



Report of the Audit Division on Friends for Menor

May 10, 2006 – December 31, 2006

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. 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)

Friends for Menor is the principal campaign committee for Ron Menor, Democratic candidate for the U.S. House of Representatives from the state of Hawaii, 2nd District and is headquartered in Honolulu, Hawaii. For more information, see chart on the Campaign Organization, p. 2.

Financial Activity (p. 2)

- **Receipts**
 - From Individuals \$ 134,292
 - From the Candidate 110,000
 - From Political Committees 27,225
 - Other Receipts 48
 - **Total Receipts** \$ 271,565
- **Disbursements**
 - Operating Expenditures & Other Disbursements \$ 245,498
 - Repayment of Candidate Loans 25,500
 - **Total Disbursements** \$ 270,998

Findings and Recommendations (p. 3)

- Apparent Impermissible Loans (Finding 1)
- Receipt of a Contribution that Exceeds Limits (Finding 2)

¹ 2 U.S.C. §438(b).

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DRAFT

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Part I

Background

Authority for Audit

This report is based on an audit of Friends for Menor (FFM), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 2 U.S.C. §438(b).

Scope of Audit

Following Commission approved procedures, the Audit staff evaluated various risk factors and, as a result, the scope of this audit was limited to the following:

1. The consistency between reported figures and bank records.
2. The disclosure of individual contributors' occupation and name of employer.
3. The receipt of loans and contributions from the Candidate.

Part II

Overview of Campaign

Campaign Organization

Important Dates	Friends for Menor
• Date of Registration	May 25, 2006
• Audit Coverage	May 10, 2006 to December 31, 2006
Headquarters	Honolulu, HI
Bank Information	
• Bank Depositories	1
• Bank Accounts	Checking Account
Treasurer	
• Treasurer When Audit Was Conducted	Amadeo P. Manuel
• Treasurer During Period Covered by Audit	Amadeo P. Manuel
Management Information	
• Attended FEC Campaign Finance Seminar	No
• Used Commonly Available Campaign Management Software Package	Yes
• Who Handled Accounting and Recordkeeping Tasks	Treasurer

Overview of Financial Activity (Audited Amounts)

Cash on hand @ May 10, 2006	\$ 0
Receipts	
○ From Individuals	\$ 134,292
○ From the Candidate	110,000
○ From Political Committees	27,225
○ Other Receipts	48
Total Receipts	\$ 271,565
Disbursements	
○ Operating Expenditures & Other Disbursements	\$ 245,498
○ Repayment of Candidate Loans	25,500
Total Disbursements	\$ 270,998
Cash on hand @ December 31, 2006	\$ 567

Part III

Summaries

Findings and Recommendations

Finding 1. Apparent Impermissible Loans

FFM disclosed loans and/or contributions from the Candidate totaling \$75,000 that initially could not be verified as coming from the Candidate's personal funds. These funds were all transferred to FFM from the Candidate's business account and potentially resulted in impermissible contributions. The Audit staff recommended that FFM demonstrate that loans were from the Candidate's personal funds. Absent such a demonstration, the Audit staff recommended that FFM refund any impermissible funds and properly disclose the source of these loans. In response to the interim audit report, FFM provided evidence that all but \$20,500 of the \$75,000 were the Candidate's personal funds. The source of the \$20,500 not considered as the personal funds of the Candidate was determined to be three individuals and a corporation. FFM's receipt of these funds resulted in excessive contributions totaling \$8,780 and a prohibited contribution of \$5,500.

(For more detail, see page 4.)

Finding 2. Receipt of a Contribution that Exceeds Limits

The Candidate made a \$9,000 loan to FFM with funds from a trust. A \$10,000 check was drawn on a trust and made payable to the Candidate's spouse. These funds were deposited into a personal account of the Candidate and his spouse. On the same day, a \$9,000 check signed by the Candidate's spouse was made payable to FFM. The memo line of this check identified the purpose as a loan to FFM. The interim audit report stated that depending on who established the trust and the terms thereof, a possible excessive contribution was made by the Candidate's spouse, the beneficiaries of the trust, or the person(s) who established the trust. The Audit staff recommended that FFM provide evidence demonstrating that the Candidate was legally entitled to the funds received from the trust including information regarding the establishment and terms of the trust. Absent such evidence, FFM likely received an excessive contribution and should refund the excessive portion. In response to the interim audit report, FFM stated the source of the funds was the Candidate's spouse. These funds are contributions to the campaign and subject to the contribution limits. As a result, FFM received an excessive contribution of \$8,526 from the Candidate's spouse.

(For more detail, see page 7.)

Part IV

Finding and Recommendation

Finding 1. Apparent Impermissible Loans

Summary

FFM disclosed loans and/or contributions from the Candidate totaling \$75,000 that initially could not be verified as coming from the Candidate's personal funds. These funds were all transferred to FFM from the Candidate's business account and potentially resulted in impermissible contributions. The Audit staff recommended that FFM demonstrate that loans were from the Candidate's personal funds. Absent such a demonstration, the Audit staff recommended that FFM refund any impermissible funds and properly disclose the source of these loans. In response to the interim audit report, FFM provided evidence that all but \$20,500 of the \$75,000 were the Candidate's personal funds. The source of the \$20,500 not considered as the personal funds of the Candidate was determined to be three individuals and a corporation. FFM's receipt of these funds resulted in excessive contributions totaling \$8,780 and a prohibited contribution of \$5,500.

Legal Standard

A. Contents of Reports. Each report must disclose for the reporting period and election cycle, the total amount of loans made by or guaranteed by the candidate and the identification of each person who makes, endorses or guarantees a loan to the committee. 2 U.S.C. §434(b)(2)(G) and (3)(E).

B. Contribution Defined: A gift, subscription, loan (except when made in accordance with 11 CFR §§100.72 and 100.73), 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 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, to the extent it is repaid, is no longer a contribution. 11 CFR §100.52(a), (b)(1) and (b)(2).

C. Candidate as Agent of Authorized Committee. Any candidate who receives a contribution, obtains any loan, or makes any disbursement, in connection with his or her campaign shall be considered as having received such contribution, obtained such loan or made such disbursement as an agent of his or her authorized committee(s). When an individual becomes a candidate, any funds received, loans obtained, or disbursements made prior to becoming a candidate in connection with his or her campaign shall be deemed to have been received, obtained or made as an agent of his or her authorized committee(s). 11 CFR §101.2(a).

D. Personal Use Defined. Personal use is defined as any use of funds in a campaign account of a present or former candidate to fulfill a commitment, obligation or expense of any person that would exist irrespective of the candidate's campaign or duties as a Federal officeholder. 11 CFR §113.1(g). This includes instances where the Candidate receives funds from others and uses the funds to make loans to the campaign, or directly pay for certain campaign or living expenses. 11 CFR §101.2(a) and 11 CFR §113.1(g).

E. Expenditures by Candidates. Candidates for Federal office may make unlimited expenditures from personal funds. 11 CFR §110.10.

F. Definition of Personal Funds. *Personal funds* of the candidate mean the sum of all of the following:

(a) *Assets.* Amounts derived from any asset that, under applicable State law, at the time the individual became a candidate, the candidate had legal right of access to or control over, and with respect to which the candidate had legal and rightful title or an equitable interest;

(b) *Income.* Income received during the current election cycle, as defined in 11 CFR §400.2, of the candidate, including:

- (1) A salary and other earned income that the candidate earns from bona fide employment;
- (2) Income from the candidate's stocks or other investments;
- (3) Bequests to the candidate;
- (4) Income from trusts established before the beginning of the election cycle as defined in 11 CFR §400.2;
- (5) Income from trusts established by bequest after the beginning of the election cycle of which the candidate is the beneficiary;
- (6) Gifts of a personal nature that had been customarily received by the candidate prior to the beginning of the election cycle, as defined in 11 CFR §400.2; and
- (7) Proceeds from lotteries and similar legal games of chance. 11 CFR §100.33

G. 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.

Facts and Analysis

FFM disclosed loans and/or contributions from the Candidate totaling \$75,000 that could not be verified as coming from the Candidate's personal funds. These funds were all transferred to FFM from the Candidate's business account. Based on an examination of bank statements and other records relating to the Candidate's business account, the Audit staff determined the source of the funds was apparently \$54,000 from two corporations and \$21,000 from an unknown source.

During audit fieldwork, the Audit staff noted several deposits to the Candidate's business account that were made on the same day or just prior to the Candidate's transfers of the same or similar amounts to FFM. The average daily balance in the business account was only \$2,700 during the period when transfers to FFM were made.

The funds from the two corporations were from a mortgage lending company (\$29,000) and a housing construction company (\$25,000). Funds from these two corporations were part of three transfers to FFM from the Candidate's business account. During fieldwork, FFM did not provide documentation to establish that the funds were the personal funds of the Candidate.

FFM also did not provide documentation for the Audit staff to determine the source for the \$21,000 deposited in the Candidate's business account and transferred to FFM. This amount included a \$6,000 deposit made on August 25, 2006 for which the deposit slip has a handwritten notation stating "Cash" and no indication as to its source. On the same day, a \$5,000 transfer from this account was made to FFM. For the remaining \$16,000 in deposits, the Audit staff could not identify the source of the receipts based on the examination of the accompanying deposit slips.

The source for these Candidate loans was discussed at the exit conference. In support of his claim that the amounts were from personal funds, the Candidate provided a letter to the Audit staff which emphasized that contributions to his campaign were never deposited into the law firm account.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that FFM provide evidence demonstrating that \$75,000 transferred to FFM came from the Candidate's personal funds. The evidence was to include records to establish that the funds deposited into the Candidate's business account meet the definition of *personal funds* in accordance with 11 CFR §110.10(a). The records could include the following:

- Documentation such as copies of contracts, agreements, specific terms of service, and/or billing statements illustrating that the \$75,000 was received for services provided by the Candidate's business.
- For the \$21,000 from an unknown source, FFM was to provide documentation such as copies of checks, bank credit memoranda, or any other records necessary to identify the source of amounts deposited and establish the funds as personal funds of the Candidate.
- Records to demonstrate the monthly financial position of the Candidate's business (i.e. net earnings statements, balance sheets)
- Tax returns or other documentation for calendar year 2006 to establish that the Candidate's business is a sole proprietorship for which the Candidate has legal entitlement to any assets or income.

Absent such evidence, the Audit staff recommended that FFM refund the apparent impermissible amounts (\$75,000) to the original source(s) and amend its reports to properly disclose the source of the loans. FFM was to provide evidence of all repayments of these funds (legible copies of the front and back of the negotiated repayment checks).

In response to the interim audit report, FFM provided a legal service agreement and a counsel retention agreement to establish that all but \$5,500 of the \$75,000 from the two corporations was income for services provided by the Candidate's law firm. As a result, the Audit staff considered these funds (\$69,500) to be the personal funds of the Candidate since it was considered earned income. The remaining \$5,500 not considered to be personal funds of the Candidate was from a separate loan extended by the mortgage lending company to the Candidate. For this arrangement, FFM provided a promissory note between the Candidate's law firm and the CEO of the mortgage lending company and asserts this loan agreement was "negotiated as part of discussions for the provision of legal services by the candidate to the company."² FFM also provided a declaration from the Candidate stating the purpose of the \$5,500 loan was to "cover general overhead expenses related to [the Candidate's] law practice" and was made "in recognition of [the Candidate's] agreement to represent and perform work on behalf of [the mortgage lending company] in Hawaii and to foster a positive working relationship between [the Candidate] and his client going forward." The promissory note and the declaration by the Candidate do not establish that the loan was made in exchange for the provision of legal services. Since the proceeds of the loan for \$5,500 have not been established as the Candidate's personal funds, FFM received a prohibited contribution of \$5,500 from the mortgage lending company.

FFM provided the following documents to clarify the source of the \$21,000 and as evidence that the funds were the personal funds of the Candidate. For the \$6,000 cash deposit into the Candidate's business account, FFM documented that the funds represented payment for legal services provided to the same housing construction company as noted above. The Audit staff considered these funds to be the personal funds of the Candidate.

² Although the promissory note was made between the Candidate's law firm and the CEO of the mortgage lending company, the loan proceeds were actually paid by the incorporated mortgage lending company.

For the remaining \$15,000, FFM provided records indicating the \$10,000 was a personal loan from FFM's Treasurer and spouse. The source of the remaining \$5,000 was a personal loan from another individual. The documentation provided for these personal loans did not indicate that loans were for income earned by bona fide employment, investments, bequests, or customarily received gifts. As such, the proceeds of these loans were not the Candidate's personal and resulted in FFM's receipt of excessive contributions from three individuals totaling \$8,780.³ Moreover, FFM's Treasurer and his spouse subsequently waived repayment by the Candidate for \$8,000 of the \$10,000 loan amount in exchange for legal services provided by the Candidate's law firm. A copy of a receipt indicating the repayment of \$3,900 by the Candidate was also provided for the \$5,000 personal loan from the other individual. The repayments on both of these loans by the Candidate totaling \$11,900 (\$8,000 + \$3,900) are considered contributions to FFM. FFM has not filed amended reports to disclose the source of these loans or to report the repayments made by the Candidate as contributions.

Finding 2. Receipt of a Contribution that Exceeds Limits

Summary

The Candidate made a \$9,000 loan to FFM with funds from a trust. A \$10,000 check was drawn on a trust and made payable to the Candidate's spouse. These funds were deposited into a personal account of the Candidate and his spouse. On the same day, a \$9,000 check signed by the Candidate's spouse was made payable to FFM. The memo line of this check identified the purpose as a loan to FFM. The interim audit report stated that depending on who established the trust and the terms thereof, a possible excessive contribution was made by the Candidate's spouse, the beneficiaries of the trust, or the person(s) who established the trust. The Audit staff recommended that FFM provide evidence demonstrating that the Candidate was legally entitled to the funds received from the trust including information regarding the establishment and terms of the trust. Absent such evidence, FFM likely received an excessive contribution and should refund the excessive portion. In response to the interim audit report, FFM stated the source of the funds was the Candidate's spouse. These funds are contributions to the campaign and subject to the contribution limits. As a result, FFM received an excessive contribution of \$8,526 from the Candidate's spouse.

Legal Standard

A. Authorized Committee Limits: An authorized committee may not receive more than a total of \$2,000 per election from any one person.⁴ 2 U.S.C. §441a(a)(1)(A) and 11 CFR §110.1(a) and (b). The Bipartisan Campaign Reform Act of 2002 (BCRA) includes provisions that indexes the individual contribution limit for

³ One of the three individuals also made other contributions totaling \$80 to FFM. The excessive amount from all three individuals is calculated as \$8,780 (\$15,000 + \$80 - \$6,300 combined contribution limit of three individuals).

⁴ Person refers to an individual, partnership, or any group of persons, not including the federal government. 11 CFR §100.10.

inflation. The limit for individuals' contributions to candidates for the 2006 election cycle was \$2,100.

- B. Handling Contributions That Appear Excessive.** If a committee receives a contribution that appears to be excessive, the committee must either:
- return the questionable contribution to the donor; or
 - deposit the contribution into a campaign depository and keep enough money on account to cover all potential refunds until the legality of the contribution is established. 11 CFR §103.3(b)(3) and (4).

C. Refund or Disgorge Questionable Contributions. If the identity of the original contributor is known, the committee must either refund the funds to the source of the original contribution or pay the funds to the U.S. Treasury. AO 1996-5.

D. Definition of Personal Funds. *Personal funds* of the candidate mean the sum of all of the following:

- (a) *Assets.* Amounts derived from any asset that, under applicable State law, at the time the individual became a candidate, the candidate had legal right of access to or control over, and with respect to which the candidate had legal and rightful title or an equitable interest;
- (b) *Income.* Income received during the current election cycle, as defined in 11 CFR §400.2, of the candidate, including:
- (1) A salary and other earned income that the candidate earns from bona fide employment;
 - (2) Income from the candidate's stocks or other investments;
 - (3) Bequests to the candidate;
 - (4) Income from trusts established before the beginning of the election cycle as defined in 11 CFR §400.2;
 - (5) Income from trusts established by bequest after the beginning of the election cycle of which the candidate is the beneficiary;
 - (6) Gifts of a personal nature that had been customarily received by the candidate prior to the beginning of the election cycle, as defined in 11 CFR §400.2; and
 - (7) Proceeds from lotteries and similar legal games of chance. 11 CFR §100.33

Facts and Analysis

FFM reported a \$9,000 loan from the Candidate that was made with funds from a trust. A check for \$10,000 was drawn on a trust and made payable to the Candidate's spouse. This check was deposited into a joint personal account of the Candidate and his spouse. On the same day as this deposit, a \$9,000 check from this joint personal account was deposited into the FFM campaign account. The check to FFM was signed by the Candidate's spouse and included a notation "loan to campaign" on the memo line. It is noted that the balance in this joint personal account on the day prior to the deposit of funds from the trust was not sufficient to allow for the transfer of the \$9,000 to FFM. In

addition, the average daily balance of the joint personal account for the period audited was only \$2,600.

During audit fieldwork, FFM did not provide documentation regarding the terms of the trust or the identity of the beneficiary of the trust or the person(s) that established the trust. It was also not known what relationship the Candidate's spouse had with the trust or the trustees. Therefore, absent evidence that the Candidate was entitled to the funds, the Audit staff considered the source of the funds for the loan to FFM to be either the Candidate's spouse or the trust. Given the above, it appeared that either the Candidate's spouse or the person(s) who established the trust made an excessive or potentially prohibited contribution to FFM.⁵

At the exit conference, the Audit staff discussed this issue with FFM's treasurer. No additional documentation that demonstrates the Candidate was entitled to the funds from the trust was provided.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that FFM:

- Provide evidence demonstrating that the contribution was not excessive or prohibited. Such evidence was to include documentation demonstrating the Candidate's entitlement to the funds from the trust and the purpose of the \$10,000 check issued to the Candidate's spouse from the trust account. FFM also was to provide information regarding the person(s) who established the trust and the beneficiary of the trust.
- Absent such evidence, FFM was to refund the excessive portion of the contribution or, if determined to be a prohibited contribution, FFM was to refund the entire contribution. Alternatively, FFM was to make a disgorgement to the U.S. Treasury. FFM was to provide evidence of contribution refunds with copies of the front and back of negotiated refund checks.
- If funds are not available to make the necessary refunds, FFM was to disclose the contributions requiring refunds on Schedule D (Debt and Obligations) until funds become available to make such refunds.

In response to the interim audit report, FFM states that the source of the \$10,000 was the Candidate's spouse. FFM also explained that it was their understanding that under Federal law a Candidate's spouse could contribute or lend an unlimited amount of his/her personal funds to the Candidate's campaign. However, funds given to or loaned to a candidate from any person, including a relative or friend of the candidate, are not considered the personal funds of the Candidate. Instead, the \$9,000 is a contribution from the Candidate's spouse to FFM and subject to the contribution limits. Therefore, FFM received an excessive contribution of \$8,526 from the Candidate's spouse.⁶

⁵ The amount from the trust account may be considered a prohibited contribution depending on the identification of the beneficiary.

⁶ The Candidate's spouse made other contributions totaling \$1,626 to FFM. The excessive amount is calculated as \$8,526 (\$9,000 + \$1,626 - \$2,100).