FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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SUBJECT: Interim Audit Report on the Utah State Democratic Committee (LRA 983)

I. INTRODUCTION

The Office of the General Counsel has reviewed the Interim Audit Report ("IAR") on the Utah State Democratic Committee ("the Committee"). The IAR contains five findings: Misstatement of Financial Activity (Finding 1); Recordkeeping for Employees (Finding 2); Improper Bank Account Structure (Finding 3); Receipt of Levin Fund Donations that Exceed the Limit (Finding 4); and Receipt of Contributions that Exceed Limits (Finding 5). Our comments address Findings 1 and 4. We concur with any findings not specifically discussed in this memorandum. If you have any questions, please contact Joshua Blume, the attorney assigned to this audit.

II. MISSTATEMENT OF FINANCIAL ACTIVITY (Finding 1)

The IAR finds that the Committee misstated its cash on hand and receipts at various times during the audit cycle. In the discussion of this finding, the audit report notes that the Committee maintained an improper bank account structure, which is the subject of Finding 3, during some of the audit cycle. Specifically, the Committee maintained two bank accounts at its depository – a Federal operating account and a non-federal operating account. At the same time, the Committee maintained a "parent account," the function of which was to accept daily transfers of funds from both the Federal and the non-federal operating accounts, and to transfer funds in turn to the operating accounts for the payment of Federal and non-federal expenses. Thus, the parent account contained commingled Federal and non-federal funds in violation of 11 C.F.R. § 102.5, as discussed in Finding 3.

We agree that the use of the parent account in this manner – commingling Federal and non-Federal funds – was not in compliance with 11 C.F.R. § 102.5. The report, however, discusses a related issue – whether to treat the parent account as a Federal allocation account and, as a consequence, include its activity in the scope of Finding 1. With respect to this question, the Committee filed a request for Commission consideration. The Committee, however, withdrew the request when the Audit Division decided, in consultation with this office, not to treat the parent account as a Federal allocation account and, therefore, not to include that account's activity in the scope of this finding.

We do not believe that the parent account is a Federal allocation account As a general rule, a Federal account must only hold Federal funds. 11 C.F.R. § 102.5(a)(1)(i). A committee cannot deposit non-Federal funds into a Federal account and allow the commingling of Federal and non-Federal funds. *Id.* The exception to this rule is the Federal allocation account. *See* 11 C.F.R. § 102.5(a)(1)(i); 11 C.F.R. § 106.7(f). The Federal allocation account may maintain Federal and non-Federal funds for the purpose of paying allocable expenses. 11 C.F.R. § 106.7(f)(1)(ii). Were the parent account a Federal allocation account, the Committee would have been required to report all of its activity, including its non-federal activity. 11 C.F.R. §§ 104.17, 106.7(f).

The Commission addressed a similar question of whether an account that combined Federal and non-Federal funds should be considered a Federal allocation account in two prior audits, that of the Georgia Federal Elections Committee and that of the Minnesota Democratic Farmer-Labor Party. *See Final Audit Report of the Commission on the Georgia Federal Elections Committee*, at 13-14 (Aug. 9, 2011) ("GFEC audit report"); *Final Audit Report of the Commission on the Minnesota Democratic Farmer-Labor Party*, at 9-15 (Dec. 17, 2012) ("MNDFL audit report"). At issue in both audit reports was whether an account used by the committees to pay Federal, non-federal, and allocated payroll ("payroll account") was an allocation account as that term is employed in 11 C.F.R. § 106.7(f), or the functional equivalent of an allocation account, and therefore whether the committees were required to report the non-federal activity associated with their payroll accounts.[1] *Id.* The committees argued that the payroll accounts were not Federal or

[1] In the GFEC audit, the GFEC used the payroll account to pay federal, non-federal, and allocated salaries and wages. GFEC audit report, at 13. In the MNDFL audit, the MNDFL used the payroll account to pay 100 percent

allocation accounts but simply were used as escrow or "pass through" accounts that accepted transfers from the committees' Federal and non-federal accounts and used these transferred funds to pay employees' Federal, non-federal, and allocated salary and wages. MNDFL audit report, at 13; GFEC audit report, at 14.

The Commission ultimately did not approve, by the required four votes, the Audit Division's recommendation to conclude that the accounts were allocation accounts. GFEC audit report, at 14; MNDFL audit report, at 14-15.

The parent account in this case bears less resemblance to an allocation account than the payroll accounts at issue in the two cited prior audits.[2] In those audits, the payroll accounts accepted Federal and non-federal funds from the Federal and non-federal accounts and used those funds to pay allocable salary and wages. This procedure resembles the manner in which State, district, and local party committees customarily pay allocable expenses using an allocation account. *See* 11 C.F.R. § 106.7(f)(1)(ii) (State, district, and local party committees may establish separate allocation accounts in which Federal and non-federal funds may be deposited for the purpose of paying allocable expenses).

Here, in contrast, apart from minimal disbursements for credit card service charges, the Committee did not use the parent account to pay any of its expenses, allocable or otherwise. Rather, the parent account functioned merely as a temporary "holding account," accepting and making transfers of Federal and non-federal funds from and to the respective operating accounts; the Committee made its disbursements from its operating accounts. The Commission's disposition of the previous audits presenting this question, where the accounts in question bore a greater resemblance to allocation accounts than in this matter, suggests that the Commission would not, by a majority vote, view the parent account at issue here as a Federal account or the functional equivalent of an allocation account.[3]

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federal and 100 percent non-federal salaries and wages. MNDFL audit report, at 11. Also, whereas the GFEC created its payroll account at the request of a third party vendor, the MNDFL created its payroll account on its own initiative. *Compare* GFEC audit report, at 13 *and* MNDFL audit report, at 12-13.

[2] In the October 4, 2012 open meeting on the Audit Division Recommendation Memorandum for the MNDFL audit, there was discussion about whether the Commission's vote in the GFEC audit should be construed as establishing a general rule that payroll accounts of the type in GFEC are permissible, or whether the vote should be interpreted narrowly as a decision not to render an adverse finding because no overfunding had actually taken place. In this matter, however, the Audit staff has established that no overfunding has actually taken place.

[3] There is a distinction between this matter and the previous audits in that here, Federal and non-federal funds transferred to the parent account were periodically redirected to the Federal and non-federal operating accounts. During the GFEC audit hearing, Commissioner McGahn noted that the GFEC facts involved only a unidirectional flow of money into the payroll account. *See* Audio File of Audit Hearing in Audit of GFEC, at 41:57 – 42:58 (June 15, 2010) at http://www.fec.gov/agenda/2010/agenda20100615.shtml. *See also Office of the General Counsel Comments on Draft Final Audit Report on [the MNDFL]*, LRA 835, at 4 (Apr. 9, 2012).

III. RECEIPT OF LEVIN FUND DONATIONS THAT EXCEED THE LIMIT (Finding 4)

The IAR finds that two donations of non-federal funds that the Committee characterized as donations of Levin funds in its reports exceeded the maximum permissible amount for that category of funds. Specifically, one donation of $18,000 from Energy Solutions, and one donation of $14,000 from 1-800 Contacts, exceeded the $10,000 limit per person per calendar year by $8,000 and $4,000, respectively, for a total of $12,000. *See IAR*, at 12; *see also* 11 C.F.R. § 300.31(d)(1).[4]

The Committee argues that the disclosure of these two donations as Levin donations was a clerical error. *See Committee Letter in Response to Exit Conference*, at 2 (Nov. 26, 2014). The Committee states that although it had a separate account dedicated for the deposit of Levin funds, it did not actually deposit Levin donations into this account. Rather, the Committee deposited Levin funds into its non-federal account, identified them as such, and subsequently transferred them as needed into its Levin account for subsequent disbursement on permissible Federal Election Activity ("FEA"). *Id.* The Committee states that it erroneously marked the two donations at issue in this finding as Levin donations and that there were other donations made to the non-federal account that are eligible to be treated as Levin donations. The Committee proposes to substitute two such donations, one from SKIPAC in the amount of $8,000, and one from Bruce Bastian in the amount of $4,000, which, at a total amount of $12,000, would replace the excessive contributions. *Id*, at 2-3.

We conclude that the proposed substitution is permissible provided that the Committee demonstrates that: 1) at the time it made disbursements on FEA using the donations identified in this finding, it otherwise had enough Levin-eligible funds in its non-federal account to cover the disbursements; and 2) the two specific donations the Committee proposes to substitute are Levin-eligible donations.

The FECA requires State party committees to finance FEA with Federal funds. *See* 52 U.S.C. § 30125(b)(1). However, the FECA also allows State party committees to finance certain types of FEA with a special class of non-federal funds – "Levin Funds" - that are raised in accordance with certain conditions.[5] *See* 52 U.S.C. § 30125(b)(2); 11 C.F.R. § 300.31. One such condition is that the party committee may raise donations from each donor aggregating no more than a maximum of either the donation limitation applied by the State in which the donation is

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[4] The $10,000 maximum of this subsection applies in this case because the State of Utah permits unlimited contributions to political parties. *See* Utah Code, Title 20A, Chapter 11 (containing no affirmative limit on contributions to party committees); *see also* http://www.ncsl.org/research/elections-and-campaigns/limits-on-contributions-to-political-parties.aspx (last updated Feb. 5, 2008) (last viewed June 8, 2015). Where a State does impose a contribution maximum less than the $10,000 limit prescribed by subsection (d)(1), then that lower State limit would apply instead. *See* 11 C.F.R. § 300.31(d)(2).

[5] "Levin funds" refers to funds raised pursuant to 11 C.F.R. § 300.31 and are or will be disbursed pursuant to 11 C.F.R. § 300.32. 11 C.F.R. § 300.2(i).

raised or $10,000, whichever is less, during a calendar year. 52 U.S.C. § 30125(b)(2)(B)(iii); 11 C.F.R. § 300.31(d).

The Commission's regulations specify that State, district, and local party committees intending to raise and spend Levin funds may, but are not required to, establish separate Federal, non-federal, and Levin accounts. These committees may, in the alternative, establish separate Federal and non-federal accounts; if they do so, they must use the non-federal account as a Levin account. 11 C.F.R. §§ 102.5(a)(3), 300.31(c)(2)-(3). If a committee chooses the latter option, it must demonstrate through a reasonable accounting method approved by the Commission that whenever it makes a disbursement for FEA or for any lawful use under State law, it had received sufficient donations of Levin funds to make the disbursement.[6] 11 C.F.R. §§ 102.5(a)(3)(ii), 300.30(c)(3)(ii).

The Commission's regulations, however, do not require an accounting of the excessive portion of particular Levin Fund donations to make disbursements for FEA. The accounting is more holistic. The regulations only require an accounting to ensure that the Committee has sufficient donations of Levin Funds to make the disbursement for FEA. *See* 11 C.F.R. §§ 102.5(a)(3)(ii), 300.30(c)(3)(ii). A State party committee, therefore, should be able to substitute Levin Fund donations to show that it has sufficient Levin Funds to make disbursements for FEA.

We believe that State party committees have discretion to make this proposed type of a substitution of Levin Fund donations. The fact that a State party committee need not establish a separately dedicated Levin account but may commingle Levin funds and ordinary, non-federal funds in its accounts suggests that such committees have discretion, within the framework for raising Levin donations established by 11 C.F.R. § 300.31, to characterize non-federal funds as Levin funds so long as those funds are otherwise Levin-eligible. That committees have such discretion is also suggested by the fact that the Commission also declined to require committees raising Levin funds to include specific language informing the donor about how the funds will be directed and used. *See Explanation and Justification for Final Rules on Prohibited and Excessive Contributions: Non-Federal Funds or Soft Money*, 67 Fed. Reg. 49064, 49093 (July 29, 2002) ("2002 E&J") (rejecting proposed requirements that solicitations for Levin donations must expressly state that the donations will be subject to the special limitations and prohibitions of section 300.31, or that there must be an express designation to the Levin account by the donors). Thus, whereas committees are required to notify contributors that their funds are subject to the limitations and prohibitions of the FECA, or that they will be used in connection with a Federal election, in the absence of a designation of a contribution to the Federal account in order to be able to treat such funds as Federally permissible funds, *see* 11 C.F.R. 102.5(a), committees are not under similar obligations with respect to funds they collect that they wish to treat as Levin funds. In declining to require the creation of separate Levin accounts, the Commission stated that it was "very aware of, and concerned about, the complexities of FECA as amended by [the Bipartisan

[6] Here, the Committee apparently availed itself of aspects of both of the account structure options Commission regulations prescribe. It maintained a separately dedicated Levin account but did not deposit donations it intended to treat as Levin funds into the Levin account; rather, it deposited these funds into its non-federal account, apparently identifying the donations as Levin donations as it did so, and then transferred them as needed to its Levin account for subsequent disbursement for FEA from the Levin account.

Campaign Reform Act of 2002] and want[ed] to provide party organizations with procedural flexibility to facilitate compliance with the substantive conditions and restrictions arising from the Levin amendment." 2002 E&J, at 49093.

Given this regulatory history, we agree with the Committee that it may substitute the two Levin-eligible donations for the excessive portions of the two donations at issue in the audit report.[7] The Committee, however, must submit additional information to support its proposal to substitute the donations. The Committee must demonstrate through a reasonable accounting method that it had sufficient Levin-eligible funds to make the Levin disbursements at the time when it spent the monies acquired from the two excessive donations on Levin activities,[8] and it must demonstrate that the two donations it wishes to substitute were, in fact, Levin-eligible donations.[9] Even though the Committee did not make FEA disbursements from its non-federal account directly, the Levin funds the Committee used originated in its non-federal account where they were commingled with other non-federal funds. Thus, we believe that the rule in 11 C.F.R. §§ 102.5(a)(3)(ii), 300.30(c)(3)(ii) requiring the Committee to demonstrate by a reasonable accounting method that it has sufficient Levin funds to make Levin disbursements applies to the Committee. We, therefore, recommend that that the Audit Division revise the Interim Audit Report to request this information.

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[7] The Committee also proposes to amend its previous reports to reflect the substitutions. The Reports Analysis Division has indicated to us, however, that in this situation it would require the Committee to file new schedules L-A (Itemized Receipts of Levin Funds) and L-B (Itemized Disbursements of Levin Funds), showing disbursements of the excessive portions of the Levin donations identified in the finding from the Levin account to the non-federal account, and receipts of the substituted Levin donations by the Levin account from the non-federal account.

[8] It is our understanding from the auditors that the Committee made two lump-sum transfers from its non-federal account to its Levin account in anticipation of making Levin disbursements. If it is not possible to ascertain the time at which the monies from the two excessive donations were disbursed, we would suggest that the auditors use the time of the lump-sum transfer following the receipt of the two donations.

[9] We note that, in addition to the requirements that the donations comply with State law, and with either the State law maximum or the $10,000 maximum, 11 C.F.R. § 300.31, State, district and local party committees that raise Levin funds to be used wholly or partly for FEA must pay the direct costs of such fundraising with either Federal or Levin funds. 11 C.F.R. § 300.32(a)(4).