

**AGENDA DOCUMENT NO. 15-18-A**



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

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April 29, 2015

**MEMORANDUM**

**AGENDA ITEM**

To: The Commission

Through: Alec Palmer *for PCO*  
Staff Director

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

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

Martin Favini *TH S-WF*  
Audit Manager

By: Camilla Reminsky *CR*  
Lead Auditor

Subject: Audit Hearing for Gary Johnson 2012, Inc

For Hearing of 5-6-15

Attached for your information is a copy of the Draft Final Audit Report (DFAR) and Office of General Counsel legal analysis that was mailed to Gary Johnson 2012, Inc (GJ2012) on March 20, 2015. Counsel representing GJ2012 responded to the DFAR on April 14, 2015, and requested a hearing before the Commission to present its case relative to DFAR Findings 1-5. The hearing was granted on April 16, 2015, and has been scheduled for May 6, 2015.

Findings 1 and 2 are, respectively, Net Outstanding Campaign Obligations and Amounts Owed to the U.S. Treasury. These findings are both based on Title 26 of the United States Code, and the hearing process was not designed to address these findings. Accordingly, these will be addressed in the Audit Division Recommendation Memorandum and subsequent reports as required, but not detailed in this memo. After the Committee has been notified of the Commission's repayment determination in the Final Audit Report, the Candidate will have the option of requesting administrative review under 11 CFR §9038.2(c) and may request a hearing about the repayment at that time.

**Finding 3 - Use of General Election Contributions for Primary Election Expenses.** This finding is based on GJ2012's use of general election contributions for primary election expenses in contravention of 11 CFR §102.9(e). Committees are required to use a reasonable method of accounting to keep general and primary election expenses separate, and not use general election contributions for primary election expenses prior to the primary election date. In this case, the primary election date was the date of Gary Johnson's nomination by the Libertarian Party to run for the office of President of the United States on May 5, 2012.

In the Preliminary Audit Report (PAR) presented to GJ2012, Finding 3 noted that during fieldwork, Audit staff found GJ2012 received a total of \$22,396 designated to the general election that was deposited in the primary election account. Of this amount, a total of \$10,000 was deposited to the general election account by September 6, 2011. Beginning on February 21, 2012, GJ2012 did not maintain enough contributions designated to the primary election to pay for all of its primary expenditures, and used contributions designated to the general election to make up the difference. The Audit staff's review identified \$12,396 in contributions designated to the general election that were spent on primary election expenses prior to the primary election date. In the PAR, the Audit staff recommended that GJ2012 provide documentation to demonstrate that general election contributions were not used to fund primary election activity. In accordance with 11 CFR §102.9, documentation should have demonstrated that an acceptable accounting method was used. Absent such a demonstration, GJ2012 was to provide any additional comments it considered necessary with respect to this matter.

In response to the PAR recommendation, GJ2012 stated that the \$12,396 was treated as an advance against anticipated matching funds from the general election contributions to the primary election.

The Audit staff disagrees with GJ2012's contention. To the extent that GJ2012 is characterizing the advance of general election funds as a loan to the primary account, it is noted that regulations specify that such loans or advances must come from a qualified financial institution, which the general account is not. It is also noted that short term loans to Presidential primary committees were obtained in the past, however, these loans were secured by matching fund amounts certified and expected to be received by the committees and occurred only when the Presidential Campaign fund was in a shortfall position. Matching funds for GJ2012 were not certified until May 25, 2012 and the Presidential Campaign fund was not in a shortfall position in 2012. In no instances were general election contributions permitted to be used for primary election expenditures. These conclusions were stated in the DFAR presented to GJ2012.

Also in response to the PAR recommendation, GJ2012 stated that they "...used an acceptable accounting method in accordance with 11 CFR §102.9," and that there were separate accounts for primary and general election contributions.

As explained in the "Committee Structure" section on pages 1 and 2 of the PAR and DFAR, in practice, GJ2012 deposited nearly all receipts before the Candidate's date

of ineligibility (DOI) in its designated primary account and nearly all receipts after DOI in its designated general account. GJ2012 did not submit any documentation other than a statement about the accounting method it employed.

In its response to the DFAR, GJ2012 requested that its arguments regarding the advance of general election funds based on anticipated matching funds be reconsidered. The Audit staff maintains that GJ2012 was not permitted to use general election funds for primary election activity prior to the Candidate's DOI.

**Finding 4 – Reporting of Debts and Obligations.** This finding is based on GJ2012 not disclosing a total of \$447,567 in debts owed to nine vendors on Schedule D-P (Debts and Obligations) as required under 11 CFR §104.11(b).

In the PAR presented to GJ2012, Finding 4 noted that during audit fieldwork, the Audit staff identified debts to seven of GJ2012's vendors totaling \$407,455 that were not reported on Schedule D-P as required. Of these debts, \$300,000 was owed to its major vendor NSON<sup>1</sup> for a bonus after the Candidate received the nomination as the Libertarian Party candidate for the Presidential general election. This bonus was incurred, per contract, as of the date of nomination, May 4, 2012, and should have been reported on the 2012 June Monthly report, covering the time period from May 1, 2012 through May 31, 2012. In the PAR, the Audit staff recommended that GJ2012 provide documentation demonstrating that these expenditures did not require reporting on Schedule D-P. Absent such documentation, the Audit staff recommended that GJ2012 amend its reports to disclose the outstanding debts.

In response to the PAR, GJ2012 submitted additional invoices and documentation for other previously undisclosed debts. Adjustments made by the Audit staff based on the additional documentation provided reduced the original determination of debts and obligations not timely reported amount by \$7,758. GJ2012 submitted additional invoices from two new vendors that were not previously provided to the Audit staff, nor disclosed on Schedule D-P, for debts incurred within the audit period totaling \$47,870. In combination with the seven vendors noted in the PAR, the Audit staff identified a total of nine vendors that GJ2012 owed \$447,567 that was not reported on Schedule D-P as required. GJ2012 filed amendments that materially corrected these omissions.

The DFAR noted the above response to the PAR and stated that GJ2012 had materially corrected its reporting of debts and obligations.

In response to the DFAR, GJ2012 made no further comment directly about the content of Finding 4, but made an argument that relates to Finding 2.

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<sup>1</sup> NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

The Audit staff concludes that GJ2012 failed to report \$447,567 on Schedule D-P as required at the time it was incurred, but did amend reports to materially correct the reporting of debts and obligations.

**Finding 5 – Extension of Credit by a Commercial Vendor.** This finding is based on the Audit staff’s review of GJ2012’s disbursements, which suggested that NSON made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered, in violation of 52 U.S.C. §30118(a).

In the PAR presented to GJ2012, Finding 5 noted that the Audit staff’s review of GJ2012’s disbursements suggested that NSON made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered relating to the primary election<sup>2</sup>. From April 21, 2011 through December 21, 2012, NSON invoiced GJ2012 \$2,198,204 for campaign management expenses, including fundraising, clerical work, and travel arrangements. As of March 31, 2013, \$1,752,032 had been outstanding more than 120 days, and \$936,247 remains outstanding. To date, GJ2012 has only made payments of \$1,261,957 for the \$2,198,204 invoiced by NSON. NSON had not assessed any interest charges as of March 31, 2013. Audit staff also did not locate any documentation of attempts by NSON to collect on the outstanding debt in the records provided by GJ2012. In response to the exit conference, GJ2012 submitted documents internally generated by NSON and a statement from NSON that attempts had been made to collect on the debt and that attempts to collect would continue. GJ2012 also submitted new invoices for interest owed to NSON.

In the PAR, Audit staff recommended that GJ2012 provide documentation, to include statements from this vendor that demonstrates the credit extended was in the normal course of business and did not represent an excessive in-kind contribution by the vendor. Also, GJ2012 should provide information concerning the presence of safeguards such as billing policies for similar non-political clients and work, advance payment policies, and debt collection policies and practices to show that this was normal business practice for NSON or provide additional explanation about the situation.

In response to the PAR, GJ2012 provided additional information about the business practices of NSON. In an affidavit, Ron Nielson, the proprietor of NSON, stated that his company did not extend credit to GJ2012 that it would not have extended to a similar non-political campaign. Mr. Nielson stated that NSON exercises discretion in the assessing and collecting of finance charges in order to collect on the principal, and that NSON has previously waived finance charges in favor of collecting on the principal. In addition, Mr. Nielson stated that NSON has engaged in discussions with GJ2012 to accept campaign assets in lieu of payment. GJ2012 also submitted redacted contracts that NSON used for other political and non-political campaigns. The non-redacted portions of these contracts are substantially similar to the one signed by GJ2012. Counsel for GJ2012 further states that NSON acted according to normal and usual practice in the

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<sup>2</sup> Audit staff restricted this review to only primary campaign services, as per the scope of this Audit.

industry, and that NSON and its competitors frequently extend credit to clients seeking similar services in anticipation that doing so would enable the clients to raise funds.

In addition, Counsel for GJ2012 stated that NSON and GJ2012 were negotiating for the acceptance of campaign assets in lieu of payments owed, and that NSON may waive interest fees “as is routine in such matters.”

The DFAR noted the response from GJ2012, and stated that the NSON contracts provided by GJ2012 are redacted to the extent that the Audit staff cannot verify whether or not the clients are political or non-political. Since the nature of these entities cannot be verified, the Audit staff does not find these contracts to be adequate evidence that credit was extended to GJ2012 in the same way as other political and non-political clients.

Furthermore, documentation provided by GJ2012 to show that NSON attempted to collect on outstanding debts did not show that “NSON regularly invoiced GJ2012 for all services...” In fact, GJ2012 was not invoiced for services in some cases until months or even more than a year after the services were performed. NSON did not submit invoices for interest due on amounts owed until December 31, 2013, more than a year after the Candidate’s date of ineligibility, for invoices that had been outstanding for thirteen to twenty-two months. In addition, no documentation such as invoices to other non-political clients has been presented to show that NSON has also treated the collection of amounts due by non-political clients in the same manner.

In response to the DFAR, GJ2012 stated that it would be an unreasonable burden to expect NSON to identify its clients and that the contracts as submitted show enough information to show that other clients were treated similarly to GJ2012. GJ2012 also stated that Audit staff was using a relatively small number of invoices as evidence that invoices were not submitted in a timely manner, and contends that these invoices were exceptions to the normal procedure. GJ2012 further stated that it is not outside the normal course of business for an entity to be late in issuing invoices.

The Audit staff notes that GJ2012 and NSON did previously reveal the names of some of NSON’s other clients when the internally generated documents were submitted in response to the exit conference. The clients revealed at the time were by and large political clients, and thus Audit staff cannot be certain that the redacted contracts submitted in response to the PAR were not all to political clients.

The Audit staff also notes that no invoices for interest due on outstanding amounts were submitted until well after the time when the original invoiced amounts were due. Furthermore, documentation submitted to Audit staff during audit fieldwork shows that twenty-nine invoices were sent totaling \$1,142,689 for primary election activity through May of 2012. Thirty-one invoices revising those primary election invoices, and invoices for additional activity and expenses for the primary campaign were then sent on December 18, 2012 totaling an additional amount billed of \$1,268,610. The Audit staff does not view this as a small number of invoices or small amount of billing, and does not see evidence that these late invoices were an exception to the rule in the

billing of GJ2012. The Audit staff maintains that GJ2012 has still not shown that NSON conducted business with it in the same way as other political *and* non-political clients, nor has GJ2012 shown that NSON made commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered.

Documents related to this audit report can be viewed in the Voting Ballot Matters folder. Should you have any questions, please contact Camilla Reminsky or Marty Favin at 694-1200.

Attachments:

- Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc
- Office of General Counsel Legal Analysis, dated March 18, 2015
- GJ2012 Response to Draft Final Audit Report, dated April 14, 2015

cc: Office of General Counsel



# Draft Final Audit Report of the Audit Division on Gary Johnson 2012, Inc

(April 1, 2011 – November 30, 2014)

## Why the Audit Was Done

Federal law requires the Commission to audit every political committee established by a candidate who receives public funds for the primary campaign.<sup>1</sup> The audit determines whether the candidate was entitled to all of the matching funds received, whether the campaign used the matching funds in accordance with the law, whether the candidate is entitled to additional matching funds, and whether the campaign otherwise complied with the limitations, prohibitions, and disclosure requirements of the election law.

## 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. 3)

Gary Johnson 2012, Inc is the principal campaign committee for Gary Johnson, a candidate for the Libertarian Party nomination for the office of President of the United States. The Committee is headquartered in Salt Lake City, Utah. For more information, see the chart on the Campaign Organization, p. 3.

## Financial Activity (p. 4)

• <b>Receipts</b>	
○ Contributions from Individuals	\$ 2,249,318
○ Matching Funds Received	510,261
<b>Total Receipts</b>	<b>\$ 2,759,579</b>
• <b>Disbursements</b>	
○ Operating Expenditures	\$ 2,534,497
○ Fundraising Disbursements	153,019
○ Exempt Legal and Accounting Disbursements	28,130
<b>Total Disbursements</b>	<b>\$ 2,715,646</b>

## Findings and Recommendations (p. 5)

- Net Outstanding Campaign Obligations (Finding 1)
- Amounts Owed to the U.S. Treasury (Finding 2)
- Use of General Election Contributions for Primary Election Expenses (Finding 3)
- Reporting of Debts and Obligations (Finding 4)
- Extension of Credit by a Commercial Vendor (Finding 5)

<sup>1</sup> 26 U.S.C. §9038(a).

**Draft Final Audit Report of the  
Audit Division on  
Gary Johnson 2012, Inc**

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(April 1, 2011 – November 30, 2014)



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# Part I

## Background

### Authority for Audit

This report is based on an audit of Gary Johnson 2012, Inc (GJ2012), undertaken by the Audit Division of the Federal Election Commission (the Commission) as mandated by Section 9038(a) of Title 26 of the United States Code. That section states, “After each matching payment period, the Commission shall conduct a thorough examination and audit of the qualified campaign expenses of every candidate and his authorized committees who received [matching] payments under section 9037.” Also, Section 9039(b) of the United States Code and Section 9038.1(a)(2) of the Commission’s Regulations state that the Commission may conduct other examinations and audits from time to time as it deems necessary.

### Scope of Audit

This audit examined original and amended reports filed by GJ2012 before the audit notification letter was sent on December 3, 2012<sup>2</sup>. The audit also examined the original filings of the 2012 30 Day Post-General and Year-End reports. The following areas were covered by this audit:

1. the campaign’s compliance with limitations for contributions and loans;
2. the campaign’s compliance with the limitations for candidate contributions and loans;
3. the campaign’s compliance with the prohibition on accepting prohibited contributions;
4. the disclosure of contributions received;
5. the disclosure of disbursements, debts and obligations;
6. the consistency between reported figures and bank records;
7. the accuracy of the Statement of Net Outstanding Campaign Obligations;
8. the campaign’s compliance with spending limits;
9. the completeness of records; and
10. other campaign operations necessary to the review.

### Inventory of Campaign Records

The Audit staff routinely conducts an inventory of campaign records before it begins audit fieldwork. GJ2012’s records were materially complete and fieldwork commenced immediately.

### Committee Structure

GJ2012 was the only campaign committee authorized by Gary Johnson, the Candidate, for the 2012 Presidential election. This committee conducted both primary and general election activity for the Candidate. GJ2012 opened two bank accounts: a primary account and a general account. In practice, GJ2012 deposited nearly all contributions

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<sup>2</sup> Amendments filed after December 3, 2012, were given a limited review to determine if issues noted in the Preliminary Audit Report were corrected by GJ2012.

received before the Candidate's nomination in the primary account, and most contributions received after the nomination in the general account. GJ2012 received matching funds for the primary campaign and this audit covered committee activity and information obtained to determine whether or not expenses were qualified campaign expenses defrayed in connection with the primary election.

## Part II

### Overview of Campaign

#### Campaign Organization

<b>Important Dates</b>	
• Date of Registration	April 22, 2011
• Date of Ineligibility <sup>3</sup>	May 5, 2012
• Audit Coverage	April 1, 2011 - November 30, 2014 <sup>4</sup>
<b>Headquarters</b>	Salt Lake City, Utah
<b>Bank Information</b>	
• Bank Depositories	One
• Bank Accounts	One primary checking account and one general checking account
<b>Treasurer</b>	
• Treasurer When Audit Was Conducted	Chet Goodwin
• Treasurer During Period Covered by Audit	Elizabeth Hepworth (4/22/11 – 1/4/12) Chet Goodwin (1/5/12 – Present)
<b>Management Information</b>	
• Attended Commission Campaign Finance Seminar	No
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

<sup>3</sup> A threshold submission was submitted on April 26, 2012, and the Commission certified the Candidate as eligible to receive matching funds on May 24, 2012. The period during which the Candidate was eligible for matching funds ended on May 5, 2012, his date of ineligibility (DOI). However, GJ2012 submitted contributions for matching funds it had received before DOI. Due to the campaign's outstanding debt, GJ2012 was able to submit primary election contributions received after DOI for matching as well.

<sup>4</sup> The Audit staff conducted limited reviews of receipts and expenditures after December 31, 2012 to determine whether the Candidate was eligible to receive additional matching funds.

## Overview of Financial Activity (Audited Amounts)

<b>Cash-on-hand @ April 1, 2011</b>	<b>\$ 0</b>
<b>Receipts</b>	
○ Contributions from Individuals <sup>5</sup>	2,249,318
○ Matching Funds Received <sup>6</sup>	510,261
<b>Total Receipts</b>	<b>\$ 2,759,579</b>
<b>Disbursements</b>	
○ Operating Expenditures	2,534,497
○ Fundraising Disbursements	153,019
○ Exempt Legal and Accounting Disbursements	28,130
<b>Total Disbursements</b>	<b>\$ 2,715,646</b>
<b>Cash-on-hand @ December 31, 2012</b>	<b>\$ 43,933</b>

<sup>5</sup> CiJ2012 received approximately 24,500 contributions from more than 1,400 individuals.

<sup>6</sup> As of the Candidate's DOI (May 5, 2012), GJ2012 had received no matching funds. GJ2012 received 6 payments totaling \$632,017 as of January 8, 2013.

## **Part III**

### **Summaries**

#### **Findings and Recommendations**

##### **Finding 1. Net Outstanding Campaign Obligations**

The Audit staff's review of GJ2012's financial activity through November 30, 2014, and estimated winding down costs indicated that the Candidate did not receive matching fund payments in excess of his entitlement.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the Preliminary Audit Report. (For more detail, see p. 8.)

##### **Finding 2. Amounts Owed to the U.S. Treasury**

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements determined that primary election funds were spent on non-qualified campaign expenses and that matching funds were received for contributions that were not eligible to be matched.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information, and disputed the Audit staff's conclusion. Audit staff does not find GJ2012's arguments compelling, and recommends that the Commission make a determination that \$333,441 is payable to the United States Treasury. (For more detail, see p. 11.)

##### **Finding 3. Use of General Election Contributions for Primary Election Expenses**

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements during the pre-DOI period indicated that GJ2012 spent \$12,396 in general election receipts on primary election expenses prior to the Candidate's DOI.

In response to the Preliminary Audit Report, GJ2012 stated that the use of general election receipts for primary election expenses was an advance against anticipated matching funds. The Audit staff notes that short-term advances against matching funds must come from a qualified financial institution, and be secured by certified matching funds amounts. (For more detail, see p. 18.)

##### **Finding 4. Reporting of Debts and Obligations**

During audit fieldwork, the Audit staff's review of GJ2012's disbursements indicated that debts from seven vendors totaling \$407,455 were not disclosed on Schedule D-P (Debts and Obligations), as required.

In response to the Preliminary Audit Report, GJ2012 submitted additional invoices for debts to two vendors that were not previously disclosed to Audit staff. This resulted in a total of \$447,567 in debts owed to nine vendors that were not disclosed on Schedule D-P as required. GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P. (For more detail, see p. 20.)

**Finding 5. Extension of Credit by a Commercial Vendor**

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON<sup>7</sup> made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered.

In response to the Preliminary Audit Report, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. However, neither GJ2012 nor the vendor presented any documentation to demonstrate that other clients were subject to the same billing practices, or that GJ2012 was regularly and timely billed for services rendered. (For more detail, see p. 22.)

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<sup>7</sup> NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

## Summary of Amounts Owed to the United States Treasury

• Finding 2.A. (p. 13)	Payment of Non-Qualified Expenses with Primary Election Funds	\$ 332,191
• Finding 2.B. (p. 15)	Receipt of Matching Funds Based on Ineligible Contributions	1,250
	<b>Total Due U.S. Treasury</b>	<b>\$ 333,441</b>

## Part IV

# Findings and Recommendations

### Finding 1. Net Outstanding Campaign Obligations

#### Summary

The Audit staff's review of GJ2012's financial activity through November 30, 2014, and estimated winding down costs indicated that the Candidate did not receive matching fund payments in excess of his entitlement.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the Preliminary Audit Report.

#### Legal Standard

**A. Net Outstanding Campaign Obligations (NOCO).** Within 15 days after the candidate's date of ineligibility (see definition below), the candidate must submit a statement of "net outstanding campaign obligations." This statement must contain, among other things:

- The total of all committee assets including cash on hand, amounts owed to the committee and capital assets listed at their fair market value;
- The total of all outstanding obligations for qualified campaign expenses; and
- An estimate of necessary winding-down costs. 11 CFR §9034.5(a).

**B. Date of Ineligibility.** The date of ineligibility is whichever of the following dates occurs first:

- The day on which the candidate ceases to be active in more than one state;
- The 30th day following the second consecutive primary in which the candidate receives less than 10 percent of the popular vote;
- The end of the matching payment period, which is generally the day when the party nominates its candidate for the general election; or
- In the case of a candidate whose party does not make its selection at a national convention, the last day of the last national convention held by a major party in the calendar year. 11 CFR §§9032.6 and 9033.5.

**C. Definition of Non-Qualified Campaign Expense.** A non-qualified campaign expense is any expense that is not included in the definition of a qualified campaign expense (see below).

**D. Qualified Campaign Expense.** Each of the following expenses is a qualified campaign expense.

- An expense that is:

- Incurred by or on behalf of the candidate (or his or her campaign) during the period beginning on the day the individual becomes a candidate and continuing through the last day of the candidate's eligibility under 11 CFR §9033.5;
- Made in connection with the candidate's campaign for nomination; and
- Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9032.9.
- An expense incurred for the purpose of determining whether an individual should become a candidate, if that individual subsequently becomes a candidate, regardless of when that expense is paid. 11 CFR §9034.4.
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).

**E. Entitlement to Matching Payments after Date of Ineligibility.** If, on the date of ineligibility (see above), a candidate has net outstanding campaign obligations as defined under 11 CFR §9034.5, that candidate may continue to receive matching payments for matchable contributions received and deposited on or before December 31<sup>st</sup> of the Presidential election year provided that he or she still has net outstanding campaign debts on the day when the matching payments are made. 11 CFR §9034.1(b).

**F. Winding Down Costs.** A primary election candidate who does not run in the general election may receive and use matching funds after notifying the Commission in writing of the candidate's withdrawal from the campaign for nomination or after the date of the party's nominating convention, if the candidate has not withdrawn before the convention. A primary election candidate who runs in the general election must wait until 31 days after the general election before using any matching funds for winding down costs, regardless of whether the candidate receives public funds for the general election. 11 CFR §9034.11(d).

## **Facts and Analysis**

### **A. Facts**

The Candidate's date of ineligibility (DOI) was May 5, 2012. The Audit staff reviewed GJ2012's financial activity through November 30, 2014, analyzed estimated winding down costs and prepared the Statement of Net Outstanding Campaign Obligations that appears on the following page.

**Gary Johnson 2012, Inc**  
**Statement of Net Outstanding Campaign Obligations**  
**As of May 5, 2012**  
**Prepared February 10, 2015**

**Assets**

Cash in bank	\$ (10,856) <sup>8</sup>	
<b>Total Assets</b>		<b>\$ (10,856)</b>

**Liabilities**

Accounts Payable (AP) for Qualified Campaign Expenses as of 5/5/12	\$ (1,268,352)	
AP (Primary Account) Billed Post-DOI	(713,952)	
Winding Down (WD) Costs (5/5/12 – 12/6/12)	0	
Actual WD Costs (12/7/12 - 11/30/14) [a]	(22,899)	
Estimated WD Costs (12/1/14 - 6/30/15) [b]	(112,268)	
<b>Total Liabilities</b>		<b>\$(2,117,471)</b>

**Net Outstanding Campaign Obligations (Deficit) as of May 5, 2012** **\$(2,128,327)**

**Footnotes to NOCO Statement:**

- [a] The General election was held on November 6, 2012. The winding down period began 31 days after the General election on December 7, 2012.
- [b] Estimated winding down costs will be compared to actual winding down costs and adjusted accordingly.

Shown below are adjustments for funds received after the Candidate's DOI on May 5, 2012 through January 8, 2013, the date GJ2012 received its last matching fund payment.

Net Outstanding Campaign Obligations (Deficit) as of May 5, 2012		\$(2,128,327)
Less: Contributions Received (May 6, 2012 to January 8, 2013)		1,216,661
Less: Matching Funds Received through January 8, 2013		632,017
<b>Remaining Net Outstanding Campaign Obligations (Deficit) as of January 8, 2013<sup>9</sup></b>		<b>\$ (279,649)</b>

As presented above, the Candidate has not received matching funds in excess of his entitlement.

<sup>8</sup> The primary election campaign's May 5, 2012 cash balance was negative due to short term use of funds from the general election account. (see Finding 3 on page 16 for more detail).

<sup>9</sup> GJ2012 and its major vendor, NSON, are discussing the possibility of waiving the interest on debts not repaid. If this debt is forgiven, the NOCO will require an adjustment. See Finding 5 for additional detail.

### **B. Preliminary Audit Report Recommendation**

The Audit staff presented a preliminary NOCO statement and related work papers to GJ2012 representatives at the exit conference. The preliminary NOCO statement showed that GJ2012 was in a surplus position and GJ2012 would be required to repay some matching funds received to the U.S. Treasury<sup>10</sup>. Audit staff requested that GJ2012 provide additional documentation after the exit conference to enable the Audit staff to update the NOCO statement as necessary. On January 24, 2014, and June 18, 2014, GJ2012 submitted additional invoices in support of debts incurred for primary election expenses. These additional invoices were mostly for interest owed on debts incurred in relation to the primary election that had not been paid, and one invoice previously not provided to the Audit staff for a debt incurred for fundraising activity in relation to the primary election. The Audit staff reviewed this documentation and revised the NOCO accordingly. As a result of this additional documentation, the revised NOCO indicated that the Candidate did not receive matching funds in excess of his entitlement.

The Audit staff recommended that GJ2012 demonstrate any adjustments it believes are required in connection with any part of the NOCO statement or provide any other additional comments.

### **C. Committee Response to Preliminary Audit Report**

In response to the Preliminary Audit Report recommendation, GJ2012 did not dispute the NOCO calculations contained on the Preliminary Audit Report, however, provided additional bank statements and invoices to show actual and additional estimated winding down costs as well as additional accounts payable for qualified campaign expenses. These expenses have been incorporated into the revised NOCO that reflects a deficit of \$279,649 as of November 30, 2014. The revised NOCO indicates that the Candidate did not receive matching funds in excess of his entitlement<sup>11</sup>.

## **Finding 2. Amounts Owed to the U.S. Treasury**

### **Summary**

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements determined that primary election funds were spent on non-qualified campaign expenses and that matching funds were received for contributions that were not eligible to be matched.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information, and disputed the Audit staff's conclusion. Audit staff does not

<sup>10</sup> This NOCO was prepared on December 12, 2013, and contains the same figures as the NOCO prepared on May 8, 2013. The May 8, 2013 NOCO was included in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.

<sup>11</sup> GJ2012 and its major vendor, NSON, are discussing the possibility of waiving the interest on debts not repaid. If this debt is forgiven, the NOCO will require an adjustment. See Finding 5 for additional detail.

find GJ2012's arguments compelling, and recommends that the Commission make a determination that \$333,441 is payable to the United States Treasury.

### **Legal Standard**

**A. Qualified Campaign Expense.** Each of the following expenses is a qualified campaign expense.

- An expense that is:
  - Incurred by or on behalf of the candidate (or his or her campaign) during the period beginning on the day the individual becomes a candidate and continuing through the last day of the candidate's eligibility under 11 CFR §9033.5;
  - Made in connection with the candidate's campaign for nomination; and
  - Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9032.9.
- An expense incurred for the purpose of determining whether an individual should become a candidate, if that individual subsequently becomes a candidate, regardless of when that expense is paid. 11 CFR §9034.4.
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).

**B. Definition of Non-Qualified Campaign Expense.** A non-qualified campaign expense is any expense that is not included in the definition of a qualified campaign expense (see above). These include, for example, but are not limited to:

- Excessive expenditures. An expenditure which is in excess of any of the limitations under 11 CFR §9035 shall not be considered a qualified campaign expense.
- General election and post-ineligibility expenditures. Except for winding down costs pursuant to 11 CFR §9034.4(a)(3) and certain convention expenses described in 11 CFR §9034.4(a)(6), any expenses incurred after a candidate's date of ineligibility, as determined under 11 CFR §9033.5, are not qualified campaign expenses. In addition, any expenses incurred before the candidate's date of ineligibility for goods and services to be received after the candidate's date of ineligibility, or for property, services, or facilities used to benefit the candidate's general election campaign, are not qualified campaign expenses.
- Civil or criminal penalties. Civil or criminal penalties paid pursuant to the Federal Election Campaign Act are not qualified campaign expenses and cannot be defrayed from contributions or matching payments. Any amounts received or expended to pay such penalties shall not be considered contributions or expenditures but all amounts so received shall be subject to the prohibitions of the Act.
- Payments to candidate. Payments made to the candidate by his or her committee, other than to reimburse funds advanced by the candidate for qualified campaign expenses, are not qualified campaign expenses.
- Lost, misplaced, or stolen items. The cost of lost, misplaced, or stolen items may be considered a nonqualified campaign expense. Factors considered by the Commission in making this determination shall include, but not be limited to,

whether the committee demonstrates that it made conscientious efforts to safeguard the missing equipment; whether the committee sought or obtained insurance on the items; whether the committee filed a police report; the type of equipment involved; and the number and value of items that were lost. 11 CFR §9034.4(b).

**C. Matching Funds Used for Non-Qualified Campaign Expenses.** If the Commission determines that a campaign used matching funds for non-qualified campaign expenses, the candidate must repay the Secretary of the United States Treasury an amount equal to the amount of matching funds used for the non-qualified campaign expenses. 26 U.S.C. §9038(b)(2)(A).

**D. Seeking Repayment for Non-Qualified Campaign Expenses.** In seeking repayment for non-qualified campaign expenses from committees that have received matching fund payments after the candidate's date of ineligibility, the Commission will review committee expenditures to determine at what point committee accounts no longer contain matching funds. In doing this, the Commission will review committee expenditures from the date of the last matching funds payment to which the candidate was entitled, using the assumption that the last payment has been expended on a last-in, first-out basis. 11 CFR §9038.2(b)(2)(iii)(B).

**E. Primary Winding Down Costs During the General Election Period.** A primary election candidate who runs in the general election, regardless of whether the candidate receives public funds for the general election, must wait until 31 days after the general election before using any matching funds for winding down costs related to the primary election. No expenses incurred by a primary election candidate who runs in the general election prior to 31 days after the general election shall be considered primary winding down costs. 11 CFR §9034.11(d).

**F. How to Determine Repayment Amount for Non-Qualified Campaign Expenses When Candidate in Surplus Position.** If a candidate must make a repayment to the United States Treasury because his or her campaign used matching funds to pay for non-qualified campaign expenses, the amount of the repayment must equal that portion of the surplus that bears the same ratio to the total surplus that the total amount received by the candidate from the matching payment account bears to the total deposits made to the candidate's accounts. 11 CFR §9038.2(b)(2)(iii).

**G. Bases for Repayment.** The Commission may determine that certain portions of the payments made to a candidate from the matching payment account were in excess of the aggregate amount of payments to which such candidate was entitled. Examples of such excessive payments include, but are not limited to, the following:

- Payments or portions of payments made on the basis of matched contributions later determined to have been non-matchable 11 CFR §9038.2(b)(1)(iii).

**H. Notification of Repayment Obligation.** The Commission will notify a candidate of any repayment determinations as soon as possible, but no later than three years after the

close of the matching payment period. The Commission's issuance of the audit report to the candidate (under 11 CFR §9038.1(d)) will constitute notification for purposes of this section. 11 CFR §9038.2(a)(2).

## **Facts and Analysis**

### **A. Payment of Non-Qualified Expenses with Primary Election Funds**

#### **1. Facts**

During an examination of disbursement records, the Audit staff identified \$1,199,701<sup>12</sup> in disbursements for general election expenses paid with primary election funds. Of this amount, disbursements totaling \$1,192,400 occurred during the period between the Candidate's DOI, May 5, 2012, and 31 days after the general election, December 7, 2012. During this period, expenses incurred are not considered primary winding down costs. Since these expenses are not related to the primary election of the Candidate, they are considered non-qualified campaign expenses.

In the post-election wind-down period, when wind-down expenses must be allocated between the primary and general election campaigns, \$7,301 was spent<sup>13</sup>. Since these amounts were not allocated between campaigns, these are also non-qualified expenses. Additionally, the accounting staff for GJ2012 stated that expenses identified by themselves, or by NSON, as general election expenses were paid from the general account, and expenses identified as primary expenses were paid from the primary account. Of the expenses identified by Audit staff as non-qualified expenses, expenses totaling \$1,191,856 were paid out of the general account.

After the Candidate's DOI, GJ2012 continued to raise funds to pay off the debt incurred during the primary election, as permitted by law. Approximately \$1.2 million in private contributions designated for the primary election were deposited into GJ2012's general election account, and were used to pay general election expenses. Audit staff determined the private contributions designated for the primary election using the same calculations as in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.

To determine which general election expenses were paid using the contributions designated for the primary election, Audit staff followed the following procedures:

1. Used the list of primary and general contributions calculated for the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.
2. Used GJ2012's disbursement database of disbursements from the primary election account. The dates from GJ2012's database were the check dates

<sup>12</sup> The initial amount of non-qualified expenses was subsequently reduced to \$1,194,425 after the Audit staff calculated the matching funds cut-off date earlier (December 20, 2012) than had been previously calculated.

<sup>13</sup> The amount using an end date of December 20, 2012 (as explained in the previous footnote) is \$2,025.

- rather than the dates that the checks cleared the bank account. Any disbursements from the bank statements that were not in GJ2012's database were also included by Audit staff in this review. The same procedure was followed for the review of the general election account.
3. For each day analyzed, Audit staff first summed the three different types of receipts separately (primary contributions, general contributions and receipts of matching funds from the U.S. Treasury). Contributions were considered spent on a first-in, first-out (FIFO) basis. If multiple types of contributions were received on the same day, the contributions were applied to disbursements in the following order: primary, general, matching funds.
  4. The last day that any primary election contributions submitted for matching funds were still in the general election account was December 20, 2012. Therefore, the calculation of non-qualified campaign expenses from that account ended on that date.

Following these procedures resulted in the most favorable repayment calculation for GJ2012.

Pursuant to 11 CFR §9038.2(b)(2)(iii)(B), calculation of non-qualified expenses from all of GJ2012's accounts would continue until no matching funds were left in any of the accounts. This "zero-out date" occurred on February 20, 2014. In order to completely and accurately calculate whether non-qualified expenses were paid with matching funds, Audit staff needed information from GJ2012 about contributions received so that the amounts received for the primary and general elections could be accurately recorded. Although this information was requested, GJ2012 provided no contribution detail dated after December 31, 2012. In addition, although Audit staff requested bank statements, no bank statements for the general account were received after the November 2013 statement. This type of information is regularly requested from committees that have received federal matching funds. Without these bank statements, Audit staff does not know what expenditures have been made and cannot determine if these expenditures were for the primary or general election. Given the lack of documentation, Audit staff was unable to verify the receipts or expenditures after December 31, 2012. However, the Audit staff was able to verify the date the last contribution submitted for matching funds was deposited to the general account. Thus, the Audit staff used December 20, 2012, as the cutoff date for examining the both accounts for non-qualified expenses.<sup>14</sup>

In accordance with 11 CFR §9038.2(b)(2)(iii), the ratio of repayment was calculated at 27.9053%.<sup>15</sup> This ratio applied to the non-qualified expenses equals a repayment amount of \$334,780<sup>16</sup>.

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<sup>14</sup> Audit staff's estimate of the additional amount of possible non-qualified expenses is \$16,000, which would result in an additional repayment amount of about \$4,450. The \$16,000 estimate is based on the provided bank statements through November 2014, and assumes that all the expenses were paid using contributions to the primary election.

<sup>15</sup> Matching funds certified as of 90 days post-DOI divided by deposits for the Primary election as of 90 days post-DOI ( $\$303,751/\$1,088,509=.279053$ ).

## **2. Preliminary Audit Report Recommendation**

The Audit staff presented this matter to GJ2012 representatives at the exit conference along with schedules detailing the finding. GJ2012 representatives did not comment on this finding. The Audit staff recommended that GJ2012 demonstrate it did not make non-qualified expenses or provide any other additional comments it deemed necessary. It was further recommended that, absent such evidence, the Audit staff would recommend that the Commission determine that \$334,780<sup>17</sup> is repayable to the U.S. Treasury.

## **3. Committee Response to Preliminary Audit Report**

In response to the Preliminary Audit Report, GJ2012 counsel stated that since qualified campaign expenses exceeded the amount of matching funds received by \$95,585, "...no matching funds were used to pay for non-qualifying campaign expenses..." In addition, GJ2012 claims that certain non-qualified campaign expenses totaling \$1,220 identified by the Audit staff were paid solely with available general election funds. GJ2012 also states that expenses totaling \$7,301 identified as being unallocated between primary and general activities were not paid with matching funds but solely with general election funds.

In each of the instances noted above, GJ2012's calculation fails to apply the amount of private contributions received and applied towards remaining net outstanding campaign obligations after the Candidate's DOI. Pursuant to 11 CFR §9034.4, "...all contributions received by an individual from the date he or she becomes a candidate and all matching payments received by the candidate shall be used only to defray qualified campaign expenses..." Therefore, the Audit staff maintains that both the amount of private contributions and the amount of matching funds are applied to qualified campaign expenses. According to the Audit staff, this calculation continues to indicate that matching funds were part of GJ2012's account balance until February 20, 2014 and prior to that time the identified non-qualified campaign expenses for the general election were paid, in part, with primary election matching funds and are subject to repayment.

GJ2012's response also references newly discovered debts and other debts related to the Primary activity, including a \$300,000<sup>18</sup> win bonus owed to NSON, and states that these debts should be included in the calculation. In doing so, GJ2012 asserts that this would move up the date on which Federal matching funds were no longer in

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<sup>16</sup> The ratio applied to the Audit staff's revised non-qualified expenses using an end calculation date of December 20, 2012 (as explained in footnote 12) is \$333,307.

<sup>17</sup> See footnote 16.

<sup>18</sup> GJ2012 further states that the bonus is a qualified campaign expense, however, pursuant to 11 CFR §9034.4(a)(5)(ii), monetary bonuses must be paid no later than thirty days after the date of ineligibility to be considered qualified campaign expenses. These bonuses have not been paid, therefore, the \$300,000 bonus owed to NSON is a non-qualified campaign expense, and as such, is not reflected in the NOCO (Finding 1).

the account, thereby reducing the repayment amount.<sup>19</sup> The Audit staff notes that debts are not part of the calculation of non-qualified expenses. Expenditures considered in a repayment determination under 11 CFR 9038.2(b)(2(ii) and (3) include all non-qualified and undocumented expenditures incurred and **paid** between the campaign's date of inception, and the date on which the candidate's accounts no longer contain any matching funds. Outstanding debts and newly discovered debts are not included in the repayment calculation.

Finally, GJ2012's response noted an expense incorrectly classified by Audit staff as a general election expense instead of a primary election expense. The amount of identified non-qualified campaign expense has been adjusted to be considered as a qualified campaign expense and accordingly, the Audit staff has reduced the total repayment amount by \$1,116 (\$4,000 x 27.9053%).

The Audit staff recommends that the Commission make a determination that \$332,191 is repayable to the U.S. Treasury.

## **B. Receipt of Matching Funds Based on Ineligible Contributions**

### **1. Facts**

During an examination of receipts in audit fieldwork, the Audit staff identified five contributions designated to the general election totaling \$8,000 that were submitted for matching funds. These contributions were ineligible to be matched for primary election funds. The amount of matching funds awarded for these ineligible contributions was \$1,250.

### **2. Preliminary Audit Report Recommendation**

The Audit staff presented this matter to GJ2012 representatives at the exit conference along with schedules detailing the finding. GJ2012 representatives did not comment on this finding. The Audit staff recommended that GJ2012 show that the contributions were not general election contributions or provide any other additional comments it deemed necessary. It was further recommended that, absent such evidence, the Audit staff would make a recommendation that the Commission make a determination that \$1,250 is repayable to the U.S. Treasury.

### **3. Committee Response to Preliminary Audit Report**

In response to the Preliminary Audit Report recommendation, GJ2012 stated that it was investigating whether or not these contributions were "...accidentally attributed to the wrong spouse." If the Committee's investigation determines that the contributions were, in fact, ineligible, Counsel states that GJ2012 would refund the appropriate amount to the U.S. Treasury.

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<sup>19</sup> Non-qualified expenses paid after the candidate's accounts are presumed to have been purged of all matching funds are not subject to repayment since the candidate's accounts contained no matching funds.

The Audit staff recommends that the Commission make a determination that \$1,250 is repayable to the U.S. Treasury.

### **Finding 3. Use of General Election Contributions for Primary Election Expenses**

#### **Summary**

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements during the pre-DOI period indicated that GJ2012 spent \$12,396 in general election receipts on primary election expenses prior to the Candidate's DOI.

In response to the Preliminary Audit Report, GJ2012 stated that the use of general election receipts for primary election expenses was an advance against anticipated matching funds. The Audit staff notes that short-term advances against matching funds must come from a qualified financial institution, and be secured by certified matching funds amounts.

#### **Legal Standard**

##### **Receipt of General Election contributions before the date of the Primary Election.**

(1) If the candidate, or his or her authorized committee(s), receives contributions that are designated for use in connection with the general election pursuant to 11 CFR §110.1(b) prior to the date of the primary election, such candidate or such committee(s) shall use an acceptable accounting method to distinguish between contributions received for the primary election and contributions received for the general election. Acceptable accounting methods include, but are not limited to:

- (i) The designation of separate accounts for each election, caucus or convention; or
- (ii) The establishment of separate books and records for each election.

(2) Regardless of the method used under paragraph (e)(1) of this section, an authorized committee's records must demonstrate that, prior to the primary election, recorded cash-on-hand was at all times equal to or in excess of the sum of general election contributions received less the sum of general election disbursements made. 11 CFR §102.9(e).

#### **Facts and Analysis**

##### **A. Facts**

During audit fieldwork, the Audit staff reviewed available receipt and disbursement records to determine what contributions, if any, were designated per contributor solicitation devices to the general election and then spent by GJ2012 on primary election expenses prior to the primary election date (May 5, 2012). Committees are not permitted to spend funds designated to the general election for primary election expenses prior to the primary election date. If general election funds are held in the primary election account, the general election funds should be held in reserve and not spent for primary election purposes.

Prior to the primary election, GJ2012 received a total of \$22,396 designated to the general election that was deposited in the primary election account. The Audit staff determined the private contributions designated for the general election using the same calculations as were employed in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013. Of this amount, a total of \$10,000 was deposited to the general election account by September 6, 2011. Beginning on February 21, 2012, GJ2012 did not maintain enough contributions designated to the primary election to pay for all of its primary expenditures, and used contributions designated to the general election to make up the difference. The Audit staff's review identified \$12,396 in contributions designated to the general election that were spent on primary election expenses prior to the primary election date. These expenditures were identified as primary election expenses as they were bank fees incurred prior to the Candidate's DOI and payments on invoices submitted for various services incurred in connection with the Candidate's campaign for nomination. In addition, no invoices for any services rendered in conjunction with the general election were received prior to the payment of these expenses.

#### **B. Preliminary Audit Report & Audit Division Recommendation**

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the payments made using general election funds for primary election expenses prior to the candidate's DOI for the audited cycle. GJ2012 representatives did not comment on this finding.

The Audit staff recommended that GJ2012 provide documentation to demonstrate that general election contributions were not used to fund primary election activity. In accordance with 11 CFR §102.9, documentation should demonstrate that an acceptable accounting method was used. Absent such a demonstration, GJ2012 was to provide any additional comments it considered necessary with respect to this matter.

#### **C. Committee Response to Preliminary Audit Report**

In response to the Preliminary Audit Report recommendation, GJ2012 stated that the \$12,396 was treated as an advance against anticipated matching funds from the general election contributions to the primary election.

To the extent that GJ2012 is characterizing the advance of general election funds as a loan to the primary account, it is noted that regulations specify that such loans or advances must come from a qualified financial institution, which the general account is not. It is also noted that short term loans to Presidential primary committees were obtained in the past, however, these loans were secured by matching fund amounts certified and expected to be received by the committees and occurred only when the Presidential Campaign fund was in a shortfall position. Matching funds for GJ2012 were not certified until May 25, 2012 and the Presidential Campaign fund was not in a shortfall position in 2012. In no instances were general election contributions permitted to be used for primary election expenditures.

GJ2012 stated that they "...used an acceptable accounting method in accordance with 11 CFR §102.9," and that there were separate accounts for primary and general election

contributions. As explained in the “Committee Structure” section on pages 1 and 2 of this report, in practice, GJ2012 deposited nearly all receipts before DOI in its designated primary account and nearly all receipts after DOI in its designated general account. GJ2012 further stated that Audit staff based its calculation on cash on hand and did not take into account the delay in deposits collected through credit card processors. These would be considered received, but would not be in GJ2012’s bank account immediately.

In fact, as this is a common occurrence with campaign committees, the Audit staff took this deposit delay into account. The Audit staff used GJ2012’s contributions database for this calculation, which uses the date of contribution rather than the date of deposit.

#### **Finding 4. Reporting of Debts and Obligations**

##### **Summary**

During audit fieldwork, the Audit staff’s review of GJ2012’s disbursements indicated that debts from seven vendors totaling \$407,455 were not disclosed on Schedule D-P (Debts and Obligations), as required.

In response to the Preliminary Audit Report, GJ2012 submitted additional invoices for debts to two vendors that were not previously disclosed to Audit staff. This resulted in a total of \$447,567 in debts owed to nine vendors that were not disclosed on Schedule D-P as required. GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P.

##### **Legal Standard**

**A. Continuous Reporting Required.** A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished. 52 U.S.C. §30104(b)(8) (formerly 2 U.S.C. 434(b)(8)) and 11 CFR §§104.3(d) and 104.11(a).

**B. Separate Schedules.** A political committee must file separate schedules for debts owed by and to the committee with a statement explaining the circumstances and conditions under which each debt and obligation was incurred or extinguished. 11 CFR §104.11(a).

##### **C. Itemizing Debts and Obligations.**

- Once it has been outstanding 60 days from the date incurred, a debt of \$500 or less must be reported on the next regularly scheduled report.
- A debt exceeding \$500 must be disclosed in the report that covers the date on which the debt was incurred, except reoccurring administrative expenses (such as rent) shall not be reported as a debt before the payment due date. 11 CFR §104.11(b).

## **Facts and Analysis**

### **A. Facts**

During audit fieldwork, the Audit staff used available disbursement records to reconcile the accounts<sup>20</sup> of GJ2012's vendors<sup>21</sup>. These vendors provided GJ2012 with various campaign management services such as fundraising, accounting, clerical and administrative staff, and travel arrangements.

The Audit staff identified debts to seven of GJ2012's vendors totaling \$407,455 that were not reported on Schedule D-P as required. Of these debts, \$300,000 was owed to NSON for a bonus after the Candidate received the nomination as the Libertarian Party candidate for the Presidential general election. This bonus was incurred, per contract, as of the date of nomination, May 4, 2012, and should have been reported on the 2012 June Monthly report, covering the time period from May 1, 2012 through May 31, 2012.

It should be noted that GJ2012 was invoiced for half of this debt (\$150,000) on December 21, 2012, and reported it on the 2012 Year-End report. However, the Audit staff maintains the debts should have been reported as debt for the entire amount based on the date and terms of the contract. The remaining reportable debts of \$107,455 were for smaller amounts to all six vendors identified by the Audit staff.

### **B. Preliminary Audit Report & Audit Division Recommendation**

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the unreported debts for each reporting period covered by the audit. In response to the exit conference, GJ2012 submitted one additional invoice for the other half of the bonus referenced in the "Facts" section above. This invoice was dated January 1, 2013. As of the date the Preliminary Audit Report was sent to GJ2012, this \$150,000 had not been disclosed on any reports filed with the Commission.

The Audit staff recommended that GJ2012 provide documentation demonstrating that these expenditures did not require reporting on Schedule D-P. Absent such documentation, the Audit staff recommended that GJ2012 amend its reports to disclose the outstanding debts.

### **C. Committee Response to Preliminary Audit Report**

In response to the Preliminary Audit Report recommendation, GJ2012 amended its reports and submitted additional invoices and documentation for other previously undisclosed debts. Adjustments made by the Audit staff based on the additional documentation provided reduced the original determination of debts and obligations not timely reported amount by \$7,758.

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<sup>20</sup> The reconciliation consisted of calculating invoiced and paid amounts for individual reporting periods in the 2011-2012 campaign cycle. The Audit staff then determined whether any outstanding debts were correctly disclosed on Schedule D-P. Each debt amount was counted once, even if it required disclosure over multiple reporting periods.

<sup>21</sup> Audit staff restricted this review to only primary campaign debts, as per the scope of this Audit.

GJ2012 submitted additional invoices from two new vendors that were not previously provided to the Audit staff, nor disclosed on Schedule D-P, for debts incurred within the audit period totaling \$47,870. In combination with the seven vendors noted in the Preliminary Audit Report, the Audit staff has thus identified nine vendors that GJ2012 owed \$447,567 that was not reported on Schedule D-P as required. GJ2012 filed amendments that materially corrected these omissions.

In its initial response to the PAR, GJ2012 disputed that the \$300,000 owed to NSON for a bonus was not timely reported. GJ2012 states that the NSON contract "...specifically states that invoices are due and payable upon receipt," and that the vendor not invoicing timely does not create a reportable debt, since the campaign would not be able to base the debt reporting on an invoice.

Pursuant to 11 CFR §104.11(b), "[a] debt or obligation, including a loan, written contract, written promise or written agreement to make an expenditure...shall be reported as of the date on which the debt or obligation is incurred..." GJ2012 made a written agreement on October 14, 2011, that NSON would be owed a bonus of "\$300,000 for receiving any party nomination as either VP or President." Thus, this debt was incurred on the date of the Candidate's nomination by the Libertarian Party at its convention on May 5, 2012, and should have been reported as a debt or obligation on Schedule D-P on the June Monthly Report that covered May 1, 2012 through May 31, 2012, regardless of when it was invoiced.

In a supplemental response to the PAR, GJ2012 stated that it has deferred to Audit staff's judgment that the \$300,000 win bonus should be reported as of the date of the Candidate's nomination, despite not having been invoiced<sup>22</sup>. GJ2012 filed amendments to its reports to report this obligation as of May 2012.

## **Finding 5. Extension of Credit by a Commercial Vendor**

### **Summary**

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON<sup>23</sup> made a prohibited contribution to GJ2012 by extending credit beyond its

<sup>22</sup> GJ2012 further stated that they, "in conjunction with NSON, reallocated prior payments to NSON to this earlier Primary expenditure to ensure that payments were made on a First in-First out basis." The Audit staff believes that GJ2012 cannot reallocate these payments in such a manner. It appears that GJ2012 has decided to apply this procedure in an attempt to reduce the amount of repayment to the U.S. Treasury as detailed in Finding 2. However, this "re-allocation" of payments would still not result in the win bonus being paid within the statutory 30 day period (see footnote 13 for additional detail), so this remains a non-qualified expense regardless of the accounting convention used. In fact, to alter the accounting method to pay this debt off would result in additional non-qualified expenses paid using matching funds, which would actually result in an even larger repayment to the U.S. Treasury.

<sup>23</sup> NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered.

In response to the Preliminary Audit Report, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. However, neither GJ2012 nor the vendor presented any documentation to demonstrate that other clients were subject to the same billing practices, or that GJ2012 was regularly and timely billed for services rendered.

### **Legal Standard**

**A. 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 a person for the purpose of influencing any election for Federal office is a contribution. The term "anything of value" includes all in-kind contributions.

The usual and normal charge for a service is the commercially reasonable rate that one would expect to pay at the time the services were rendered.

The provision of services at a charge less than the usual and normal charge results in an in-kind contribution. The value of such a contribution would be the difference between the usual and normal charge for the services and the amount the political committee was billed and paid. 11 CFR §100.52(a) and (d).

**B. Corporate Contributions Impermissible.** A corporation is prohibited from making any contribution in connection with a federal election. 52 U.S.C. §30118(a) (formerly 2 U.S.C. 441b(a)).

**C. Definition of Commercial Vendor.** A commercial vendor is any person who provides goods or services to a candidate or political committee and whose usual and normal business involves the sale, rental, lease or provision of those goods or services. 11 CFR §116.1(c).

**D. 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).

**E. 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).

## **Facts and Analysis**

### **A. Facts**

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect \$1,752,032 from GJ2012 for services rendered relating to the primary election<sup>24</sup>.

On October 14, 2011, GJ2012 entered into a contract with NSON to manage the campaign. NSON handled fundraising, press and media relations, creative advertising, and all administrative functions of the primary election campaign. Disbursements to NSON totaled 86% of the total of all disbursements by GJ2012, and accounted for 89% of GJ2012's outstanding debt as of December 31, 2012 was owed to NSON. From April 21, 2011 through December 21, 2012, NSON invoiced GJ2012 \$2,198,204 for campaign management expenses, including fundraising, clerical work, and travel arrangements. As of March 31, 2013, \$1,752,032 had been outstanding more than 120 days, and \$936,247 remains outstanding. To date, GJ2012 has only made payments of \$1,261,957 for the \$2,198,204 invoiced by NSON.

The terms of the contract between GJ2012 and NSON stated that:

NSON may assess a carrying charge of eighteen percent (18%) per annum on payments not made within thirty (30) days of the date of the invoice. NSON may, at its sole discretion and without notice, suspend its services hereunder should Client not pay in full any amount invoiced. NSON further reserves the right, at its sole discretion to withhold from Client any instruments of NSON's services pending payment on Client's account.

NSON had not assessed any interest charges as of March 31, 2013. Audit staff also did not locate any documentation of attempts by NSON to collect on the outstanding debt in the records provided by GJ2012.

### **B. Preliminary Audit Report & Audit Division Recommendation**

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the extensions of credit for primary election expenses. Audit staff requested that GJ2012 provide evidence that NSON made commercially reasonable attempts to collect the outstanding amount. In response to the exit conference, on January 17, 2014, GJ2012 submitted an accounts receivable aging schedule for other

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<sup>24</sup> Audit staff restricted this review to only primary campaign services, as per the scope of this Audit.

clients of NSON to show that credit was extended on similar terms to other committees, a copy of a lawsuit filed by NSON in the state of Utah against another client, and a bill dated December 31, 2013, for \$245,527 in interest on the outstanding debts from GJ2012 to show that NSON was attempting to collect on the outstanding debt. The aging schedule detailed the outstanding amounts from nine clients, including another political committee also associated with the Candidate. Six of these clients had debt outstanding more than 300 days, and 84% of the total debt outstanding on the aging schedule was owed by the political committee.

GJ2012 quoted an NSON response to a query the Committee had made to this vendor,

Ongoing attempts have been made and continue to be made to collect the outstanding debt owed from the Gary Johnson 2012 campaign. These include support and help with continued solicitation for donations. Any and all other legal remedies are and will be considered to satisfy the obligation.

The Audit staff reviewed the documentation submitted in response to the exit conference. Although GJ2012 provided an internally generated aging schedule and a copy of a lawsuit filed, GJ2012 did not provide any contracts with, or invoices to, other clients of NSON. As such, the Audit staff cannot verify with a reasonable certainty that NSON's contract with GJ2012 was offered on the same terms or pursued in the same manner as other NSON clients, political or non-political.

In addition, on June 18, 2014, GJ2012 submitted several new invoices for interest charged by NSON on debts outstanding from January 2014 through June 2014.

The Audit staff recommended that GJ2012 provide documentation, to include statements from this vendor that demonstrates the credit extended was in the normal course of business and did not represent an excessive in-kind contribution by the vendor. The information provided may include examples of other non-political customers/clients of similar size and risk for which similar services were provided and similar billing arrangements were used. Also, GJ2012 should provide information concerning the presence of safeguards such as billing policies for similar non-political clients and work, advance payment policies, and debt collection policies and practices to show that this was normal business practice for NSON or provide additional explanation about the situation.

### **C. Committee Response to Preliminary Audit Report**

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information about the business practices of NSON. In an affidavit, Ron Nielson, the proprietor of NSON, stated that his company did not extend credit to GJ2012 that it would not have extended to a similar non-political campaign. Mr. Nielson stated that NSON exercises discretion in the assessing and collecting of finance charges in order to collect on the principal, and that NSON has previously waived finance charges in favor of collecting on the principal. In addition, Mr. Nielson stated that NSON has engaged in discussions with GJ2012 to accept campaign assets in lieu of payment.

GJ2012 also submitted redacted contracts that NSON used for other political and non-political campaigns. The non-redacted portions of these contracts are substantially similar to the one signed by GJ2012. Counsel for GJ2012 further states that NSON acted according to normal and usual practice in the industry, and that NSON and its competitors frequently extend credit to clients seeking similar services in anticipation that doing so would enable the clients to raise funds.

In addition, Counsel for GJ2012 stated that NSON and GJ2012 were negotiating for the acceptance of campaign assets in lieu of payments owed, and that NSON may waive interest fees “as is routine in such matters.”<sup>25</sup>

The NSON contracts provided by GJ2012 are redacted to the extent that the Audit staff cannot verify whether or not the clients are political or non-political. Since the nature of these entities cannot be verified, the Audit staff does not find these contracts to be adequate evidence that credit was extended to GJ2012 in the same way as other political and non-political clients.

Furthermore, documentation provided by GJ2012 to show that NSON attempted to collect on outstanding debts did not show that “NSON regularly invoiced GJ2012 for all services...” In fact, GJ2012 was not invoiced for services in some cases until months or even more than a year after the services were performed. NSON did not submit invoices for interest due on amounts owed until December 31, 2013, more than a year after the Candidate’s date of ineligibility, for invoices that had been outstanding for thirteen (13) to twenty-two (22) months. In addition, no documentation such as invoices to other non-political clients has been presented to show that NSON has also treated the collection of amounts due by non-political clients in the same manner.

Pursuant to 11 CFR §9034.5(c), Presidential campaigns are required to report on the NOCO all capital assets whose purchase price exceeded \$2,000, and other assets whose value exceeds \$5,000, and maintain a list of these items. GJ2012 did not disclose any assets on the NOCO statements submitted when applying for matching funds, nor were any lists provided to the Audit staff during fieldwork. The Audit staff requests that GJ2012 submit documentation for any assets owned and not previously disclosed to the Commission.

The Audit staff notes that NSON had billed GJ2012 \$345,333 in interest as of October 15, 2014, and the Audit staff has estimated that \$85,893 in additional interest will be billed by NSON to GJ2012 by June 30, 2015. Both of these amounts are reflected in the NOCO in Finding 1 of this report.

If GJ2012 and NSON come to a mutual agreement on debts less than the amounts owed and the debt settlement plan is reviewed and approved by the Commission, then the lower amount owed would necessarily reduce the total liabilities on the NOCO statement and

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<sup>25</sup> If GJ2012 and NSON come to an agreement to settle the Committee’s debts for less than has been billed, GJ2012 will need to file a debt settlement plan and seek Commission review of this settlement, pursuant to 11 CFR §116.7.

likely result in the receipt of matching funds in excess of the Candidate's entitlement. Further repayment may also result if GJ2012 discloses newly-discovered assets.<sup>26</sup>

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<sup>26</sup> Also note the repayment amount for non-qualified expenses identified in Finding 2 would also require adjustment.



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

MAR 18 2015

**MEMORANDUM**

**TO:** Patricia C. Orrock  
Chief Compliance Officer

Thomas E. Hintermister  
Assistant Staff Director  
Audit Division

**FROM:** Lisa J. Stevenson *JB for LS*  
Deputy General Counsel - Law

Lorenzo Holloway *JB for LHH*  
Assistant General Counsel  
Compliance Advice

Joshua Blume *JB*  
Attorney

**SUBJECT:** Draft Final Audit Report on Gary Johnson 2012, Inc. (LRA # 905)

**I. INTRODUCTION**

The Office of the General Counsel ("OGC") has reviewed the proposed Draft Final Audit Report ("DFAR") on Gary Johnson 2012, Inc. ("the Committee"). The DFAR contains five findings: Finding 1 - Net Outstanding Campaign Obligations, Finding 2 - Amount Owed to the U.S. Treasury, Finding 3 - Use of General Election Contributions for Primary Election Expenses, Finding 4 - Reporting of Debts and Obligations, and Finding 5 - Extension of Credit by a Commercial Vendor. We concur with these findings, but we provide some comments on certain issues raised in Findings 2 through 5. If you have any questions, please contact Joshua Blume, the attorney assigned to this audit.

**II. FINDING 2 - AMOUNTS OWED TO THE U.S. TREASURY**

Finding Two recommends that the Committee repay a total of \$ 334,914 to the United States Treasury. This finding has two aspects, the most significant of which is that the Committee used primary election funds on expenses incurred in connection with the general election. According to the Audit Division, the vast majority of these expenditures occurred

between May 5, 2012, the Candidate's date of ineligibility, and December 7, 2012. The Audit Division, therefore, recommends that the Committee repay a pro-rata portion of the total amount of funds so spent, in this case \$333,664, to the United States Treasury. *See* 11 C.F.R. § 9038.2(b)(2)(iii) (setting forth formula for computing amount to be repaid).

We concur with Finding Two. In response to the Preliminary Audit Report, the Committee makes two arguments related to this finding and we provide comments on both. As a part of our comments in response to the Committee's first argument, we have comments on the Audit Division's calculation of the repayment for non-qualified campaign expenses.

#### **A. The Calculation of The Repayment for Non-Qualified Campaign Expenses**

##### **1. The Commission Uses Repayment Ratio to Calculate Repayment for Nonqualified Campaign Expenses**

First, the Committee contends that at all times when it received public funds, the amount of money it spent on qualified campaign expenses exceeded the amount of public funds it received. As a result, the Committee implies it can separate private contributions and public funds and conclude that it spent private funds, and not public funds, on any non-qualified campaign expenses. Initial Response, at 1.

We disagree with this argument. The Committee fails to take into account Commission regulations that prohibit the spending of *any* funds collected for the primary election on non-qualified campaign expenses. *See* 11 C.F.R. § 9034.4(a) (all contributions received for the primary election as well as public funds may only be spent on qualified campaign expenses). While the Commission can only seek a repayment under 26 U.S.C. § 9038(b) for the portion of total spending that represents public funds when a committee spends primary funds on non-qualified campaign expenses, *see Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558, 1561 (D.C. Cir. 1984), a publicly-funded committee's private primary contributions and public funds are, as a matter of law, considered a "commingled pool of federal and private monies." *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558, 1564 (D.C. Cir. 1984).

To determine if any portion of public funds in this commingled pool of Federal and private funds was used to pay for non-qualified campaign expenses, the Commission does not examine how much of the public funds remained after the Committee paid for non-qualified campaign expenses. Rather, the Commission applies a repayment ratio to determine the pro rata share of total non-qualified campaign spending that is attributable to the use of public funds. 11 C.F.R. § 9038.2(b)(2)(iii) (the "repayment ratio"). The Committee's detailed examination of its actual spending, the result of which, it claims, shows that public funds were not actually spent on non-qualified campaign expenses is precisely the kind of analysis that the repayment ratio is intended to obviate. The *Kennedy* court recognized that, because all funds are commingled, the determination of the amount of public funds that were spent for non-qualified purposes "may never be perfectly accurate." *Id.* at 1562. Rather, Congress delegated to the Commission the task of devising a method that would reasonably estimate the amount of public funds improperly

spent. *Id.* This is what the repayment ratio is designed to accomplish. See *Explanation and Justification for Final Rule on Repayments by Publicly Financed Presidential Candidates*, 50 Fed. Reg. 9421 (Mar. 8, 1985) (“The use of such formulas is consistent with the court’s opinion, which does not require a mathematically precise determination of the amount of the Federal funds spent improperly but only a reasonable determination of the amount of Federal matching funds so used.”).<sup>1</sup>

## **2. The Audit Division Uses The Date That It Can Verify To Determine When The Committee’s Accounts No Longer Contain Public Funds**

Before applying the repayment ratio, however, the Commission must determine the date when a committee’s account no longer contains public funds. 11 C.F.R. § 9038.2(b)(2)(iv). To calculate this date, the Commission examines the committee’s expenditures starting with the date that the committee received its last payment of public funds. 11 C.F.R. § 9038.2(b)(2)(iii)(B). The Commission assumes that this last payment of public funds is expended on a last-in and first-out basis. *Id.* In the DFAR, the Audit Division states that the date upon which matching funds were no longer in the accounts was February 20, 2014. However, because the Committee has not provided an itemization of the general account’s receipts, the Audit Division cannot determine with certainty what expenditures have been made for what purposes, and therefore whether expenditures were made for the general or the primary election using the February 20, 2014 date. Rather than using the date of February 20, 2014, the Audit Division instead uses the last date that it can verify – December 20, 2012 – which is the date the last contribution submitted for matching funds was deposited in the Committee’s general account.

We concur with this approach. While extending the date when the Committee’s accounts no longer contained public funds may produce a slightly higher repayment obligation for non-qualified campaign expenses,<sup>2</sup> the Audit Division does not have the information necessary to verify the nature of the expenditures using the later date. Given that the Commission’s repayment determination must include a factual basis, 11 C.F.R. § 9038.2(c)(1), we believe that the repayment determinations for non-qualified campaign expenses should be based on the dates for which the Commission can verify the nature of the expenditures. The DFAR indicates that the Audit Division has requested the necessary information and the Committee has not provided it. The Commission, therefore, has the option of issuing a subpoena to obtain this information. 11 C.F.R. § 9038.1(b)(1)(v). We, therefore, recommend that the Audit Division raise this issue in the memorandum that forwards this report to the Commission.

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<sup>1</sup> For this reason, the Committee’s argument regarding \$7,301 spent on winding-down expenses that the PAR identifies as part of the non-qualified expenses for which repayment is required is also of no avail. See Interim Response, at 2. That the Committee may not have specifically used public funds, as opposed to other primary funds, to pay these expenses is not a relevant consideration.

<sup>2</sup> We understand from the Audit Division that using the estimated date of February 20, 2014 would result in an estimated additional repayment of \$4,462.62.

## **B. The Commission May Only Seek A Repayment for Non-Qualified Campaign Expenses That Have Been Paid**

Second, the Committee identifies several items that were not previously reported as debts and argues that, because of this information, “the effective matching funds cut-off date is moved forward, and the amount to be paid to the U.S. Treasury is reduced.” Supplemental Response (“Supp. Response”), at 1. Specifically, the Committee states that if all the newly discovered debts are included as reportable debt, then the “matching funds cut-off date” is moved forward to October 22, 2012, and the amount the Committee must repay is reduced to a maximum of \$33,930.70. Supp. Response, at 1. The Committee asks that the declared amount owed by the Committee be no greater than this amount, pending any additional deductions that may be appropriate to make in the future. *Id.* at 3.

We disagree with the Committee’s assertion that a reduction in the amount of funds repayable for non-qualified campaign expenses is in order because of newly discovered reportable debts. Neither the existence nor the magnitude of the Committee’s primary election debt has any relationship to the Committee’s repayment obligation for non-qualified campaign expenses.<sup>3</sup> The Committee’s repayment obligation is premised wholly upon its actual expenditures of primary funds, and not upon the mere incurrence of indebtedness in connection with the primary election. 11 C.F.R. § 9038.2(b)(2)(iv). *See Kennedy for President Committee v. Federal Election Commission*, 734 F.2d at 1565 (authority to seek repayment limited to amount of public funds actually spent on non-qualified expenses). It would be inequitable, in fact, for the Commission to seek repayment for debts that a committee has not actually paid. Rather, the effect of the Committee’s discovery of additional debt would be to increase its net outstanding campaign obligations, thereby necessitating revision of the Statement of Net Outstanding Campaign Obligations. *See* 11 C.F.R. § 9034.5(a)(1) (statement of net outstanding campaign obligations composed consists in part of “[t]otal of all outstanding obligations for qualified campaign expenses as of the candidate’s date of ineligibility . . .”). The Audit Division has already accounted for these newly-discovered debts on the NOCO Statement.

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<sup>3</sup> While debt *per se* would not affect the Committee’s repayment obligation, changing the matching funds cut-off date would affect the calculation of the amount of funds that the Committee must repay to the U.S. Treasury because the cut-off date determines how much of a committee’s non-qualified expenses should be included in the repayment ratio. *See* 11 C.F.R. § 9038.2(b)(2)(iv) (“Repayment determinations under 11 CFR 9038.2(b) will include all non-qualified campaign expenses paid before the point when committee accounts no longer contain matching funds . . .”). The Committee’s calculations suggest that the *later* the matching funds cut-off date is, the less the amount of funds it must repay to the U.S. Treasury. *See* Supp. Response, at 1 (noting that if cut-off date is moved to October 4, then Committee will owe no more than \$110,941.76, whereas if cut-off date is moved to October 22, then Committee will owe no more than \$33,930.70). This relationship is the opposite of the relationship posited in section 9038.2(b)(2)(iv). Under that provision, the *earlier* the matching funds cut-off date is, the less the Committee will be required to repay. This is because fewer non-qualified campaign expenses would be included in the calculation with an earlier date, as section 9038.2(b)(2)(iv) shows.

### III. FINDING 3 - USE OF GENERAL ELECTION CONTRIBUTIONS FOR PRIMARY ELECTION EXPENSES

Finding Three concludes that the Committee used \$12,396 in contributions designated for the general election to pay expenses incurred in connection with the primary election before the date of the primary election.<sup>4</sup> The Committee originally deposited \$22,396 in contributions designated for the general election in its primary election account, but shortly thereafter transferred \$10,000 of this amount to its general election account. The balance of \$12,396 remained in the primary election account.

In response to this finding, the Committee states that it treated the \$12,396 as “an advance against anticipated matching funds, which the [Commission] notes were not paid to [the Committee] until after the [date of ineligibility].” Initial Response, at 2. This statement implies that the use of contributions designated for the general election in this manner is permissible.

To the extent that the Committee is characterizing the advance of general election funds as a loan to the primary account, the Commission’s regulations specify that such loans must come from a qualified financial institutions, which the general account clearly was not. 11 C.F.R. § 100.82(e)(2). *See also Explanation and Justification for Final Rule on Loans From Lending Institutions to Candidates and Political Committees*, 56 Fed. Reg. 67118 (Dec. 27, 1991) (provision does not extend to loans from lenders other than banks or other qualified financial institutions).

Alternatively, the Committee’s use of its general election contributions to pay for primary election expenses could be viewed as a transfer of funds from the general election account to the primary election account. *See* Advisory Opinion 1996-04 (LaRouche) (Commission analyzed proposed “loan” of funds from previous presidential primary committee to current campaign committee based on anticipated receipt of public funds as transfer between committees). However, none of the transfer rules permit such a transfer under the circumstances presented here. While campaigns are permitted to transfer unused primary election contributions to their general election accounts in spite of the contribution limitations announced in section 110.1, *see* 11 C.F.R. § 110.3(c)(3), Commission regulations do not authorize transfers from the general election account to the primary election account.

The Commission has issued audit reports in the past in which publicly funded presidential campaigns misallocated the costs of goods of services between their primary and their general election committees, or their general election legal and accounting compliance fund (GELAC) committees. In those reports, the Commission recommended reimbursement by one committee to the other to bring the various committees within their expenditure limitations. *See Final Audit Report on Dole for President, Inc.*, at 24 (approved June 3, 1999); *Final Audit*

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<sup>4</sup> The date of the primary election in this case is identical to the date of ineligibility – both being May 5, 2012 – the date upon which the Candidate received the nomination for election to the office of President by his party during his party’s nominating convention. *See* 52 U.S.C. § 30101(b); 11 C.F.R. § 100.2(e) (selection of nominee at convention with authority to nominate is an election). *See also* 26 U.S.C. § 9032(7); 11 C.F.R. § 9032.7 (same).

*Report on Kerry-Edwards 2004, Inc. and the Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund*, at 14-22 (approved June 14, 2007); *Final Audit Report on Clinton/Gore '96 Primary Committee*, at 10-16 (approved June 3, 1999).<sup>5</sup> See also 11 C.F.R. § 9034.4(e) (providing bright-line rule for attributing expenditures of publicly-funded committees to the primary or the general election). However, the ability of committees in this position to undertake corrective action for a misallocation of expenditures does not cure the underlying impropriety of one committee's (or, in this case, one account's) payment of another committee's expenses.

#### IV. FINDING 4 - REPORTING OF DEBTS AND OBLIGATIONS

Finding Four concludes that the Committee failed to continuously report debts totaling approximately \$407,000 owed to six creditors. Of this amount, \$300,000 represented a bonus owed to the Committee's principal campaign consultant, NSON, which, according to the terms of the contract between NSON<sup>6</sup> and the Committee, was payable to NSON "for receiving any party nomination as either [Vice President] or [President]." See Addendum to NSON Service Agreement, signed Oct. 14, 2011. The Audit Division concludes that the Committee's reporting obligation with respect to the bonus began on the date of the Candidate's nomination, May 4, 2012.

The Committee argues in its Initial Response, however, that it was not required to report the bonus owed to NSON as a debt until it received the invoice for the bonus, citing a provision of its contract with NSON specifying that payments would not be due until receipt of the invoice. Initial Response, at 3. According to the PAR, the Committee did not receive an invoice for the bonus (actually for one-half of the bonus amount, or \$150,000) until December 21, 2012.

In its Supplemental Response, the Committee states that it defers to the "Audit staff's recommendation that the Committee treat the bonus as a primary expenditure." Supp. Response, at 3. Based upon our understanding that the Committee has not actually made an expenditure to pay the bonus to NSON as of yet, this statement may indicate the Committee's acceptance of the Audit Division's position regarding when reporting of the debt should have begun. In the event that it does not, however, we agree with the Audit Division that the Committee was required to begin reporting the debt to NSON for the bonus on May 4, 2012, and to report the debt continuously thereafter under 11 C.F.R. § 104.11(b). This regulation requires debts or obligations, "including a loan, written contract, written promise or written agreement to make an

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<sup>5</sup> These recommendations were made in the context of findings that the committees in question exceeded their expenditure limitations. The Audit Division, however, is not recommending such corrective action in this case, because its calculations already assume that such correction would have taken place in the ordinary course of events. This corrective action would not have an impact on the Committee's repayment obligation because the Committee used general election funds to pay primary election expenses.

<sup>6</sup> The PAR noted that NSON is a registered corporation in the State of Utah that also does business as Political Advisors. It is our understanding that Political Advisors is the Committee's principal creditor and that it provided political consulting services to the Committee. The PAR also noted that although the Committee reported disbursements to this entity as disbursements to Political Advisors, the entity billed the Committee as NSON.

expenditure”, if totaling over \$500, to be reported “as of the date on which the debt or obligation is incurred.” 11 C.F.R. § 104.11(b).

Here, according to the terms of the contract, payment of the \$300,000 bonus was conditioned upon the Candidate’s receipt of nomination to the office of Vice President or President. This condition occurred on May 4, 2012. Consequently, the Committee incurred an obligation to pay the bonus on that date, and, according to the terms of section 104.11(b), a concomitant obligation to begin reporting its debt in this amount to NSON.

#### **V. FINDING 5 - EXTENSION OF CREDIT BY A COMMERCIAL VENDOR**

Finding Five concludes that NSON made a prohibited corporate contribution to the Committee by extending credit to the Committee outside of its normal course of business and by not making commercially reasonable attempts to collect approximately \$1.75 million dollars in debt owed by the Committee for services rendered. The PAR notes that NSON provided services to the Committee between April 2011 and December 2012, for which it billed the Committee approximately \$2.2 million. As of March 2013, however, approximately \$1.75 million had been outstanding for over 120 days, and approximately \$936,000 remains outstanding to date.

We do not have comments on the substance of this finding. However, we do have two observations regarding the Committee’s statement that NSON may agree to waive interest assessments it has recently applied to the Committee, and perhaps the underlying principal indebtedness as well, in exchange for assets of the Committee. *See* Interim Response, at 3-4. First, as the DFAR notes, Commission regulations would not allow the Committee to settle its debt to NSON, or take any action on that settlement, without previous Commission review and approval of a debt settlement plan embodying the terms of the proposal. *See* 11 C.F.R. § 116.7(a). Second, the Committee refers to specific assets that it may use to settle part of its debt to NSON. However, the DFAR notes that these assets were not previously disclosed. Further, the existence of these assets has not actually been verified. Assuming proper verification of the existence of these assets, the Committee would be required to disclose them in its Statement of Net Outstanding Campaign Obligations. 11 C.F.R. § 9034.5(a), (c). Thus, that statement will require amendment in light of any previously undisclosed assets. *See* 11 C.F.R. § 9034.5(a)(2)(ii) (statement of net outstanding obligations includes “[t]he fair market value of capital assets and other assets on hand.”)

April 14, 2015

**SENT VIA EMAIL AND FIRST CLASS MAIL**

Federal Election Commission  
Audit Division  
Mr. Marty Favin  
999 E Street, NW  
Washington, DC 20463  
Audit@fec.gov

**RE: Draft Final Audit Report on Gary Johnson 2012 Inc**

Dear Mr. Favin:

I am writing on behalf of my client, Gary Johnson 2012 Inc (“GJ2012”), in response to the Draft Final Audit Report of the Audit Division (“DFAR”).

**I. Request for a Hearing before the Commission**

GJ2012 requests a hearing to discuss its responses to Findings 1-5 in the DFAR, and to the comments on those same Findings in the March 18, 2015 Office of General Counsel memo (“OGC Memo”).

**II. Finding 1. Net Outstanding Campaign Obligations**

GJ2012 accepts the Audit Division finding that GJ2012 did not receive matching fund payments in excess of its entitlement. Any changes to the Statement of Net Outstanding Campaign Obligations (“NOCO”) to account for debt settlement or asset valuation can only be properly addressed if and when such actions are actually taken.

The Audit Division requested copies of invoices from this firm to corroborate the expenses added to the NOCO. Those fees listed are estimates of total cost for our services in relation to the audit, and, given the unpredictable nature of that process, will not be invoiced for until the work has been completed. Once GJ2012 has been invoiced for the work, copies of the invoices will be provided.

**III. Finding 2. Amounts Owed to the U.S. Treasury**

It should be noted from the outset that during the campaign, GJ2012 acted on a good faith basis that contributions received were subject to its understanding of what the disclaimer should have been had it been properly updated, and that were this the case its intended allocation formula for contributions received after the candidate’s date of ineligibility (“DOI”), with the first \$250 of each contribution being designated to the primary, was permissible. As the *Kennedy* court noted, “the violation of campaign spending limitations is often, if not usually, inadvertent.” *Kennedy for President Committee v. FEC*, 734 F.2d 1558, 1560 (D.C. Cir. 1984). But for the failure to update the disclaimer on the campaign’s donation page, this repayment issue would never have arisen, because the campaign acted in a manner consistent with what it intended the disclaimer to be, notionally the optimal format of such disclaimer. While the Commission has already ruled on the

impact of the failure to change the disclaimer, it does not change that the outcome was an unintentional one, and that the Committee acted in good faith – if incorrectly – despite the error, and that its lack of intent is precisely the kind of inadvertent error the *Kennedy* court noted.

It is improper to base the committee’s repayment obligation on the repayment ratio of 11 C.F.R. § 9038.2(b)(2)(iii), which is not a “reasonable method for determining the extent to which matching funds, rather than private contributions, were used for unqualified purposes.” *Id.* at 1563. The OGC Memo’s reliance on *Kennedy* to support the Audit Division’s application of the repayment ratio seems misplaced, as that case clearly supports the committee’s position on this issue.

While a committee is prohibited from spending both matching funds and comingled primary funds on non-qualifying expenses, the penalty is limited to repayment of the amount of matching funds that can be reasonably determined to have been spent on such expenses. *Id.* at 1562. As the court recognized, 26 U.S.C. § 9038(b)(2) “expressly limits the repayment obligation to . . . the amount of matching funds ‘so used’”; “the statute plainly allows the Commission to take back only the amount of *federal funds* used for unqualified purpose.” *Id.* at 1561, 1562 (emphasis in original).

The OGC Memo correctly notes that the *Kennedy* court left it to the Commission to decide on a method to determine the amount of matching funds used for non-qualifying purposes, but the court did impose limits on what that method could be – it must produce a reasonable estimation of the amount of matching funds spent on non-qualifying expense. *Id.* at 1563. The court stated that section 9038(b)(2) “delegates to the Commission the task of estimating the amount of federal funds, rather than private contributions, that were spent for unqualified purposes,” and that the Commission had “the responsibility to make a reasonable determination that the repayment sum represents the matching funds used for unqualified purposes.” *Id.* at 1562.

In *Kennedy*, a pro rata share of the total amount spent on non-qualifying expenses may well have been a reasonable estimate of the matching funds so spent, but that is not the case here. There, the matching funds were deposited into the same bank account as the funds used to pay for the non-qualifying expenses, but in the instant case, the matching funds were held in a separate account, and, at most, only a small fraction of the non-qualifying expenses were paid out it. The intentional segregation of funds was based on the Committee’s belief that it operated under what was intended to be the correct disclaimer language, and consequently it is easy to determine that no federal funds were spent on non-qualifying campaign activity. Only by the disclaimer error, and artificial post-hac comingling of funds contained in separate accounts, does the Audit Division arrive at (notionally) additional funds being included in these calculations. Even if that is the case, it does not mean that actual federal funds were spent on non-qualifying campaign activity.

As the Audit Division’s own findings indicate, matching funds were all deposited into GJ2012’s primary election account, and the overwhelming majority of private contributions received post-DOI were deposited into the general account. *See* Calculation of unqualified expenses worksheet. GJ2012 considered these general contributions, and intended to spend them on general expenses. GJ2012 believed that its disclaimer had been updated, and operated on that assumption, treating contributions as general or primary based on the intended terms of the disclaimer. This detailed accounting resulted in the matching funds in the primary account only being used for qualified campaign expenses, and the Audit Division’s own analysis supports this.

Of the total \$1,199,701 that the Audit Division claims was spent on non-qualifying expenses, it identifies a total of \$2,510.32 that was paid out of the primary account. Although GJ2012 maintains that even these amounts were not paid for with matching funds, this figure is the maximum possible amount of matching funds that could have been used to pay for non-qualifying expenses. The remaining \$1.1 million in non-qualifying expenses was paid out of the general account, which none of the matching funds were ever deposited into.

As in *Kennedy*, the Commission is vastly overestimating the amount of matching funds that were spent on non-qualifying expenses, and, as in that case, its methodology must be rejected. The Audit Division's calculation of when matching funds were no longer in the account is fundamentally flawed, since those funds were only ever in the primary account, and their analysis uses both accounts. The repayment ratio therefore estimates in an incongruent manner GJ2012's repayment obligation from the activity of a bank account that never contained matching funds, and, as the *Kennedy* court said, the Commission's discretion in choosing a methodology of calculating repayment "does not legitimate such a clearly unreasonable formula as the one used by the FEC in this case." *Id.* (footnote omitted).

The OGC Memo states that the repayment ratio was intended to avoid forcing the Commission to conduct in-depth analyses of committee finances in order to determine the appropriate repayment obligation. Considering imitation on agency time and resources, that is certainly an admirable goal. However, that does not relieve the Commission of its obligation to reasonably estimate the amount of matching funds to be repaid, and should not prevent the committee from conducting its own analysis to show that its repayment obligation is lower than that calculated by whatever method the Commission uses. In this case, the Commission has already conducted a sufficiently in-depth analysis of GJ2012's finances to determine that the repayment ratio vastly overstates GJ2012's repayment obligation, and, having done so, it cannot willfully ignore those results.

Finally, with respect to the funds submitted for matching that were identified as being ineligible, GJ2012 has not found any indication that the funds were misattributed. The \$1,250 total will be included in any amount repaid to the US Treasury.

#### **IV. Finding 3. Use of General Election Contributions for Primary Election Expenses**

GJ2012 urges the Commission to reconsider its arguments regarding the use of general election funds as an advance against matching funds.

#### **V. Finding 4. Reporting of Debts and Obligations**

The Audit division specifically found that the \$300,000 contractual win bonus was a primary expense, and should have been paid from primary funds. Consequently, in order to comply with Commission directive here, NSON reallocated the \$171,200 in payments from GJ2012 to NSON during the 30 days subsequent to the DOI (5/5/14 – 6/4/12) to what would have been the earlier invoices based on the reasonable preference of the time-limited win bonus over other pre-DOI expenses.. The remaining balance of the \$300,000 win bonus would be a non-qualified campaign

expense and will be addressed through the ultimate debt settlement negotiation between NSON and GJ2012, subject to Commission approval.

#### **VI. Finding 5. Extension of Credit by a Commercial Vendor**

The Audit Division objects to redaction of the NSON contracts submitted with GJ2012's response to the Preliminary Audit Report. However, it would work an unreasonable burden on NSON to be forced to disclose its other clients – including being in violation of relevant contract or trade custom – in order to demonstrate the similarity of terms here, and neither the statute nor regulations require such. The client identity-redacted contracts clearly demonstrate that NSON was conducting its services in a manner consistent with its ordinary course of business for other clients.

With respect to NSON's regular invoicing for services it provided the committee, the Audit Division points to a small number of invoices out of a great many from the campaigns principle vendor that were invoiced late as evidence that NSON is not attempting to collect on its outstanding debts. Although some invoices were received "late" relative to the services performed, these are the exceptions rather than the rule. Moreover, it is not obviously outside the ordinary course of business for an enterprise to be sluggish in its own invoices, particularly where such a substantial number of invoices were issued. Mistakes happen in business, as in government, and it is patently unreasonably to draw the inference that this constitutes a pattern of intentional unlawful conduct.

The Audit Division notes that, other than the balance of its bank accounts, GJ2012 did not include any assets on the NOCO, but referred in its response to the Preliminary Audit Report to the possibility of settling its debts with NSON in exchange for certain committee assets. The assets referred to are currently intangible and not readily susceptible to easy valuation. For example, the use of the name, likeness, and/or signature of the candidate for fundraising, or a copy of the committee's mailing and email lists might be worth a great deal, but the time and resources required to convert these intangible assets into a tangible form with a readily identifiable fair market value is substantial, and the Committee must first resolve its audit matter to understand what resources and obligations it still has.

With respect to the remaining outstanding debt of GJ2012 to NSON, the parties have agreed to defer resolution of that matter until conclusion of the audit process. The outcome of the audit bears directly on the scope of committee assets – and potentially the amounts owed to NSON. Consequently, providing a comprehensive debt settlement plan to the Commission for its approval must necessarily wait until conclusion of the audit process for the parties to possess all materially relevant facts to such negotiation.

Sincerely,

/s/

Dan Backer

(202)-210-5431 Direct

dbacker@dbcapitolstrategies.com

CC: mfavin@fec.gov

creminsky@fec.gov