



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

November 7, 2012

MEMORANDUM

To: Anthony Herman
General Counsel

AUDIT REFERRAL # 12-09

Through: Alec Palmer
Staff Director

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Subject: Los Angeles County Democratic Central Committee (A09-07)-
Referral Matters

On October 18, 2012, the Commission approved the Final Audit Report on the Los Angeles County Democratic Central Committee (A09-07). This report includes the following matters that are referable:

Misstatement of Financial Activity
Misstatement of Levin Financial Activity

All work papers and related documentation are available for review in the Audit Division. Should you have any questions regarding this matter, please contact Bill Antosz or Marty Kuest at 694-1200.

Attachments:

Finding 1 - Misstatement of Financial Activity
Finding 2 - Misstatement of Levin Financial Activity

Finding 1. Misstatement of Financial Activity

Summary

A comparison of LACDCC's reported federal activity with bank records revealed a misstatement of cash-on-hand, receipts and disbursements in 2007 and 2008. In 2007, LACDCC overstated beginning cash-on-hand by \$5,228, understated receipts by \$8,920, understated disbursements by \$9,311 and overstated ending cash-on-hand by \$5,619. In 2008, LACDCC understated receipts by \$34,277 and disbursements by \$33,410, and overstated ending cash-on-hand by \$4,752. In response to the Interim Audit Report, LACDCC amended its reports to correct these misstatements.

The Audit staff also identified an apparent prohibited or excessive contribution contained in the 2008 misstated receipts. In response to the Interim Audit Report recommendation, LACDCC provided evidence showing that the receipts should not be considered contributions.

The Commission approved a finding that LACDCC misstated financial activity for 2007 and 2008.

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 the calendar year;
- the total amount of disbursements for the reporting period and 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 (i.e. any incorporated organization, including a non-stock corporation, an incorporated membership organization or an incorporated cooperative);
- labor organizations; or
- national banks. 2 U.S.C. §441b.

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 (see below); and
- the terms of the credit are similar to the terms the vendor observes when extending a similar amount of credit to a nonpolitical client of similar risk. 11 CFR §116.3(a) and (b).

D. Definition of Ordinary Course of Business.

In determining whether credit was extended in the ordinary course of business, the Commission will consider whether:

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

E. Party Committee Limits.

A party committee may not receive more than \$5,000 per year from any one contributor. 2 U.S.C. §441a(a)(1)(C), (2)(C) and (f); 11 CFR §§110.1(d) and 110.9.

F. Contributions by Limited Liability Companies (LLCs).

A limited liability company is a business entity that is recognized as an LLC 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

The Audit staff reconciled the reported financial activity with the bank records for 2007 and 2008. It determined that LACDCC misstated cash-on-hand, receipts and disbursements for both years. The following charts outline the discrepancies and provide explanations for the differences.

| 2007 Activity | | | |
|--|-----------------|---------------------|------------------------|
| | Reported | Bank Records | Discrepancy |
| Opening Cash Balance @ January 1, 2007 | \$24,116 | \$18,888 | \$5,228 Overstated |
| Receipts | \$312,959 | \$321,879 | \$8,920 Understated |
| Disbursements | \$299,683 | \$308,994 | \$9,311 Understated |
| Ending Cash Balance @ December 31, 2007 | \$37,392 | \$31,773 | \$5,619 Overstated |

The understatement of receipts resulted from the following:

| | |
|---|----------------|
| • Offset to operating expenditures not reported | + \$9,245 |
| • Unexplained differences | - 325 |
| Net Understatement of Receipts | \$8,920 |

The understatement of disbursements resulted from the following:

| | |
|--|----------------|
| • Disbursements not reported | + \$847 |
| • Disbursements reported with incorrect amounts | + 9,389 |
| • Reported disbursements that did not clear bank | - 98 |
| • Reported voided disbursements | - 827 |
| Net Understatement of Disbursements | \$9,311 |

| 2008 Activity | | | |
|--|-----------------|---------------------|-------------------------|
| | Reported | Bank Records | Discrepancy |
| Opening Cash Balance @ January 1, 2008 | \$37,392 | \$31,773 | \$5,619 Overstated |
| Receipts | \$501,758 | \$536,035 | \$34,277 Understated |
| Disbursements | \$532,364 | \$565,774 | \$33,410 Understated |
| Ending Cash Balance @ December 31, 2008 | \$6,786 | \$2,034 | \$4,752 Overstated |

The understatement of receipts resulted from the following:

| | |
|---|-----------------|
| • Unreported advance from credit card processor (see below) | + \$7,700 |
| • Unreported transfers from non-federal account (see below) | + 42,596 |
| • Reported transfer from Levin fund that was never made | - 16,272 |
| • Unexplained differences | + 253 |
| Net Understatement of Receipts | \$34,277 |

The understatement of disbursements resulted from the following:

| | |
|---|-----------------|
| • Unreported repayment of advance from credit card processor | + \$7,700 |
| • Unreported disbursements to credit card processor (see below) | + 15,000 |
| • Unreported disbursements | + 7,877 |
| • Reported disbursements with incorrect amounts | + 26,873 |
| • Reported disbursements that did not clear bank | - 1,374 |
| • Reported voided disbursements | - 66 |
| • Reported disbursement paid from Levin account | - 22,600 |
| Net Understatement of Disbursements | \$33,410 |

LACDCC misstated the cash balances throughout 2007 and 2008 due to the errors outlined above and unknown adjustments from prior reporting periods. LACDCC overstated the cash balance on December 31, 2008, by \$4,752.

Advance from and Repayment to Credit Card Processor-\$7,700

LACDCC's federal account received advances from its accounting firm and credit card processor, Durkee & Associates, on credit card proceeds that were being delayed. The advances totaled \$7,700 and occurred between December 22 and December 26, 2008. Durkee & Associates prepared and dated checks to repay the advances on the days it received them, but the checks did not clear the bank until February 17, 2009. LACDCC did not report the advances of \$7,700 and the repayments of the same amount, as noted above.

In addition to the reporting issues relating to these transactions, the Audit staff considered the \$7,700 received from Durkee & Associates an advance or an extension of credit outside the ordinary course of business. See 2 U.S.C. § 431(8)(A)(i) or 11 CFR §§ 100.55, 116.1(e), 116.3. As such, the \$7,700 received by LACDCC is a contribution and either an excessive contribution of \$2,700 (\$7,700 less the allowable contribution limit of \$5,000) or a prohibited contribution of \$7,700, depending on whether Durkee & Associates, as a limited liability company, elected to be treated as a partnership or a corporation for tax purposes.

Disbursed to Credit Card Processor-\$15,000

On December 31, 2008, three checks totaling \$15,000 were drawn from the federal account. Each check was payable to Durkee & Associates. LACDCC did not report the checks on its disclosure reports. LACDCC's former counsel explained that Ms. Durkee withdrew the funds from the federal account as part of the reconciliation process to identify possible errors involving the deposit of credit card contributions. LACDCC returned the funds to the federal account once it determined that there were no problems with credit card contributions. As was the case with the redeposit of the \$45,000 to the Levin account (see Finding 2) however, LACDDC re-deposited the \$15,000 in the federal account months later. Durkee & Associates returned the money in four increments between May and December 2009.

Ms. Durkee provided a list of credit card contributions totaling \$61,491 that were deposited into the shared credit card merchant account and identified as contributions to LACDCC. These credit card contributions apparently represent the funds Durkee & Associates withdrew from LACDCC's bank accounts (Levin account (\$45,000) and the federal account (\$15,000)) while reconciling the credit card merchant account. Based on available records of Durkee & Associates, the Audit staff could not determine whether Durkee & Associates used LACDCC funds during the period it held them.

Transfer from Non-federal Account-\$15,000

LACDCC failed to report a transfer received from its non-federal account in the amount of \$15,000. According to LACDCC's former counsel, the \$15,000 was erroneously transferred from LACDCC's non-federal account to its federal account on December 31, 2008, the same day it wrote the checks to the credit card processor. Without receipt of this transfer, LACDCC's federal bank account would have had a negative balance of \$7,044 on December 31, 2008.

LACDCC transferred \$15,000 on November 9, 2009, to return the funds to the non-federal account. LACDCC's former counsel stated the purpose for the original transfer was unclear, and that no one from LACDCC's management was informed of, or consulted about, the erroneous \$15,000 transfer or the return of those funds. Rather, LACDCC management became aware of

these transactions solely as a result of this audit. The Audit staff could not determine the reason for the transfer from the non-federal account based on available records. The Audit staff verified that the funds were returned to the LACDCC's non-federal account.

The non-federal account transferred less than its share of allocated federal/non-federal costs during the audit period. As such, the federal account could have accepted the non-federal transfer without resulting in overfunding.

B. Interim Audit Report & Audit Division Recommendation

The Audit staff presented the misstatements noted above to LACDCC representatives, which included the former treasurer, Ms. Durkee¹ of Durkee & Associates, during the exit conference. The representatives did not provide any information to explain the misstatements, but indicated that they would file amended reports to correct these errors.

The Interim Audit Report recommended that LACDCC:

- file amended reports to correct the misstatements; and,
- amend the cash balance of its most recent report with an explanation that the amendments are due to audit adjustments from a prior reporting period.

The Interim Audit Report further recommended that LACDCC should also provide information concerning the \$7,700 advance from its credit card processor to establish that it was made in the ordinary course of business. The information should include:

- the specific terms that Durkee & Associates apply to such extensions of credit;
- whether similar terms are offered to nonpolitical customers of similar size and risk of obligation;
- the rationale for why Durkee & Associates chose the time it did to negotiate LACDCC's checks representing repayment;
- information about Durkee & Associates' tax status; and
- any other information LACDCC believes might clarify the transactions.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, LACDCC amended its reports, correcting the misreporting. Also, LACDCC amended the cash balance on its May 2011 monthly report and noted that the adjustment was pursuant to the Audit staff's direction.

To establish that the advance of \$7,700 from its credit card processor was made in the ordinary course of business, LACDCC's response explained that Durkee & Associates considered short-term advances to its clients as benefits encompassed in its 3 percent credit card transaction fee. It provided a listing of 45 short-term advances that Durkee & Associates made to both its political and non-political clients dating back to 2001.

LACDCC sufficiently demonstrated that the \$7,700 from Durkee & Associates had a business purpose and was not for the purpose of influencing a federal election. As a result, the transaction is not considered a contribution.

¹ See "Unauthorized Activity of Former Treasurer" in the Background Section on page 1.

D. Committee Response to the Draft Final Audit Report

In response to the Draft Final Audit Report, LACDCC requested an audit hearing to discuss new issues related to this matter.

E. Audit Hearing

During the audit hearing, LACDCC representatives described the alleged embezzlement activity of their former Treasurer, Kinde Durkee. LACDCC representatives indicated that transactions involved with the alleged embezzlement should not be characterized as activity of the committee and did not require reporting. Subsequent to the audit hearing, LACDCC provided a description of the internal controls that were in place during the period that the alleged misappropriations took place and addressed additional practices implemented to ensure greater accountability.

Commission Conclusion

On June 7, 2012, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission find that LACDCC misstated its financial activity for 2007 and 2008 including any transactions associated with the alleged embezzlement activity.

The Commission approved the Audit staff's recommendation.

Finding 2. Misstatement of Levin Financial Activity

Summary

A comparison of LACDCC's reported Levin activity with bank records revealed a misstatement of cash-on-hand, receipts and disbursements in 2008. LACDCC understated receipts by \$16,328 and disbursements by \$101,669 and overstated ending cash-on-hand by \$85,341. In response to the Interim Audit Report recommendation, LACDCC amended its reports to correct the misstatement of Levin financial activity.

The Commission approved a finding that LACDCC misstated Levin financial activity for 2008.

Legal Standard

A. Reporting.

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

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

- the amount of cash-on-hand for Levin funds at the beginning and end of the reporting period;
- the total amount of Levin fund receipts for the reporting period and the calendar year;

- the total amount of Levin fund disbursements for the reporting period and the calendar year; and
- certain transactions that require itemization on Schedule L-A (Itemized Receipts of Levin Funds) or Schedule L-B (Itemized Disbursements of Levin Funds). 11 CFR §300.36 (b)(2).

Facts and Analysis

A. Facts

The Audit staff reconciled the reported Levin financial activity with the bank records for 2007 and 2008. Staff determined that LACDCC misstated cash-on-hand, receipts and disbursements for 2008. The following chart outlines the discrepancies for 2008 and provides explanations for the misstated Levin activity:

| 2008 Levin Activity | | | |
|--|-----------|------------------------|--------------------------|
| | Reported | Bank Records | Discrepancy |
| Opening Cash Balance @ January 1, 2008 | \$960 | \$960 | \$0 |
| Receipts | \$135,990 | \$152,318 | \$16,328 Understated |
| Disbursements | \$54,685 | \$156,354 | \$101,669 Understated |
| Ending Cash Balance @ December 31, 2008 | \$82,265 | \$(3,076) ² | \$85,341 Overstated |

The understatement of receipts resulted from the following:

| | |
|---|-----------------|
| • Unreported transfer from federal account | + \$6,328 |
| • Unreported contribution | + 5,000 |
| • Refund of contribution reported as a negative receipt instead of a disbursement | + 5,000 |
| Understatement of Receipts | \$16,328 |

The understatement of disbursements resulted from the following:

| | |
|---|------------|
| • Unreported disbursements to Durkee & Associates (see below) | + \$45,000 |
| • Unreported transfer to non-party committee (see below) | + 35,000 |
| • Other unreported disbursements | + 32,941 |

² The negative ending cash balance resulted from an outstanding check that was not negotiated until February 2009. During the period that it was outstanding, the Levin bank statements showed a positive cash balance.

| | |
|---|------------------|
| • Disbursement incorrectly reported as transfer to federal account ³ | - 16,272 |
| • Refund of contribution reported as a negative receipt instead of a disbursement | + 5,000 |
| Net Understatement of Disbursements | \$101,669 |

LACDCC misstated its Levin ending cash balances for 2008 due to the errors outlined above. On December 31, 2008, the committee overstated the Levin cash by \$85,341.

Amount Disbursed from Levin Fund-\$45,000

Between December 5 and December 22, 2008, four checks made out to Durkee & Associates totaling \$45,000 were drawn on the Levin account. LACDDC did not report the checks on its Schedule L. According to LACDCC's former counsel, Durkee & Associates closely examined its credit card merchant account⁴ at the end of 2008 and determined that a number of clients had received duplicate transfers relating to credit card contributions. Durkee & Associates concluded that reversing all credit card transfers made to its clients was the best way to avoid potential reporting issues. Durkee & Associates would then re-transfer the correct amount of credit card contributions based upon a reconciliation of its merchant account.

However, credit card contributions were not deposited into the Levin account during the audit period. As such, there seemed to be no reason for Durkee & Associates to withdraw funds from this account. LACDCC deposited credit card contributions into the federal account. However, between December 5 and December 22, 2008, LACDCC did not have \$45,000 in its federal bank account (See Finding 1. above). The \$45,000 withdrawn from the Levin account was not re-deposited until March 23, 2010.

LACDCC made an earlier attempt to redeposit the money in March 2009. LACDCC's former counsel provided a check in the amount of \$45,000 made out to the Levin Fund, along with a deposit ticket dated March 13, 2009. However, this check never cleared and was not posted to the account.

LACDCC's former counsel stated that LACDCC management was not informed of, or consulted about, the \$45,000 originally withdrawn from the Levin Fund account, the merchant account check issued to LACDCC in March 2009 or the merchant account check issued to LACDCC in March 2010. LACDCC management became aware of these transactions only as a result of the audit. During audit fieldwork, the former treasurer, Ms. Durkee⁵ contended that Durkee & Associates had since improved its internal controls to avoid this type of situation in the future.

³ LACDCC disbursed \$22,600 from its Levin account to a vendor, but it reported this transaction as a \$16,272 transfer to the federal account; this is the amount that could have been transferred from the Levin account had the disbursement been paid properly from the federal account. The \$22,600 is included in the \$32,941 of disbursements that were not reported. LACDCC also did not report the transfer of \$6,328 – the federal share of the \$22,600 expenditure – from its federal account to the Levin account.

⁴ This merchant account was a shared account that received credit card contributions for LACDCC and Durkee & Associates' other political committee clients, many of which had the same treasurer as LACDCC.

⁵ See "Unauthorized Activity of Former Treasurer" in the Background Section on page I.

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LACDCC forwarded a description of the internal control improvements to the Audit staff. These internal controls include general changes to accounting and recordkeeping procedures, but do not specifically detail procedures that would minimize the risk of commingling LACDCC proceeds with those of other committees and Durkee & Associates.

Amount Transferred from Levin Account-\$35,000

On November 25, 2008, LACDCC made a transfer of \$35,000 from the Levin account to a non-party committee, Pasadena Area United Democratic Headquarters (Pasadena United), which is another Durkee & Associates client. LACDCC did not report the transfer on its Schedule L. LACDCC's former counsel explained that the transfer was supposed to be made from Durkee & Associates' credit card merchant account to Pasadena United, but the funds were taken from the Levin account in error.

The former Treasurer refunded the \$35,000 to the Levin Fund account from the Durkee & Associates merchant account in three increments between December 17, 2009 and January 28, 2010. The former Treasurer explained that this was more efficient than transferring \$35,000 from Pasadena United to the Levin account and then transferring \$35,000 to Pasadena United from the Durkee & Associates merchant account. The former Treasurer believed this was an appropriate resolution because the merchant account was the intended source of the funds.

LACDCC's former counsel stated that no one from LACDCC management was informed of, or consulted about, the error, the method of reversing the erroneous transaction, the timing or reporting of the error, the return of funds or any other aspect of the corrective effort undertaken by the former Treasurer.

B. Interim Audit Report & Audit Division Recommendation

The Audit staff presented the misstatements of Levin activity to the representatives for LACDCC during the exit conference. The representatives did not provide any information to explain the misstatements, but indicated that they would file amended reports to correct the errors.

The Interim Audit Report recommended that LACDCC:

- file amended reports to correct the misstatements of Levin activity; and,
- reconcile the cash balance on its most recent report to identify any subsequent discrepancies that could affect the recommended adjustments to cash.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, LACDCC amended its reports correcting the misreporting.

D. Committee Response to the Draft Final Audit Report

In response to the Draft Final Audit Report, LACDCC requested an audit hearing to discuss new issues related to this matter.

E. Audit Hearing

During the audit hearing, LACDCC representatives described the alleged embezzlement activity of their former Treasurer, Ms. Durkee. LACDCC representatives indicated that transactions

involved with the alleged embezzlement should not be characterized as activity of the committee and did not require reporting. Subsequent to the audit hearing, LACDCC provided a description of the internal controls that were in place during the period that the alleged misappropriations took place and addressed additional practices implemented to ensure greater accountability.

Commission Conclusion

On June 7, 2012, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission find that LACDCC misstated its Levin financial activity for calendar year 2008.

Due to the extraordinary circumstances surrounding this audit, the Commission acknowledges that LACDCC may wish to file amended reports that would include additional clarifying language regarding the actions of the former treasurer relative to the previously undisclosed activity.

The Commission approved the Audit staff's recommendation.

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