



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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June 23, 2011

MEMORANDUM

To: The Commission

Through: Alec Palmer *AP*
Acting Staff Director

From: Patricia Carmona *PC*
Chief Compliance Officer

Joseph F. Stoltz *JFS*
Assistant Staff Director
Audit Division

Thomas J. Nurthen *TJN*
Audit Manager

By: Mary Moss *MM*
Lead Auditor

Subject: Audit Division Recommendation Memorandum on John Edwards for President (JEFP)

Discussed below is JEFP's response to the attached Draft Final Audit Report (DFAR) as well as the Audit Division's comments and recommendations. The Office of General Counsel reviewed this memorandum, concurs with the recommendations, and provided the attached comments.

JEFP declined the opportunity for an audit hearing and did not respond to Findings 2, 3 or 4.

Finding 1. Matching Funds Received in Excess of Entitlement

In response to the Draft Final Audit Report, Counsel for JEFP (Counsel) has restated many of the same arguments made previously with respect to the February 7, 2008 payroll and to JEFP's overall objection to the repayment of matching funds. In addition to those arguments, Counsel stated that the portion of the February 7, 2008

payroll in question (\$528,454) should be treated as a "pre-DOI [date of ineligibility] qualified campaign expense" for the following reasons:¹

- To compensate staff for overtime and extra hours worked during January 2008.
- To compensate staff for remaining with the campaign after DOI to perform functions relating to closing out campaign offices.
- To compensate staff for extra expenses they may have incurred, including assisting in the close-out of the campaign.

Counsel continued that the final payroll was to compensate staff for their work prior to DOI and to deal with obligations (leased office space, rental cars, leased equipment, etc.) that were undertaken by the campaign prior to DOI. As such, according to Counsel, the final payroll amount that the Audit Division is challenging is a qualified campaign expense because the expenditure (1) occurred within several days of the end of the campaign, (2) was driven by conditions and obligations in existence prior to DOI, and (3) should be treated on the same basis as other pre-DOI expenditures. Counsel also stated that "the final payroll was intended to deal with a variety of issues, including all of the explanations enumerated in the DFAR."

In addition, the response addresses a matter not discussed in detail in any response received to date. Counsel stated:

"Since JEFP filed its Response to the Preliminary Audit Report in December 2010, JEFP has become involved in providing extensive information to the Department of Justice. Although the Committee is not under investigation, it has been necessary for JEFP to incur unanticipated expenses, including additional staff and legal costs. These costs do not fall within the ambit of typical 'winding down' costs because they are not incurred for a Commission audit or compliance with public financing laws. Rather, these costs are actually qualified campaign expenses that are beyond winding down costs. Because the Committee's efforts have been more extensive than anticipated, and have required a large financial commitment, JEFP might exceed the limit on winding down costs. (11 C.F.R. §9034.11.) Therefore, JEFP is seeking a determination from the Commission that the Committee may re-allocate those costs as qualified campaign expenses. In the alternative, the Committee requests that the Commission determine that, due to unforeseen circumstances, these expenses be excluded from winding down costs for the purposes of the 10% limit on such costs."

¹ In response to the Preliminary Audit Report, Counsel argued that this amount represented a winding down expense and identified an amount that represented staff salaries covering the period January 31, 2008, to February 7, 2008, as well as an amount that represented a lump-sum payment for expenses.

Finally, Counsel stated that the Statement of Net Outstanding Campaign Obligations (NOCO) as it appeared in the Draft Final Audit Report (DFAR) values JEPF's capital assets at \$29,134 but that this valuation is not an accurate reflection of the current value of the assets. Counsel notes that the DFAR reflects valuation of assets from 2008. Since that date, the value of these assets has declined dramatically. The response explains that electronic items substantially decreased in value with age and several of these items are no longer functional. Therefore, the value of capital assets for NOCO purposes should be reduced to \$1,775, the current value of these assets. Counsel also indicated that it will provide additional documentation.

The Audit staff offers the following concerning JEPF's response:

February 7, 2008 Payroll – JEPF has offered a number of explanations to demonstrate why this payroll should be considered a qualified campaign expense and included on the NOCO statement. To date, the Audit staff has not accepted any of the explanations. Nor does the Audit staff accept Counsel's current position: that the payroll represented a pre-DOI qualified campaign expense because staff salaries were incurred in January 2008, or that the payroll covered expenses incurred after DOI but "driven by conditions and obligations in existence prior to DOI."

Counsel has not provided any documentation in support of its positions. Ninety-nine individuals were on the payroll in January 2008. These individuals were paid for their services in the normal course. Counsel now states that a portion of the payroll in question represents "overtime and extra hours worked during January 2008." However, Counsel has provided no documentation that identifies the individuals or the hours each individual worked. If a portion of the payroll represented reimbursements for expenses incurred by staff while closing offices or returning rental cars after DOI, as well as for post-DOI compensation, then documentation in support of these expenses should have been maintained.

Expenditures Associated with Providing Information to the Department of Justice – Counsel is seeking a determination from the Commission that allows JEPF either to re-allocate the costs associated with providing information to the Department of Justice as a qualified campaign expense, or to exclude these winding down expense costs from the winding down expense limitation.

JEPF has not provided any documentation supporting any amounts paid or outstanding for providing such services. Further, the Audit staff believes that these type of expenditures are permissible winding down costs subject to the winding down expense limitation at 11 CFR §9034.11(b).

The Explanation and Justification for this regulation appears to contemplate this type of activity. While discussing a commenter's argument that the Commission could create a fund for primary candidates like the GELAC (which is for general election candidates), the Commission provided a number of reasons why such a fund was not necessary. The Commission concluded that a new primary legal defense fund for

enforcement matters and other legal proceedings (emphasis added), or a primary legal and compliance fund similar to a GELAC, is not necessary or appropriate for primary election candidates.

The Explanation and Justification further states:

“This limitation only applies to the use of public funds or a mixture of public and private funds for winding down costs. The final rule allows a primary candidate who is in a deficit position at DOI to pay for winding down costs in excess of the limitation after the committee’s accounts no longer contain any matching funds.”

The last matching payment received by JEPF was \$4,057,453, on July 17, 2008. Of this amount, JEPF was only entitled to \$1,920,946 (\$4,057,453 - \$2,136,507 (repayment amount)). Based on JEPF’s expenditures after July 17, 2008, the matching funds (\$1,920,946) would have been exhausted from JEPF bank accounts as of April 30, 2010. Therefore, JEPF can exceed the winding down expense limitation without incurring a non-qualified campaign expense(s) since matching funds would no longer be in JEPF’s bank accounts. See 11 CFR §9058.2(b)(2)(iii)(B).

Valuation of Capital Assets – The Audit staff agrees that the NOCO valuation of capital assets is not an accurate reflection of the current value of capital assets, nor should it be. The NOCO represents a committee’s financial position as of the candidate’s date of ineligibility. The Regulations include as assets the fair market value of capital assets on hand (as of the date of ineligibility). If total liabilities exceed total assets, then the candidate is entitled to additional matching funds.

As is customary, the Audit staff worked with JEPF’s representative and agreed that the fair market value of capital assets at the candidate’s date of ineligibility was \$29,134. Committees have the option of selling their capital assets or continuing to use them while winding down the campaign. Based on Counsel’s response, it appears that JEPF continued to use some of its capital assets.

The Audit staff recommends that the Commission find that JEPF was not entitled to \$2,136,507 of the matching fund payment (\$4,057,453) it received on July 17, 2008 and that JEPF should repay \$2,136,507 to the United States Treasury.

Finding 2. Misstatement of Financial Activity

The Audit staff recommends that the Commission find that JEPF understated its cash-on-hand balance.

Finding 3. Failure to Itemize Loan Repayments

The Audit staff recommends that the Commission find that JEPF failed to itemize loan repayments, totaling \$4,244,469, on Schedule B-P (Itemized Disbursements)

Finding 4. Stale-Dated Checks

The Audit staff recommends that the Commission find that JEPF should pay \$267,529 to the United States Treasury.

If the above recommendations are approved, the Audit staff will prepare a Proposed Final Audit Report within 30 days of the Commission's vote.

Should an objection be received, Directive No. 70 states that the Audit Division Recommendation Memorandum will be placed on the next regularly scheduled open session agenda.

Documents related to this audit report can be viewed in the Voting Ballot Matters folder. Should you have any questions, please contact Mary Moss or Thomas Nurthen at 694-1200.

Attachments:

- Draft Final Audit Report of the Audit Division on John Edwards for President
- Office of General Counsel Analysis (DFAR) Received May 12, 2011
- Office of General Counsel Analysis (ADRM) Received June 23, 2011

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on John Edwards for President January 3, 2007 - March 31, 2008

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.¹ 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. 2)

John Edwards for President is the principal campaign committee for John Edwards, a candidate for the Democratic Party's nomination for the office of President of the United States. The Committee is headquartered in Chapel Hill, North Carolina. For more information, see the chart on the Campaign Organization, p.2.

Financial Activity (p. 3)

• Receipts	
○ Contributions From Individuals	\$39,643,966
○ Matching Funds Received	7,404,083
○ Bank Loan	8,974,714
○ Offsets to Expenditures	967,088
○ Other Receipts	129,527
Total Receipts	\$ 57,119,378
• Disbursements	
○ Operating Expenditures	\$44,405,156
○ Contribution Refunds	3,720,268
○ Loan Repayments and Other Disbursements	7,383,067
Total Disbursements	\$ 55,508,491

Findings and Recommendations (p. 4)

- Matching Funds Received in Excess of Entitlement (Finding 1)
- Misstatement of Financial Activity (Finding 2)
- Failure to Itemize Loan Repayments (Finding 3)
- Stale-Dated Checks (Finding 4)

¹ 26 U.S.C. §9038(a).

Draft Final Audit Report of the Audit Division on John Edwards for President

January 3, 2007 – March 31, 2008



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Part I Background

Authority for Audit

This report is based on an audit of John Edwards for President (JEPP), 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 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:

1. The receipt of excessive contributions and loans.
2. The receipt of contributions from prohibited sources.
3. The receipt of transfers from other authorized committees.
4. The disclosure of contributions and transfers received.
5. The disclosure of disbursements, debts and obligations.
6. The recordkeeping process and completeness of records.
7. The consistency between reported figures and bank records.
8. The accuracy of the Statement of Net Outstanding Campaign Obligations.
9. The campaign's compliance with spending limitations.
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 the audit fieldwork. JEPP's records were substantially complete and the fieldwork began immediately.

Part II Overview of Campaign

Campaign Organization

Important Dates	
• Date of Registration	January 5, 2007
• Eligibility Period	October 31, 2007 – January 30, 2008 ²
• Audit Coverage	January 3, 2007 – March 31, 2008 ³
Headquarters	
	Chapel Hill, North Carolina
Bank Information	
• Bank Depositories	Three
• Bank Accounts	17 Checking, 2 Investment
Treasurer	
• Treasurer When Audit Was Conducted	Julius L. Chambers
• Treasurer During Period Covered by Audit	Julius L. Chambers
Management Information	
• Attended FEC Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

² The period during which the candidate was eligible for matching funds began on the date of certification of his matching fund eligibility and ended on the date the candidate announced his withdrawal from the campaign. See 11 CFR §9033.

³ Limited reviews of receipts and expenditures were performed after March 31, 2008, to determine whether the candidate was eligible to receive additional matching funds.

Overview of Financial Activity (Audited Amounts)

Cash on hand @ January 3, 2007	\$ 0
o Contributions From Individuals	39,643,966
o Matching Funds Received	7,404,083 ⁴
o Bank Loan	8,974,714
o Offset to Expenditures	967,088
o Other Receipts	129,527
Total Receipts	\$57,119,378
o Operating Expenditures	44,405,156
o Contribution Refunds	3,720,268
o Loan Repayments and Other Disbursements	7,383,067
Total Disbursements	\$55,508,491
Cash on hand @ March 31, 2008	\$ 1,610,887

⁴ JEPF received an additional \$5,478,795 in matching funds after March 31, 2008 for a total of \$12,882,878. This represents 61 percent of the maximum entitlement (\$21,025,000) a Presidential candidate could have received in the 2008 cycle.

Part III

Summaries

Findings and Recommendations

Finding 1. Matching Funds Received in Excess of Entitlement

A review of JEPF's financial activity through December 31, 2008, and estimated winding down costs indicated that it received matching funds of more than \$2.1 million in excess of the Candidate's entitlement. JEPF's Statement of Net Outstanding Campaign Obligations (NOCO) understated its cash-on-hand, overstated its accounts payable and winding down expenses. The Audit staff recommended that JEPF provide evidence that it did not receive matching funds in excess of the entitlement.

In response, Counsel for JEPF (Counsel) stated that the payroll of February 7, 2008, represents a qualified campaign expense that should be included in the NOCO. Counsel also stated JEPF's overall objection to the repayment of matching funds.

The Audit staff has reviewed JEPF's response and where appropriate made adjustments to the NOCO. However, it remains the opinion of the Audit staff that JEPF received matching funds, totaling \$2,136,507, in excess of the Candidate's entitlement. (For more detail, see p. 6.)

Finding 2. Misstatement of Financial Activity

A comparison of JEPF's reported financial activity to its bank records revealed a material misstatement of reported cash-on-hand in calendar year 2007 through March 31, 2008. JEPF understated its December 31, 2007, cash-on-hand balance by \$585,814 and understated its March 31, 2008, cash-on-hand balance by \$468,676.

The Audit staff recommended that JEPF amend its most recently filed report to correct the cash-on-hand balance.

In response, JEPF materially complied with the recommendation. (For more detail, see p. 19.)

Finding 3. Failure to Itemize Loan Repayments

During audit fieldwork, the Audit staff identified loan repayments, totaling \$4,344,469, that were not itemized. Although JEPF reported the amounts on the Detail Summary Pages and itemized them on Schedule C (Loans) and Schedule C-1 (Loans and Lines of Credit From Lending Institutions), it did not itemize them on Schedule B-P (Itemized Disbursements).

The Audit staff recommended that JEPF file amended reports to itemize the loan repayments.

In response, JEPF complied with the recommendation. (For more detail, see p. 20.)

Finding 4. Stale-Dated Checks

The Audit staff identified 202 stale-dated checks, totaling \$267,529, and recommended that JEPF provide evidence that the checks are not outstanding or make a payment to the United States Treasury.

In response, JEPF documented that 83 checks, totaling \$138,871, were no longer stale-dated as they either had cleared the bank or were for amounts that were determined to be not owed. As a result, the remaining 128 stale-dated checks, totaling \$141,808, require repayment to the United States Treasury. (For more detail, see p. 21.)

Summary of Amounts Potentially Owed to the United States Treasury

• Finding 1	Matching Funds Received in Excess of Entitlement	\$2,136,507
• Finding 4	Stale-Dated Checks	141,808
	Total Due U.S. Treasury	\$ 2,278,315

Part IV

Findings and Recommendations

Finding 1. Matching Funds Received in Excess of Entitlement

Summary

A review of JEPF's financial activity through December 31, 2008, and estimated winding down costs indicated that it received matching funds of more than \$2.1 million in excess of the Candidate's entitlement. JEPF's Statement of Net Outstanding Campaign Obligations (NOCO) understated its cash-on-hand, overstated its accounts payable and winding down expenses. The Audit staff recommended that JEPF provide evidence that it did not receive matching funds in excess of the entitlement.

In response, Counsel for JEPF (Counsel) stated that the payroll of February 7, 2008, represents a qualified campaign expense that should be included in the NOCO. Counsel also stated JEPF's overall objection to the repayment of matching funds.

The Audit staff has reviewed JEPF's response and where appropriate made adjustments to the NOCO. However, it remains the opinion of the Audit staff that JEPF received matching funds, totaling \$2,136,507, in excess of the Candidate's entitlement.

Legal Standard

A. Net Outstanding Campaign Obligations. 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. 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(a).
- 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(a)(2).
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).
- Monetary bonuses paid after the date of ineligibility for committee employees and consultants, provided that they are paid in recognition of campaign-related activities or services; pursuant to a written contract made before the date of ineligibility; and, no later than 30 days after the date of ineligibility. 11 CFR §9034.4(a)(5).

D. Value of Capital Assets. The fair market value of capital assets is 60 percent of the total original cost of the assets when acquired. A candidate may claim a lower fair market value for a capital asset by listing the asset on the NOCO statement separately and demonstrating, through documentation, the lower fair market value. 11 CFR §9034.5(c)(1).

E. Entitlement to Matching Payments after Date of Ineligibility. If, on the date of ineligibility, a candidate has net outstanding campaign obligations as defined under 11 CFR §9034.5, that candidate may continue to receive matching payments provided that he or she still has net outstanding campaign debts on the day the matching payment is made. 11 CFR §9034.1(b).

F. Winding Down Limitation. The total amount of winding down costs that may be paid for, in whole or part, with matching funds shall not exceed the lesser of:

- 10 percent of the overall expenditures limitation pursuant to 11 CFR 9035.1; or
- 10 percent of the total of:
 - The candidate's expenditures subject to the over expenditure limitation as of the candidate's date of ineligibility; plus
 - The candidate's expenses exempt from the expenditure limitations as of the candidate's date of ineligibility. 11 CFR §9034.11(b)(1) and (2).

Facts and Analysis

A. Facts

The Audit staff prepared a Statement of Net Outstanding Campaign Obligations as of January 30, 2008, the Candidate's date of ineligibility (DOI). The Audit staff presented the audited statement that appears on the next page in the Preliminary Audit Report. This statement was based on the review of JEFP's financial activity through December 31, 2008 and included estimates for winding down costs thereafter. The Audit staff and JEFP agreed on all NOCO components except for accounts payable for qualified campaign expenses.

DRAFT

John Edwards for President
Statement of Net Outstanding Campaign Obligations
As of January 30, 2008
Prepared thru April 30, 2010

Assets

Primary Election Cash-in-Bank	\$3,971,887
General Election Cash-in-Bank	3,321,290
Accounts Receivable	455,789
Capital Assets	<u>29,134</u>

Total Assets \$ 7,778,100

Liabilities

Primary Election Accounts Payable for Qualified Campaign Expenses @ 1/30/08	\$2,313,509
Refund of General Election Contributions	3,321,290
Loan Payable @ 1/30/08	8,974,713
Actual Winding Down Costs (1/31/08 – 4/30/10)	2,584,568
Estimated Winding Down Costs (5/1/10 – 12/31/11)	1,423,060 [a]
Payable to U.S. Treasury – Stale-Dated Checks	<u>72,583</u>

Total Liabilities \$18,689,723

Net Outstanding Campaign Obligations (Deficit) as of January 30, 2008 (\$10,911,623)

Footnote to NOCO Statement:

[a] Estimated winding down costs will be compared to actual winding down costs and adjusted accordingly.

Shown below are adjustments for funds received after January 30, 2008 and through July 17, 2008.

Net Outstanding Campaign Obligations (Deficit) as of 1/30/08	(\$ 10,911,623)
Private Contributions Received 1/31/08 through 7/16/08	358,983
Interest Income Received 1/31/08 through 7/16/08	22,110
Matching Funds Received 1/31/08 through 7/16/08	<u>8,825,425</u>
Remaining entitlement as of 7/16/08	(\$ 1,705,105)
Matching Funds Received 7/17/08	<u>4,057,453</u>
Amount Received in Excess of Matching Fund Entitlement	<u>\$ 2,352,348</u>

As a result, in the Preliminary Audit Report, the Audit staff concluded that JEPF was not entitled to \$2,352,348 of the matching fund payment (\$4,057,453) it received on July 17, 2008.

1. Cash-In-Bank

The primary difference between the NOCO presented on the previous page and those prepared by JEPF is the cash-in-bank balance. JEPF understated cash by \$4.5 million. Most of the understatement of cash represented funds received for the general election during the primary election period. The understatement of assets caused the NOCO statements to show a larger deficit and matching fund entitlement than was the case. The Audit staff and JEPF agree on the cash balances presented in the NOCO statement.

2. Accounts Payable for Qualified Campaign Expenses – Payroll

Even though JEPF's accounts payable figure on its NOCO was not accurate, the Audit staff and JEPF now agree on the amount of accounts payable, except for the February 7, 2008 payroll. The Audit staff's calculation of accounts payable on the NOCO statement does not include \$556,871 in payroll paid on February 7, 2008. Absent further documentation, \$556,871 is considered to be a monetary bonus paid to 99 employees. As noted in the legal standards, in order to be a qualified campaign expense, monetary bonuses paid after DOI to employees in recognition of campaign-related activities or services must be paid no later than 30 days after DOI and provided for pursuant to a written contract made prior to DOI (11 CFR §9034.4(a)(5)). JEPF representatives confirmed that there were no written contracts.

JEPF paid staff twice monthly from inception through January 30, 2008. In January 2008, the payroll periods ended on January 15, 2008 and January 30, 2008. On January 31, 2008, another pay period concluded. This payroll totaled \$761,193 and was paid on February 7, 2008. The amount, in effect, tripled each employee's pay for the month of January. Throughout the audit fieldwork, the Audit staff made numerous requests for an explanation and documentation of this payroll.

B. Preliminary Audit Report & Audit Division Recommendation

1. First Exit Conference

This matter was presented to JEPF at the exit conference held on February 3, 2009. The Audit staff provided its NOCO and workpapers supporting all NOCO components.

Subsequently, the Assistant Treasurer responded that the purpose of the February 7, 2008 payroll was to reimburse employees who had not been paid their entire salary due to limited funds available beginning sometime in August 2007. Although requested, JEPF provided no specific details to explain how this payroll was calculated or what employees were not paid their full salary. At the exit conference,

the Audit staff made the Assistant Treasurer aware that documentation supporting this payroll had not been made available.

During the exit conference response period, the Audit staff analyzed JEPF's payroll for the period August 2007 through January 2008. The review indicated that JEPF's explanation was incorrect. Employees were paid in full from August 2007 through January 15, 2008. However, during the following pay period, which ended January 30, 2008, employees received half of their normal net pay.⁵ Therefore, the Audit staff considered that portion of the February 7, 2008 payroll necessary to make up the difference in net pay plus associated employee/employer payroll taxes (\$204,322) to be a qualified campaign expense and included the amount on the NOCO in accounts payable. The Audit staff considered the remaining portion of the February 7, 2008 payroll, or \$556,871, a non-qualified campaign expense and not included in the NOCO payables.

Subsequently, JEPF provided a second explanation of this payroll. The Assistant Treasurer indicated that as of January 1, 2008, campaign staff worked 24 hours a day, seven days a week, with the understanding that salary would be increased for those affected. The Assistant Treasurer further indicated that JEPF did not have sufficient funds to pay the increased salary on the normal pay dates in January and that after DOI, JEPF calculated the total amount due each employee and paid the increased salary on February 7, 2008. It is JEPF's opinion that the February 7, 2008 payroll represents a qualified campaign expense, which was due at DOI and therefore should be included in the NOCO.

With respect to resources not being available during January 2008 to pay the increased salaries, JEPF records indicate its average daily cash was approximately \$4.2 million for January, excluding general election contributions, which could not be used for primary expenses. Further, JEPF offered no explanation as to how the increased amount was calculated or how and when employees were notified; nor did it provide any documentation for the decision to increase salary. As a result, the Audit staff did not accept JEPF's explanation.

The Audit staff notified JEPF of its conclusion by email and gave JEPF 10 days to respond. The email explained that \$556,871, representing employee net pay and employee/employer payroll taxes, would not be included in the NOCO. Counsel objected to the notification by email and demanded a second exit conference.

⁵ It is not clear why this payroll was reduced. As can be seen from the NOCO statement, JEPF appears to have had funds available to meet the payroll, even setting aside the general election contributions, which could not be used for primary expenses.

2. Second Exit Conference

Although not required, a second exit conference was held on April 2, 2009.

Payroll

The Audit staff again informed JEFPP that \$556,871 of salary and payroll taxes were considered non-qualified campaign expenses, excludable from the NOCO. Counsel offered as a possible (third) explanation that certain staff may have traveled to state office locations in order to clean out the offices and return rental cars. However, no documentation supporting this explanation was provided. Again, the Audit staff provided JEFPP an additional 10-day response period.

In response, Counsel stated that in December 2007, JEFPP determined that those staying through the end of the campaign would receive a salary increase, which would be paid out as permitted by JEFPP resources. JEFPP intended this pay increase primarily to compensate staff for the fact that JEFPP dispatched staff to many different field locations throughout the country for the January primaries and caucuses, placing them on an around-the-clock schedule. JEFPP also designed the increase in pay to cover increased costs that staffers incurred because they were on the road. In addition, Counsel stated that on January 30, 2008, the date of ineligibility, JEFPP had approximately 70 office and volunteer sites in several cities in various states. JEFPP had deployed staff to these locations, where it was necessary to clean out and close field offices. JEFPP determined that it would be more efficient to pay these individuals a finite amount instead of asking employees to turn in receipts for reimbursement. According to Counsel, this would have been a difficult accounting process, which JEFPP could more efficiently manage by a lump-sum salary payment.

A few days later, JEFPP provided a schedule that reflected JEFPP's determination that all employees received a 31 percent increase in salary between December 23, 2007 and February 15, 2008, which was paid in one lump sum on February 7, 2008. JEFPP gave examples of three different employees and how this paycheck would have been allocated between payable and winding down categories.

With respect to the accounting burden of paying travel expenses, JEFPP had accounting procedures in place for handling travel reimbursements. Throughout the campaign, the staff submitted travel reimbursements. Some were included in the NOCO's accounts payable. The effect of a campaign increasing salary in lieu of paying for travel reimbursements creates additional expenses for the campaign, such as the employer's share of payroll taxes, not to mention the additional tax burden placed on employees. While it is reasonable that some staff would have been involved in the office closeout process, it is not likely that all staff, such as the chief of staff, chief financial officer or finance director, took part in this effort. The close out took place after DOI when only 14 people remained on the payroll.

Estimated Winding Down Expenses

In response, JEPF estimated it would spend a total of \$2,771,004 in winding down expenses for calendar years 2009 through 2011 (\$969,972 for 2009, \$959,972 for 2010, \$841,060 for 2011).⁶ For the period January 31, 2008 through April 30, 2010, estimates were converted to actual winding down expenses. Based on JEPF's actual spending from January 2009 through April 2010, the Audit staff calculated that estimated winding down expenses for the period of May 1, 2010 through December 31, 2011, \$1,423,060 may be necessary to wind down the campaign. With the exception of the adjustment for storage costs, the Audit staff's remaining estimated winding down expenses are very close to the amount calculated by JEPF.

It should be noted that throughout the post-audit period, the Audit staff consistently monitored estimated winding down expenses. Bank records and reported activity are reviewed in order to convert estimated winding down expenses to actual winding down expenses.

JEPF's Overall Objection to the Repayment of Matching Funds

JEPF argues that the combination of a shortfall in the Presidential Primary Matching Payment Account (Matching Payment Account) and the lack of a quorum in the Commission during the first half of 2008 put JEPF at a disadvantage with respect to the receipt of matching funds. JEPF argued that matchable contributions received prior to DOI should be matched regardless of whether there are qualified campaign expenses to pay, and concluded that the failure to match these contributions violates the First Amendment rights of both the candidate and those individuals who contributed to the candidate's committee.

With respect to JEPF's response, the Audit staff believes that under 26 USC §9033(c)(2), a candidate who has passed the date of ineligibility is not entitled to any further matching fund payments except to defray qualified campaign expenses incurred before the candidate became ineligible. The fact that JEPF received contributions that otherwise would be matchable does not determine whether the candidate is eligible for further payments. The intent of this section is to allow the candidate to receive matching funds after the date of ineligibility only to pay debts for qualified campaign expenses. In implementing this provision, the Commission considered both debts incurred before the date of ineligibility and necessary costs of wrapping up the campaign. It also established a procedure to monitor whether the candidate still has qualified campaign expenses to be paid prior to each post date of ineligibility payment, known as the NOCO Statement.⁷ Finally, the possibility of a shortage in the Matching Payment Account is recognized and an equitable distribution calculation is specified in both 26 USC §9037(b) and 11 CFR §9037.2. That equitable distribution formula was followed.

⁶ In its 2009 estimates, JEPF included storage costs of \$18,000 for the next seven years. JEPF inadvertently included this same cost in its 2010 and 2011 estimates. The necessary adjustment has been made.

⁷ See 11 CFR 9034.1(b), and 9034.5

Subsequent to the date of ineligibility, campaigns are required to submit a NOCO indicating the campaign has sufficient net debt to justify additional matching funds. The last matching fund payment JEFP received was \$4,057,453 on July 17, 2008. This payment was based on a NOCO filed on June 25, 2008 that reflected net debt of \$4,684,340. However, as previously noted, that NOCO statement was misstated.

There is no question that the combination of the shortfall in the Matching Payment Account and the Commission's lack of a quorum delayed payments. The Commission took all steps in its power to minimize the impact on all matching fund recipients. All matching fund requests received through December of 2007 were processed and certified while the Commission still had a quorum. That allowed the Treasury Department to begin making payments as soon as funds became available without the need for further Commission action. All payments certified by the Commission before January 1, 2008 were paid as funds became available between February and April 2008. This procedure also allowed campaigns to borrow funds using the matching funds as collateral. JEFP used this avenue to borrow \$8.9 million in November and December 2007, before any payments could have been made under any circumstances. Even though the Commission could not certify any payments during the first half of 2008, matching fund requests received after January 1, 2008 were processed, and the campaigns were informed of the matchable amount. Campaigns could use those amounts as collateral for loans if they desired. Finally, any additional expenses incurred by campaigns as a result of these circumstances, such as interest on loans or increased legal costs, would have been treated as qualified campaign expenses and could have resulted in an additional matching fund entitlement.

In summary, although it is true that matching fund payments were delayed during the first half of 2008, the Act and Commission's regulations are clear that in order to receive matching fund payments after the date of ineligibility, a candidate must have net outstanding campaign obligations on the date that the matching fund payments are made. JEFP does not argue that it had sufficient obligations to justify the full amount it received and agrees that it significantly understated its assets on its NOCO Statement. The fact that JEFP may have received contributions before the date of ineligibility that were not matched or that payments were delayed for reasons beyond the control of the Commission or JEFP, does not allow JEFP to receive matching fund payments after the date of ineligibility in excess of the amount of qualified campaign expenses to be paid.

Based on the above, JEFP was not entitled to \$2,352,348 of the matching funds payment (\$4,057,453) it received on July 17, 2008. Therefore, the Audit staff recommended that JEFP demonstrate that it did not receive matching funds in excess of its entitlement. The Preliminary Audit Report noted that absent such a demonstration, the Audit staff will recommend that the Commission make a determination that \$2,352,348 in matching funds is repayable to the United States Treasury.

C. Committee Response to the Preliminary Audit Report

In response to the Preliminary Audit Report, Counsel related that there were no major discrepancies with the NOCO. Counsel continued to maintain, however, that the entire

February 7, 2008 payroll should be considered a qualified campaign expense and not as a bonus.

Counsel also restated JEPF's overall objection to repayment of Matching Funds as discussed in its exit conference response on page 13 of this report.

In addition, Counsel provided another explanation for the February 7, 2008 payroll and included a chart that categorized that portion of the payroll in dispute differently from its previous explanations.

JEPF's Breakdown of That Portion of the February 7, 2008, Payroll in Dispute:

Additional Make-up Salary	\$ 44,917
Winding Down Expenses	
Salary January 31, 2008 through February 7, 2008	\$187,567
Lump Sum Payment for Expenses	<u>\$320,659</u>
Total	<u>\$553,143^A</u>

JEPF provided a chart that indicated it reduced the salary of six employees in 2007. Although JEPF provided no documentation to support this chart, it concluded that these six employees were owed \$44,917 and that, at a minimum, this amount should be added to the \$204,322 that the Audit staff recognized as permissible make-up salary.

JEPF indicated that the remaining portion of the February 7, 2008 payroll was for winding down costs, which are qualified campaign expenses. The two main components of these winding down costs were staff salaries and lump sum payments made to staff to reimburse for travel, lodging and meal expenses incurred during the month of January, and through February 7, 2008.

According to the response, staff salaries for the period of January 31, 2008 through February 7, 2008 totaled \$187,567, an average \$3,552 per staff. Lump sum payments for expenses totaled \$320,659, an average reimbursement of \$3,239 per staff.

The Audit staff reviewed JEPF's response and offers the following:

Make-up Salary - \$44,917 - The Audit staff conducted a review of the available payroll records for each individual listed by JEPF. The payroll records supported a reduction in pay for the six employees, totaling \$44,917. However, one of the six individuals listed, (make-up salary - \$16,500) was not paid on February 7, 2008. Therefore, any reduction in pay for this individual is irrelevant when discussing the February 7, 2008 payroll. This individual received a payment of \$7,675 for salary on February 11, 2008 that had already been included in accounts payable on the NOCO. As a result, the Audit staff included an additional \$28,417 (\$44,917 - \$16,500) as a qualified campaign expense on the NOCO.

^A The amount in dispute is actually \$556,871. JEPF's total is misstated by \$3,728.

Winding Down Salary - \$187,567 January 31, 2008, to February 7, 2008. JEFP indicated that winding down salaries for the period averaged \$3,552 per employee. JEFP appears to be saying that this payroll represented salary payments for only 53 (of the 99) individuals paid on February 7, 2008 (\$187,567 / \$3,552). JEFP has not provided any documentation that identifies the staff members who were paid. This new explanation is inconsistent with the fact that 99 individuals were paid on February 7, 2008.

Further, if the average salary per staff member (\$3,552) is incorrect and JEFP meant that all 99 individuals were paid for winding down activities during this period, it should be noted that 14 of these individuals remained on the payroll and received their normal salary for this same period on February 15, 2008 (pay period January 31, 2008 through February 14, 2008). The amount of that payroll has always been included in the NOCO as a winding down expense. The Audit staff does not accept JEFP's explanation.

Lump Sum Payment for Expenses - \$320,659. JEFP claimed that all 99 individuals incurred expenses for winding down the campaign (\$320,659 / \$3,239). However, JEFP has not provided documentation demonstrating that all 99 individuals incurred expenses or retained any documentation supporting these expenses.

The response stated that high-level staff performed winding down duties such as organizing and archiving financial documents, contacting vendors, thanking donors and coordinating with the candidates. It is unlikely these types of activities would generate reimbursed expenses. Again, these high-level employees, 14 in total, received their normal pay covering the same period, likely for performing these same tasks. As indicated above, the amount of the February 15, 2008 payroll (January 31, through February 14, 2008) was included in the NOCO as a winding down expense. The Audit staff does not accept JEFP's explanation.

Finally, incurring salary and documented reimbursed expenses after the candidate's date of ineligibility would be considered permissible winding down expenses. Even if the Commission were to accept JEFP's explanation with respect to the amount in question (\$528,454 (\$556,871 - \$28,417)), the NOCO statement presented on page 18 includes maximum allowable amount of winding down expenses. Including this amount would require an adjustment to the remaining estimated winding down expenses presented in that NOCO but would not affect the amount of matching funds determined to be in excess of the candidate's entitlement. JEFP would still be required to make a repayment of matching funds, totaling \$2,136,507.

Specifically, based on JEFP's actual winding down expenses during the post ineligibility period, the Audit staff estimated that JEFP will spend an additional \$1,216,981 in winding down expenditures and reach the winding down limit (\$4,205,000) by August 31, 2012. As previously stated, should the Commission accept JEFP's position on the remaining \$528,454 the Audit staff would reduce estimated winding down expenses to \$688,527 (\$1,216,981 - \$528,454). As a result, assuming a constant level of winding down spending, JEFP would reach the winding down limit by October 2011. The repayment would remain at \$2,136,507. If, however, the Commission does not accept

JEFP's explanation and JEFP spends less than the winding down estimate shown, the repayment would increase accordingly.

The Audit staff continues to believe that only \$232,739 (\$204,322 + \$28,417) of the February 7, 2008 payroll represented a qualified campaign expense. The remaining \$528,454 represented a non-qualified campaign expense.

Additional NOCO Adjustments

Based on JEFP's response to Finding 4, Stale-Dated Checks, the following components of the NOCO have been adjusted accordingly: (1) Cash-in-bank, (2) Accounts Payable for Qualified Campaign Expenses and (3) Payable to U.S. Treasury – Stale-Dated Checks.

The Audit staff revised the NOCO to include all revisions discussed above. We have also calculated actual winding down expenses through December 31, 2010 and updated the estimated winding down expenses through August 31, 2012. The revised NOCO appears on the following page.

DRAFT

John Edwards for President
Statement of Net Outstanding Campaign Obligations
As of January 30, 2008
Prepared thru December 31, 2010

Assets

Primary Election Cash-in-Bank	\$3,968,555	
General Election Cash-in-Bank	3,321,290	
Accounts Receivable	455,789	
Capital Assets	29,134	
	<hr/>	
Total Assets		\$ 7,774,768

Liabilities

Primary Election Accounts Payable for Qualified Campaign Expenses @ 1/30/08	\$2,341,276	
Refund of General Election Contributions	3,321,290	
Loan Payable @ 1/30/08	8,974,713	
Actual Winding Down Costs (1/31/08 – 12/31/10)	2,988,019	
Estimated Winding Down Costs (1/1/11 – 8/31/12)	1,216,981	[a]
Payable to U.S. Treasury – State-Dated Checks	59,953	
	<hr/>	
Total Liabilities		\$18,902,232
		<hr/>
Net Outstanding Campaign Obligations (Deficit) as of January 30, 2008		(\$11,127,464)

Footnote to NOCO Statement:

[a] Estimated winding down costs have been calculated not to exceed limitations at 11 CFR §9034.11(b).

Shown below are adjustments for funds received after January 30, 2008 through July 17, 2008.

Net Outstanding Campaign Obligations (Deficit) as of 1/30/08	(\$ 11,127,464)
Private Contributions Received 1/31/08 through 7/16/08	358,983
Interest Income Received 1/31/08 through 7/16/08	22,110
Matching Funds Received 1/31/08 through 7/16/08	8,825,425
Remaining entitlement as of 7/16/08	(\$ 1,920,946)
Matching Funds Received 7/17/08	4,057,453
Amount Received in Excess of Matching Fund Entitlement	\$ 2,136,507

As a result, JEPF was not entitled to \$2,136,507 of the matching fund payment (\$4,057,453) it received on July 17, 2008. The Audit staff believes that JEPF should make a repayment of \$2,136,507 to the United States Treasury.

Finding 2. Misstatement of Financial Activity

Summary

A comparison of JEPF's reported financial activity to its bank records revealed a material misstatement of reported cash-on-hand in calendar year 2007 through March 31, 2008. JEPF understated its December 31, 2007, cash-on-hand balance by \$585,814 and understated its March 31, 2008, cash-on-hand balance by \$468,676.

The Audit staff recommended that JEPF amend its most recently filed report to correct the cash-on-hand balance.

In response, JEPF materially complied with the recommendation.

Legal Standard

Contents of Reports. Each report must disclose:

- the amount of cash-on-hand at the beginning and end of the reporting period;
- the total amount of receipts for the reporting period and for the election cycle;
- the total amount of disbursements for the reporting period and for the election cycle; and
- certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 2 U.S.C. §434(b)(1), (2), (3), (4), and (5).

Facts and Analysis

A. Facts

During fieldwork, a comparison of JEPF's reported financial activity to its bank records revealed a material misstatement of reported cash-on-hand for calendar year 2007 through March 31, 2008. The ending cash-on-hand balance for calendar year 2007 was understated by \$585,814 and the ending cash-on-hand balance as of March 31, 2008 was understated by \$468,676.

B. Preliminary Audit Report & Audit Division Recommendation

The misstatement of cash-on-hand was primarily due to two factors. First, JEPF understated unitemized receipts, most of which represented small credit card transactions. This was due to a contribution processing software malfunction. JEPF was unaware of this problem until the audit fieldwork. Second, certain disbursements, although initially reported, were inadvertently voided and missing from the amended reports.

This matter was discussed at the exit conference. The Audit staff provided JEPF representatives copies of the Audit staff's bank reconciliations and JEPF indicated a willingness to correct the misstated cash-on-hand figures.

The Audit staff recommended that JEPF amend its most recently filed report to correct the cash-on-hand balance, with an explanation that the change resulted from a prior period audit adjustment. It was also recommended that JEPF reconcile the cash balance of its most recent report to identify any subsequent discrepancies that may have affected the adjustments recommended by the Audit staff.

C. Committee Response to the Preliminary Audit Report

In response, JEPF amended its reports and reiterated that the misstatements were the result of an anomaly in the software used by JEPF.

Finding 3. Failure to Itemize Loan Repayments

Summary

During audit fieldwork, the Audit staff identified loan repayments, totaling \$4,344,469, that were not itemized. Although JEPF reported the amounts on the Detail Summary Pages and itemized them on Schedule C (Loans) and Schedule C-1 (Loans and Lines of Credit From Lending Institutions), it did not itemize them on Schedule B-P (Itemized Disbursements).

The Audit staff recommended that JEPF file amended reports to itemize the loan repayments.

In response, JEPF complied with the recommendation.

Legal Standard

When to Itemize. When a loan repayment is made to any person in any amount, the committee must report the:

- name and address of the payee; and
- date and amount of payment. 2 U.S.C. §434(b)(5)(D) and 11 CFR §104.3(b)(4)(iii).

Facts and Analysis

A. Facts

During fieldwork, the Audit staff identified loan repayments, totaling \$4,344,469, which JEPF did not itemize. Although JEPF included the aggregate amount of these payments on the detailed summary pages, it failed to provide supporting Schedules B-P, itemizing the payments.

B. Preliminary Audit Report & Audit Division Recommendation

This matter was discussed at the exit conference. There was no obvious reason why the loan repayments were not itemized, but a JEPF representative agreed to amend the committee's reports as necessary.

The Audit staff recommended that JEPF file amended reports itemizing the loan repayments on Schedule B-P, line 27(b).

C. Committee Response to the Preliminary Audit Report
 In response, JEPF filed amended reports itemizing the loan repayments.

Finding 4. Stale-Dated Checks

Summary

The Audit staff identified 202 stale-dated checks, totaling \$267,529, and recommended that JEPF provide evidence that the checks are not outstanding or make a payment to the United States Treasury.

In response, JEPF documented that 83 checks, totaling \$138,871, were no longer stale-dated as they either had cleared the bank or were for amounts that were determined to be not owed. As a result, the remaining 128 stale-dated checks, totaling \$141,808, require repayment to the United States Treasury.

Legal Standard

Handling Stale-Dated (Uncashed) Checks. If a committee has issued checks that the payees (creditors or contributors) have not cashed, the committee must notify the Commission of its efforts to locate the payees and encourage them to cash the outstanding checks. The committee must also submit a check payable to the United States Treasury for the total amount of the outstanding checks. 11 CFR §9038.6.

Facts and Analysis

A. Facts

During fieldwork, the Audit staff identified 202 stale-dated checks, totaling \$267,529. The checks were dated between February 22, 2007 and May 21, 2008 and had not cleared the bank as of February 28, 2010. A majority of the stale-dated checks represented refunds of general election contributions.

B. Preliminary Audit Report & Audit Division Recommendation

This matter was discussed at the exit conference during which the Audit staff provided JEPF representatives with a schedule of the stale-dated checks. In response, JEPF indicated that it contacted a number of individuals/vendors and reissued \$114,481 in stale-dated checks but did not provide the check numbers of the reissued checks. Without the check numbers, the Audit staff could not determine whether any of the reissued checks had cleared the bank.

In the Preliminary Audit report, the Audit staff recommended that JEPF provide evidence that:

- the \$114,481 in reissued checks have cleared the bank by providing copies of the front and back of the negotiated checks along with bank statements;
and
- the remaining stale-dated checks, totaling \$153,048 (\$267,529 - \$114,481) had either been reissued and cleared JEPF's bank or had been voided because no obligation exists.

Absent such evidence, the Audit staff recommended that JEPF pay \$267,529 to the United States Treasury.

C. Committee Response to the Preliminary Audit Report

In its response, JEPF stated that 83 checks, totaling \$138,871, should be removed from the stale-dated check list and provided documentation in support of its position.

Based on a review of JEPF's response and the documentation presented, the Audit staff identified that 74 checks, totaling \$125,721, were no longer stale-dated. For the remaining stale-dated checks, JEPF did not provide sufficient documentation to support its position that no obligation existed or that the checks had cleared the bank as of December 31, 2010. Therefore, JEPF is required to pay the United States Treasury for the remaining 128 stale-dated-checks, totaling \$141,808.

DRAFT



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

June 23, 2011

MEMORANDUM

TO: Patricia Carmona
Chief Compliance Officer

Joseph F. Stoltz
Assistant Staff Director

FROM: Christopher Hughey *feh*
Acting General Counsel

Lawrence L. Calvert, Jr. *LCC*
Associate General Counsel

Lorenzo Holloway *LH*
Assistant General Counsel
For Public Finance and Audit Advice

Delanie DeWitt Painter *DDP*
Attorney

Allison T. Steinle *ATS*
Attorney

SUBJECT: Proposed Audit Division Recommendation Memorandum on John Edwards for President, Inc. (LRA 743)

I. INTRODUCTION

The Office of General Counsel has reviewed the proposed Audit Division Recommendation Memorandum ("ADRM") and accompanying proposed Draft Final Audit Report ("DFAR") on John Edwards for President, Inc. ("the Committee"). We have also reviewed the Committee's response to the DFAR ("DFAR Response"). Our memorandum addresses two new issues that the Committee raises in its response. We have already addressed the other issues that the Committee raises in its response in our earlier comments on the Audit Division's proposed DFAR. We understand that the Audit Division will attach our earlier comments to the ADRM. If you have any questions, please contact Delanie DeWitt Painter or Allison T. Steinle, the attorneys assigned to this audit.

II. COSTS RELATED TO DOJ INVESTIGATION

The Committee argues that the Commission should treat costs related to providing information to the Department of Justice ("DOJ") as a separate category of qualified campaign expenses "beyond winding down costs" that should not be subject to the 10% winding down limitation.¹ DFAR Response at 6-7. The Committee explains that although it is not under investigation, it has provided "extensive information" to DOJ and has had to "incur unanticipated expenses, including additional staff and legal costs." *Id.* at 6. The Committee provided no other information about the amount or nature of these expenses. The Committee contends that these costs are qualified campaign expenses but are not typical winding down costs because they are not related to the Commission audit or compliance with the public financing laws. *Id.* It states that it might exceed the winding down limitation and asks the Commission to allow it to re-allocate these expenses as qualified campaign expenses instead of winding down costs. *Id.* at 7. Alternatively, the Committee contends that these costs should be excluded from its winding down costs for purposes of the winding down limitation. *Id.* The Committee's arguments would increase the Committee's liabilities for qualified campaign expenses incurred after the candidate's date of ineligibility ("DOI") without exceeding the winding down limitation, thus increasing the amount of matching funds to which it was entitled and reducing the repayment for funds received in excess of the candidate's entitlement.

We disagree with the Committee's arguments. The Committee's costs related to the DOJ investigation appear to be just the kind of legal and staff costs that are usually considered winding

¹ A grand jury indictment was filed against the candidate on June 3, 2011, which alleges, *inter alia*, various election law violations. It describes the alleged payment of nearly \$1 million in expenses by third parties, sometimes through fourth party intermediaries, for expenses connected with an effort to conceal certain facts about the candidate's personal life. The allegations expressed in the indictment include that these payments, and the expenditure of them, were for the purpose of influencing the candidate's election by preventing publicity about these facts from destroying his campaign, thus making the payments contributions and the consumption of the goods and services they purchased expenditures. See Indictment, *United States v. Edwards*, 1:11 CR 161-1 (M.D.N.C. June 3, 2011). Because the alleged activity involved no payments to or by the Committee, the Commission's audit of the Committee's finances produced no independent information related to the allegations in the indictment. (The fact that the audit produced no independent information does not mean that the facts alleged in the indictment did not occur, a question we do not address here). We understand from media accounts that the question of whether the alleged payments were in fact for the purpose of influencing Edwards's election, is likely to be strongly contested at trial. See Katherine Q. Seotye, *Edwards Charged with Election Finance Fraud*, NY Times, June 3, 2011, available at <http://www.nytimes.com/2011/06/04/us/politics/04edwards.html?pagewanted=1&sq=john%20edwards%20indictment&st=cse&scp=1>

We note that there is a theory under which the allegations in the indictment, if proven, could have potential repayment implications. The theory is that campaign expenses that are not properly documented as qualified campaign expenses in accordance with 11 C.F.R. § 9033.11 are non-qualified campaign expenses subject to *pro rata* repayment to the Treasury. See 11 C.F.R. §§ 9032.9, 9038.2(b)(2) and (3), 9033.11. However, the Commission declined to seek a repayment on this theory after considering the circumstances in the Tsongas for President audit, where the committee's chief fundraiser had already pled guilty to soliciting excessive contributions, depositing funds into a secret committee account, and embezzling funds. See Final Audit Report, Tsongas for President Committee, (approved Dec. 16, 1994). In contrast, there has been no guilty plea here, and the indictment's allegations remain unproven. Therefore, we are making no recommendations at this time.

down expenses rather than costs "beyond winding down." Although the Committee itself is not under investigation, several allegations in the indictment of the candidate relate to violations of campaign finance laws (presuming the indictment is related to the DOJ requests for information from the Committee). Complying with investigative requests from DOJ or any other federal or law enforcement agency is a reasonable cost of terminating a campaign. Costs related to a government agency investigation appear to be similar to winding down costs related to Commission compliance actions. The winding down rule "allows candidates to classify compliance matters arising from the campaign as winding down costs." See Explanation and Justification for 11 C.F.R. § 9004.11, 68 Fed. Reg. 47,393 (Aug. 8, 2003). The Commission considered winding down costs related to compliance actions in determining the winding down limitations. *Id.*

The Committee is asking the Commission to ignore its own regulations and exempt the Committee from the winding down limitation that applies to all other primary candidates. See 11 C.F.R. § 9034.11(b). The winding down limitation for primary candidates is the lesser of: 10% of the overall expenditure limitation of 11 C.F.R. § 9035.1, or 10% of the total of the candidate's expenditures subject to the overall expenditure limitation plus exempt expenses as of DOI. 11 C.F.R. § 9034.11(b). The winding down limitations apply to "[a]ll expenses incurred and paid by a candidate during the winding down period." See Explanation and Justification for 11 C.F.R. § 9004.11, 68 Fed. Reg. 47,392 (Aug. 8, 2003). Payment of winding down expenses in excess of the winding down limitation are non-qualified campaign expenses, but a primary candidate may pay for winding down costs in excess of the limitation after the committee's accounts no longer contain any matching funds without resulting in non-qualified campaign expenses.² Explanation and Justification for 11 C.F.R. 9034.11(d), 68 Fed. Reg. 47,409 (Aug. 8, 2003); see 11 C.F.R. § 9038.2(b)(2)(iii)(B) and (iv).

The Committee's proposals are contrary to the purpose of the winding down limitations. The winding down limitations for primary and general candidates were part of several changes to the rules for winding down costs intended to avoid future disputes over winding down costs like the disputes that had lengthened previous audit and repayment processes. 68 Fed. Reg. 47,390-391. The Commission explained that the monetary limitation "establishes a fair and readily determined amount to ensure that all campaigns are treated consistently" and that the limitation is "necessary to ensure that publicly funded campaign committees wind down as quickly and efficiently as possible and do not inflate winding down costs" to avoid repayments. 68 Fed. Reg. 47,391. Permitting the Committee to either "re-allocate" these expenses as a separate type of qualified campaign expenses instead of winding down costs or to exclude these costs from its winding down costs for purposes of the winding down limitation does not treat the Committee consistently or fairly compared to all other publicly funded candidates, who are subject to the winding down limitations. Instead of avoiding lengthy disputes over specific expenses, it would expend Commission resources to determine which specific expenses related to DOJ activity. The Committee's proposal would also allow the Committee to inflate its qualified campaign expenses

² According to the Audit staff, based on the entitlement and repayment calculations in the DFAR, the last matching funds would have been exhausted from the Committee's bank accounts as of April 30, 2010. After that date, the Committee could pay for winding down expenses in excess of the limitation without making non-qualified campaign expenses subject to repayment.

after DOI well in excess of the winding down limitation which would increase its entitlement and reduce its potential repayment.

In its alternative argument, the Committee asks the Commission to create a new category of qualified campaign expenses incurred after the candidate's DOI that is not in the regulations. Generally, after DOI, candidates may use matching funds only for qualified campaign expenses incurred prior to DOI and winding down costs. *See* 11 C.F.R. §§ 9032.9, 9034.4(a), 9034.11. Nearly all qualified campaign expenses incurred after DOI are winding down costs subject to the winding down limitation. *See* 11 C.F.R. § 9034.11. The Commission's regulations include strictly limited rules for other qualified campaign expenses after DOI for staff gifts and bonuses and convention-related costs. *See* 11 C.F.R. §§ 9034.4(a)(5) and (6). But the Commission has never created the kind of broad category of unlimited qualified campaign expenses incurred after DOI that the Committee seeks.

Indeed, in promulgating the winding down limitations, the Commission declined to create a legal defense fund for primary candidates for "enforcement matters and other legal proceedings." 68 Fed. Reg. 47,409. The Commission explained that "a separate compliance fund is not necessary" or appropriate for primary candidates because primary candidates may use private contributions for winding down expenses in excess of the limitation when they no longer retain matching funds in their accounts. *Id.* Therefore, there is no basis for allowing the Committee to treat as liabilities on its NOCO Statement both the full amount of the winding down limitation and an additional substantial amount for qualified campaign expenses related to the DOJ investigation, thereby increasing the amount of its entitlement and reducing the repayment.

Further, the Committee has not provided any information about the amount of expenses it seeks to "re-allocate" as qualified campaign expenses that are not subject to the winding down limitation. Without this information, it is impossible for the Audit Division to calculate what impact the Committee's proposals would have on the amount of the candidate's entitlement and consequently, on the amount of the repayment for matching funds received in excess of entitlement. Even if the Commission were to accept the Committee's arguments, it would be impossible to implement them without information that the Committee has failed to provide.

Finally, we recommend that the Audit staff revise the ADRM to delete the first sentence in the second paragraph of page 4, beginning with "Based on the above" and the fifth sentence in the same paragraph beginning "As a result." These sentences may cause confusion. The Commission has not yet considered the issue of whether the Committee may treat expenses in excess of the winding down limitation as liabilities on its NOCO Statement for purposes of calculating the candidate's entitlement and repayment. The question of whether winding down expenses in excess of the limitation would result in repayable non-qualified campaign expenses does not resolve this separate issue.

III. VALUATION OF CAPITAL ASSETS

The Committee also argues that the valuation of the Committee's capital assets on the Audit Division's Statement of Net Outstanding Campaign Obligations ("NOCO Statement") "is

not an accurate reflection of the current value of the Committee's assets." DFAR Response at 7. The Committee notes that the stated value of assets on the Audit Division's NOCO Statement is over two years old, and explains that since that date, "the value of those assets has declined dramatically." *Id.* The Committee points to the fact that electronic items have substantially decreased in value, and several items are no longer functional and therefore "should not figure in to the NOCO values." The Committee provided a spreadsheet that places a current value on its capital assets of \$1,775.40, in contrast to the \$29,134 figure that is reflected in the Audit Division's NOCO Statement. *Id.* at 8. The Committee's arguments would decrease the Committee's assets on the NOCO Statement, thus increasing the amount of matching funds to which it was entitled and reducing the repayment for funds received in excess of the candidate's entitlement.

Again, we disagree with the Committee's argument. The Committee's argument presupposes that the valuation of an asset on the NOCO Statement must be based on its current value. The Commission's regulations, however, do not provide that the valuation of a capital asset can be continually adjusted based on its current value. To determine a candidate's ongoing entitlement to matching funds after a candidate's DOI, a candidate must submit NOCO Statements with each post-DOI submission for matching funds that reflect the difference between the candidate's liabilities for qualified campaign expenses and the candidate's assets as of the date of that statement. 11 C.F.R. §§ 9034.5(a), 9034.5(f). Those statements must include the fair market value of any capital assets on hand. 11 C.F.R. § 9034.5(a)(2)(ii). The fair market value of a capital asset is defined as either: 60% of the total original cost of the item when equised, or for items acquired after DOI, the fair market value on the date received. 11 C.F.R. § 9034.5(c)(1). The regulations further state that a candidate "may claim a lower fair market value for a capital asset by listing that capital asset *on the statement* separately and demonstrating, through documentation, the lower fair market value." *Id.* (emphasis added). The regulations, however, do not address whether a candidate may claim a lower fair market value for a capital asset at any point beyond submissions for matching funds, such as during the audit process.

The Commission, nevertheless, has always interpreted these regulations in past audits to mean that the valuation of an asset on a NOCO Statement in an audit report should be based on the fair market value of the asset as of DOI, not the current value. Even assuming that the regulations allow for the valuation of an asset on a NOCO Statement to be based on the fair market value of an asset as of the date of that statement, not DOI, *see* 11 C.F.R. § 9034.5(f), they do not address valuation at any point beyond the submission of NOCO Statements with each post-DOI submission for matching funds.

As noted above, the starting point for determining the fair market value of a capital asset is the value when acquired or received by the candidate. 11 C.F.R. § 9034.5(c)(1). By allowing a candidate to use only 60% of the original cost of the item when acquired or the fair market value on the date received, the Commission's regulations already allow candidates to account for depreciation. *See* 11 C.F.R. § 9034.5(c)(1); Explanation and Justification for 11 C.F.R. § 9034.5, 64 Fed. Reg. 49359-60 (Sept. 13, 1999); Explanation and Justification for 11 C.F.R. § 9034.5, 52 Fed. Reg. 23670 (June 3, 1987) (noting that the basic threshold for determining whether an item should be included on the NOCO Statement is the item's original purchase price, not its value at the end of the campaign, and the regulations permit a candidate to deduct a "depreciation

allowance" or otherwise provide an appraisal of the item's value at the end of the campaign). Under the Committee's theory, however, a candidate's entitlement to matching funds could be continually adjusted based on depreciation well after the end of the campaign, until capital assets would have no impact on a candidate's entitlement to matching funds at all, since most capital assets continue to depreciate over time.

Finally, we note that the Committee states that additional documentation regarding the issue will be provided to the Audit Division. DFAR Response at 7. As of the date of this memorandum, however, it has failed to provide any documentation demonstrating the current fair market value of its capital assets. Therefore, even if the Commission were to accept the Committee's arguments and use the current value of the assets in the NOCO Statement, the Committee has failed to provide any documentation to verify its figures. *See* 11 C.F.R. § 9034.5(c)(1).