



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

2018 MAY 18 AM 11:32

May 18, 2018

MEMORANDUM

To: The Commission

Through: Alec Palmer *EWH for*
Staff Director

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

Thomas E. Hintermister
Assistant Staff Director *TH*
Audit Division

Rickida Morcomb *RM*
Audit Manager

By: Paula Nurthen *pn*
Lead Auditor

Subject: Audit Division Recommendation Memorandum on Kelly for Congress
(KFC) (A17-05)

Pursuant to Commission Directive No. 70 (FEC Directive on Processing Audit Reports), the Audit staff presented the Draft Final Audit Report (DFAR) to Kelly for Congress on April 25, 2018 (see attachment). In response to the DFAR, the committee provided additional information, as noted below. Kelly for Congress did not request an audit hearing.

This memorandum provides the Audit staff's recommendation for each finding outlined in the DFAR. The Office of General Counsel has reviewed this memorandum and concurs with the recommendations.

Finding 1. Receipt of Apparent Prohibited Contribution – Bank Loan

In response to the Interim Audit Report, KFC did not provide any new documentation. However, KFC stated that it believed the bank loan in the amount of \$50,000 was made in the ordinary course of business in that it was secured by collateral, guaranteed by an individual and repaid within thirty days. KFC

requested that the Commission consider the totality of the circumstances and determine that the loan was made on a basis that assured repayment. In response to the DFAR, KFC stated it did not intentionally break the rules and hopes the Commission takes this into consideration.

The Audit staff recommends that the Commission find that KFC's bank loan totaling \$50,000 was not made in the ordinary course of business because it was not made on a basis that assured repayment. Therefore, KFC received a prohibited contribution from the bank.

Finding 2. Receipt of Contributions that Exceed Limits

In response to the Interim Audit Report, KFC did not provide any documentation demonstrating a loan guarantor did not make an excessive contribution totaling \$49,900. KFC provided copies of redesignation and reattribution letters to resolve, albeit untimely, all of the excessive contributions from individuals totaling \$25,200. In response to the DFAR, KFC stated it did not intentionally break the rules and hopes the Commission takes this into consideration.

The Audit staff recommends that the Commission find that KFC received excessive contributions totaling \$75,100 (\$49,900 + \$25,200).

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

In case of an objection, 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 Paula Nurthen or Rickida Morcomb at 694-1200.

Attachment:

- Draft Final Audit Report of the Audit Division on Kelly for Congress

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on Kelly for Congress

(March 2, 2015 - December 31, 2016)

Why the Audit Was Done

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

Kelly for Congress is the principal campaign committee for John Trent Kelly, Republican candidate for the United States House of Representatives from the state of Mississippi, 1st Congressional District, and is headquartered in Tupelo, Mississippi. For more information, see the Campaign Organization chart, p.2.

Financial Activity (p. 2)

• Receipts	
○ Contributions from Individuals	\$ 567,830
○ Contributions from Political Committees	486,658
○ Candidate Loan	50,000
○ Other Receipts	420
Total Receipts	\$ 1,104,908
• Disbursements	
○ Operating Expenditures	\$ 839,781
○ Transfers to Other Authorized Committees	60,600
○ Candidate Loan Repayment	50,000
○ Contribution Refunds	550
Total Disbursements	\$ 950,931

Findings and Recommendations (p. 3)

- Receipt of Apparent Prohibited Contribution – Bank Loan (Finding 1)
- Receipt of Contributions that Exceed Limits (Finding 2)

¹ 52 U.S.C. §30111(b).

Draft Final Audit Report of the Audit Division on Kelly for Congress

(March 2, 2015 - December 31, 2016)



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Part I

Background

Authority for Audit

This report is based on an audit of Kelly for Congress (KFC), 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 52 U.S.C. §30111(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 52 U.S.C. §30104. 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. 52 U.S.C. §30111(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 individual contributors' occupation and name of employer;
5. the consistency between reported figures and bank records;
6. the completeness of records; and
7. other committee operations necessary to the review.

Part II

Overview of Campaign

Campaign Organization

Important Dates	
• Date of Registration	March 11, 2015
• Audit Coverage	March 2, 2015 ² - December 31, 2016
Headquarters	Tupelo, Mississippi
Bank Information	
• Bank Depositories	One
• Bank Accounts	One checking, one savings
Treasurer	
• Treasurer When Audit Was Conducted	Fred H. Page
• Treasurer During Period Covered by Audit	Fred H. Page
Management Information	
• Attended FEC Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

Overview of Financial Activity (Audited Amounts)

Cash-on-hand @ March 2, 2015	\$ 0
Receipts	
○ Contributions from Individuals	567,830
○ Contributions from Political Committees	486,658
○ Candidate Loan	50,000
○ Other Receipts	420
Total Receipts	\$ 1,104,908
Disbursements	
○ Operating Expenditures	839,781
○ Transfers to Other Authorized Committees	60,600
○ Candidate Loan Repayment	50,000
○ Contribution Refunds	550
Total Disbursements	\$ 950,931
Cash-on-hand @ December 31, 2016	\$ 153,977

² KFC opened its first bank account March 2, 2015.

Part III

Summaries

Findings and Recommendations

Finding 1. Receipt of Apparent Prohibited Contribution – Bank Loan

KFC received a bank loan totaling \$50,000 to pay for campaign advertisement expenses. John Trent Kelly (the Candidate) obtained a bank loan on behalf of KFC. Based upon loan documents provided by KFC, it does not appear that the loan was made in the ordinary course of business because it was not made on a basis that assured repayment and, therefore, appears to be a prohibited contribution from the bank. In response to the Interim Audit Report recommendation, KFC stated that it believes the bank loan was made in the ordinary course of business in that it was secured by collateral, guaranteed by an individual and repaid within 30 days. KFC requested that the Commission consider the totality of the circumstances and determine that the loan was made on a basis that assured repayment. (For more detail, see p. 4.)

Finding 2. Receipt of Contributions that Exceed Limits

During audit fieldwork, the Audit staff reviewed loans received and contributions from individuals to determine if any exceeded the contribution limit. This review indicated that KFC received apparent excessive contributions totaling \$75,100. This amount consisted of a contribution made in connection with a loan received (\$49,900) and contributions from individuals (\$25,200). In response to the exit conference following fieldwork, KFC untimely resolved excessive contributions from individuals, totaling \$25,200. In response to the Interim Audit Report recommendation, KFC noted that the bank loan was made in the ordinary course of business in that it was secured by collateral and guaranteed by an individual. Additionally, KFC stated that while they realize errors were made, that the bank loan was repaid in 30 days and all errors were ultimately resolved. KFC also provided copies of redesignation and reattribution letters, signed by the contributors, which resolved the excessive contributions from individuals totaling \$25,200. (For more detail, see p. 7.)

Part IV

Findings and Recommendations

Finding 1. Receipt of Apparent Prohibited Contribution – Bank Loan

Summary

KFC received a bank loan totaling \$50,000 to pay for campaign advertisement expenses. John Trent Kelly (the Candidate) obtained a bank loan on behalf of KFC. Based upon loan documents provided by KFC, it does not appear that the loan was made in the ordinary course of business because it was not made on a basis that assured repayment and, therefore, appears to be a prohibited contribution from the bank. In response to the Interim Audit Report recommendation, KFC stated that it believes the bank loan was made in the ordinary course of business in that it was secured by collateral, guaranteed by an individual and repaid within 30 days. KFC requested that the Commission consider the totality of the circumstances and determine that the loan was made on a basis that assured repayment.

Legal Standard

A. Loans Excluded from the Definition of Contribution. A loan of money to a political committee by a State bank, a federally chartered depository institution (including national bank) or a depository institution whose deposits and accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration is not a contribution by the lending institution if such loan is made in accordance with applicable banking laws and regulations and is made in the ordinary course of business.

A loan will be deemed to be made in the ordinary course of business if it bears the usual and customary interest rate of the lending institution for the category of loan involved; is made on a basis which assures repayment; is evidenced by a written instrument and is subject to a due date or amortization schedule. 11 CFR §100.82(a).

B. Assurance of Repayment. Commission regulations state a loan is considered made on a basis which assures repayment if:

- The lending institution making the loan has perfected a security interest in collateral owned by the candidate or political committee receiving the loan;
- Amounts guaranteed by secondary sources of repayment, such as guarantors and cosigners, do not exceed the contribution limits of 11 CFR part 110;
- The lending institution making the loan has obtained a written agreement whereby the candidate or political committee receiving the loan has pledged future receipts, such as public financing payments; and
- If these requirements are not met, the Commission will consider the totality of circumstances on a case by case basis in determining whether the loan was made on a basis which assured repayment. 11 CFR §100.82(e).

Facts and Analysis

A. Facts

KFC received a \$50,000 bank loan on May 14, 2015, to pay for campaign advertisement expenses. The Candidate obtained the loan on behalf of KFC from the First American National Bank (FANB) in Tupelo, Mississippi. This loan was guaranteed by an associate of the Candidate, who also provided collateral in the form of two automobiles. KFC submitted documentation from FANB showing that the automobiles had a combined National Automobile Dealers Association value of \$52,925, as of the date of the loan. The loan had an interest rate of 3.875% with a maturity date of May 14, 2016. KFC repaid FANB in full for the loan on June 5, 2015.

The loan was reported on Schedule A (Itemized Receipts) as being from the Candidate instead of from FANB. On Schedule C (Loans) and Schedule C-1 (Loans and Lines of Credit from Lending Institutions), the loan was reported as not secured, with no guarantor, with the incorrect interest rate and with no collateral provided.

Based upon the documents provided by KFC, it does not appear that the loan was made in the ordinary course of business because it was not made on a basis that assured repayment.

- Neither the Candidate nor KFC owned the collateral.³ A loan may be considered made on a basis that assures repayment if the lending institution making the loan perfects a security interest in collateral owned by the Candidate or political committee receiving the loan. KFC submitted a copy of the Consumer Security Agreement between the guarantor and FANB indicating that the guarantor provided the collateral (two automobiles), which he pledged as security for the loan.
- The guaranteed loan amount exceeded the contribution limit (see Finding 2, Receipt of Contributions that Exceed Limits). A loan may be considered made on a basis that assures repayment if the amount guaranteed by a secondary source of repayment, such as a guarantor, does not exceed the contribution limits. KFC provided the Audit staff with a copy of a document entitled Notice of Final Agreement that identified the guarantor of the \$50,000 loan. The contribution limit at the time that the loan was made was \$2,700 per election. Therefore, the guarantor made an excessive contribution to KFC totaling \$49,900 (\$50,000 less \$100 remaining of his contribution limit after making a \$2,600 contribution to KFC on March 2, 2015).
- Neither the Candidate nor KFC pledged future receipts as security for the loan, or provided the bank an assignment to access funds in KFC's account at another depository institution. A loan may be considered made on a basis that assures repayment if the lending institution has obtained a written agreement whereby the Candidate or political committee receiving the loan has pledged future receipts such as public financing payments, contributions or interest income or the lender obtains an assignment from the Candidate or political

³ The guarantor owned the collateral.

committee to access funds in a committee account at another depository institution. FANB did not receive from either the Candidate or KFC a pledge of future receipts or an assignment to access funds in KFC's account at another depository institution.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff discussed the loan issue with KFC representatives, including the reporting of the loan on Schedules A, C and C-1. The representatives indicated that the bank planned to draft a letter indicating that bank officials knew the loan would be repaid promptly and asked if this would be sufficient. The Audit staff stated that this letter would be taken into consideration but encouraged them to provide documentation regarding the assurance of repayment requirements. Prior to the exit conference, KFC provided a letter from the Vice President of FANB confirming the details of the loan. This was a part of the documentation examined above in Section A.

In response to the exit conference, KFC amended its reports to correctly disclose the loan on Schedules A, C and C-1.

The Interim Audit Report recommended that KFC demonstrate the loan was made in the ordinary course of business and was made on a basis that assured repayment.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, KFC did not provide any new documentation. However, KFC stated that it believes the bank loan was made in the ordinary course of business in that it was secured by collateral, guaranteed by an individual and repaid on June 5, 2015 (within 30 days). KFC requested that the Commission consider the totality of the circumstances and determine that the loan was made on a basis that assured repayment.

The Audit staff maintains that KFC has not demonstrated that the loan was made on a basis that assured repayment regardless of the totality of the circumstances. A loan shall be considered made on a basis that assures repayment if it is obtained using collateral or future receipts as a source of repayment, or a combination of these sources of repayment. KFC did not fulfill the requirements regarding the use of collateral or future receipts because: (1) neither KFC nor the Candidate owned the automobiles used as collateral, (2) the amount guaranteed by the guarantor exceeded the contribution limit by \$49,900 and (3) FANB did not receive a pledge of future receipts from KFC or the Candidate.

In addition, KFC's related contention that it repaid the loan quickly is not relevant to the question of whether the loan was made on a basis that assured repayment. The speed with which KFC met its repayment obligation has no bearing on how it obtained the loan.

As such, the Audit staff concludes that the totality of the circumstances do not indicate that the loan was made on a basis that assured repayment. Therefore, it appears the loan was not made in the ordinary course of business and was a prohibited contribution from the bank.

Finding 2. Receipt of Contributions that Exceed Limits

Summary

During audit fieldwork, the Audit staff reviewed loans received and contributions from individuals to determine if any exceeded the contribution limit. This review indicated that KFC received apparent excessive contributions totaling \$75,100. This amount consisted of a contribution made in connection with a loan received (\$49,900) and contributions from individuals (\$25,200). In response to the exit conference following fieldwork, KFC untimely resolved excessive contributions from individuals, totaling \$25,200. In response to the Interim Audit Report recommendation, KFC noted that the bank loan was made in the ordinary course of business in that it was secured by collateral and guaranteed by an individual. Additionally, KFC stated that while they realize errors were made, that the bank loan was repaid in 30 days and all errors were ultimately resolved. KFC also provided copies of redesignation and reattribution letters, signed by the contributors, which resolved the excessive contributions from individuals totaling \$25,200.

Legal Standard

- A. Authorized Committee Limits.** An authorized committee may not receive more than a total of \$2,700 per election from any one person. 52 U.S.C §30116; 11 CFR §§110.1(a) and (b) and 110.9.
- B. Contribution.** A gift, subscription, loan (except a loan made in accordance with 11 CFR §§ 100.82 and 100.83), advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for federal office is a contribution. The term *loan* includes a guarantee, endorsement, and any other form of security. A loan that exceeds the contribution limitations of 52 U.S.C. 30116 and 11 CFR part 110 shall be unlawful whether or not it is repaid. A loan is a contribution at the time it is made and is a contribution to the extent that it remains unpaid. The aggregate amount loaned to a candidate or committee by a contributor, when added to other contributions from that individual to that candidate or committee, shall not exceed the contribution limitations set forth at 11 CFR part 110. A loan is a contribution by each endorser or guarantor. Each endorser or guarantor shall be deemed to have contributed that portion of the total amount of the loan for which he or she agreed to be liable in a written agreement. 11 CFR § 100.52(a) and (b)(1)-(3).
- C. Handling Contributions That Appear Excessive.** If a committee receives a contribution that appears to be excessive, the committee must either:
- Return the questionable check to the donor; or
 - Deposit the check into its federal account and:
 - Keep enough money in the account to cover all potential refunds;
 - Keep a written record explaining why the contribution may be illegal;
 - Include this explanation on Schedule A if the contribution has to be itemized before its legality is established;

- Seek a reattribution or a redesignation of the excessive portion, following the instructions provided in the Commission regulations (see below for explanations of reattribution and redesignation); and
- If the committee does not receive a proper reattribution or redesignation within 60 days after receiving the excessive contribution, refund the excessive portion to the donor. 11 CFR §§103.3(b)(3), (4) and (5) and 110.1(k)(3)(ii)(B).

D. Joint Contributions. Any contribution made by more than one person, except for a contribution made by a partnership, must include the signature of each contributor on the check, money order, or other negotiable instrument or in a separate writing. A joint contribution is attributed equally to each donor unless a statement indicates that the funds should be divided differently. 11 CFR §110.1(k)(1) and (2).

E. Reattribution of Excessive Contributions. The Commission regulations permit committees to ask donors of excessive contributions (or contributions that exceed the committee's net debts outstanding) whether they had intended their contribution to be a joint contribution from more than one person and whether they would like to reattribute the excess amount to the other contributor. The committee must inform the contributor that:

- The reattribution must be signed by both contributors;
- The reattribution must be received by the committee within 60 days after the committee received the original contribution; and
- The contributor may instead request a refund of the excessive amount. 11 CFR §110.1(k)(3).

Within 60 days after receiving the excessive contribution, the committee must either receive the proper reattribution or refund the excessive portion to the donor. 11 CFR §§103.3(b)(3) and 110.1(k)(3)(ii)(B). Further, a political committee must retain written records concerning the reattribution in order for it to be effective. 11 CFR §110.1(l)(5).

Notwithstanding the above, any excessive contribution that was made on a written instrument that is imprinted with the names of more than one individual may be attributed among the individuals listed unless instructed otherwise by the contributor(s). The committee must inform each contributor:

- How the contribution was attributed; and
- The contributor may instead request a refund of the excessive amount. 11 CFR §110.1(k)(3)(B).

F. Redesignation of Excessive Contributions. When an authorized candidate committee receives an excessive contribution (or a contribution that exceeds the committee's net debts outstanding), the committee may ask the contributor to redesignate the excess portion of the contribution for use in another election. The committee must inform the contributor that:

- The redesignation must be signed by the contributor;

- The redesignation must be received by the committee within 60 days after the committee received the original contribution; and
- The contributor may instead request a refund of the excessive amount. 11 CFR §110.1(b)(5).

Within 60 days after receiving the excessive contribution, the committee must either receive the proper redesignation or refund the excessive portion to the donor. 11 CFR §§103.3(b)(3) and 110.1(b)(5)(ii)(A). Further, a political committee must retain written records concerning the redesignation in order for it to be effective. 11 CFR §110.1(l)(5).

When an individual makes an excessive contribution to a candidate's authorized committee, the campaign may presumptively redesignate the excessive portion to the general election if the contribution:

- Is made before that candidate's primary election;
- Is not designated in writing for a particular election;
- Would be excessive if treated as a primary election contribution; and
- As redesignated, does not cause the contributor to exceed any other contribution limit. 11 CFR §110.1(b)(5)(ii)(B)(1)-(4).

The committee is required to notify the contributor of the redesignation within 60 days of the treasurer's receipt of the contribution, and must offer the contributor the option to receive a refund instead. 11 CFR §110.1(b)(5)(ii)(B)(5)-(6).

Facts and Analysis

A. Excessive Contribution by Loan Guarantor

1. Facts

The Candidate obtained a bank loan totaling \$50,000 on behalf of KFC from the First American National Bank (FANB) in Tupelo, Mississippi on May 14, 2015. An associate of the Candidate guaranteed the loan and provided collateral for the loan in the form of two automobiles. KFC provided documentation from FANB showing that the automobiles had a combined National Automobile Dealers Association value of \$52,925, as of the date of the loan. KFC repaid FANB in full for the loan on June 5, 2015 (see Finding 1, Receipt of Apparent Prohibited Contribution - Bank Loan). Per 11 CFR 100.52(a), a loan that exceeds the contribution limitations of 52 U.S.C. 30116 and 11 CFR part 110 shall be unlawful whether or not it is repaid. The guarantor had already given \$2,600 towards the special run-off election held on June 2, 2015. Therefore, the excessive portion of the loan amount was \$49,900 (\$50,000 less \$100 remaining of the \$2,700 contribution limit for the special run-off election). A daily cash analysis performed by the Audit staff indicated that KFC would have had a negative cash balance from May 18, 2015 through May 25, 2015 without the benefit of the loan.

2. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff discussed this apparent excessive contribution with KFC representatives and provided a schedule of the identified excessive contribution. The representatives indicated that they would review the schedule.

The Interim Audit Report recommended that KFC provide documentation demonstrating that the guarantor did not make an excessive contribution totaling \$49,900 while the loan was still outstanding and/or provide any comments it deemed relevant to the matter.

3. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, KFC did not provide any documentation demonstrating the guarantor did not make an excessive contribution. However, KFC noted that the error was ultimately resolved in that the bank loan was repaid within thirty days. As stated in Finding 1, KFC believes the bank loan was made in the ordinary course of business, including being guaranteed by an individual.

The Audit staff maintains that the guarantor made an excessive contribution totaling \$49,900 while the loan was still outstanding.

B. Excessive Contributions from Individuals

1. Facts

During audit fieldwork, the Audit staff utilized a combination of sample testing and other reviews of contributions, not included in the sample population, to identify apparent excessive contributions from individuals. These reviews indicated that KFC received apparent excessive contributions totaling \$25,200.⁴ All of the excessive contributions were made by check and were the result of KFC not resolving the excessive portion of contributions by timely forwarding a presumptive letter to its contributors informing them how their contribution had been redesignated or reattributed, with the offer of a refund.

2. Interim Audit Report & Audit Division Recommendation

The Audit staff discussed this matter with KFC representatives at the exit conference and provided schedules of the apparent excessive contributions. The representatives indicated that they would review the schedule.

In response to the exit conference, KFC provided copies of redesignation and reattribution letters, signed by the contributors, and untimely resolved all of the excessive contributions, totaling \$25,200.

⁴ The sample error estimate (\$2,600) is based on a Monetary Unit Sample with a 95 percent confidence level. A review of other contributions not included in the sample population identified apparent excessive contributions totaling \$22,600. The sample projection estimate of \$2,600 could be as low as \$488 or as high as \$7,370.

The Interim Audit Report recommended that KFC demonstrate the excessive contributions were resolved in a timely manner and/or provide any additional comments it deemed relevant to the matter.

3. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, KFC stated that they made some errors and that the contributions in question, totaling \$25,200, were resolved as soon as they were brought to KFC's attention. KFC provided copies of redesignation and reattribution letters, signed by the contributors, which ultimately resolved, albeit untimely, all of the excessive contributions totaling \$25,200.

The Audit staff acknowledges that KFC acquired and provided signed redesignation and reattribution letters in response to the audit, which resolved all of the excessive contributions from individuals totaling \$25,200, albeit untimely.