



# Draft Final Audit Report of the Audit Division on Smoot for Congress

(March 11, 2009 - December 31, 2010)

## 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 Campaign (p. 2)

Smoot for Congress is the congressional campaign committee for Sheila Smoot, Democratic candidate for the U.S. House of Representatives from the State of Alabama, 7<sup>th</sup> District, and is headquartered in Birmingham, Alabama. For more information, see the chart on the campaign organization, p. 2.

## Financial Activity (p. 2)

• <b>Receipts</b>	
○ Contributions from Individuals	\$ 151,083
○ Contributions from Other Political Committees	98,750
<b>Total Receipts</b>	<b>\$ 249,833</b>
• <b>Disbursements</b>	
○ Operating Expenditures	\$ 250,380
○ Other Disbursements	1,030
<b>Total Disbursements</b>	<b>\$ 251,410</b>

## Findings and Recommendations (p. 3)

- Misstatement of Financial Activity (Finding 1)
- Receipt of Apparent Prohibited Contributions (Finding 2)

<sup>1</sup> 2 U.S.C. §438(b).

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# Part I

## Background

### Authority for Audit

This report is based on an audit of Smoot for Congress (SFC), 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 individual contributors' occupation and name of employer;
4. the consistency between reported figures and bank records;
5. the completeness of records; and
6. other committee operations necessary to the review.

## Part II

### Overview of Campaign

#### Campaign Organization

<b>Important Dates</b>	
• Date of Registration	April 22, 2009
• Audit Coverage	March 11, 2009 - December 31, 2010
<b>Headquarters</b>	Birmingham, Alabama
<b>Bank Information</b>	
• Bank Depositories	Two
• Bank Accounts	Three
<b>Treasurer</b>	
• Treasurer When Audit Was Conducted	Adrienne Ellison
• Treasurer During Period Covered by Audit	Johanna Martin. March 11, 2009 - October 17, 2010; and Adrienne Ellison. October 18, 2010 - December 31, 2010
<b>Management Information</b>	
• Attended FEC Campaign Finance Seminar	No
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

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

<b>Cash-on-hand @ March 11, 2009</b>	<b>\$ 0</b>
<b>Receipts</b>	
○ Contributions from Individuals	151,083
○ Contributions from Other Political Committees	98,750
<b>Total Receipts</b>	<b>\$ 249,833</b>
<b>Disbursements</b>	
○ Operating Expenditures	250,380
○ Other Disbursements	1,030
<b>Total Disbursements</b>	<b>\$ 251,410</b>
<b>Cash-on-hand @ December 31, 2010</b>	<b>\$ (1,577)<sup>2</sup></b>

<sup>2</sup> SFC overdrawed its bank accounts in the amount of \$1,577. The bank later forgave \$1,574 when one account was closed out. See Finding 2 for discussion of apparent prohibited contribution from the bank for \$1,574.

## Part III Summaries

### Findings and Recommendations

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

A comparison of SFC's reported financial activity with its bank records revealed a misstatement of receipts and disbursements in calendar years 2009 and 2010. The Interim Audit Report recommended that SFC amend its disclosure reports to correct the misstatements. No amended reports have been filed to date. The candidate stated that SFC would file the amended reports in the near future. (For more detail, see p. 4)

#### **Finding 2. Receipt of Apparent Prohibited Contributions**

Based on a review of all contributions received by SFC, the Audit staff identified 15 contributions totaling \$9,994 that appear to be from prohibited sources. The Interim Audit Report recommended that SFC demonstrate that it made the contributions with permissible funds or refund them. In response to the Interim Audit Report, SFC stated that one of the contributions in question was refunded, one was not incorporated, 12 were from sole proprietors or partnerships, and one was not prohibited but resulted from a vendor error. However, SFC provided no documentation to support its statement and therefore the Audit staff still considers the contributions totaling \$9,994 apparent prohibited contributions. (For more detail, see p. 6)

## Part IV

# Findings and Recommendations

### Finding 1. Misstatement of Financial Activity

#### Summary

A comparison of SFC's reported financial activity with its bank records revealed a misstatement of receipts and disbursements in calendar years 2009 and 2010. The Interim Audit Report recommended that SFC amend its disclosure reports to correct the misstatements. No amended reports have been filed to date. The candidate stated that SFC would file the amended reports in the near future.

#### Legal Standard

**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 election cycle;
- the total amount of disbursements for the reporting period and for the election cycle; 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).

#### Facts and Analysis

##### A. Facts

The Audit staff reconciled SFC's reported activity with its bank records and identified a misstatement of receipts and disbursements for 2009 and 2010. The following charts detail the discrepancies and succeeding paragraphs explain the reasons for the misstatements, if known.

2009 Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ March 11, 2009	\$0	\$0	\$0
Receipts	\$60,008	\$60,038	\$(30) Understated
Disbursements	\$55,674	\$54,678	\$996 Overstated
Ending Cash Balance @ December 31, 2009	\$4,334	\$5,360	\$(1,026) Understated

SFC understated receipts in 2009 by \$30. However, when evaluating the identified errors, regardless of whether the errors were positive or negative (absolute values), the Audit staff discovered that the committee misstated receipts by \$5,694 (\$2,862 + \$2,270 + \$562).

The misstatement of receipts resulted from the following differences:

• Receipts not reported, primarily contributions from individuals	\$2,862
• Receipts reported twice	2,270
• Reported receipts not supported by bank deposits or credits	<u>562</u>
Sum of Reporting Adjustments	<u>\$5,694</u>

SFC overstated disbursements in 2009 by \$996. However, when evaluating the identified errors, regardless of whether the errors were positive or negative (absolute values), The Audit staff discovered that the committee misstated disbursements by \$4,305 (\$1,383 + 2,922).

The misstatement of disbursements resulted from the following differences:

• Disbursements not reported	\$1,383
• Disbursements reported not supported by canceled checks	<u>2,922</u>
Sum of Reporting Adjustments	<u>\$4,305</u>

<b>2010 Activity</b>			
	<b>Reported</b>	<b>Bank Records</b>	<b>Discrepancy</b>
Opening Cash Balance January 1, 2010	\$4,334	\$5,360	\$(1,026) Understated
Receipts	\$170,698	\$189,795	\$(19,097) Understated
Disbursements	\$199,604	\$196,732	\$2,872 Overstated
Ending Cash Balance December 31, 2010	\$(24,572)	\$(1,577)	\$(22,995) Understated

The understatement of receipts resulted from the following:

• Receipts not reported	\$22,417
• Receipts reported twice or incorrectly	(410)
• Reported contributor checks returned by bank for insufficient funds with no report adjustments	(700)
• Reported receipts not supported by bank deposits or credits	(1,810)
• Bank correction erroneously reported as receipt	<u>(400)</u>
Net Understatement of Receipts	<u>\$19,097</u>

SFC overstated disbursements in 2010 by \$2,872. However, when evaluating the identified errors, regardless of whether the errors were positive or negative (absolute values), the Audit staff discovered that the committee misstated disbursements by \$35,357 (\$15,481 + 19,876).

The misstatement of disbursements resulted from the following differences:

• Disbursements not reported	\$15,481
• Disbursements reported not supported by canceled checks	<u>19,876</u>
Sum of Reporting Adjustments	<u>\$35,357</u>

The reporting discrepancies noted above resulted in the \$22,995 understatement of the ending cash balance.

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

The Audit staff and SFC representatives discussed this matter at the exit conference held at the end of audit fieldwork. SFC representatives acknowledged the discrepancies in the reports and indicated that the committee would file corrective amendments.

The Interim Audit Report recommended that SFC amend its reports to correct the misstatements for 2009 and 2010 as noted above 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. It further recommended that SFC reconcile the cash balance on its most recent report to identify any subsequent discrepancies that may impact the \$22,995 adjustment.

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

SFC did not file any amended reports in response to the Interim Audit Report. In a subsequent communication, however, the candidate stated that the requested amendments would be filed in the near future.

## **Finding 2. Receipt of Apparent Prohibited Contributions**

### **Summary**

Based on a review of all contributions received by SFC, the Audit staff identified 15 contributions totaling \$9,994 that appear to be from prohibited sources. The Interim Audit Report recommended that SFC demonstrate that it made the contributions with permissible funds or refund them. In response to the Interim Audit Report, SFC stated that one of the contributions in question was refunded, one was not incorporated, 12 were from sole proprietors or partnerships, and one was not prohibited but resulted from a vendor error. However, SFC provided no documentation to support its statement and therefore the Audit staff still considers the contributions totaling \$9,994 apparent prohibited contributions.

### **Legal Standard**

**A. 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.

**B. Definition of Limited Liability Company.** A limited liability company (LLC) is a business entity recognized as an LLC under the laws of the state in which it was established. 11 CFR §110.1(g)(1).

**C. Applications of Limits and Prohibitions to LLC Contributions.** A contribution from an LLC is subject to contribution limits and prohibitions, depending on several factors, as explained below:

1. **LLC as Partnership.** The contribution is considered a contribution from a partnership if the LLC chooses to be treated as a partnership under Internal Revenue Service (IRS) tax rules, or if it makes no choice at all about its tax status. 11 CFR §110.1(g)(2).
2. **LLC as Corporation.** The contribution is considered a corporate contribution—and is barred under the Act—if the LLC chooses to be treated as a corporation under IRS rules, or if its shares are traded publicly. 11 CFR §110.1(g)(3).
3. **LLC with Single Member.** The contribution is considered a contribution from a single individual if the LLC is a single-member LLC that has not chosen to be treated as a corporation under IRS rules. 11 CFR §110.1(g)(4).
4. **At the time it makes the contribution, an LLC shall provide to the recipient committee information on how the contribution is to be attributed and affirm that it is eligible to make the contribution.** 11 CFR §110.1(g)(5).

**D. Questionable Contributions.** If a contribution that presents genuine questions about its permissibility is received and deposited, the treasurer shall make his or her best efforts to determine whether it is from a prohibited source. If the legality of the contribution cannot be verified in 30 days of the treasurer's receipt, it shall be refunded to the contributor. 11 CFR §103.3(b)(1).

## **Facts and Analysis**

### **A. Facts**

Based on a review of all contributions received by SFC, the Audit staff identified 15 contributions totaling \$9,994 that appear to be from prohibited sources. This amount includes contributions from 12 LLCs, totaling \$7,720, two corporations, totaling \$700, and one national bank, totaling \$1,574.

The Audit staff requested that SFC provide documentation confirming how each LLC elected to be treated under IRS rules at the time the contributions were made. To date, SFC has provided no such documentation. The Audit staff verified the corporate status with the appropriate Secretaries of State and could not determine the status of one of the entities.

SFC incurred a negative bank account balance in November 2010, when it overdrew its account with a debit charge for a rental car. In January 2011, the account was closed when the bank posted a \$1,574 credit. SFC provided no information to indicate that the credit posted by the bank was the result of a deposit by the committee.

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

The Audit staff requested that SFC provide documentation from the bank explaining this transaction. The candidate stated that SFC would provide a letter from the bank. To

date, no such letter has been provided. The Audit staff and committee representatives discussed this matter at the exit conference held at the end of audit fieldwork. The Audit staff requested that SFC provide documentation verifying that the contributions in question were permissible. To date, SFC has not submitted any additional documentation concerning this matter.

The Interim Audit Report recommended that SFC provide evidence demonstrating that the contributions in question were made with permissible funds. For the contributions from LLCs, it was recommended that SFC provide documentation from each entity explaining its tax treatment. It was further recommended that SFC provide documentation from the bank explaining the \$1,574 credit posted to SFC's account.

The Interim Audit Report stated that if SFC did not provide evidence that the funds were permissible, it should have made refunds to the contributors or disgorged to the U.S. Treasury the impermissible amounts. The Audit staff requested that SFC provide evidence of any refunds by providing the front and back of the negotiated refund checks.

In addition, if funds were not available to make the necessary refunds or disgorgement, the Audit staff requested that SFC disclose the contributions requiring refunds on Schedule D (Debts and Obligations) until funds became available to make such refunds.

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

In response to the Interim Audit Report, SFC stated that it refunded one of the two corporate contributions, one was not incorporated, one was not prohibited but rather the result of a vendor error, and 12 were made by sole proprietors or partnerships.

In its response, SFC explained that the vendor error resulted from a double charge by a rental car company, which led to a negative balance in the committee's bank account. According to SFC, the \$1,574 credited by the bank to SFC's account occurred after SFC worked with both the bank and the rental car company to correct a duplicate charge by the rental car company. The SFC did not submit any documentation in support of this explanation so the Audit staff still considers the \$1,574 to be an apparent prohibited contribution from the bank.

With respect to the contribution SFC stated was not incorporated, the Audit staff was unable to verify its corporate status with the Secretary of State. However, since the name on the contribution check included "Inc.," the Audit staff still considers this item to be an apparent prohibited contribution.

SFC did not document the contribution it claimed to have refunded or the 12 contributions SFC claimed were made by sole proprietors or partnerships. Without further documentation to support the statements above, SFC did not comply with the Interim Audit Report recommendation. The Audit staff considers the contributions totaling \$9,994 to be apparent prohibited contributions.