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June 6, 2012

MEMORANDUM

AGENDA ITEM

To: The Commission

Through: Alec Palmer *AP*
Staff Director

From: Patricia Carmona *PC*
Chief Compliance Officer

Tom Hintermister *TH*
Assistant Staff Director
Audit Division

Marty Kuest *MK*
Audit Manager

By: Bill Antosz *BA*
Lead Auditor

Subject: Audit Division Recommendation Memorandum (ADRM) on the Los Angeles County Democratic Central Committee (A09-07)

For Meeting of 6-7-12

SUBMITTED LATE

This document was originally circulated May 10, 2012. It has been recently determined there was an error in this circulation as the Office of General Counsel's legal analysis of the ADRM was not included. Therefore, we are withdrawing the prior circulation of this document and simultaneously resubmitting the attached document which includes that analysis.

Pursuant to Commission Directive No. 70 (FEC Directive on Processing Audit Reports), the Audit staff's recommendations are presented below and the findings are discussed in the attached Draft Final Audit Report (DFAR). The Office of General Counsel has reviewed this memorandum and concurs with the recommendations.

Finding 1. Misstatement of Financial Activity

The Audit staff recommends that the Commission find that Los Angeles County Democratic Central Committee (LACDCC) misstated their financial activity for calendar years 2007 and 2008.

Finding 2. Misstatement of Levin Financial Activity

The Audit staff recommends that the Commission find that Los Angeles County Democratic Central Committee misstated their Levin financial activity for calendar year 2008.

LACDCC requested an audit hearing to discuss the new facts that had come to light as a result of the arrest of its former treasurer on September 2nd, 2011. Its request for a hearing was granted and was subsequently held on December 14, 2011.

In their hearing testimony, LACDCC representatives described the alleged embezzlement activity of their former treasurer and the known extent of the losses incurred by a number of her former client committees. They stated their belief that LACDCC "...lost almost \$200,000, given all of their accounts, which include state accounts and federal accounts." Next, LACDCC representatives questioned whether the committee should be held responsible for reporting unauthorized and unknown transactions that were attributed to its former Treasurer's alleged embezzlement scheme. Further, LACDCC representatives requested that the Commission revisit the issues raised in the DFAR, which, they contended, in light of the arrest of the former treasurer, was not an accurate presentation of the committee's financial activity. LACDCC representatives indicated that transactions involved with the former treasurer's malfeasance cannot and should not be characterized as activity of the committee.

Also during the audit hearing, LACDCC was requested to provide additional relevant documentation, including materials that would:

- Provide detailed documentation/information about the aforementioned \$200,000 embezzlement and how this might apply to or affect the conclusions of the DFAR;
- Demonstrate how each transaction identified in either of the misstatement findings was a result of the former treasurer's alleged unauthorized activity;
- Provide information regarding the internal controls in place at the time of the possible misappropriation; and
- Document any post-discovery steps taken by LACDCC pursuant to the Commission's "Best Practices for Committee Management".

Subsequent to the audit hearing, the Audit staff forwarded its workpapers related to the misstatements of financial activity and again requested the documentation/information discussed at the audit hearing.

On February 21, 2012, LACDCC representatives provided supplemental information. The additional information did not include any new documentation or information relating to the alleged \$200,000 embezzlement. The response did include a detailed discussion on the key misstatement components that were highlighted in the Audit report. LACDCC believes that these transactions were all the result of the former Treasurer's alleged embezzlement scheme and subsequent cover-up, and questions whether it or its former Treasurer should be held responsible for failing to report these unauthorized and unknown transactions. If the Commission proceeds to issue an Audit report that states any findings against the committee or the former Treasurer, LACDCC proposes that the following language be used to characterize the transactions at issue: "Unauthorized transfer of funds by the Committee's former treasurer".

The supplemental information also included the internal controls that were in place during the period that the alleged misappropriations took place. LACDCC explained that it had hired an experienced campaign finance firm and retained an experienced law firm to oversee the committee's activities and finances. Tasks at the campaign finance firm were divided among its employees. Payments were only permitted if they were authorized by one of three designated committee representatives who were not employed by nor had any business relationship with the campaign finance firm. LACDCC received daily financial reports, which were sent to at least two officers and its counsel. Thus, LACDCC believed that it had sufficient controls in place to avoid any misconduct.

LACDCC has implemented additional practices to ensure as much accountability as possible. New safeguards in place include:

- The Committee receives copies of its monthly bank statements and reconciliation reports from its new compliance firm.
- The Committee has authorization to contact the bank directly to verify its account activity on a regular basis.
- Committee representatives may not approve payments or reimbursements for themselves.

LACDCC concluded by requesting that the Commission re-evaluate the findings, and issue an Audit report that properly characterizes these transactions and places responsibility in the hands of those who should be held accountable.

Recommendations to Audit Report post Audit Hearing

It is further recommended that the Commission approve that the Audit Hearing section of the Proposed Final Audit Report contain a brief discussion of the circumstances concerning the former Treasurer's alleged illegal activity and that she has plead guilty to five counts of mail fraud involving several other state and federal committees (but not naming LACDCC) that were also her clients. The discussion will also explain that the fact pattern for the misstated transactions presented in the DFAR are similar to those described with respect to other committees in the criminal charges filed against the former Treasurer.

It is also recommended that the Proposed Final Audit Report not adjust the amount of misstated activity identified by the Audit staff in Findings 1 and 2. Consistent with the handling of prior audits involving embezzlement, such as the Lockheed Martin Employees' Political Action Committee (A03-54), the Audit staff maintains that all receipts and disbursements of a committee's federal account are reportable; including those that may have been involved in the alleged embezzlement. Given the unknown circumstances and amounts involved in the alleged embezzlement, the Audit staff recommends that the Proposed Final Audit Report request LACDCC to amend reports for the audit period or provide information with current filings that properly discloses any unauthorized transactions when and if sufficient information is made available.

If this memorandum is approved, a Proposed Final Audit Report will be prepared within 30 days of the Commission's vote. Should an objection be received, 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 Bill Antosz or Marty Kuest at 694-1200.

Attachments:

- Draft Final Audit Report on the Los Angeles County Democratic Central Committee
- Legal Analysis, Draft Final Audit Report for Los Angeles County Democratic Central Committee (LRA 816), August 10, 2011
- Legal Analysis, Audit Division Recommendation Memorandum and Draft Final Audit Report for Los Angeles County Democratic Central Committee (LRA 816), April 20, 2012

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on the Los Angeles County Democratic Central Committee

January 1, 2007 – December 31, 2008

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 Committee (p. 2)

Los Angeles County Democratic Central Committee is a local party committee headquartered in Burbank, California. For more information, see the chart on the Committee Organization, p.2.

Financial Activity (p. 2)

• Receipts	
○ Contributions	\$ 297,749
○ Loans Received	7,700
○ Other Receipts	10,025
○ Transfers from Non-Federal Funds	503,595
○ Transfers from Levin Funds	38,845
Total Receipts	\$ 857,914
• Disbursements	
○ Operating Expenditures	\$ 787,495
○ Loan Repayments	7,700
○ Other Disbursements	79,573
Total Disbursements	\$ 874,768
• Levin Receipts	\$153,473
• Levin Disbursements	\$156,930

Findings and Recommendations (p. 3)

- Misstatement of Financial Activity (Finding 1)
- Misstatement of Levin Financial Activity (Finding 2)

¹ 2 U.S.C. §438(b).

**Draft Final Audit Report of
the Audit Division
on the
Los Angeles County Democratic
Central Committee**

January 1, 2007 – December 31, 2008



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Part I

Background

Authority for Audit

This report is based on an audit of the Los Angeles County Democratic Central Committee (LACDCC), 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 the following areas in this audit:

1. the consistency between reported figures and bank records;
2. the disclosure of individual contributors' occupation and name of employer;
3. the disclosure of disbursements, debts and obligations;
4. the disclosure of expenses allocated between federal, Levin and non-federal accounts;
5. the completeness of records; and
6. other committee operations necessary to the review.

Scope Limitation

The treasurer of LACDCC (the Treasurer) operates an accounting firm that handles LACDCC's accounting, recordkeeping and reporting. The firm also acts as LACDCC's credit card processor. The same credit card merchant account is used to process contributions for LACDCC and a number of other clients. The Audit staff did not have access to complete records for this account and therefore was limited in its ability to verify the proper accounting of transactions relating to the account.

Part II

Overview of Committee

Committee Organization

Important Dates	LACDCC
• Date of Registration	September 6, 1994
• Audit Coverage	January 1, 2007 – December 31, 2008
Headquarters	Burbank, CA
Bank Information	
• Bank Depositories	1
• Bank Accounts	4 (1 Federal Account, 1 Levin Account and 2 Non-Federal Accounts)
Treasurer	
• Treasurer When Audit Was Conducted	Kinde Durkee
• Treasurer During Period Covered by Audit	Kinde Durkee
Management Information	
• Attended FEC Campaign Finance Seminar	Yes
• Used Commonly Available Campaign Management Software Package	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid staff and volunteer

Overview of Financial Activity

(Audited Amounts)

Federal Cash-on-hand @ January 1, 2007	\$ 18,888
o Contributions	297,749
o Loans Received	7,700
o Other Receipts	10,025
o Transfers from Non-Federal Funds	503,595
o Transfers from Levin Funds	38,845
Total Federal Receipts	\$ 857,914
o Operating Expenditures	787,495
o Loan Repayments	7,700
o Other Disbursements	79,573
Total Federal Disbursements	\$ 874,768
Federal Cash-on-hand @ December 31, 2008	\$ 2,034
Levin Cash-on-Hand @ January 1, 2007	\$ 381
Total Levin Receipts	\$ 153,473
Total Levin Disbursements	\$ 156,930
Levin Cash-on-hand @ December 31, 2008	-\$ 3,076

Part III

Summaries

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

A comparison of LACDCC's reported federal activity with bank records revealed a misstatement of cash-on-hand, receipts and disbursements in 2007 and 2008. In 2007, LACDCC overstated beginning cash-on-hand by \$5,228, understated receipts by \$8,920, understated disbursements by \$9,311 and overstated ending cash-on-hand by \$5,619. In 2008, LACDCC understated receipts by \$34,278, disbursements by \$33,411 and ending cash-on-hand by \$25,661. In response to the Interim Audit Report, LACDCC amended its reports to correct the misstatements presented in that report.

The Audit staff also identified an apparent prohibited or excessive contribution contained in the 2008 misstated receipts. In response to the Interim Audit Report, LACDCC provided evidence showing that the receipts should not be considered contributions. (For more detail, see p. 4.)

Finding 2. Misstatement of Levin Financial Activity

A comparison of LACDCC's reported Levin activity with bank records revealed a misstatement of cash-on-hand, receipts and disbursements in 2008. Specifically, LACDCC understated receipts by \$16,328 and disbursements by \$101,669 and overstated ending cash-on-hand by \$85,341. In response to the Interim Audit Report, LACDCC amended its reports to correct the misstatement of Levin financial activity. (For more detail, see p. 9.)

Part IV

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

Summary

A comparison of LACDCC's reported federal activity with bank records revealed a misstatement of cash-on-hand, receipts and disbursements in 2007 and 2008. In 2007, LACDCC overstated beginning cash-on-hand by \$5,228, understated receipts by \$8,920, understated disbursements by \$9,311 and overstated ending cash-on-hand by \$5,619. In 2008, LACDCC understated receipts by \$34,278, disbursements by \$33,411 and ending cash-on-hand by \$25,661. In response to the Interim Audit Report, LACDCC amended its reports to correct the misstatements presented in that report.

The Audit staff also identified an apparent prohibited or excessive contribution contained in the 2008 misstated receipts. In response to the Interim Audit Report, LACDCC provided evidence showing that the receipts should not be considered contributions.

Legal Standard

A. Contents of Reports. Each report must disclose:

- The amount of cash-on-hand at the beginning and end of the reporting period;
- The total amount of receipts for the reporting period and the calendar year; and
- The total amount of disbursements for the reporting period and the calendar year; and;
- Certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 2 U.S.C. §434(b)(1), (2) and (4).

B. Receipt of Prohibited Contributions – General Prohibition.

Candidates and committees may not accept contributions (in the form of money, in-kind contributions or loans) from the treasury funds of the following prohibited sources:

- Corporations (i.e. any incorporated organization, including a non-stock corporation, an incorporated membership organization or an incorporated cooperative);
- Labor Organizations; or
- National Banks. 2 U.S.C. §441b.

C. Extension of Credit by Commercial Vendor.

A commercial vendor, whether or not it is a corporation, may extend credit to a candidate or political committee provided that:

- The credit is extended in the vendor's ordinary course of business (see below); and
- The terms of the credit are similar to the terms the vendor observes when extending a similar amount of credit to a nonpolitical client of similar risk. 11 CFR §116.3(a) and (b).

D. Definition of Ordinary Course of Business.

In determining whether credit was extended in the ordinary course of business, the Commission will consider whether:

- The commercial vendor followed its established procedures and its past practice in approving the extension of credit;
- The commercial vendor received prompt, full payment if it previously extended credit to the same candidate or political committee and
- The extension of credit conformed to the usual and normal practice in the commercial vendor's industry or trade. 11 CFR §116.3(c)

E. Party Committee Limits.

A party committee may not receive more than \$5,000 per year from any one contributor. 2 U.S.C. §441a(a)(1)(C), (2)(C) and (f); 11 CFR §§110.1(d) and 110.9.

F. Contributions by Limited Liability Companies (LLCs).

A limited liability company is a business entity that is recognized as an LLC under the laws of the state in which it is established. An LLC that elects to be treated as a corporation by the Internal Revenue Service under 26 CFR 301.7701-3 shall be considered a corporation pursuant to 11 CFR Part 114. An LLC that makes a contribution to a candidate or committee shall provide information as to how the contribution is to be attributed and affirm that it is eligible to make the contribution. 11 CFR §110.1(g)

Facts and Analysis**A. Facts**

The Audit staff reconciled the reported financial activity with the bank records for 2007 and 2008. It determined that LACDCC misstated cash-on-hand, receipts and disbursements for both years. The following charts outline the discrepancies and provide explanations for the differences.

2007 Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance	\$24,116	\$18,888	\$5,228 Overstated
Receipts	\$312,959	\$321,879	\$8,920 Understated
Disbursements	\$299,683	\$308,994	\$9,311 Understated
Ending Cash Balance	\$37,392	\$31,773	\$5,619 Overstated

The net understatement of receipts resulted from the following:

• Offset to operating expenditures not reported	+ \$9,245
• Unexplained differences	- <u>325</u>
Net Understatement of Receipts	\$8,920

The net understatement of disbursements resulted from the following:

• Disbursements not reported	+ \$847
• Disbursements reported with incorrect amounts	+ 9,389
• Reported disbursements that did not clear bank	- 98
• Reported voided disbursements	- <u>827</u>
Net Understatement of Disbursements	\$9,311

2008 Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance	\$37,392	\$31,773	\$5,619 Overstated
Receipts	\$501,758	\$536,035	\$34,277 Understated
Disbursements	\$532,364	\$565,774	\$33,410 Understated
Ending Cash Balance	\$6,786	\$2,034	\$4,752 Overstated

The net understatement of receipts resulted from the following:

• Unreported advance from credit card processor (see below)	+ \$7,700
• Unreported transfers from non-federal account (see below)	+ 42,596
• Reported transfer from Levin fund that was never made	- 16,272
• Unexplained differences	+ <u>253</u>
Net Understatement of Receipts	\$34,277

The net understatement of disbursements resulted from the following:

• Unreported repayment of advance from credit card processor	+ \$7,700
• Unreported disbursements to credit card processor (see below)	+ 15,000
• Unreported disbursements	+ 7,877
• Reported disbursements with incorrect amounts	+ 26,873
• Reported disbursements that did not clear bank	- 1,374
• Reported voided disbursements	- 66
• Reported disbursement paid from Levin account	- <u>22,600</u>
Net Understatement of Disbursements	\$33,410

LACDCC misstated the cash balances throughout 2007 and 2008 due to the errors outlined above and unknown adjustments from prior reporting periods. LACDCC overstated the cash balance on December 31, 2008 by \$4,752.

Advance from and Repayment to Credit Card Processor-\$7,700

LACDCC's federal account received advances from its accounting firm and credit card processor, Durkee & Associates,³ on credit card proceeds that were being delayed. The advances totaled \$7,700 and occurred between December 22 and December 26, 2008. The committee prepared and dated checks to repay the advances on the days it received them, but the checks did not clear the bank until February 17, 2009. LACDCC did not report the advances of \$7,700 and the repayments of the same amount, as noted above.

In addition to the reporting issues relating to these transactions, the Audit staff considers the \$7,700 received from Durkee & Associates an advance or an extension of credit outside the ordinary course of business. See 2 U.S.C. § 431(8)(A)(i) or see 11 C.F.R. §§ 100.55, 116.1(e), 116.3. As such, the \$7,700 received by LACDCC is a contribution and either an excessive contribution of \$2,700 (\$7,700 less the allowable contribution limit of \$5,000) or a prohibited contribution of \$7,700, depending on whether Durkee & Associates, as a limited liability company, elected to be treated as a partnership or a corporation for tax purposes.

Disbursed to Credit Card Processor-\$15,000

On December 31, 2008, three checks totaling \$15,000 were drawn from the federal account. Each check was payable to Durkee & Associates. LACDCC did not report the checks on its disclosure reports. LACDCC's counsel explained that the Treasurer withdrew the funds from the federal account as part of the reconciliation process to identify possible errors involving the deposit of credit card contributions. LACDCC returned the funds to the federal account once it determined that there were no problems with credit card contributions. As was the case with the redeposit of the \$45,000 to the Levin account (see Finding 2), however, LACDDC redeposited the \$15,000 in the federal account months later. Durkee & Associates returned the money in four increments between May and December of 2009.

The Treasurer provided a listing of credit card contributions totaling \$61,491 that were deposited into the shared credit card merchant account and identified as contributions to LACDCC. These credit card contributions apparently represent the funds Durkee & Associates withdrew from LACDCC's bank accounts (Levin account (\$45,000) and the federal account (\$15,000)) while reconciling the credit card merchant account. Based on available records of Durkee & Associates, the Audit staff could not determine whether LACDCC funds were used by Durkee & Associates during the period it held them.

³ Durkee & Associates is operated by LACDCC's Treasurer, Kinde Durkee. Durkee & Associates is an accounting and business management firm with clients including political and non-profit organizations, as well as small businesses.

Transfer from Non-federal Account-\$15,000

LACDCC failed to report a transfer received from its non-federal account in the amount of \$15,000. According to LACDCC's counsel, the \$15,000 was erroneously transferred from LACDCC's non-federal account to its federal account on December 31, 2008, the same day it wrote the checks to the credit card processor. Without receipt of this transfer, LACDCC's federal bank account would have had a negative balance of \$7,044 on December 31, 2008.

LACDCC transferred \$15,000 on November 9, 2009 to return the funds to the non-federal account. LACDCC's counsel stated the purpose for the original transfer was unclear, and that no one from LACDCC's management was informed of, or consulted about, the erroneous \$15,000 transfer or the return of those funds. Rather, LACDCC management became aware of these transactions solely as a result of this audit. The Audit staff could not determine the reason for the transfer from the non-federal account based on available records. The Audit staff verified that the funds were returned to the LACDCC's non-federal account.

The non-federal account transferred less than its share of allocated federal/non-federal costs during the audit period. As such, the federal account could have accepted the non-federal transfer without resulting in overfunding.

B. Interim Audit Report & Audit Division Recommendation

The Audit staff presented the misstatements noted above to the representatives for LACDCC during the exit conference. The representatives did not provide any information to explain the misstatements, but indicated that they would file amended reports to correct these errors.

The Audit staff recommended that LACDCC file amended reports to correct the misstatements. LACDCC should amend the cash balance of its most recent report with an explanation that the amendments are due to audit adjustments from a prior reporting period.

LACDCC should also provide information concerning the \$7,700 advance from its credit card processor to establish that it was made in the ordinary course of business. The information should include:

- The specific terms that Durkee & Associates apply to such extensions of credit;
- Whether similar terms are offered to nonpolitical customers of similar size and risk of obligation;
- Rationale for why Durkee & Associates chose the time it did to negotiate LACDCC's checks representing repayment;
- Information about Durkee & Associates' tax status; and
- Any other information LACDCC believes might clarify the transactions.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, LACDCC amended its reports, correcting the misreporting. Also, LACDCC amended its cash balance on its May 2011 monthly report and noted that the adjustment was pursuant to the Audit staff's direction.

To establish that the advance of \$7,700 from its credit card processor was made in the ordinary course of business, LACDCC's response explained that Durkee & Associates considered short-term advances to its clients as benefits encompassed in its 3 percent credit card transaction fee. It provided a listing of 45 short-term advances that Durkee & Associates made to both its political and non-political clients dating back to 2001.

LACDCC sufficiently demonstrated that the \$7,700 from Durkee & Associates had a business purpose and was not for the purpose of influencing a federal election. As a result, the transaction is not considered a contribution.

Finding 2. Misstatement of Levin Financial Activity

Summary

A comparison of LACDCC's reported Levin activity with bank records revealed a misstatement of cash-on-hand, receipts and disbursements in 2008. For 2008, LACDCC understated receipts by \$16,328 and disbursements by \$101,669 and overstated ending cash-on-hand by \$85,341. In response to the Interim Audit Report, LACDCC amended its reports to correct the misstatement of Levin financial activity.

Legal Standard

A. Reporting.

If a state, district or local party committee's combined annual receipts and disbursements for federal election activity (FEA) total \$5,000 or more during the calendar year, the committee must disclose receipts and disbursements of Federal funds and Levin funds used for FEA. 11 CFR §300.36 (b)(2).

B. Contents of Levin Reports. Each report must disclose:

- The amount of cash-on-hand for Levin funds at the beginning and end of the reporting period;
- The total amount of Levin fund receipts for the reporting period and the calendar year;
- The total amount of Levin fund disbursements for the reporting period and the calendar year; and
- Certain transactions that require itemization on Schedule L-A (Itemized Receipts of Levin Funds) or Schedule L-B (Itemized Disbursements of Levin Funds). 11 CFR §300.36 (b)(2).

Facts and Analysis

A. Facts

The Audit staff reconciled the reported Levin financial activity with the bank records for 2007 and 2008. Staff determined that LACDCC misstated cash-on-hand, receipts and disbursements for 2008. The following chart outlines the discrepancies for 2008 and provides explanations for the misstated Levin activity.

2008 Levin Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance	\$960	\$960	\$0
Receipts	\$135,990	\$152,318	\$16,328 Understated
Disbursements	\$54,685	\$156,354	\$101,669 Understated
Ending Cash Balance	\$82,265	\$(3,076) ⁵	\$85,341 Overstated

The understatement of receipts resulted from the following:

• Unreported transfer from federal account	+ \$6,328
• Unreported contribution	+ 5,000
• Refund of contribution reported as a negative receipt instead of a disbursement	+ 5,000
Understatement of Receipts	\$16,328

The understatement of disbursements resulted from the following:

• Unreported disbursements to Durkee & Associates (see below)	+ \$45,000
• Unreported transfer to non-party committee (see below)	+ 35,000
• Other unreported disbursements	+ 32,941
• Disbursement incorrectly reported as transfer to federal account ⁶	- 16,272
• Refund of contribution reported as a negative receipt instead of a disbursement	+ 5,000
Net Understatement of Disbursements	\$101,669

LACDCC misstated its Levin ending cash balances for 2008 due to the errors outlined above. On December 31, 2008, the committee overstated the Levin cash by \$85,341.

⁵ The negative ending cash balance was due to an outstanding check that was not negotiated until February 2009. During the period that it was outstanding, the Levin bank statements showed a positive cash balance.

⁶ LACDCC disbursed \$22,600 from its Levin account to a vendor, but it reported this transaction as a \$16,272 transfer to the federal account, which is the amount that could have been transferred from the Levin account if the disbursement had been paid properly from the federal account. The \$22,600 is included in the \$32,941 amount of disbursements that were not reported. LACDCC also did not report the transfer of \$6,328 – the federal share of the \$22,600 expenditure – from its federal account to the Levin account.

Amount Disbursed from Levin Fund-\$45,000

Between December 5 and December 22, 2008, four checks made out to Durkee & Associates totaling \$45,000 were drawn on the Levin account. LACDDC did not report the checks on its Schedules L. According to LACDCC's counsel, Durkee & Associates closely examined its credit card merchant account⁷ at the end of 2008 and determined that a number of clients had received duplicate transfers relating to credit card contributions. Durkee & Associates concluded that reversing all credit card transfers made to its clients was the best way to avoid potential reporting issues. Durkee & Associates would then re-transfer the correct amount of credit card contributions based upon a reconciliation of its merchant account.

However, credit card contributions were not deposited into the Levin account during the audit period. As such, there seemed to be no reason for Durkee & Associates to withdraw funds from this account. LACDCC deposited credit card contributions in the federal account. However, between December 5 and December 22, 2008, LACDCC did not have \$45,000 in its federal bank account (See Finding 1. above). The \$45,000 withdrawn from the Levin account was not re-deposited until March 23, 2010.

The committee made an earlier attempt to redeposit the money in March 2009. LACDCC's counsel provided a check in the amount of \$45,000 made out to the Levin Fund, along with a deposit ticket dated March 13, 2009. However, this check never cleared and was not posted to the account.

LACDCC's counsel states that LACDCC management was not informed of, or consulted about, the \$45,000 originally withdrawn from the Levin Fund account, the merchant account check issued to LACDCC in March 2009 or the merchant account check issued to LACDCC in March 2010. LACDCC management became aware of these transactions only as a result of the audit. The Treasurer contends that Durkee & Associates has since improved its internal controls to avoid this type of situation in the future. LACDCC forwarded a description of the internal control improvements to the Audit staff. These internal controls include general changes to accounting and recordkeeping procedures, but do not specifically detail procedures that would minimize the risk of commingling LACDCC proceeds with those of other committees and Durkee & Associates.

Amount Transferred from Levin Account-\$35,000

On November 25, 2008, LACDCC made a transfer of \$35,000 from the Levin account to a non-party committee, Pasadena Area United Democratic Headquarters (Pasadena United), which is another Durkee & Associates client. The committee did not report the transfer on its Schedules L. LACDCC's counsel explained that the transfer was supposed to be made from Durkee & Associates' credit card merchant account to Pasadena United, but the funds were taken from the Levin account in error.

⁷ This merchant account was a shared account that received credit card contributions for LACDCC and Durkee & Associates' other political committee clients, many of which had the same treasurer as LACDCC.

The Treasurer refunded the \$35,000 to the Levin Fund account from the Durkee & Associates merchant account in three increments between December 17, 2009 and January 28, 2010. The Treasurer explained that this was more efficient than transferring \$35,000 from Pasadena United to the Levin account and then transferring \$35,000 to Pasadena United from the Durkee & Associates merchant account. The Treasurer believed this was an appropriate resolution because the merchant account was the intended source of the funds.

LACDCC's counsel states that no one from LACDCC management was informed of, or consulted about, the error, the method of reversing the erroneous transaction, the timing or reporting of the error, the return of funds or any other aspect of the corrective effort undertaken by the Treasurer.

B. Interim Audit Report & Audit Division Recommendation

The Audit staff presented the misstatements of Levin activity to the representatives for LACDCC during the exit conference. The representatives did not provide any information to explain the misstatements, but indicated that they would file amended reports to correct the errors.

The Audit staff recommended that LACDCC file amended reports to correct the misstatements of Levin activity. The Audit staff also recommended that LACDCC reconcile the cash balance on its most recent report to identify any subsequent discrepancies that could affect the recommended adjustments to cash.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, LACDCC amended its reports correcting the misreporting.



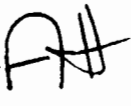
FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463


April 20, 2012


MEMORANDUM

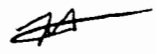
TO: Patricia Carmona
Chief Compliance Officer


Thomas Hintermister
Assistant Staff Director
Audit Division

FROM: Anthony Herman 
General Counsel

Christopher Hughey 
Deputy General Counsel

Lawrence L. Calvert, Jr. 
Associate General Counsel

Lorenzo Holloway 
Assistant General Counsel
For Public Finance and Audit Advice

Delanie DeWitt Painter 
Attorney

SUBJECT: Audit Division Recommendation Memorandum and Draft Final Audit Report for Los Angeles County Democratic Central Committee. (LRA 816)

I. INTRODUCTION

The Office of General Counsel has reviewed the proposed Audit Division Recommendation Memorandum (“ADRM”) and accompanying proposed Draft Final Audit Report (“DFAR”) on Los Angeles County Democratic Central Committee (“the Committee”). We have also reviewed the Committee’s response to the DFAR (“DFAR Response”) and considered the Committee’s comments at the audit hearing on December 14, 2011 and its written supplemental response after the audit hearing submitted on February 21, 2012 (“Supplemental Response”). We generally concur with the ADRM. We concur that the Proposed Final Audit Report (“PFAR”) should contain a brief discussion of the former treasurer’s criminal activities. We also agree with the ADRM recommendation that the amounts of the misstatement findings (Findings 1 and 2) should not be adjusted because the Committee was required to report all

receipts and disbursements, including transactions that it contends were unauthorized. We understand that the Audit Division will also attach our comments on the Audit Division's proposed DFAR to the ADRM.¹ If you have any questions, please contact Delanie DeWitt Painter, the attorney assigned to this audit.

As a threshold issue, we concur with the Audit staff's recommendation in the ADRM that the Audit Hearing section of the PFAR should contain a brief discussion of the former Committee treasurer's criminal activities. This information is the basis for the Committee's arguments at the audit hearing, and describing arguments made by a committee at an audit hearing is part of the standard format for an audit report. The information will also provide the public a more complete picture of the circumstances surrounding the Committee's finances during the audit period. The Committee's response to the DFAR, the audit hearing, and the supplemental response focus on the alleged² embezzlement and fraudulent activity by the Committee's former treasurer, Kinde Durkee. Durkee operated an accounting and business management firm, Durkee and Associates ("D&A") which handled the Committee's accounting, recordkeeping, and reporting. It also processed the Committee's credit card transactions. On September 2, 2011 -- by coincidence, roughly the same time as the DFAR was transmitted to the Committee -- Durkee was arrested and charged with mail fraud related to embezzlement and unauthorized transfers involving a California state candidate's committee for which she was also treasurer.³ Subsequently, an Information was filed including the original charges and additional charges against Durkee to include transactions involving several other state and federal committees (but not naming the Committee here) that were also Durkee clients. The Information stated that there were at least 50 victims of Durkee's fraudulent scheme and that she caused losses of more than \$7 million to her clients. Durkee pleaded guilty to all of the charges in the Information, five counts of mail fraud, on March 30, 2012. *See Plea Agreement - United States v. Durkee*, 2:12 - cr - 0123 - KJM (E.D.C.A. Mar. 30, 2012); <http://www.washingtonpost.com/national/calif-democratic-campaign-treasurer-pleads->

¹ We commented in the DFAR only on a payment by Durkee and Associates ("D&A") to the Committee's federal account of \$7,700 for delayed credit card proceeds and concurred with the auditors that the transaction was not a contribution by D&A.

² We use the word "alleged" because there has been no specific legal determination in any forum that Durkee engaged in illegal activities with respect to *this* Committee's funds. Rather, the Committee alleges that Durkee took illegal actions with respect to its funds, and that those actions caused most of the misstatements identified in the audit.

³ The original criminal complaint, dated September 2, 2011, provided with the Committee's DFAR response, charges Durkee with violating 18 U.S.C. § 1341 by mailing inaccurate disclosure reports to the California Fair Political Practices Commission as a part of a fraudulent scheme to obtain money from a state candidate's campaign. The criminal complaint alleges that Durkee, through D&A, misappropriated money from her client's bank accounts and mailed false state disclosure reports to hide the misappropriations. The criminal complaint alleges that Durkee transferred funds from the candidate committee's accounts to her firm's bank accounts without the client's knowledge or authorization, and sometimes refunded misappropriated funds to cover checks and avoid detection. The complaint alleges she routinely moved substantial sums of money out of client accounts into D&A accounts or other client accounts. Durkee allegedly admitted to FBI agents "that she has been misappropriating her client's money for years" and filing false reports with the state. Complaint, *United States v. Durkee*, 2:11mj274 DAD (E.D.C.A. Sept. 2, 2011) at 4.

-guilty-to-looting-7m-from-candidates-committees/2012/03/30/gIQABzafIS_story.html, "Calif. Democratic campaign treasurer pleads guilty to looting \$7M from candidates, committees," *Washington Post* (Mar. 30, 2012).

The Committee asserts that the majority of the misstatements identified in this audit were caused by Durkee's alleged illegal actions with respect to Committee funds. We question whether all of the transactions related to the misstatement findings in the audit report were caused by Durkee's alleged illegal activity, but we agree that the ADRM should explain the circumstances surrounding the Durkee criminal case, including that there are similarities between the fact patterns described in the DFAR and those described with respect to other committees in the criminal charges, and stating that Durkee pleaded guilty to five counts of mail fraud.

II. MISSTATEMENT OF FINANCIAL ACTIVITY AND MISSTATEMENT OF LEVIN FINANCIAL ACTIVITY (FINDINGS 1 AND 2)

The DFAR concludes that the Committee misstated receipts and disbursements in 2007 and 2008 (Finding 1). In 2007, the Committee overstated beginning cash-on-hand by \$5,228, understated receipts by \$8,920, understated disbursements by \$9,311 and overstated ending cash-on-hand by \$5,619. In 2008, the Committee understated receipts by \$34,278, disbursements by \$33,411 and ending cash-on-hand by \$25,661. The Committee also misstated Levin activity cash-on-hand, receipts and disbursements in 2008 (Finding 2). The Committee understated receipts by \$16,328 and disbursements by \$101,669 and overstated ending cash-on-hand by \$85,341. In response to the IAR, and prior to Durkee's removal as treasurer, the Committee amended its reports to correct both the 2007 and 2008 misstatements. The ADRM recommends that the PFAR "not adjust the amount of misstated activity" in Findings 1 and 2 because "all receipts and disbursements of a committee's federal account are reportable." ADRM at 3.

The Committee contends that the financial transactions related to the audit findings "bear a striking resemblance" to transactions in the original criminal complaint.⁴ DFAR Response at 2. The Committee argues that Durkee "engaged in unauthorized transactions that had no relation to the Committee's activities." It argues that Durkee's unauthorized use of Committee funds and efforts to cover up her activity "are the basis for most, if not all, of the misstatements that

⁴ The audit revealed that D&A transferred to its own accounts funds from the Committee's federal and Levin accounts. Most of the funds at issue were transferred to a merchant account that D&A used to process credit card transactions for the Committee and other clients. With respect to the federal account, D&A owed the Committee \$15,000 that D&A repaid in four installment payments between May 26, 2009 and December 15, 2009, and \$3,564 in credit card proceeds that were delayed. From the Levin account, D&A transferred to itself \$45,000 that was repaid on March 23, 2010, and disbursed \$35,000 to another D&A client, Pasadena Area United Democratic Headquarters, that was repaid by D&A in transfers between December 17, 2009 and January 28, 2010. D&A eventually returned all of the funds to the Committee's federal and Levin accounts, but did not return some of the funds until more than a year after withdrawing them from the accounts. In addition to these transactions, \$15,000 was transferred from the Committee's non-federal account to its federal account on December 31, 2008 and returned to the Committee's non-federal account on November 9, 2009. The Committee's responses and/or its comments at the audit hearing addressed the following transactions discussed in the DFAR: \$7,700 advance from and repayment to credit card processor; \$15,000 in checks paid to D&A from the federal account; \$15,000 transfer from non-federal account; \$45,000 in checks written to D&A from the Levin account; and the \$35,000 transfer from the Levin account to Pasadena United Democratic Headquarters.

ultimately appeared on the Committee's campaign finance reports." *Id.*; Supplemental Response at 2. The Committee "believes these transactions to be so completely outside the realm of any authorized activity that they cannot be properly characterized as 'receipts' or 'disbursements'" under 2 U.S.C. § 434(b)(2) and (4) and 11 C.F.R. § 104.1, and it argues that the failure to disclose them should not be treated as misstatements in the report. Supplemental Response at 2. The Committee argues that it was not required to report these transactions as receipts and disbursements because "embezzlement" and "cover up" do not fit into the categories of receipts delineated in section 434(b). Audit Hearing Transcript at 23. The Committee proposes that if the Commission makes audit findings it should characterize the transactions not as "misstatements of financial information" but as "unauthorized transfer of funds by the Committee's former treasurer." Supplemental Response at 5. Moreover, while it argues that it should not be required to report these transactions at all, it argues in the alternative that if it is required to report the transactions it should be permitted to characterize them using the same phrase, "unauthorized transfer of funds by the Committee's former treasurer." *Id.*

We agree with the Committee that at least those specific transactions described in prose in the DFAR "bear a striking resemblance" to the pattern of transactions described in the original criminal complaint. We disagree, however, with the Committee's argument that these transactions are neither "receipts" nor "disbursements." Unlike the terms "contribution" and "expenditure," which are carefully defined terms of art in the Act and regulations, "receipts" and "disbursements" are not specifically defined; instead, they carry their meaning in ordinary usage of, in essence, money in and money out. And a committee must report *all* receipts and disbursements, 2 U.S.C. § 434(a)(1) and (b), 11 C.F.R. § 104.3, including "other forms of receipts" and "any other disbursements." 2 U.S.C. § 434(b)(2)(J) and (4)(H); 11 C.F.R. § 104.3(a)(2) and (b)(1). There are no exceptions in the statute or regulations for unauthorized transactions, embezzled funds or possible criminal activity. The statute and regulations do not define or list every possible type of receipt or disbursement, nor do they consider intent or whether receipts or disbursements are "authorized." The "other" receipts and disbursements are broad catch-all categories that include any transactions that are not otherwise specifically listed, such as the transactions the Committee contends were not authorized. A receipt or disbursement that was not authorized still must be disclosed. Committees are generally responsible for the accurate reporting of even embezzled funds. *See, e.g.,* Advisory Opinion ("AO") 2006-16 (Detert)(Committee should report misappropriated funds as an "other disbursement" and reimbursement of those funds as an "other receipt"); MUR 5872 (Hague); MUR 5923 (American Dream PAC); MUR 6299 (NRCC); MUR 5962 (Istook); MUR 5610 (Dole); MUR 5721 (Lockheed). Therefore, committees must account for all transactions – every penny in and every penny out of a committee's accounts should be disclosed to provide a complete and accurate picture of its finances. In particular, omitting certain receipts and disbursements from disclosure reports would result in inaccurate reporting of the Committee's ending cash on hand, which is the Committee's cash on hand at the beginning of a reporting period, plus all receipts during the period, minus all disbursements during the period.

As noted above, the Committee has also suggested that the audit report and any additional required amendments describe these transactions as "unauthorized transfers by the Committee's former treasurer." But while the Committee has asserted that the particular fact patterns described in prose in the DFAR represent unauthorized transactions, and those fact patterns resemble the

patterns of transactions in the criminal complaint, those transactions do not account for all of the misstatements itemized in the charts at pages 5-6 and 10 of the DFAR. Other misstatements identified in the charts may have represented unauthorized transactions, but they might also have represented ordinary reporting errors. Thus, we do not see a basis for changing the characterization of these transactions or the title of the misstatement findings in the audit report. Therefore, we concur that the amounts of the misstatement findings should not be changed and that the Committee was required to report all transactions, including those it contends were not authorized, as receipts or disbursements.⁵

⁵ As noted, the Committee has already amended its reports in response to the Interim Audit Report, but did so while Durkee was treasurer. Nevertheless, if the Committee wishes further to amend its reports, it could work with the Reports Analysis Division concerning the proper characterization of the purpose of any disbursements it establishes to have been unauthorized.



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

August 10, 2011

MEMORANDUM

TO: Thomas Hintermister
Acting Assistant Staff Director

FROM: Christopher Hughey *pch*
Acting General Counsel
Lawrence L. Calvert, Jr. *LLC*
Associate General Counsel
Lorenzo Holloway *LH*
Assistant General Counsel
For Public Finance and Audit Advice
Delanie DeWitt Painter *DDP*
Attorney

SUBJECT: Draft Final Audit Report for Los Angeles County Democratic Central Committee (LRA 816)

The Office of the General Counsel has reviewed the proposed Draft Final Audit Report ("DFAR") for the Los Angeles County Democratic Central Committee (the "Committee").¹ We comment on the payment of \$7,700 for delayed credit card proceeds to the Committee by the Committee's accounting firm, Durkee & Associates (D&A). We concur that this transaction was not a contribution by D&A.² We also concur with the remaining findings not specifically discussed in this memorandum. If you have any questions, please contact Delanie DeWitt Painter, the attorney assigned to this audit.

The Interim Audit Report ("IAR") recommended that the Committee provide information to demonstrate that an apparent \$7,700 advance to the Committee was in the

¹ We recommend that the Commission consider this document in open session as there is no legal basis to justify a closed Commission meeting.

² D&A is an accounting and business management firm operated by the Committee's treasurer, Kinde Durkee. The firm handles the Committee's accounting, recordkeeping, and reporting and acts as its credit card processor. D&A used a merchant account to process credit card transactions for the Committee and other clients including political committees. The Committee explained in response to the IAR that D&A is a single principal limited liability company, and the sole owner is Kinde Durkee, who reports D&A's income on a Schedule C of her individual tax return.

ordinary course of business. The Committee's federal account received payments from D&A totaling \$7,700 for delayed credit card proceeds. D&A apparently became aware of a delay in transmission from the credit card company to D&A's merchant account of funds for credit card contributions to the Committee. However, it apparently was not aware of the actual amount of contributions that were delayed. It estimated the amount of the delayed credit card proceeds and paid the Committee \$7,700 from the merchant account on December 22 (in a check of \$5,700) and December 26 (in a check of \$2,000), 2008. Checks in the same amounts from the Committee to repay D&A were prepared on the same dates but did not clear the bank until February 17, 2009.³ D&A provided the auditors a list of credit card contributions associated with these transactions, which totaled \$5,887. The auditors, however, determined that the net credit card proceeds that should have been transferred from D&A to the Committee amounted to \$5,424.

In response to the IAR, the Committee contends that the \$7,700 payment was an extension of credit by D&A in the ordinary course of business and provided the following information, along with a signed declaration from Ms. Durkee. The Committee explained that D&A reviews credit card contribution transactions, and if the transactions are approved by the contributor's credit card company but payment is not received within a reasonable period of time, D&A transfers the funds to the client and repays itself when the payment is received from the credit card company. D&A charges clients a 3% fee for each credit card transaction and considered the "advance to its clients as one of the client benefits encompassed by its 3% credit card transaction fee." IAR Response at 2. D&A said it considered the cost of this benefit as minimal compared to the fee received because it was unusual for credit card companies to delay forwarding funds. The Committee further explained that D&A offers similar terms to non-political customers of similar size and risk of obligations. The Committee provided a list of 45 advances to non-political customers over a ten year period (March 27, 2001 to April 13, 2011) for amounts ranging from \$20 to \$15,000. Based on the Committee's response, the auditors conclude in the DFAR that the Committee demonstrated that the payment from D&A was in the ordinary course of business.

We conclude that, at a minimum, \$5,424 of this transaction was not a contribution. A contribution includes any gift, subscription, loan, advance, deposit of money, or anything of value made by any person for the purpose of influencing a federal election. 2 U.S.C. § 431(8)(A)(i); 11 C.F.R. § 100.52(a). Anything of value includes goods and services provided without charge or at less than the normal charge. 11 C.F.R. § 100.52(d).

³ The Committee stated that the repayment was on February 17, 2009 because the last batch of delayed credit card proceeds was received from the credit card companies at that time. The auditors, however, conclude that the last batch of credit card funds included in the payment was received later than that date.

In our comments on the IAR, we stated that additional information was necessary to clarify whether this transaction was an advance that resulted in an excessive or prohibited contribution or an extension of credit in the ordinary course of business. *See* 2 U.S.C. § 431(8)(A)(i); 11 C.F.R. §§ 100.55, 116.1(e), 116.3. Having considered the matter further, we are of the opinion that the transaction does not precisely fit the definition of either an advance or an extension of credit. While we do believe that D&A provided the Committee with something of value, we do not believe the facts indicate that the provision of something of value was made for the purposes of influencing a federal election. Thus, at a minimum, \$5,424 of the transaction was not a contribution.

The Commission's regulations define "extension of credit" as including, but not being limited to,

- (1) any agreement between the creditor and political committee that full payment is not due until after the creditor provides goods or services to the political committee
- (2) any agreement between the creditor and the political committee that the political committee will have additional time to pay the creditor beyond the previously agreed to due date; and
- (3) the failure of the political committee to make full payment to the creditor by a previously agreed to due date.

11 C.F.R. § 116.1(e). The facts here do not show that there was an extension of *credit* from D&A to the Committee in the sense of D&A providing goods or services for which it accepted a delayed payment. Rather, it was the *Committee* that was owed money by the credit card company, through D&A.

The transaction here was closer to being an advance of funds by D&A to the Committee. Unlike "extension of credit," "advance" is not defined by the Act or regulations. However, the transaction was not an "advance" in the sense of being an early payment of money due at a later time; contributors had made contributions to the Committee which were supposed to be forwarded to the Committee between 10 and 30 days after receipt, *see* 2 U.S.C. § 432(b)(2), so the funds appear to have been due and payable to the Committee. They simply had not yet made their way to the Committee due to delay on the part of the credit card company.

But however the transaction is characterized, the D&A funds provided to the Committee constituted *something of value*. To be a contribution, it is necessary not merely that the funds constituted something of value, but that they have been provided "for the purpose of influencing any election for Federal office." 2 U.S.C. § 431(8)(A)(i).

The information submitted in response to the IAR suggests that D&A did not provide this service for the purpose of influencing a federal election. Rather, it was treating the Committee in the same way that it treats its other non-political clients who are in a similar situation. The Committee demonstrated that D&A has provided 45 similar payments for delayed credit card funds to non-political clients over a period of ten years ranging from \$20 to \$15,000. D&A considers these payments as one benefit paid for by its 3% charge on its clients' credit card transactions. Thus, we conclude that the payment had a business purpose, consistent with D&A's services for its other clients, and was not for the purpose of influencing a federal election. Therefore, this transaction was not a contribution.

We note that D&A's estimated \$7,700 payment to the Committee exceeded the net delayed credit card proceeds that should have been transferred of \$5,424. The Committee has not provided any information clarifying whether the amounts paid to other non-political clients were estimated and similarly exceeded the amounts of delayed credit card proceeds to those clients. Nevertheless, given the fact that D&A could have contributed the estimated excess of \$2,276 to the Committee within Durkee's limitation, we do not believe this aspect of the transaction is worth pursuing further. *See* 2 U.S.C. § 441a(a)(1)(C).