



FEDERAL ELECTION COMMISSION
Washington, DC 20463

May 28, 2008

MEMORANDUM

To: Thomasenia P. Duncan
General Counsel

Through: Patrina M. Clark *PMC*
Staff Director

From: John D. Gibson *JDG*
Chief Compliance Officer

Joseph F. Stoltz *JFS*
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Audit Division

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Subject: Missouri Democratic State Committee (A05-30) - Referral Matters

AUDIT REFERRAL #08-11

On May 23, 2008, the final audit report on the Missouri Democratic State Committee was forwarded to the Commission. At this time, the Commission does not have a quorum necessary to take any action on the final audit report.

The final audit report includes the following two matters that meet the criteria for referral to your office:

- **Cash Disbursements (Finding 1) - MDSC made 408 cash disbursements totaling \$62,552, each of which exceeded the \$100 transaction limit for cash disbursements. The Act requires political committees to make all disbursements, except those from a petty cash fund, by check or similar draft drawn on a committee account. In its response to the interim audit report, MDSC states that the amount in excess of the per-transaction limit was modest, that its log of the payments was scrupulously kept and that the facts present nothing untoward about the payments, but for the issue of the per-transaction limit.**

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- **Payment of Federal Activity with Non-Federal Funds (Finding 2) - Initially, MDSC appeared to have improperly made payments totaling \$5,099,909 from its non-federal operating account for federal expenses. In its response to the interim report MDSC provided documentation demonstrating that some of the expenditures were solely non-federal in nature. As a result, the amount MDSC is required to transfer to its non-federal operating account for its share of federal expenses was reduced to \$2,541,689. MDSC should amend its reports to show these transactions as memo entries. Neither evidence of the transfer nor amended reports were submitted as part of the response.**

All work papers and related documentation are available for review in the Audit Division. Should you have any questions regarding this matter, please contact Alex Boniewicz at 694-1200.

Attachments:

Cash Disbursements (Finding 1)

Payment of Federal Activity with Non-Federal Funds (Finding 2)

**cc: Lorenzo Holloway
Lawrence Calvert**

Finding 1. Cash Disbursements

Summary

MDSC made 408 cash disbursements totaling \$62,552, each of which exceeded the \$100 transaction limit for cash disbursements. The Act requires political committees to make all disbursements, except those from a petty cash fund, by check or similar draft drawn on a committee account. In its response to the interim audit report, MDSC states that the amount in excess of the per-transaction limit was modest, that its log of the payments was scrupulously kept and that the facts present nothing untoward about the payments, but for the issue of the per-transaction limit.

Legal Standard

Disbursement by Check. A political committee may only make expenditures in cash, not to exceed \$100 from a petty cash fund. A written journal for such cash expenditures is to be maintained by the treasurer. All other disbursements shall be made by check or similar draft drawn on account(s) established at the committee's campaign depository(ies). 2 U.S.C. §432(h).

Facts and Analysis

MDSC made 408 cash disbursements totaling \$62,552, each of which exceeded the \$100 transaction limit. These expenditures were to pay canvassers and vendors during the general election period. These cash expenditures were funded by eight checks and three wire transfers totaling \$120,175. Seven of the eight checks totaling \$70,562 were made out to "Cash." According to MDSC officials, a petty cash fund was not maintained. MDSC maintained records of the name, address, date, and amount paid for each canvasser.

The Audit staff presented this matter at the exit conference along with workpapers. MDSC representatives had no comment.

Interim Audit Report Recommendation and Committee's Response

The Audit staff recommended that MDSC:

- Demonstrate it complied with the provisions of 2 U.S.C. §432(h) regarding cash disbursements; or
- Provide any comments it deems relevant regarding the cash disbursements.

In its response, MDSC stated that the amount in excess of the per-transaction limit was modest, that its log of the payments was scrupulously kept and that the facts present nothing untoward about the payments, but for the issue of the per-transaction limit. MDSC also stated that due to logistical burdens in making payments for election-day and canvassing activities, the use of petty cash is a practical necessity and while the petty cash per-transaction limit has stayed static over the years, the costs of election-day activities have risen with inflation.

Finding 2. Payment of Federal Activity with Non-Federal Funds

Summary

Initially, MDSC appeared to have improperly made payments totaling \$5,099,909 from its non-federal operating account for federal expenses. In its response to the interim report MDSC provided documentation demonstrating that some of the expenditures were solely non-federal in nature. As a result, the amount MDSC is required to transfer to its non-federal operating account for its share of federal expenses was reduced to \$2,541,689. MDSC should amend its reports to show these transactions as memo entries. Neither evidence of the transfer nor amended reports were submitted as part of the response.

Legal Standard

- A. Accounts for Federal and Non-federal Activity.** A party committee that finances political activity in connection with both federal and non-federal elections must establish two accounts (federal and non-federal) and allocate shared expenses—those that simultaneously support federal and non-federal election activity—between the two accounts. Alternatively, the committee may conduct both federal and non-federal activity from one bank account, considered a federal account. 11 CFR §102.5(a)(1)(i).
- B. Paying for Allocable Expenses.** Commission regulations offer party committees two ways to pay for allocable, shared federal/non-federal expenses.
 - They may pay the entire amount of the shared expense from the federal account and transfer funds from the non-federal account to the federal account to cover the non-federal share of that expense; or
 - They may establish a separate, federal allocation account into which the committee deposits funds from both its federal and non-federal accounts solely for the purpose of paying the allocable expenses of shared federal/non-federal activities. 11 CFR §106.5(g)(1)(i) and (ii)(A).
- C. Reporting Allocable Expenses.** A political committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report these kinds of disbursements on Schedule H-4 (Joint Federal/Non-federal Activity Schedule). 11 CFR §104.10(b)(4).
- D. Allocation Ratio for Administrative & Generic Voter Drive Costs.** State and local party committees must allocate their administrative expenses and generic voter drive costs according to the fixed percentage method. Under this method, a committee determines the ratio of federal offices to the total number of federal and non-federal offices expected on the ballot in the next general election in the state or geographic area. 11 CFR §106.5(d)(1) and (2).

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E. Allocation of Costs of Federal Election Activity. State and local party committees may allocate disbursements or expenditures, except salaries and wages for employees, between Federal funds and Levin funds for voter registration activity that takes place during the period that begins on the date that is 120 days before the date of a regularly scheduled Federal election and ends on the date of the election, provided that the activity does not refer to a clearly identified Federal candidate. 11 CFR §300.33(a)(1)

State, and local party committees and organizations may allocate disbursements or expenditures, except salaries and wages for employees, between Federal funds and Levin funds for voter identification, get-out-the-vote activity, or generic campaign activities that are conducted in connection with an election in which a candidate for Federal office is on the ballot provided that the activity does not refer to a clearly identified Federal candidate. 11 CFR §300.33(a)(2)

If a Presidential candidate and Senate candidate appear on the ballot, State and local party committees must allocate at least 36% of expenses to their Federal funds. 11 CFR §300.33(b)(2)

F. Salaries and Wages. Committees must keep a monthly log of the percentage of time each employee spends in connection with a Federal election. Salaries and wages for employees who spend more than 25% of their compensated time in a given month on Federal election activity or activities in connection with a Federal election must be paid only from a Federal account. 11 CFR §106.7(d)(1)(ii)

G. Reporting Expenses Allocated Between Federal Funds and Levin Funds. A State, district, or local political party committee that makes a disbursement for Federal election activity that is allocated between Federal funds and Levin funds must state the category of Federal election activity for which each allocable disbursement was made. 11 CFR §300.36(b)(2)(i)(B)

Facts and Analysis

MDSC made payments from its non-federal operating account totaling \$5,099,909 that appeared to be for federal election expenses. MDSC maintained several federal, non-federal and Levin bank accounts. Shared expenses were paid from the federal accounts and funds were transferred from the non-federal and Levin accounts to the federal accounts to cover the non-federal and Levin share of those expenses. To allocate administrative and generic voter drive expenses, MDSC correctly utilized the fixed percentage ratio of 36% federal and 64% non-federal. Allocable federal election activity is allocated between federal and Levin funds according to the fixed percentage method noted above. The Audit staff reviewed disbursements from both the federal and non-federal accounts.

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Payment and Disclosure of Salaries and Related Expenses

MDSC made payments from its non-federal operating account totaling \$1,376,575, which appeared to be for non-allocable expenses such as salaries, payroll taxes, healthcare and insurance. However, MDSC failed to maintain time sheets, employee logs or other documentation demonstrating the portion of their time spent on federal versus non-federal tasks. Absent such documentation, MDSC should have made these payments from its federal account. Since this activity was not reported, MDSC should disclose these salary payments as memo entries on Schedule B (Itemized Disbursements), Line 30b.

Payment and Disclosure of Non Allocable Federal Election Activity and Other Federal Expenses

Other expenses totaling \$3,408,722 were disbursed from the non-federal operating account for television and radio ads, phone banks, and lodging for the national party convention. Television and radio ads represent \$2,062,000 of that amount. Available documentation did not indicate that any of these payments were for solely non-federal activities. Absent documentation detailing the nature of these expenditures, it appeared they should have been made from the federal account. Since this activity was not reported, MDSC should disclose the federal portion of these payments as memo entries on Schedule B, Line 21b or 30b, as appropriate, once the nature of these expenses is determined.

Payment and Disclosure of Administrative/Generic Voter Drive

Additional expenses totaling \$311,212 disbursed from MDSC's non-federal operating account for postage, building repairs, consulting, taxes, legal services and state convention planning, were identified as apparent allocable administrative/generic voter drive activity. Available documentation did not indicate that any of these payments were for solely non-federal activities; therefore, they were treated as allocable administrative expenses. The federal share for these expenses is \$112,036 ($\$311,212 \times .36$). Unless documented as wholly non-federal, MDSC should disclose these payments (\$311,212) as memo entries on H-4 (Joint Federal/Non-federal Activity Schedule).

Funding by the Non-federal Account for Shared Activity

The Audit staff's analysis indicated that during the audit period the non-federal account transferred less than it could have to the federal account for its share of allocable expenses. A total of \$1,012,873 was transferred; however, the non-federal share of allocated costs was \$1,123,535, leaving an additional \$110,662 which could have been transferred. In addition MDSC made transfers to its non-federal account totaling \$87,120. Therefore, the interim audit report noted that MDSC would be required to transfer \$4,699,551 ($\$1,376,575 + \$3,408,722 + \$112,036 - \$110,662 - \$87,120$) from its federal account to pay for its share of expenses paid from the non-federal account.

At the exit conference, the Audit staff addressed these matters and provided schedules identifying the transactions noted above to the MDSC representatives. MDSC representatives stated that MDSC's focus for 2003 and part of 2004 was geared toward

the gubernatorial race and that no employee spent more than 25% of his/her time on federal related activity.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that MDSC:

- Provide signed and notarized affidavits from employees stating that they did not spend more than 25% of their time on Federal election activities or activities in connection with a Federal election.
- Demonstrate that the identified disbursements paid from non-federal accounts are solely non-federal expenses.
- Absent such a demonstration, MDSC should reimburse the non-federal operating account \$4,699,551.
- In addition, MDSC should file Schedules B (Itemized Disbursements) or H-4 (Joint Federal/Non-federal Activity Schedule), as appropriate, disclosing as memo entries the expenditures paid from the non-federal account.

MDSC's initial response to the interim audit report consisted of a narrative which listed various vendors and discussed the services/goods provided, some documents and copies of reports filed by its non-federal committee.

MDSC stated that in 2003, and the first half of 2004, MDSC engaged in a public media campaign to inform the public on non-federal issues. This activity included polling, radio advertising, press and communications spokesmen, print advertising, direct mail, outreach via the internet with a website, and a statewide canvassing effort. Further, MDSC conducted a multi-million dollar campaign to support the 2004 democratic gubernatorial nominee as well as candidates for the state legislature. MDSC provided copies of its non-federal reports filed with the Missouri State Ethics Commission to support this argument. The response also notes that copies of ads were presented to the Audit staff demonstrating that the communications were promoting its gubernatorial candidate.

Finally, MDSC argues that the Audit staff disregards the law allowing MDSC to pay for convention and building fund expenses 100% with non-federal funds. MDSC refers to 2 USC Section 431(20) which states that the costs of a state, district, or local political convention is excepted from the definition of federal election activity and thus may be paid 100% from its non-federal account. MDSC also cites 2 USC 453(b) which excludes the purchase or construction of an office building for a state or local committee. MDSC also states that advisory opinions allowed parties to pay expenses described as capital expenditures under the Internal Revenue Code out of the non-federal account.

Although MSDC provided some schedules it had apparently generated, the response did not include any documentation, such as invoices, from vendors.

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The Audit staff contacted MDSC to inform them that their response was not sufficient. The Audit staff agreed to meet with MDSC to discuss what documentation would be required to resolve this matter.

Subsequent to that meeting, MDSC provided documentation from 14 vendors and salary documentation consisting of partial timesheets for seven staff members, and one affidavit. Although additional documentation has been promised, MDSC has not provided any additional invoices, documentation or contracts from the other vendors, or samples of the goods provided demonstrating that the expenses incurred for polling, radio advertising, print advertising, direct mail, and canvassing were to promote the election or defeat of non-federal candidates.

Audit Staff Analysis of Committee Response

MDSC provided documentation from 14 vendors that demonstrated the services provided were for solely non-federal activities. The amount covered by the documentation is \$2,542,961. In addition, MDSC provided partial timesheets for seven staff members, and one affidavit, for salaries totaling \$192,355 detailing that each staff member spent 25% or less of their time on federal election activity or activities in connection with a Federal election.

In addition, except as described above, MDSC did not provide affidavits or timesheets from other staff stating that they did not spend more than 25% of their time on federal election activity, as recommended in the interim report. Clearly, 11 CFR §106.7(d)(1)(ii) specifies that a log documenting the percentage of time spent by staff on non-federal activity must be maintained. Again, MDSC did not maintain such logs.

Although the regulation appears only to exclude convention expenses from the definition of federal election activity; the Audit staff has excluded convention costs as allocable expenses based on language contained in the Explanation & Justification (E&J) arising from revisions to 2 U.S.C. §431(20)(B). The E&J states, "In BCRA, Congress specifically excluded certain activities from the definition of Federal election activities, 2 U.S.C. 431(20)(B). Activities falling within one of the exceptions may be paid for entirely with non-Federal funds." One of these activities is the cost of state, district or local political conventions.

Finally, the Audit staff does not dispute that capital expenditures may be paid from MDSC's building fund. However, the documentation provided was not sufficient for the Audit staff to determine if these were capital expenditures. The invoices provided were for painting, plumbing, changing door locks and flooring. These types of expenses if incurred as part of a building improvement could qualify as a capital expenditure under the Internal Revenue Code. These same types of expenses could be for repairs and maintenance and thus administrative expenses.

Based on its review of the documentation submitted, the Audit staff reduced the amount MDSC is required to transfer to its non-federal operating account for its share of federal

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expenses from \$4,699,551 to \$2,541,689³. In addition, MDSC should file Schedules B, H-4, as appropriate, disclosing as memo entries the expenditures paid from the non-federal account.

Neither evidence of the transfer nor amended reports were submitted as part of the response.

³ Some of the expenditures were allocable; therefore the reduction of the amount to be transferred is not dollar for dollar.