



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

AK006370

May 31, 1995

MEMORANDUM

TO: RON M. HARRIS, PRESS OFFICER
PRESS OFFICE

FROM: ROBERT J. COSTA *AK*
ASSISTANT STAFF DIRECTOR
AUDIT DIVISION

SUBJECT: PUBLIC ISSUANCE OF THE FINAL AUDIT REPORT ON
THE MINNESOTA DEMOCRATIC-FARMER-LABOR STATE PARTY

Attached please find a copy of the final audit report and related documents on the Minnesota Democratic-Farmer-Labor State Party which was approved by the Commission on May 23, 1995.

Informational copies of the report have been received by all parties involved and the report may be released to the public.

Attachment as stated

cc: Office of General Counsel
Office of Public Disclosure
Reports Analysis Division
FEC Library

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REPORT OF THE AUDIT DIVISION
 ON THE
 MINNESOTA DEMOCRATIC-FARMER-LABOR STATE PARTY

I. Background

A. Overview

This report is based on an audit of the Minnesota Democratic-Farmer-Labor State Party ("the Committee",) undertaken by the Audit Division of the Federal Election Commission in accordance with the provisions of the Federal Election Campaign Act of 1971, as amended ("the Act".) The audit was conducted pursuant to 2 U.S.C. §438(b) which states, in part, that the Commission may conduct audits and field investigations of any political committee required to file a report under Section 434 of this title. Prior to conducting any audit under this subsection, the Commission shall 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.

The Minnesota Dollars for Democrats registered with the Comptroller General of the United States on July 15, 1975, as the State committee of the Minnesota Democratic-Farmer-Labor State Party. In 1980, the Committee filed an Amended Statement of Organization changing the name of the Committee to Minnesota Democratic-Farmer-Labor State Party. The Committee maintains its headquarters in Saint Paul, Minnesota.

Two separate audits were conducted which covered the period from January 1, 1987 through December 31, 1990. The Committee reported a beginning cash balance at January 1, 1987 of \$3,005; total receipts for the period of \$2,024,122; total disbursements for the period of \$2,028,294; and a cash balance on December 31, 1990 of \$1,647.*/

*/ There are mathematical discrepancies within the Committee's reported figures. All figures in this report have been rounded to the nearest dollar.

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This report is based on documents and work papers which support each of its factual statements. They form part of the record upon which the Commission based its decisions on the matters in the report, and were available to the Commissioners and appropriate staff for review.

B. Key Personnel

The Treasurer of the Committee during the period covered by the audits was Ms. Joyce Brady from January 1, 1987 through June 1988, and Mr. William J. Davis from June 1988 to the present.

C. Scope

The audit included such tests as verification of total reported receipts, disbursements, and individual transactions; review of required supporting documentation; analysis of Committee debts and obligations; and such other audit procedures as deemed necessary under the circumstances. Although the contribution records provided by the Committee substantially met the recordkeeping requirements at 2 U.S.C. §432(c) and 11 C.F.R. §102.9(a), the 1987 contributor records were batched to include deposit ticket copies in no apparent order or identifiable manner. The batch order precluded the testing of aggregate year-to-date totals and allowed only a partial verification of the Committee's 1987 itemization system.

II. Audit Findings and Recommendations

A. Allocation of Administrative Expenses

Section 106.1(e) of Title 11 of the Code of Federal Regulations states, in part, that Party committees which have established federal campaign committees pursuant to 11 C.F.R. 102.5 shall allocate administrative expenses on a reasonable basis between their Federal and non-Federal accounts in proportion to the amount of funds expended on Federal and non-Federal elections, or on another reasonable basis.

Section 102.5(a)(1)(i) and (ii) of Title 11 of the Code of Federal Regulations states, in part, that political committees, including a party committee, which finances political activity in connection with both federal and non-Federal elections shall establish a separate federal account in a depository. Only funds subject to the prohibition and limitations of the Act shall be deposited in such federal account. All disbursements, contributions, expenditures, and transfers by the committee in connection with any federal election shall be made from its federal account; or, establish a political committee which shall receive only contributions subject to the prohibitions and limitations of the Act, regardless of whether such contributions are for use in connection with Federal or non-Federal elections.

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The Committee has established a separate account and has treated it as a separate Federal political committee. However, the Committee has not allocated its administrative expenses between its Federal and non-Federal accounts as required by 11 C.F.R. 106.1(e). During the audit of the 1988 election cycle, a review of Committee records disclosed expenditures of \$1,082,371 for administrative activities. Relative to the above amount, \$388,268 was paid from the Committee's federal accounts. When asked about a ratio method established for allocating these expenses to its Federal and non-Federal accounts, Committee officials responded that there was none but felt that a 50/50 or 60/40 federal split was used.

The Audit staff reviewed the official DFL (Democratic-Farmer-Labor) ballot for the Minnesota general election which indicated that three Federal candidates and two non-Federal candidates would appear on the ballot in Minnesota's general election. It was determined that the make-up of the Minnesota sample ballot reflected a 3:2 federal ratio or 60% federal candidates of total candidates. Since the Committee had no allocation method for its Federal/non-Federal accounts, the Audit staff reviewed several Commission-approved methods to determine the method(s) that would result in the least financial outlay by the Committee. Based on the review of those methods, the auditors selected the Commission's expenditures method to determine the Federal allocation share. The results of applying the relevant percentage from this method indicated that the Committee underpaid its share of administrative expenses by \$104,834.

During the audit of the 1990 election cycle, the Committee's federal account paid more than its share of administrative expenses, which more than offsets the shortage of \$104,834 from the audit of the 1988 election cycle. Therefore, averaging the Committee's administrative expenses over a four year period the Committee has paid its fair share of administrative expenses.

The Interim Audit Report recommended no further action with respect to the 1987-1990 period. However it was noted that effective January 1, 1991 the Commission's Regulations at 11 CFR §§ 106.5 and 6 were revised to specify in greater detail the requirements for the allocation of administrative and other expenses. It was recommended that the Committee implement a system to insure compliance with these regulations and provide the records which demonstrate the system in use.

In its response, the Committee provided the Audit staff with a document which outlines the procedures currently used by the Committee to determine the allocation of expenses between its Federal and non-Federal accounts in accordance with the current regulations.

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Recommendation #1

The Audit staff recommends no further action with regard to this matter.

B. Failure to Itemize Debts and Obligations

Sections 434(b)(2)(H), (3)(E), and (8) of Title 2 of the United States Code state, in part, that each report shall disclose for the reporting period and calendar year, the total amount of all loans; the identification of each person who makes a loan to the reporting committee during the reporting period, together with the identification of any endorser or guarantor of such loan, and date and amount or value of such loan; each report should also disclose the amount and nature of outstanding debts and obligations owed by or to such political committee; and where such debts and obligations are settled for less than their reported amount or value, a statement as to the circumstances and conditions under which such debts or obligations were extinguished and the consideration therefore.

Section 104.3(d) of Title 11 of the Code of Federal Regulations states, in part, that each report filed under 11 CFR 104.1 shall, on Schedule C or D, as appropriate, disclose the amount and nature of outstanding debts and obligations owed by or to the reporting committee. Where such debts and obligations are settled for less than their reported amount or value, each report shall contain a statement as to the circumstances and conditions under which such debts or obligations were extinguished and the amount paid.

Further, Section 104.11(a) of Title 11, Code of Federal Regulations states, in part, the debts and obligations owed by or to a political committee which remain outstanding shall be continuously reported until extinguished. These debts and obligations shall be reported on separate schedules together with a statement explaining the circumstances and conditions under which each debt or obligation was incurred or extinguished.

During the review of Committee vendor files, it was noted that the Committee did not itemize the Federal share of nine debts and obligations totaling \$228,916 as of December 31, 1990 as required. Of the \$228,916 in debts and obligations, \$111,600 were for three outstanding loans obtained by the Committee. Six of the debts and obligations totaling \$117,316 were for various services which included legal fees, telephone, consulting, polling and phone banks.

At the exit conference, the Committee was provided with a schedule listing the debts and obligations that were not disclosed as required.

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The Interim Audit Report recommended that the Committee file amended Schedules C (Loans) and D (Debts other than Loans) for the year end 1990 report.

The Committee's response to the Interim Audit Report included proposed amended schedules. However, in determining the Federal share of these obligations, the Committee used their revised and undocumented allocation percentages (29% Federal and 71% non-Federal). Although the Audit staff does not accept the allocation percentages, the material provided shows both the allocation and the full amount of each obligation.

Recommendation #2

The Audit staff recommends no further action with respect to this matter.

C. Itemization of Transfers to Other Political Party Committees

Sections 434(b)(4)(C) and (5)(C) of Title 2 of the United States Code state, in part, that each report shall disclose for the reporting period and the calendar year, the total amount of all transfers to affiliated committees or organizations and, where the reporting committee is a political party committee, the name and address of each affiliated committee to which a transfer is made by the reporting committee and, where the reporting committee is a political party committee, each transfer of funds by the reporting committee to another political party committee, regardless of whether such committees are affiliated, together with the date and amount of such transfers.

During the audit of the 1988 election cycle, a review of Committee transfers to affiliated party committees resulted in a determination by the Audit staff that 74 transfers which totaled \$7,328 had been made to affiliated committees. The results of the review indicated that 65 transfers for \$3,006 had not been itemized. Committee officials offered no response relative to the itemization of the transfers. A schedule of those unitemized transfers was provided to Committee officials at the exit conference.

In its May 16, 1990 comprehensive amendment filed with the Commission, the Committee itemized all of the transfers.

Recommendation #3

The Audit staff recommends no further action with respect to this matter.

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D. Loans Not Made in the Ordinary Course of Business
and Loans Made in Excess of the Limitation

Section 441b(a) of Title 2 of the United States Code states, in part, that it is unlawful for any national bank to make a contribution in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office, or for any candidate, political committee, or other person knowingly to accept or receive any contribution prohibited by this section, or any officer or director of any national bank to consent to any contribution by the national bank.

Section 100.7(b)(11) of Title 11 of the Code of Federal Regulations states, in part, a loan of money by a State bank, a federally chartered depository institution (including a national bank) or a depository institution whose deposits and accounts are insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan 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. 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. Any reduction in the unpaid balance of the loan shall reduce proportionately the amount endorsed or guaranteed by each endorser or guarantor in such written agreement. In the event that such agreement does not stipulate the portion of the loan for which each endorser or guarantor is liable, the loan shall be considered a contribution by each endorser or guarantor in the same proportion to the unpaid balance that each endorser or guarantor bears to the total number of endorsers or guarantors.

Section 441a(a)(1)(C) of Title 2 of the United States Code states that no person shall make contributions to any other political committee in any calendar year, which in the aggregate, exceed \$5,000.

1. Unsecured Loans

The Committee received or had outstanding five loans during the period January 1, 1987 through December 31, 1990. Each loan and one long term lease had formal agreements, with a specific timetable for repayment and the interest rate charged.

970 / 02501 / 1

The long-term lease was entered into with Preferred Financial Corporation on February 28, 1986 for an offset printer with payments being made to Norwest Bank in Stillwater, Minnesota.

The Committee also obtained a \$25,000 loan from Firststar/Metropolitan Bank in Saint Paul, Minnesota on January 22, 1987 to purchase a computer. The loan agreement was signed by the State Party Chairman and the note was secured by the computer equipment.

On August 11, 1989, the Democratic-Farmer-Labor Party of Minnesota made a 30 day, 11.5% business loan for \$7,000 with Firststar Metro Bank in Saint Paul, Minnesota. There was a formal agreement; however, the loan was unsecured and there were no apparent guarantors. The loan agreement was signed by the State Party Chairman.

The Committee used a 50/50 method for allocating expenses at the time the loans were made. Therefore, the Committee's federal portion for the unsecured loan would have been \$3,500 for the \$7,000 loan (See Finding II.A.).

Although the unsecured loan for \$7,000 has been repaid, there appears to be some question whether the loan was made in the ordinary course of business considering the Committee's cash position and the other outstanding loans at the time these additional loans were made.

The Interim Audit Report recommended that the Committee provide evidence that the \$7,000 loan was made in the ordinary course of business and identify any endorsers or guarantors of the loan. In addition, it was recommended that documentation be provided to demonstrate that the loan was made on a basis that assured repayment.

In its response, the Committee contends that the \$7,000 loan was a 30 day loan for the purpose of financing the HHH Day dinner. The Committee states that loans for the purpose of financing the HHH dinner were common for the DFL for many years. "Since the dinner is primarily a social event, its cost is not generally in the regular party budget. Therefore, monies [sic] are borrowed shortly before the event to finance it and the proceeds of the dinner are used to repay the loan. Essentially the dinner is a 'break-even' event used almost exclusively for party building purposes." The Committee further submits that rather than the 50%/50% Federal/ non-Federal allocation contained in the Interim Audit Report, "the more appropriate method of allocation should have been the ballot allocation method (29% Federal - 71% non-Federal), which would result in a \$2,000 federal allocation." No support for this contention is provided. Given the Committee's explanation of this loan, the relatively small

970 / 02501 / 2

amount involved, that the loan was outstanding for approximately 7 weeks, and that the majority of the repayment was made from the Federal accounts, the response is accepted as adequate.

2. Loans in Excess of the Limitation

The Democratic-Farmer-Labor Party of Minnesota obtained a \$125,000 loan from Firststar Metro Bank on January 4, 1990 to pay accumulated 1988 and 1989 payroll taxes and associated interest and penalties. The loan carried a due date of July 4, 1990. The loan was unsecured, but it was guaranteed by four individuals. One individual did not sign as the guarantor until April 12, 1990. In addition, the agreement was signed by the State Party Chairman for the Party. The loan was deposited in the Committee's non-Federal account. The Committee's Federal share of the loan was \$62,500 based on a 50/50 allocation method used by the Committee at the time the loan was made. Each guarantor's liability for the federal share of the loan was \$15,625 ($\$62,500 \div 4$). Individuals may make contributions of \$5,000 per year to State party committees. Therefore, the Interim Audit Report concludes that the Committee had received at the time the loan was made an excessive contribution from each guarantor in the amount of \$10,625 ($\$15,625 - \$5,000$) excluding any other contributions made to the Committee from these individuals.

On September 10, 1990 the balance of the original \$125,000 loan was renewed in the amount of \$96,500. The renewal was subject to monthly payments through March of 1995. The loan renewal was necessitated by the withdrawal of one of the guarantors on the original \$125,000 loan. This guarantor was subsequently replaced by another individual. The Committee's loan balance as of December 31, 1990 was \$96,500. The three original guarantors did not sign the agreements until March 28, 1991. The new guarantor did not sign until May 9, 1991. The Federal portion of the loan at that time was \$48,250 based on the 50/50 allocation method. Therefore it appeared that each contributor had made an excessive contribution to the Committee of \$7,062.50 ($\$48,250 \div 4 - \$5,000$) excluding any other contributions that have been made to the Committee from these individuals. Three of the guarantors made contributions to the Committee during 1990. These contributions totaled \$285 ($\$250 + \$10 + \25).

The Interim Audit Report recommended that the Committee provide evidence that the loans did not result in a excessive contribution from the guarantors, and demonstrate that the loan balance has been paid down to where the guarantees are not excessive or provide evidence that additional guarantors have been added to reduce the amount of each contribution to \$5,000 or less.

The Committee responded that "the 50/50 allocation set forth in the Audit report as having been used by the party was unrealistic and inaccurate at the time. A more

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appropriate allocation method would have been based upon the ballot place allocation method (29% Federal and 71% non-Federal). If that method is used, the Federal share was \$36,250 and each guarantor's share was \$9,062.50. To date, the DFL's information is that the loans were taken out on an emergency basis to satisfy pressing Internal Revenue Service claims." The Committee provides no documentation for their revised allocation percentages. The Committee notes that the State Party Chair also signed the loan agreement and should be considered an additional obligator for a total of five rather than four.

The Committee's response also provides a schedule of payments on the loan. As of December 31, 1992, the schedule shows an outstanding balance of \$53,220. The Federal share would be half of that amount or \$26,610. With four guarantors each had a remaining contribution of \$6,653. However, the Committee had been making regular payments that would, if continued, reduce each guarantors share to less than \$5,000 within 7 months. Twelve payments were reported during 1993. Payments on the loan through December 31, 1992, total \$97,176 with \$58,458 being made from the Federal account.

Recommendation #4

Since the guarantors are no longer in excess of the contribution limit, and the proceeds of the loan were used to pay administrative expenses for which the Federal share was paid with permissible funds (See Finding II.A.), the Audit staff recommends no further action with regards to this matter.

E. Matters Referred to the Office of General Counsel

Certain matters noted during the audit have been referred to the Commission's Office of General Counsel.

970 / 02501 / 4

970 / 02501 / 5

