



FEDERAL ELECTION COMMISSION
WASHINGTON, D C 20463

September 19, 2005

MEMORANDUM

To: Lawrence H. Norton
General Counsel

Through: James A. Pehrkon
Staff Director

Robert J. Costa
Deputy Staff Director

From: Joseph F. Stoltz
Assistant Staff Director
Audit Division

Martin L. Favin
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Subject: Colorado Democratic Party (A03-31)—Referral Matters

On September 7, 2005, the Commission approved the final audit report on the Colorado Democratic Party (CDP). The report, which was released to the public on September 15, 2005, includes the following matters that meet the criteria for referral:

- Finding 1, Misstatement of Financial Activity, meets the criteria for referral to your office because reported 2001 receipts, 2002 receipts and 2002 disbursements were misstated by more than 10% and the misstated amounts exceeded \$100,000. In response to the interim audit report, CDP filed amended reported which corrected these misstatements. Please note that the date of the earliest violation was April 3, 2001.
- Finding 3, Receipt of Prohibited Contribution,

This finding

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AUDIT REFERRAL # 05-08

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is based on a \$10,000 contribution (4/28/02) from the non-federal account of a PAC which was refunded on 7/14/03, prior to audit notification (4/22/04). This finding is referable because the \$10,000 exceeds 1% of contributions from individuals and political committees combined and was refunded untimely.

- Finding 5, Non-federal Funding of Federal Activity The CDP provided documentation in response to the interim audit report that resulted in the amount of potential Non-federal over funding of allocable expenses to decrease from \$8,436,101 to \$3,182,718. As noted in the finding, subpoenas were issued on August 26, 2005 to three vendors for disbursement records not provided to the Audit staff during the audit process. Upon review of these records, the amount of Non-federal over funding could decrease further. Please note that the date of the earliest violation was January 24, 2001.

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

Attachments:

Finding 1, Misstatement of Financial Activity

Finding 3, Receipt of Prohibited Contribution

Finding 5, Non-federal Funding of Federal Activity

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Finding 1. Misstatement of Financial Activity

Summary

CDP misstated receipts, disbursements, and cash balances for calendar years 2001 and 2002. In response to the interim audit report, CDP filed amended reports that corrected the misstatements.

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 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), Schedule B (Itemized Disbursements) or Schedule H4. 2 U.S.C. §434(b)(1), (2), and (4).

Facts and Analysis

The Audit staff reconciled CDP's reported activity to its bank records for calendar years 2001 and 2002. CDP was not able to provide us with work papers to support its reported figures. The following charts outline the discrepancies for the beginning cash balances, receipts, disbursements, and the ending cash balances. The succeeding paragraphs explain why the differences occurred, if known.

2001 Committee Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance @ January 1, 2001	\$306,115	\$26,127	\$279,988 Overstated
Receipts	\$556,198	\$675,546	\$119,348 Understated
Disbursements	\$614,253	\$635,017	\$20,764 Understated
Ending Cash Balance @ December 31, 2001	\$248,060	\$66,656	\$181,404 Overstated

Opening Cash Balance – 2001

The beginning cash on hand was overstated by \$279,988 due to prior period misstatements which could not be explained by CDP personnel.

Receipts – 2001

The understatement of receipts was the net result of the following:

- Unreported receipts from Gordon & Schwenkmeyer, Inc., a fundraising firm \$ 99,802
- Unreported receipts from Political Committees 10,200
- Unreported Offset of Operating Expense 5,784
- Underreporting of Transfers from Non-federal Accounts 4,653

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• Unexplained difference	- 1,091
Total understatement	<u>\$ 119,348</u>

Disbursements – 2001

The understatement of disbursements was the net result of the following:

• Unreported Legal expenses	\$ 20,000
• Unreported Fundraising expenses	1,725
• Other Unreported expenses	1,492
• Unexplained difference	- 2,453
Total understatement	<u>\$ 20,764</u>

Ending Cash Balance – 2001

The \$181,404 overstatement of the closing cash on hand was the net result of the misstatements described above.

2002 Committee Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance @ January 1, 2002	\$305,278	\$66,656	\$238,622 Overstated
Receipts	\$5,413,294	\$6,393,874	\$980,580 Understated
Disbursements	\$5,448,495	\$6,376,813	\$928,318 Understated
Ending Cash Balance @ December 31, 2002	\$270,077	\$83,717	\$186,360 Overstated

Opening Cash Balance – 2002

As a result of the prior year's misstatement and an unsupported change in the cash on hand balance for January 1, 2002, as compared to the ending cash on hand for December 31, 2001, the beginning cash balance was overstated by \$238,622.

Receipts – 2002

The understatement of receipts was the result of the following:

• Underreporting of Transfers from Non-federal Accounts	\$ 463,012
• Unreported receipts from Political Committees	262,289
• Unreported receipts from Gordon & Schwenkmeyer, Inc.	112,700
• Unreported Receipts from Individuals	85,650
• Unreported Offset of Operating Expense	20,927
• Unexplained difference	36,002
Total understatement	<u>\$ 980,580</u>

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Disbursements – 2002

The understatement of disbursements was the result of the following:

• Math Error (reported \$343 instead of \$343,000)	\$ 342,657
• Unreported Transfers to Non-Federal account	231,200
• Unreported Media expenses	96,696
• Unreported Payroll and Taxes	88,320
• Unreported payments to Voterweb for website hosting	70,000
• Other Unreported Operating Expenses	38,040
• Unreported Printing expenses	22,581
• Unreported Telemarketing payments	22,289
• Unreported Rental Car expenses	10,225
• Unexplained Difference	+ 6,310
Total understatement	<u>\$ 928,318</u>

Ending Cash Balance – 2002

The \$186,360 overstatement of the closing cash on hand was the net result of the misstatements described above.

The majority of the difference between reported and actual receipts is a result of several unreported and under reported transfers from CDP's non-federal accounts (\$4,653 in 2001; \$463,012 in 2002). CDP personnel were unable to explain why these transfers were not reported.

Another large part of the under reported receipts is attributable to unreported contributions from individuals in 2001 and 2002. CDP used a third party fundraising company, Gordon & Schwenkmeyer (GSI), to solicit contributions on its behalf. Contributions received in this manner account for approximately 57% of unreported receipts from individuals. CDP did not report receipts from GSI totaling \$99,802 in 2001 and \$112,700 in 2002. CDP officials were unable to explain why some GSI contributions were not reported.

A large portion of the disbursement understatement was caused by an apparent data entry error. A payment for media consulting in the amount of \$343,000 was reported as a \$343 payment. This error caused reported disbursements to be \$342,657 (\$343,000 - \$343) less than actual disbursements.

The Audit staff discussed this finding with CDP's representatives during the exit conference and provided them with schedules detailing the discrepancies. The representatives stated that corrective amendments would be filed.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that CDP amend its reports to correct the misstatements noted above, including its most recent report to show the adjusted cash balance with an explanation that it resulted from audit adjustments from a prior period. In response to the interim audit report, CDP filed corrective amended reports.

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Finding 3. Receipt of Prohibited Contribution

Summary

CDP received a \$10,000 contribution from the non-federal account of a non-connected political committee. In response to the interim audit report, CDP submitted documentation showing that the contribution had been refunded but not in a timely manner.

Legal Standard

Receipt of Prohibited Contributions – General Prohibition. Candidates and committees may not accept contributions (in the form of money, in-kind contributions or loans):

1. In the name of another; or
2. 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;
 - National Banks;
 - Federal Government Contractors (including partnerships, individuals, and sole proprietors who have contracts with the federal government); and
 - Foreign Nationals (including individuals who are not U.S. citizens and not lawfully admitted for permanent residence; foreign governments and foreign political parties; and groups organized under the laws of a foreign country or groups whose principal place of business is in a foreign country, as defined in 22 U.S.C. §611(b)). 2 U.S.C. §441b, 441c, 441e, and 441f.

Questionable Contributions. If a committee receives a contribution that appears to be prohibited (a questionable contribution), it must follow the procedures below:

1. Within 10 days after the treasurer receives the questionable contribution, the committee must either:
 - Return the contribution to the contributor without depositing it; or
 - Deposit the contribution (and follow the steps below). 11 CFR §103.3(b)(1).
2. If the committee deposits the questionable contribution, it may not spend the funds and must be prepared to refund them. It must therefore maintain sufficient funds to make the refunds or establish a separate account in a campaign depository for possibly illegal contributions. 11 CFR §103.3(b)(4).
3. The committee must keep a written record explaining why the contribution may be prohibited and must include this information when reporting the receipt of the contribution. 11 CFR §103.3(b)(5).
4. Within 30 days of the treasurer's receipt of the questionable contribution, the committee must make at least one written or oral request for evidence that the contribution is legal. Evidence of legality includes, for example, a written statement from the contributor explaining why the contribution is legal or an oral explanation that is recorded by the committee in a memorandum. 11 CFR §103.3(b)(1).

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5. Within these 30 days, the committee must either:
 - Confirm the legality of the contribution; or
 - Refund the contribution to the contributor and note the refund on the report covering the period in which the refund was made. 11 CFR §103.3(b)(1).

Facts and Analysis

The Audit staff reviewed all contributions from political committees and noted a \$10,000 check from The New Democrat Network (NDN), dated April 28, 2002. The check included "THE NEW DEMOCRAT NETWORK" as the accountholder and also included the FEC Identification number for the federally registered committee. However, the check was from a NDN non-federal account and was therefore impermissible. The Audit staff presented this matter to CDP representatives during the exit conference. Representatives for CDP stated that they would examine the contribution and take the necessary action to correct the matter.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that CDP:

- Provide evidence demonstrating that the contribution in question was not prohibited; or
- Refund \$10,000 to New Democrat Network and provide evidence of the refund (copy of the front and back of the negotiated refund check); and
- If funds were not available to make the necessary refund, disclose the refund due on Schedule D (Debts and Obligations Excluding Loans) until funds become available to make the refund.

In response to the interim audit report, CDP provided the Audit staff with a copy of the front and back of the negotiated refund check showing that the contribution from NDN had been refunded on July 14, 2003, over a year from the date of the contribution check.

Finding 5. Non-federal Funding of Federal Activity

Summary

A review of expenditures made from federal and non-federal accounts indicated that the non-federal account potentially paid more than its share of allocable expenses by \$8,436,101. Media expenditures made up a significant portion of this over funding. Documentation such as invoices, scripts or copies of advertisements were not made available or did not demonstrate that these media expenditures were for shared expenses. In addition, CDP made disbursements from its non-federal accounts that appeared to be either federal or allocable expenses. In response to the interim audit report, CDP provided additional documentation that reduced its potential liability to the non-federal account to \$3,182,718.

Legal Standard

Accounts for Federal and Non-federal Activity. A party committee that finances political activity in connection with both federal and non-federal elections must establish two accounts (federal and non-federal) and allocate shared expenses—those that

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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, considered a federal account. 11 CFR §102.5(a)(1)(i).

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

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).

Paying for Allocable Expenses. FEC 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, federal 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).

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 (Shared Expenses). 11 CFR §104.10(b)(4).

Allocation Ratio for Administrative & Generic Voter Drive Costs. State and local party committees must allocate their administrative expenses and generic voter drive costs according to the ballot composition method. Under this method, a committee determines the ratio of federal offices to the total number of federal and non-federal offices expected on the ballot in the next general election in the state or geographic area. 11 CFR §106.5(d)(1) and (2).

Required Records for Reports and Statements. The treasurer of a political committee will maintain records, including bank records, vouchers, worksheets, receipts and bills, in sufficient detail to verify the accuracy and completeness of the information contained in the reports. 11 CFR §104.14(b)(1).

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Facts and Analysis

CDP maintained separate federal and non-federal bank accounts. Generally, it paid shared expenses from the federal account and transferred funds from the non-federal account to cover the non-federal share of those expenses. CDP paid allocable expenses for administrative and generic get out the vote (GOTV) expenses from the federal account using a ratio of 22% federal and 78% non-federal and disclosed this ratio on its Schedules H1 (Method of Allocation for Shared Federal and Non-federal Administrative Expenses and Generic Voter Drive Costs).¹ The Audit staff reviewed disbursements from both the federal and non-federal accounts and found that the non-federal had potentially over funded its share of allocable expenses by \$8,436,101. Much of the amount in question was not sufficiently documented to make a determination on the proper allocation of the expenses.

Among the disbursements questioned were payments to large vendors from CDP's non-federal accounts totaling \$7,051,098 that appeared to be for potentially allocable expenses such as media, postage, consulting, research services and other miscellaneous expenses. Documentation for these expenses which would have assisted the auditors in determining the nature of these expenses was not available. Therefore, the Audit staff considered these disbursements from the non-federal accounts to be potentially for 100% federal activity.

The Audit staff also reviewed disbursements to large vendors paid from CDP's federal accounts, totaling \$3,824,901 including some that were not reported. These expenditures included payments for media, postage, web hosting, legal services, consulting and other miscellaneous expenses. Due to the very limited documentation available for these expenses, they were considered to be potentially 100% Federal. Since many were reported as allocable expenses, \$1,665,670 was added to the potential over funding by the non-federal accounts.

At the exit conference, the Audit staff informed CDP representatives that there were several expenditures from both federal and non-federal accounts which were lacking documentation. Schedules of the contributions in questions were provided. It should be noted that the representatives present during audit fieldwork were not employed by CDP during the period being audited. The representatives indicated that they would attempt to retrieve the documentation necessary for the Audit staff to determine the proper allocation for these expenses.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that CDP:

- Provide documentation detailing the nature and purpose of the potentially allocable disbursements to demonstrate that the disbursements paid from the non-federal and federal accounts were not allocable or 100% federal expenses. Absent such a

¹ The actual ratio disclosed on CDP's Schedule H1 shows a Federal Allocation of 22.22%. While reporting shared expenses, CDP routinely rounded down and used 22% as the federal share of administrative type expenses. The affect on the reported amounts is negligible.

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demonstration, CDP was requested to file Schedules B and/or Schedules H4 disclosing as memo entries the allocable expenditures paid from the non-federal accounts.

- Absent a demonstration there has been no over funding by the non-federal account, it was recommended that CDP's federal account reimburse the non-federal account(s) for the amount of any over funding and provide evidence of such reimbursement. If CDP lacked the funds to reimburse the non-federal account(s), then the amount owed was to be disclosed on Schedule D as a debt, until such time that funds were available to make the reimbursement.
- The Audit staff further recommended CDP provide a written description of system changes it has implemented to ensure all allocable disbursements are paid from a federal account.

In response to the interim audit report, CDP submitted documentation for disbursements from both the federal and non-federal accounts for a significant portion of the undocumented disbursements. In addition, CDP filed the requested amended reports. CDP response did not include any narrative addressing the findings or any procedural changes that have been implemented.

With respect to payments from the non-federal accounts, of the \$7,509,641 questioned CDP provided documentation showing the nature of expenditures totaling \$5,239,540. The documentation indicated that expenditures paid from CDP's non-federal account were for 100% non-federal expenses (\$796,779), the non-federal portion of shared expenses (\$3,455,579)², or the federal share of shared expenses \$987,182. Among the shared expenses were forty payments for media totaling \$3,829,600, thirty-three payments for postage totaling \$292,128, nine payments for consulting totaling \$105,297, seven payments for research totaling \$131,736, and four payments for legal services totaling \$84,000. For the remainder of the \$7,509,641 questioned, \$2,270,101, no additional documentation was provided and they are considered potentially 100% federal. These expenses included thirty-one payments for media totaling \$2,240,045, and three payments for consulting totaling \$30,056.

With respect to disbursements from the federal accounts, CDP submitted documentation detailing several expenditures which the Audit staff was previously unable to evaluate. The documentation demonstrated that disbursements totaling \$3,824,901 were for shared expenses rather than for 100% federal activity. There remains a group of these expenditures that are not adequately documented totaling \$265,694 which are still considered to be potentially 100% federal. These expenditures include seven payments for media totaling \$246,197, seven payments for printing totaling \$7,264, four payments for postage and mailing totaling \$8,112, and one payment for consulting totaling \$4,121. Considering these expenditures to be potentially 100% federal contributes \$206,102 to the non-federal over funding.

² These disbursements were not originally reported by CDP but were included in the amended reports discussed in Finding 4

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As a result of the documentation provided, the Audit staff re-calculated the amount of the over funding by CDP's non-federal account. A revised Non-federal Funding Analysis is presented below.

Revised Non-federal Funding Analysis		
Description		
Net Transfers made from Non-federal Accounts per Bank Records	\$ 3,216,366	
Less: Non-federal Portion of Allocable Expenditures as Reported	<u>(3,497,033)</u>	
Net (Under funding)/Over funding by the Non-federal Accounts:		\$ (280,667)
Adjustments:		
Federal portion of shared expenses paid from the non-federal account		\$987,182
Potential Federal Expenses paid from the non-federal account		\$ 2,270,101
Reported non-federal portion of disbursements from Federal accounts lacking documentation		\$ 206,102
Adjusted Amount of Potential Non-federal OVER Funding of Allocable Expenses		\$ 3,182,718

As part of its response to the Interim Audit Report, CDP filed amended Schedules H4 to correct the disclosure for several of the items from both the federal and non-federal accounts. The amended reports contained memo entries to disclose a number of transactions from CDP's non-federal accounts that were previously unreported. CDP did not include an amount owed to the non-federal account on its amended Schedules D or its most recently filed report.

It should be noted that the Commission issued subpoenas on August 26, 2005 to several firms requiring the production of the records not provided to date. Additional information will be considered in any subsequent actions taken by the Commission.

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