



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

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August 2, 2012

**MEMORANDUM**

To: The Commission

Through: Alec Palmer *AP*  
Staff Director

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

Tom Hintermister *TH*  
Assistant Staff Director  
Audit Division

Marty Favin *MLF*  
Audit Manager

By: Gary Hache *GH*  
Lead Auditor

Subject: Audit Division Recommendation Memorandum on the Minnesota  
Democratic-Farmer-Labor Party (MNDFL) (A09-08)

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

**Finding 1. Misstatement of Financial Activity**

- A. In response to the DFAR, the MNDFL acknowledged filing amendments to its 2007 – 2008 reports to correct certain items and cash-on-hand amounts. However, the MNDFL did not agree with the Audit staff's conclusion that the payroll account was a federal account requiring all activity (federal and non-federal) to be disclosed. It is the MNDFL's contention that the payroll account is neither a federal nor non-federal account but rather an "escrow account" used to

transmit payroll from its federal and non-federal accounts similar to the account used by the Georgia Federal Elections Committee (GFEC) that was an issue in the 2006 election cycle.

The MNDFL states that the payroll account was established to address the need to pay employees and the Internal Revenue Service from one account. While the MNDFL acknowledged that it “apparently and inadvertently” overfunded the non-federal payroll during the 2008 election cycle, the overfunding was offset by the underfunding of the non-federal share of overall expenses. The MNDFL further stated that it “believes that these were funds in-transit, and were ultimately used only for non-federal activity” and none of the funds “were used to subsidize any federal activity.”

The Audit staff maintains that the payroll account was used by the MNDFL in a manner similar to an “allocation account.” Although the MNDFL did not report any allocated salary and payroll tax expenditures on Schedule H4<sup>1</sup>, when viewed from a global perspective each pay period involved an allocation of federal and non-federal salaries and taxes paid from one account. The payroll account was funded by transfers from federal and non-federal accounts. As stated in Finding 2 below, the MNDFL did not overfund the non-federal share of overall expenses, but an analysis of the receipts and disbursements from the payroll account showed that there were insufficient federal funds in the payroll account to pay for the total reported federal expenditures resulting in an overfunding of the federal share of salaries and taxes by the non-federal accounts.

The Audit staff recommends that the Commission find that the MNDFL misstated 2007 – 2008 activity and failed to report non-federal salaries and taxes paid from their payroll account.

- B. At the 2008 Democratic National Convention, the MNDFL had an event or events at the Sheraton Four Points Denver Southeast hotel. The catering bill for this event or events totaled \$36,943. The MNDFL had already paid a deposit of \$17,634 to the Sheraton Four Points, which was applied to the bill, leaving a balance due of \$19,309.

Subsequently, the Sheraton Four Points applied an unexplained \$10,000 credit to the remaining bill, reducing the remaining balance to \$9,309. The invoice showing the credit was accompanied by a copy of a \$10,000 check to the Sheraton Four Points from South Clinton Street Investments, LLC (SCSI). The MNDFL paid the remaining balance, and reported that payment, but did not report the receipt of or application of the \$10,000 credit.

In the Interim Audit Report (IAR), the Audit staff recommended that the MNDFL provide documentation to show that the \$10,000 received from SCSI was a

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<sup>1</sup> Federal and non-federal employee benefits were paid from a federal administrative account and reported on Schedule H4, Disbursements for Federal/Nonfederal Activity.

permissible in-kind contribution. In response to the IAR, the MNDFL provided documentation from SCSi purporting to show that the funds were not an in-kind contribution – at least, not from SCSi. SCSi is the owner/operator of a different Denver-area Sheraton hotel, the Sheraton Denver Tech Center. SCSi's statement asserted that the Sheraton Denver Tech Center received and deposited the funds in error, and subsequently forwarded them by SCSi's check to the Sheraton Four Points, which applied the funds to the MNDFL's catering bill. However, SCSi did not identify from whom it received the funds, nor did it describe the nature of the error that led it to receive and deposit the funds. Neither SCSi nor the Sheraton Denver Tech Center ever received any funds from the MNDFL.

Audit staff examined information in the Commission's possession, including disclosure reports, and discovered that the Denver 2008 Convention Host Committee (Denver Host) had reported a \$10,000 disbursement for "sponsor benefit fulfillment" to the Sheraton Tech Center. In the DFAR, the Audit staff concluded that the in-kind contribution was received from the Denver Host rather than SCSi.

In response to the DFAR, the MNDFL acknowledged that while the funds applied to the MNDFL's catering bill "may have derived from funds that were paid by the Denver 2008 Convention Host Committee to the hotel, it is not clear, and in [their] view, unlikely, that this payment was, in fact, an in-kind contribution." Based on oral discussions with the representatives of the Denver Host (which has terminated) and other information gathered, the MNDFL believes that the funds most likely represented a refund (although no details or documentation was provided by the MNDFL in its response) for a cancelled event honoring the Minnesota delegation that was to be paid by the Denver Host. The supposed refund, through a series of transactions, wound up credited to the MNDFL's catering bill at the Sheraton Four Points Denver Southeast. The MNDFL stated that it could not determine if the credit to their account was intentional or accidental, nor could the original source of the funds be determined.

The Audit staff concludes that the MNDFL received an in-kind contribution from an unknown source that was not reported nor disgorged to the U.S. Treasury when the permissibility of the funds could not be confirmed.

The Audit staff recommends that the Commission find that the MNDFL misstated activity in 2008 and failed to report an in-kind contribution in the amount of \$10,000. Since the source and permissibility of the contribution remains in question, the Audit staff further recommends that the Commission request that the MNDFL disgorge \$10,000 to the U.S. Treasury.

## **Finding 2. Overfunding of Federal Accounts by Non-federal Accounts**

In the DFAR, the Audit staff concluded that the MNDFL sufficiently demonstrated that it did not overfund its federal accounts with funds from its non-federal accounts. The Audit

staff recommends that the Commission find that the MNDFL has demonstrated that its non-federal accounts did not overfund its federal accounts.

The Committee did not request an audit hearing.

If this memorandum is approved, a Proposed Final Audit Report will be prepared within 30 days of the Commission's vote.

Should an objection be received, 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 Gary Hache or Marty Favin at 694-1200.

**Attachments:**

- Draft Final Audit Report of the Audit Division on the Minnesota Democratic-Farmer-Labor Party
- Legal Report Analysis (LRA835) of the Draft Final Audit Report on the Minnesota Democratic-Farmer-Labor Party

cc: Office of General Counsel



# Draft Final Audit Report of the Audit Division on the Minnesota Democratic-Farmer-Labor Party (January 1, 2007 - December 31, 2008)

## Why the Audit Was Done

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

## Future Action

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

## About the Committee (p. 2)

The Minnesota Democratic-Farmer-Labor Party is a state party committee with headquarters in St. Paul, Minnesota. For more information, see the chart on the Committee Organization, p. 2.

## Financial Activity (p. 3)

• Receipts	
○ Individual Contributions	\$ 1,839,117
○ Political Committee Contributions	2,233,845
○ Transfers from Affiliates	5,898,356
○ Transfers from Non-federal Accounts	2,394,428
○ Recount Fund Contributions	694,850
○ Offsets and Other Receipts	1,042,345
<b>Total Receipts</b>	<b>\$ 14,102,941</b>
• Disbursements	
○ Operating Expenditures	\$ 6,458,425
○ Federal Election Activity	6,398,033
○ Transfers to Non-federal Accounts	287,061
○ Contributions to Candidates	20,000
○ Coordinated Expenditures	266,844
○ Recount Expenditures	660,719
<b>Total Disbursements</b>	<b>\$ 14,091,082</b>

## Findings and Recommendations (p. 4)

- Misstatement of Financial Activity (Finding 1)
- Over-funding of Federal Accounts by Non-federal Accounts (Finding 2)

<sup>1</sup> 2 U.S.C. §438(b).

# **Draft Final Audit Report of the Audit Division on the Minnesota Democratic-Farmer-Labor Party**

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(January 1, 2007 - December 31, 2008)

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# **Part I**

## **Background**

### **Authority for Audit**

This report is based on an audit of the Minnesota Democratic-Farmer-Labor Party (MNDFL), 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. §438(b).

### **Scope of Audit**

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

1. the receipt of excessive contributions and loans;
2. the receipt of contributions from prohibited sources;
3. the disclosure of contributions received;
4. the disclosure of disbursements, debts and obligations;
5. the disclosure of expenses allocated between federal and non-federal accounts;
6. the consistency between reported figures and bank records;
7. the completeness of records; and
8. other committee operations necessary to the review.

## Part II

### Overview of Committee

#### Committee Organization

<b>Important Dates</b>	
• Date of Registration	July 15, 1975 <sup>2</sup>
• Audit Coverage	January 1, 2007 – December 31, 2008
<b>Headquarters</b>	
	St. Paul, Minnesota
<b>Bank Information</b>	
• Bank Depositories	Three
• Bank Accounts	13 Federal Accounts Five Non-federal Accounts
<b>Treasurer</b>	
• Treasurer When Audit Was Conducted	Lori Sellner [thru February 8, 2011] Thomas Hamilton [as of February 9, 2011]
• Treasurer During Period Covered by Audit	William J. Davis [thru February 18, 2009]
<b>Management Information</b>	
• Attended FEC Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

<sup>2</sup> The committee registered with the Secretary of the Senate as the Minnesota Dollars for Democrats (a federal committee of the Minnesota Democratic-Farmer-Labor State Party). In 1980, the committee filed an Amended Statement of Organization, changing the name of the committee to the Minnesota Democratic-Farmer-Labor Party.

## Overview of Financial Activity (Audited Amounts)

<b>Cash-on-hand @ January 1, 2007</b>	<b>\$ 225,904</b>
<b>Receipts</b>	
o Individual Contributions	\$ 1,839,117
o Political Committee Contributions	2,233,845
o Transfers from Affiliates	5,898,356
o Transfers from Non-federal Accounts	2,394,428
o Recount Fund Contributions	694,850
o Offsets and Other Receipts	1,042,345
<b>Total Receipts</b>	<b>\$ 14,102,941</b>
<b>Disbursements</b>	
o Operating Expenditures	\$ 6,458,425
o Federal Election Activity	6,398,033
o Transfers to Non-federal Accounts	287,061
o Contributions to Candidates	20,000
o Coordinated Expenditures	266,844
o Recount Expenditures	660,719
<b>Total Disbursements</b>	<b>\$ 14,091,082</b>
<b>Cash-on-hand @ December 31, 2008</b>	<b>\$ 237,763</b>

## **Part III**

### **Summaries**

#### **Findings and Recommendations**

##### **Finding 1. Misstatement of Financial Activity**

During audit fieldwork, a comparison of the MNDFL's reported financial activity with its bank records revealed a misstatement of receipts and disbursements in calendar years 2007 and 2008. The misstatements were due mainly to unreported transfers from the non-federal accounts to the Payroll account and unreported receipts and operating expenditures. For 2007, the MNDFL understated receipts by \$441,228 and disbursements by \$469,230. For 2008, the MNDFL understated receipts by \$1,303,611 and disbursements by \$1,205,799. In response to the Interim Audit Report recommendation, the MNDFL amended its reports to materially correct the misstatements noted above except for the reporting of the Payroll account transactions related to the 100% non-federal employees.

Also, the MNDFL submitted documentation to show that an apparent prohibited contribution it received was, in fact, permissible. However, the MNDFL did not include this contribution in its amended reports. (For more detail, see p. 5)

##### **Finding 2. Over-funding of Federal Accounts by Non-federal Accounts**

During audit fieldwork, an analysis of the MNDFL's transfers from its non-federal accounts indicated that the MNDFL may have overfunded its federal accounts by as much as \$277,103. The overfunding resulted from unsupported transfers from the non-federal accounts to the federal accounts, an overfunding of the Payroll account for the non-federal portion of payroll, and reported federal activity paid from the non-federal accounts.

In response to the Interim Audit Report recommendation, the MNDFL submitted additional documentation, in conjunction with its amended reports, which showed that the committee did not overfund its federal account. (For more detail, see p. 11)

## Part IV

# Findings and Recommendations

### **Finding 1. Misstatement of Financial Activity**

#### **Summary**

During audit fieldwork, a comparison of the MNDFL's reported financial activity with its bank records revealed a misstatement of receipts and disbursements in calendar years 2007 and 2008. The misstatements were due mainly to unreported transfers from the non-federal accounts to the Payroll account and unreported receipts and operating expenditures. For 2007, the MNDFL understated receipts by \$441,228 and disbursements by \$469,230. For 2008, the MNDFL understated receipts by \$1,303,611 and disbursements by \$1,205,799. In response to the Interim Audit Report recommendation, the MNDFL amended its reports to materially correct the misstatements noted above except for the reporting of the Payroll account transactions related to the 100% non-federal employees.

Also, the MNDFL submitted documentation to show that an apparent prohibited contribution it received was, in fact, permissible. However, the MNDFL did not include this contribution in its amended reports.

#### **Legal Standard**

##### **A. Contents of Reports.** Each report must disclose:

- the amount of cash-on-hand at the beginning and end of the reporting period;
- the total amount of receipts for the reporting period and for the calendar year;
- the total amount of disbursements for the reporting period and for the calendar year; and
- certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 2 U.S.C. §434(b)(1), (2), (3), (4) and (5).

##### **B. Receipt of Prohibited Contributions – General Prohibition.** Candidates and committees may not accept contributions (in the form of money, in-kind contributions or loans) from the treasury funds of the following prohibited sources:

- corporations (this means any incorporated organization, including a non-stock corporation, an incorporated membership organization, and an incorporated cooperative);
- labor organizations; or
- national banks. 2 U.S.C. §441b.

##### **C. Contributions by Limited Liability Companies (LLC).** A limited liability company is a business entity that is recognized as same under the laws of the state in which it is established. An LLC that elects to be treated as a corporation by the Internal Revenue Service under 26 CFR 301.7701-3 shall be considered a corporation pursuant to 11 CFR Part 114. An LLC that makes a contribution to a candidate or committee shall

provide information as to how the contribution is to be attributed and affirm that it is eligible to make the contribution. 11 CFR §110.1(g).

## Facts and Analysis

### A. Facts

During audit fieldwork, the Audit staff reconciled the MNDFL's reported activity with its bank records and identified a misstatement of receipts and disbursements for calendar years 2007 and 2008. The following charts detail the discrepancies between the totals on the MNDFL's disclosure reports and bank records. Succeeding paragraphs explain why the discrepancies occurred.

<b>2007 Activity</b>			
	<b>Reported</b>	<b>Bank Records</b>	<b>Discrepancy</b>
Beginning Cash Balance @ January 1, 2007	\$212,947	\$225,904	\$12,957 Understated
Receipts	\$1,381,869	\$1,823,097	\$441,228 Understated
Disbursements	\$1,409,884	\$1,879,114	\$469,230 Understated
Ending Cash Balance @ December 31, 2007	\$184,932	\$169,887	\$15,045 Overstated

The \$12,957 understatement of the beginning cash balance was likely due to prior period reporting discrepancies.

The understatement of receipts was the result of the following:

• Transfers from the non-federal accounts to the Payroll Account for 100 percent non-federal payroll and benefits not reported	\$ 395,072
• Non-payroll transfers from the non-federal accounts not reported	46,040
• Non-federal share of vendor refunds reported as a negative receipt on Schedule H-3 <sup>3</sup>	24,261
• Transfer from the non-federal account reported twice	(5,000)
• Unexplained difference	<u>(19,145)</u>
<b>Net Understatement of Receipts</b>	<b><u>\$ 441,228</u></b>

The understatement of disbursements was the result of the following:

• 100 percent non-federal salaries, taxes and benefits paid from the Payroll account and federal accounts not reported	\$ 431,292
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<sup>3</sup> A refund of the federal and non-federal share of allocable activity may be disclosed either as negative entries on Schedule H-4 or as a receipt on Line 15 of Schedule A and a disbursement to the non-federal account for the non-federal share on Schedule H-4.

• Transfer to the non-federal account not reported	7,000
• Non-federal share of vendor refunds reported as a negative receipt on Schedule H-3	24,261
• Operating expenditures not reported	12,630
• Reported disbursements subsequently voided with no adjustment made to reports	(1,392)
• Reported disbursements not supported by a cancelled check	(4,173)
• Unexplained difference	(388)
<b>Net Understatement of Disbursements</b>	<b><u>\$ 469,230</u></b>

The \$15,045 overstatement of the ending cash balance resulted from the reporting discrepancies noted above.

<b>2008 Activity</b>			
	<b>Reported</b>	<b>Bank Records</b>	<b>Discrepancy</b>
Beginning Cash Balance @ January 1, 2008	\$184,932	\$169,887	\$15,045 Overstated
Receipts	\$10,976,233	\$12,279,844	\$1,303,611 Understated
Disbursements	\$11,006,169	\$12,211,968	\$1,205,799 Understated
Ending Cash Balance @ December 31, 2008	\$154,996	\$237,763	\$82,767 Understated

The understatement of receipts was the result of the following:

• Transfers from the non-federal accounts to the Payroll Account for 100 percent non-federal payroll and benefits not reported	\$ 827,853
• Non-payroll transfers from the non-federal accounts not reported	108,975
• Non-federal share of vendor refunds reported as a negative receipt on Schedule H-3	2,716
• Receipts not reported <sup>4</sup>	402,186
• In-kind contributions not reported	13,127
• Reported receipt deposited in the non-federal account	(14,627)
• Reported receipts that did not clear the federal accounts	(21,243)
• Unexplained difference	(15,376)
<b>Net Understatement of Receipts</b>	<b><u>\$ 1,303,611</u></b>

The understatement of disbursements was the result of the following:

• 100 percent non-federal salaries, taxes and benefits paid from the Payroll account and federal accounts not reported	\$ 591,524
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<sup>4</sup> Includes a \$150,000 non-federal receipt deposited into the federal account in error (funds were transferred to the non-federal account), an \$81,000 reimbursement from the non-federal account for a non-federal expenditure paid by the federal account in error, a \$61,000 transfer from a national party committee and a \$16,000 transfer from an authorized committee.

• Non-federal share of vendor refunds reported as a negative receipt on Schedule H-3	2,716
• Operating expenditures not reported	406,312
• Bank and credit card fees not reported	38,345
• Transfers to non-federal accounts not reported	251,450
• Reported disbursements paid from the non-federal accounts	(51,105)
• In-kind contributions not reported	16,111
• Reported disbursements subsequently voided with no adjustment made to reports	(33,666)
• Reported disbursements not supported by a cancelled check	(24,356)
• Unexplained difference	<u>8,468</u>
<b>Net Understatement of Disbursements</b>	<b><u>\$ 1,205,799</u></b>

The \$82,767 understatement of the ending cash balance resulted from the reporting discrepancies noted above.

The discrepancies in financial activity noted above occurred primarily because the MNDFL did not report certain payroll transactions involving the Payroll account and the federal administrative accounts. The MNDFL separated its employees into two classes: 100 percent federal and 100 percent non-federal.<sup>5</sup> A MNDFL representative stated that the MNDFL established the system to ease the administrative burden of payroll processing. If an employee spent any time working on federal activity during the pay period, he or she was paid 100 percent from federal funds transferred to the Payroll account and the MNDFL disclosed the salary payments on Schedule B. If an employee spent the pay period working solely on non-federal activity, the MNDFL paid them 100 percent from non-federal funds transferred to the Payroll account and did not report the salary and related costs.

The MNDFL paid all salaries and related employee taxes from one Payroll account administered by MNDFL staff and paid employee health insurance and retirement benefits from the federal administrative accounts. Transfers from the federal and non-federal accounts funded the Payroll account. The Audit staff included the Payroll account as a federal account.<sup>6</sup> The MNDFL disclosed only the federal activity paid out of the Payroll account and the portion of benefits relating to federal employees paid from the federal administrative accounts. An analysis of the salaries paid to all employees during the audit period showed that the MNDFL paid \$3,176,793 (81 percent) of the salaries as 100 percent federal and \$756,744 (19 percent) as 100 percent non-federal. Subsequent to the period under audit, the MNDFL established a separate non-federal Payroll account.

The MNDFL also processed the payroll costs for the employees of three federal candidate committees and included them in the payroll amounts above. The candidate

<sup>5</sup> There was no allocated payroll.

<sup>6</sup> A federal account means an account at a campaign depository that contains funds to be used in connection with a Federal election. 11 CFR §300.2(f).

committees reimbursed the MNDFL to offset the payroll costs for their employees. The MNDFL and the candidate committees properly disclosed the salary payments and reimbursements. The MNDFL made expenditures for salary payments totaling \$731,449 and the candidate committees reimbursed the MNDFL \$705,734. The salary payments in excess of the reimbursement amount (\$25,715) resulted in an in-kind contribution to the candidates from the MNDFL.<sup>7</sup>

A \$10,000 contribution from South Clinton Street Investments, LLC (SCSI) was included among the 2008 unreported in-kind contributions. During the 2008 Democratic National Convention held in Denver, Colorado, the MNDFL contracted with the Four Points by Sheraton Denver Southeast to provide catering services for the Minnesota State delegation. On August 24, 2008, the committee paid the hotel a deposit of \$17,634. The hotel provided catering services on August 25 – 29, 2008, totaling \$36,943, leaving a balance due of \$19,309. On September 22, 2008, the hotel applied a \$10,000 check drawn on the operating account of SCSI to the MNDFL's account. The MNDFL did not report this in-kind contribution and during fieldwork the Audit staff did not find any documentation in the MNDFL's files to show that SCSI was permitted to make the contribution.

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

At the exit conference, the Audit staff provided the MNDFL representatives with workpapers detailing the misstatements of financial activity, including the apparent prohibited contribution. Regarding the Payroll account, counsel for the MNDFL stated that the Payroll account was neither a federal nor a non-federal account, but merely a pass-through account established to reduce the administrative workload of the MNDFL, and only the expenditures related to federal activity needed to be reported.<sup>8</sup>

The Audit staff and the MNDFL representatives discussed the contribution from SCSI before and at the exit conference. The Audit staff requested that MNDFL provide information and/or documentation to show that the payment was either not a contribution or that SCSI was permitted to make a contribution. The MNDFL had not submitted any additional documentation concerning this matter, as of the transmittal of the Interim Audit Report to the MNDFL.

The Interim Audit Report recommended that the MNDFL:

- amend its reports to correct the misstatements for 2007 and 2008 as noted above;
- amend its most recent report to correct the cash-on-hand balance with an explanation that the change resulted from a prior period audit adjustment;

<sup>7</sup> The Audit staff concluded that the excess salary payments made on behalf of two of the candidates were permissible because they did not exceed the contribution limit for a state party committee to a federal candidate. For the remaining candidate, the in-kind contribution exceeded the contribution limit by \$11,368. Since the MNDFL had not exceeded its limit for coordinated expenditures for this candidate, the Audit staff concluded that the excess payments were permissible.

<sup>8</sup> In the Final Audit Report of the Commission on the Georgia Federal Elections Committee (2006), where funds were transferred from federal and non-federal accounts to a payroll escrow account at the request of a third party payroll vendor that could not draw funds from two different accounts, the Commission concluded that the committee did not have to further amend its reports in relation to transactions involving the payroll escrow account.

- reconcile the cash balance of its most recent report to identify any subsequent discrepancies that may affect the adjustment recommended by the Audit staff; and
- provide evidence to show that the unreported in-kind payment made by SCSJ was either not a contribution or that SCSJ was permitted to make a contribution. Absent such evidence, the Audit staff recommended that the MNDFL report the in-kind contribution and refund \$10,000 to SCSJ.

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

In response to the Interim Audit Report recommendation relating to the misstatement of financial activity, the MNDFL amended its reports to materially correct the misstatements noted above except for the reporting of the Payroll account transactions related to the 100 percent non-federal employees. Based on the amended reports filed in response to Interim Audit Report, receipts are understated by \$395,072 for 2007 and \$857,747 for 2008. Disbursements are understated by \$433,311 for 2007 and \$701,688 for 2008.

The MNDFL stated that it will not be amending its reports to include the non-federal Payroll account activity at this time because it believes the account is not a federal account but rather a "pass through account" not intended to pay any expenses other than the payroll expenses which are handled in-house by the committee. The MNDFL believes that to require disclosure of these amounts would result in an artificial increase of its federal activity and be confusing to the readers of their disclosure reports. The MNDFL referenced the Commission's action previously taken in regard to the Georgia Federal Elections Committee (GFEC) in which it was determined that the GFEC did not have to report the non-federal payroll activity.

In the case of the GFEC, a separate payroll account was created for the purpose of facilitating a single payment to a payroll processing vendor. In approving the motion that the GFEC did not have to report the non-federal activity, the Commissioners advanced different rationales. Some Commissioners indicated agreement with the GFEC's argument that a payroll escrow account is neither a federal nor non-federal account, nor the "functional equivalent" of an allocation account. Other Commissioners indicated that because the GFEC audit noted that the committee did not overfund federal payroll transactions by the non-federal accounts, the payroll account was permissible in this context. Conversely, the audit of the MNDFL identified an overfunding of the payroll account by the non-federal accounts totaling \$102,663 (Finding 2).

The Audit staff maintains that the MNDFL's Payroll account is a federal account because the MNDFL utilized the account in a manner similar to an "allocation account." Unlike the payroll escrow account established by the GFEC, the MNDFL account was not created at the request of a third party vendor. Although the MNDFL did not allocate any payroll disbursements between federal and non-federal funds (employees were identified as either 100 percent federal or 100 percent non-federal), funds were transferred from its federal and non-federal accounts to the Payroll account to pay salaries and taxes.

In addition, funds were transferred from the MNDFL's non-federal accounts to its federal administrative account to pay for the non-federal share of employee benefits. These transfers were initially not reported and were included in the misstatement of financial activity presented in the Interim Audit Report. However, in response to the Interim Audit Report, the MNDFL amended its reports to include these transfers and to report the non-federal share of the benefits paid from its federal administrative account. The Audit staff believes there is no distinction in the requirement to report the non-federal activity associated with the MNDFL's federal administrative account or its Payroll account. Therefore, non-federal salaries and taxes from the MNDFL's Payroll account also require reporting.

In response to the Interim Audit Report recommendation, the MNDFL submitted documentation to show that an apparent prohibited contribution it received was, in fact, permissible. The documentation supports that the MNDFL received a permissible \$10,000 in-kind contribution from the Denver 2008 Convention Host Committee (DCHC). However, it is noted that the MNDFL's amended reports filed in response to the Interim Audit Report did not include this in-kind contribution.

## **Finding 2. Over-funding of Federal Accounts by Non-federal Accounts**

### **Summary**

During audit fieldwork, an analysis of the MNDFL's transfers from its non-federal accounts indicated that the MNDFL may have overfunded its federal accounts by as much as \$277,103. The overfunding resulted from unsupported transfers from the non-federal accounts to the federal accounts, an overfunding of the Payroll account for the non-federal portion of payroll, and reported federal activity paid from the non-federal accounts.

In response to the Interim Audit Report recommendation, the MNDFL submitted additional documentation, in conjunction with its amended reports, which showed that the MNDFL did not overfund its federal account.

### **Legal Standard**

**A. Accounts for Federal and Non-federal Activity.** A party committee that finances political activity in connection with both federal and non-federal elections may establish two accounts (federal and non-federal) and allocate shared expenses - expenses that simultaneously support federal and non-federal election activity - between the two accounts. Alternatively, the committee may conduct both federal and non-federal activity from one bank account, which is considered a federal account. 11 CFR §102.5(a)(1)(i).

**B. Federal v. Non-federal Account.** The federal account may contain only those funds that are permissible under the federal election law. The non-federal account may contain funds that are not permitted under the federal law (but are legal under state law), such as contributions that exceed the limits of the federal law and contributions from otherwise

prohibited sources, such as corporations and labor organizations. 11 CFR §102.5(a)(1)(i) and (a)(3).

**C. Transfers.** Generally, a political committee may not transfer funds from its non-federal account to its federal account, except when the committee follows specific rules for paying for shared federal/non-federal election activity. 11 CFR §§102.5(a)(1)(i) and 106.5(g).

**D. Paying for Allocable Expenses.** The Commission regulations offer party committees two ways to pay for allocable, shared federal/non-federal expenses.

- They may pay the entire amount of the shared expense from the federal account and transfer funds from the non-federal account to the federal account to cover the non-federal share of that expense; or
- They may establish a separate allocation account into which the committee deposits funds from both its federal and non-federal accounts solely for the purpose of paying the allocable expenses of shared federal/non-federal activities. 11 CFR §106.5(g)(1)(i) and (ii)(A).

**E. Reporting Allocable Expenses.** A political committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report these kinds of disbursements on Schedule H-4. 11 CFR §104.17(b).

**F. Salaries and Wages.** Committees must keep a monthly log of the percentage of time each employee spends in connection with a Federal election. Employees who spend 25 percent or less of their compensated time in a given month on Federal election activity or on activities in connection with a Federal election must either be paid only from the Federal account or be allocated as an administrative cost. 11 CFR §106.7(d)(1).

## **Facts and Analysis**

### **A. Facts**

During audit fieldwork, the Audit staff identified a possible overfunding of MNDFL's federal activity with funds from its non-federal accounts. The overfunding was calculated to be \$277,103 and was based on the following:<sup>9</sup>

1. Underfunding of the non-federal portion of shared activity -  
The MNDFL reported a total of \$1,055,437 as the non-federal share of allocated activity and reported \$1,041,688 in transfers from the non-federal accounts to the federal accounts, resulting in an underfunding of \$13,748.
2. Overfunding of non-federal payroll -  
The MNDFL used a single Payroll account to pay employee salaries (both 100 percent federal and 100 percent non-federal) – no employee salaries were

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<sup>9</sup> The Audit staff's review of the transfer activity between the committee's federal and non-federal accounts was initially limited because the MNDFL did not maintain adequate records to support the transfers.

allocated) and related taxes. The MNDFL paid employee benefits out of a federal administrative account and transferred funds from the federal and non-federal accounts to the Payroll account to pay salaries and taxes. The MNDFL did not report any of the non-federal payroll activity. The MNDFL's total non-federal payroll expenditures of \$1,129,157 includes \$756,744 for salaries, \$226,155 for taxes and \$146,257 for benefits. The MNDFL transferred a total of \$1,215,520 from the non-federal accounts to the Payroll account for the non-federal share of payroll, resulting in an overfunding of \$86,363 (\$1,215,520 - \$1,129,157) for the non-federal portion.<sup>10</sup>

3. Reported federal activity paid from non-federal accounts -  
The MNDFL reported \$51,105 as federal activity paid from the non-federal accounts. Due to the lack of supporting documentation available during audit fieldwork, the Audit staff was initially unable to determine if the MNDFL reimbursed the non-federal accounts for any of this reported federal activity.
4. Unsupported transfers from non-federal accounts -  
The MNDFL made unsupported transfers from the non-federal accounts to the federal accounts totaling \$38,263 for 2007 and \$115,120 for 2008. Due to the lack of supporting documentation available during audit fieldwork, the Audit staff was unable to determine if the transfers from the non-federal account were for the non-federal portion of shared activity.

It is noted that the Audit staff identified a total of \$103,450 in transfers from the federal accounts to non-federal accounts that lacked adequate supporting documentation detailing the purpose of the transfer. If supported by documentation that shows the transfers were related to any of the activity noted above, the amount of overfunding by the non-federal accounts may be reduced.

In summary, the apparent overfunding by the non-federal accounts identified in fieldwork was calculated as follows:

Underfunding of non-federal portion of shared activity	(\$ 13,748)
Overfunding of non-federal payroll	86,363
Unsupported transfers from non-federal accounts	153,383
Reported federal activity paid from non-federal accounts	<u>51,105</u>
Total over-funding by the non-federal account	<u>\$ 277,103</u>

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

At the exit conference, the Audit staff provided the MNDFL representatives with workpapers detailing the transfer activity noted above. The MNDFL representatives provided no additional comments.

The Audit staff recommended that the MNDFL provide documentation that showed:

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<sup>10</sup> See committee statement concerning the Payroll account on page 8.

- the MNDFL did not make disbursements from the non-federal accounts for the purpose of financing federal activity;
- reported federal activity paid from the non-federal accounts was reimbursed by the federal accounts; and
- the unsupported transfers from the non-federal accounts were made for purposes other than federal activity.

In addition, the Audit staff recommended that the MNDFL provide any additional comments and/or documentation that detailed the purpose of the transfers of \$103,450 made from the federal accounts to the non-federal accounts.

If the MNDFL was unable to provide any documentation to reduce the amount of overfunding noted above, the Audit staff recommended that the MNDFL reimburse \$277,103 to the non-federal account.

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

In response to the Interim Audit Report recommendation for Finding 1, the MNDFL filed amended reports which included the transfers from the non-federal account to the federal account for the non-federal share of employee benefits payments. Additional documentation was submitted which addressed the overfunding of the Payroll account for the non-federal portion of the payroll, the unsupported transfers from the non-federal accounts and the apparent payment of federal activity by the non-federal account. The following details the changes resulting from the MNDFL's response:

1. The underfunding of the non-federal share of allocable activity increased from \$13,748 to \$120,960 because of the disclosure of previously unreported payments for allocable activity, including the non-federal share of employee benefits, and transfers from the non-federal account to the federal account for the non-federal share of employee benefits payments. The non-federal share of allocable activity increased from \$1,055,437 to \$1,252,561 and the transfers from the non-federal account for this activity increased from \$1,041,688 to \$1,131,601.
2. The overfunding of the Payroll account for the non-federal portion of the payroll increased from \$86,363 to \$102,663. The increase was due to the removal of a transfer from the non-federal account of \$20,000 which was listed twice and the addition of \$36,300 for a transfer that was deposited into a federal account in error, then subsequently transferred from the federal account to the Payroll account.
3. The unsupported transfers of \$153,383 from the non-federal account were cleared by the submission of additional documentation and the amended disclosure reports filed by the MNDFL in response to Finding 1 and the increase in the overfunding of the non-federal share of allocable activity discussed above.
4. The apparent payment of federal activity by the non-federal account was decreased from \$51,105 to \$8,833. The MNDFL demonstrated that \$31,529 was

properly paid for by the non-federal account, \$16,785 was allocable activity (\$6,042 is the federal share – 36 percent) and \$2,791 is 100 percent federal activity. The amended reports filed by the MNDFL corrected the misstatement of this activity.

In summary, the response to the Interim Audit Report resulted in the following:

Underfunding of non-federal portion of shared activity	(\$ 120,960)
Overfunding of non-federal payroll	102,663
Unsupported transfers from non-federal accounts	-0-
Reported federal activity paid from non-federal accounts	<u>8,833</u>
Total under-funding by the non-federal account	<u>(\$ 9,464)</u>

As a result of its response to the Interim Audit Report Recommendation, the MNDFL sufficiently demonstrated that it did not overfund its federal accounts with funds from its non-federal accounts.