the formation of the current Committee.

Part III

Summaries

Findings and Recommendations

Finding 1. Misstatement of Levin Financial Activity

During audit fieldwork, a comparison of CRP's reported Levin activity with bank records revealed a material misstatement of receipts and disbursements in 2008. CRP understated receipts and disbursements by \$50,071 and \$54,000, respectively.

In response to the Interim Audit Report recommendation, CRP filed amended reports to correct the misstatements. (For more detail, see p. 4.)

Finding 2. Reporting of Debts & Obligations

Audit fieldwork indicated that CRP did not accurately disclose debts and obligations for 28 vendors totaling \$2,188,950 on Schedule D (Debts and Obligations).

In response to the Interim Audit Report recommendation, CRP filed amended reports to correct the debt reporting. (For more detail, see p. 5.)

Finding 3. Extension of Credit by a Commercial Vendor

After reviewing and comparing disbursement records during audit fieldwork, the Audit staff noted that an unincorporated vendor appeared to make a prohibited contribution to CRP by extending credit beyond its normal course of business and by failing to make commercially reasonable attempts to collect \$1,001,002 for services rendered.

In response to the Interim Audit Report recommendation, CRP and the vendor presented a detailed analysis of the circumstances that led to the incurred debt, their attempts to develop payment plans to resolve the debt, and why the extension of credit was beneficial to both parties. However, neither CRP nor the vendor provided any documents or examples demonstrating that the extension of credit was in the vendor's ordinary course of business or that commercially reasonable attempts had been made to collect the debts. (For more detail, see p. 7.)

Part IV Findings and Recommendations

Finding 1. Misstatement of Levin Financial Activity

Summary

During audit fieldwork, a comparison of CRP's reported Levin activity with bank records revealed a material misstatement of receipts and disbursements in 2008. CRP understated receipts and disbursements by \$50,071 and \$54,061, respectively.

In response to the Interim Audit Report recommendation, CRP filed amended reports to correct the misstatements.

Legal Standard

A. Reporting. If a state, district or local party committee's combined annual receipts and disbursements for federal election activity (FEA) are \$5,000 or more during the calendar year, then it must disclose receipts and disbursements of Federal funds and Levin funds used for FEA. 11 CFR § 101.11-2(a)(2).

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

- The amount of cash-on-hand for Levin funds at the beginning and end of the reporting period;
- The total amount of receipts and disbursements (including allocation transfers) for the reporting period and for the calendar year; and,
- Certain transactions require itemization on Schedule L-A (Itemized Receipts of Levin Funds) or Schedule L-B (Itemized Disbursements of Levin Funds). 11 CFR § 101.11-2(b)(2).

Facts and Analysis

A. Facts

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

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

The beginning cash-on-hand balance was overstated by \$545, which is unexplained, but likely resulted from prior period discrepancies. The \$50,071 understatement of receipts resulted mostly from contributions from individuals that were not reported. The understatement of disbursements by \$54,000 resulted from a vendor payment that was not reported, and the \$4,474 overstatement of ending cash-on-hand balance is the result of the misstatements previously described.

B. Interim Audit Report & Audit Division Recommendation

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

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

C. Committee Response to Interim Audit Report

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

Finding 2. Reporting of Debts & Obligations

Summary

Audit fieldwork indicated that CRP did not accurately disclose debts and obligations for 28 vendors totaling \$2,188,950 on Schedule D (Debts and Obligations).

In response to the Interim Audit Report recommendation, CRP filed amended reports to correct the debt reporting.

Legal Standard

A. Continuous Reporting Required. A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished. 2 U.S.C §434(b)(8) and 11 CFR §§104.3(d) and 104.11(a).

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

C. Itemizing Debts and Obligations.

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

Facts and Analysis

A. Facts

During fieldwork, the Audit staff reviewed disbursement and disclosure reports for proper reporting of debts and obligations. This review identified debts owed to 28 vendors totaling \$7,178,950 that required disclosure. Most of the identified debts were greater than \$500 and remained outstanding during the reporting period in which they were incurred.

B. Interim Audit Report & Audit Division Recommendation

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

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

C. Committee Response to Interim Audit Report

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

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

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

Finding 3. Extension of Credit by a Commercial Vendor

Summary

After reviewing and analyzing disbursement records during fieldwork, the Audit staff noted that an incorporated vendor appeared to make a prohibited contribution to CRP by extending credit beyond its normal course of business and by failing to make commercially reasonable attempts to collect \$41,112 for services rendered.

In response to the Interim Audit Report recommendation, CRP and the vendor presented a detailed analysis of the circumstances that led to the incurred debt, their attempts to devise payment plans to resolve the debt, and why the extension of credit was beneficial to both parties. However, neither CRP nor the vendor provided any documents or examples demonstrating that the extension of credit was in the vendor's ordinary course of business or that commercially reasonable attempts were made to collect the debts.

Legal Standard

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

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

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

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

11 CFR §116.3(a) and (b).

Facts and Analysis

A. Facts

During fieldwork, the Audit staff identified an incorporated vendor that appeared to make a prohibited contribution to CRP by impermissibly extending credit beyond its normal course of business and by not providing documentation demonstrating that the vendor

made commercially reasonable attempts to collect the debts. The vendor, Strategic Fundraising, Inc. (SFI), performed voter/donor file prospecting and telephone fundraising services for CRP. There are 297 invoices, totaling \$1,171,002, which were outstanding between 121 and 757 days. Several of these invoices, dated between October and December 2006, were outstanding for services rendered during the 2006 election cycle. CRP paid all invoices between March and October 2007 and also in November 2008. Other than the initial invoices, CRP made no other documentation available to demonstrate that SFI made further attempts to collect these debts.

B. Interim Audit Report & Audit Division Recommendation

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

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

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

The letter from SFI stated that credit was extended to CRP because it, as well as many of SFI's other Republican Party clients, was unable to engage in sustainable new donor acquisition, renewal and reactivation of old donors as a result of the external political climate at the time. SFI further stated that it believed at all times that this extension of

credit would further CRP's receipt of new funding, and that at no time did it intend to make a contribution by virtue of its extension of credit. SFI contended that the extension of credit was in its ordinary course of business, and that it followed its established procedures and its past practice with other telephone fundraising clients in the political arena in approving the extension of credit. SFI further added that CRP and SFI negotiated a resolution of disputed billing items by devising a payment plan that involved its continued telephone fundraising for CRP and retention against the outstanding but unpaid balances of receipts until the obligation was satisfied in 2009. SFI contended that it received reasonable, prompt payment in full from CRP based on this extension of credit.

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

Ordinary Course of Business

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

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

The terms of the "No-Risk Guarantee" and the exclusivity clause in the contract raise a question of whether SFI's extension of credit to CRP was in its ordinary course of business. The Guarantee appears very similar to the type of "no-risk" or "limited-risk" provisions that, in previous matters, the Commission has found could constitute in-kind contributions in the absence of safeguards ensuring that (1) the committee would pay for all of the costs of the fundraising programs and (2) the vendor would bear all of the financial risk of programs not paying for themselves (MUR 5635; AO 1991-18; AO 1979-36). However, unlike the previous cases, SFI was not responsible for the "aging" of contributions resulting from its fundraising activity. The contract outlines that contributions were to be sent to CRP, which was supposed to deposit them in its own account and then pay the invoiced amounts to SFI. This provision, in combination with

the Guarantee, raises questions as to whether the arrangement between CRP and SFI was one in which "the committee retain[ed] contribution proceeds while giving up little, or assum[ing] little to no risk with the vendor bearing all, or nearly all the risk." See AO 1991-18 (New York State Democratic Party). It appears that the exclusivity clause was included to offset any risk that prospecting calls would not generate contributions sufficient to cover SFI's costs in making them. This raises a question regarding whether this clause provided sufficient financial value to SFI such that it negated SFI's assumption of the risk that it would lose money on the prospecting calls. However, absent additional information showing that the value of the exclusivity clause was comparable to SFI's financial risk or that "no-risk" or "limited-risk" agreements such as the Guarantee between CRP and SFI conform to the usual and normal practices in the telemarketing industry, the Audit staff concludes that SFI did not extend credit to CRP in its ordinary course of business.

Commercially Reasonable Debt Collection

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

- As previously mentioned, other than initial invoices, no other documentation was made available to demonstrate that CRP was billed weekly or that any further attempts were made to collect these debts.
- No documentation was presented to the Audit staff to demonstrate that CRP was billed the interest compounded monthly, for its debts outstanding more than 30 days.

In regard to the debt collection by SFI, SFI admits that credit was extended to CRP and other political clients. SFI also mentions a negotiated repayment plan; however, this has never been discussed with the Audit staff nor presented to the Audit staff for review.

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

In addition, the Interim Audit Report recommended that CRP provide documentation or any other comments to demonstrate that SFI made commercially reasonable attempts to collect these debts. The documentation should have included, but not been limited to, evidence supporting the negotiated payment plan and examples of other SFI customers or

clients of similar risk for which similar services had been provided and similar billing arrangements had been utilized. CRP should have also provided documentation concerning SFI's billing policies for similar clients and work, advance payment policies, debt collection policies, and billing cycles.

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

C. Committee Response to Interim Audit Report

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

CRP discussed the many factors that led to its incurrence of the debt to SFI. Specifically, CRP presented the following:

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

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

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

Counsel for the CRP commented that in July 2008 a negotiated agreement with SFI "(1) resolved disputes about billing items; (2) negotiated a set aside of SFI-generated tele-fundraising receipts that were dedicated and credited to pay-down of the CRP debt; and (3) extended the SFI-CRP fundraising agreement into 2009-2010."

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

To supplement its Interim Audit Report response, CRP provided comments from the CFO to address that credit was extended in the ordinary course of business. The CFO contended that extending credit was in the best interest of CRP from a prospecting and fundraising perspective, and in the best interest of SFI from the perspective of helping a valued, long term client by working out a mutually beneficial payment plan. The CFO stated that it believed that by continuing to prospect and fundraise for CRP, in spite of the debt, not only would funds eventually be realized but its donor base would not decline. CRP would possibly acquire new donors. The CFO stated that the result of the agreement was CRP gaining new or lapsed donors. Therefore, SFI extended credit to CRP. The CFO noted that at the time had SFI decided to make a contribution to the CRP by virtue of an extension of credit.

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

Regarding SFI's commercially reasonable attempts to collect the CRP debt, the CFO contended that besides its normal weekly invoices, SFI also sends out via an e-mail link bi-weekly summaries and open invoice reports which contain the 'aging' for each client.

He added that this was done for all SFI clients, political and non-profit. As further evidence, the CFO stated, "SFI requested and was presented with several informal payment plans in the fall/winter of 2007. They would be adhered to for a while, and then the CRP would be unable to keep up with the payments..." The CFO concurs with Counsel that a new agreement was created in 2008 that resulted in the debt being paid off in early 2009.

Assessment by the Audit Staff

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

1. Other than providing written comments, no documentation was submitted to demonstrate that SFI extended credit to CRP in the ordinary course of business. The CFO stated that the "Break Even Guarantee" and the exclusivity clause within the SFI contract is common industry practice, but no examples of other client contracts or any supporting documentation was provided to verify this statement. The CFO cites confidentiality issues in contracts with its non-profit clients that do not fall under the purview of the Commission. In addition, neither CRP nor the CFO provided confirmation that the terms of the credit issued to CRP are similar to the terms SFI reserves when extending a similar amount of credit to a nonpolitical client organization.

Further research by the Audit staff indicates that the "Break Even Guarantee" and the exclusivity clause are not unusual in the fundraising industry. SFI does not "cage" the contributions resulting from the fundraising activity. Under its contract, contributions were to be sent directly to CRP which was to deposit the contributions into its own account and then pay the invoiced amounts to SFI. This provision, in combination with the "Break Even Guarantee", raises questions as to whether the relationship between CRP and SFI is one in which CRP retained contribution proceeds while assuming little to no risk with the SFI bearing all, or nearly all, the risk. The Audit staff's research also indicates this provision is unusual.

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

2. CRP and the CFO both detail SFI's attempts at collecting the CRP debt. However, neither provided any evidence to support the various negotiated payment plans, the bi-weekly summaries or open invoice reports, the meetings between CRP and SFI officials, the hundreds of communications between the two parties, etc. In addition, neither CRP nor the CFO provided any examples of

other SFI customers or clients of similar risk for which similar services had been provided and similar billing arrangements had been utilized.

SFI's effort to convince the CRP to resume the fundraising program and SFI's continued provision of services when CRP had repeatedly failed to pay raises the question of whether SFI's debt collection efforts were commercially reasonable. Among the debt collection practices that may be regarded as evidence of commercial reasonableness is the withholding of additional services until overdue debts are satisfied. Here, it appears the opposite happened; CRP, concerned about the level of debt it had accumulated, sought to suspend delivery of services from SFI, and it was SFI that convinced CRP that the only viable way for CRP to get out of debt to SFI was for it to continue the fundraising program. If this is correct, it may be that SFI's decision to give CRP additional time to pay and SFI's decision to continue providing services was commercially reasonable. However, the Audit staff believes that additional information is necessary to reach this conclusion. SFI asserted in its response that, as part of its effort to convince the CRP, it met with CRP and presented a detailed house file analysis which included details on historical fundraising trends at various levels. In addition, SFI contended that this meeting led to a better understanding of the need to prospect and fundraise to help CRP out of the situation and help itself in. Information supporting this contention by SFI would be precisely the type of information that would demonstrate the commercial reasonableness of its course. In addition, the specifics of the negotiated payment plan, how the plans compare to the terms SFI has provided to similarly situated other clients may also demonstrate the commercial reasonableness and reasonable debt collection efforts by SFI. However, while both CRP and SFI say that SFI provided such information, CRP in fact, neither has provided a copy of the detailed house file analysis or the specifics of the negotiated payment plans to the Audit staff.

After reviewing the response to the Interim Audit Report submitted by CRP and the CFO, the Audit staff concludes that CRP has not demonstrated that SFI extended credit with its ordinary course of business or that commercially reasonable attempts were made to collect the CRP debt. Until further documentation is provided by CRP, the Audit staff considers this matter an impermissible contribution of \$1,171,002 to CRP.