



FEDERAL ELECTION COMMISSION  
WASHINGTON, DC 20543

February 19, 1998

**MEMORANDUM**

TO: RON M. HARRIS  
PRESS OFFICER  
PRESS OFFICE

FROM: ROBERT J. COSTA   
ASSISTANT STAFF DIRECTOR  
AUDIT DIVISION

SUBJECT: PUBLIC ISSUANCE OF THE REPORT OF THE AUDIT DIVISION ON  
THE DEMOCRATIC PARTY OF ILLINOIS

Attached please find a copy of the final audit report and related documents on the Democratic Party of Illinois, which was approved by the Commission on February 6, 1998.

Informational copies of the report have been received by all parties involved and the report may be released to the public.

Attachment as stated

cc: Office of General Counsel  
Office of Public Disclosure  
Reports Analysis Division  
FEC Library

ENCLOSURE

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**REPORT OF THE AUDIT DIVISION  
ON THE  
DEMOCRATIC PARTY  
OF  
ILLINOIS**

**Approved February 6, 1998**



**FEDERAL ELECTION COMMISSION  
999 E STREET, N.W.  
WASHINGTON, D.C.**

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**FINAL AUDIT REPORT  
ON THE  
DEMOCRATIC PARTY OF ILLINOIS**

The Democratic Party of Illinois (the Committee) registered with the Federal Election Commission on May 4, 1983 and maintains its headquarters in Chicago, Illinois. The audit was conducted pursuant to 2 U.S.C. Section 438(b), which states that the Commission may conduct audits of any political committee whose reports fail to meet the threshold level of compliance set by the Commission. The findings of the audit were presented to the Committee at an exit conference held subsequent to the completion of fieldwork and later in an interim audit report. The Committee's responses to those findings are included in this final audit report.

**APPARENT PROHIBITED CONTRIBUTIONS AND REPORTING OF DEBTS** — 2 U.S.C. §§441b(a) and (b)(2), 11 CFR §§116.3(b) and (c), and 104.3(d) and 104.11. The Committee received an apparent prohibited corporate contribution from Gordon and Schwenkmeyer, Inc. (GSI). The contribution resulted from GSI's extension of credit which for the audit period totaled approximately \$67,600. In addition, the Committee did not report any debt owed to GSI on Schedule D. In response to the interim audit report, the Committee filed amended Schedules D that materially disclosed the amounts owed to GSI. Also, the Committee contended that no impermissible contribution resulted in its arrangement with GSI.

**MISSTATEMENT OF FINANCIAL ACTIVITY** — 2 U.S.C. §§434(b)(1), (2) and (4). Reported totals for receipts, disbursements and cash on hand for calendar years 1993 and 1994 were misstated. In response to the interim audit report, the Committee filed amendments which materially corrected the misstatements noted.

**RECORDKEEPING FOR CONTRIBUTIONS FROM INDIVIDUALS** — 2 U.S.C. §§432(c)(3) and (i), and 11 CFR §104.7(b). The Committee did not obtain and/or maintain documentation relative to the occupation and name of employer for approximately \$71,000 in contributions received from individuals. The Committee asserted that it did meet the best efforts provision; however, the audit report noted the Committee did not provide documentation to demonstrate that it met the best effort requirements.





FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20543

***REPORT OF THE AUDIT DIVISION  
ON THE  
DEMOCRATIC PARTY OF ILLINOIS***

**I. BACKGROUND**

**A. AUDIT AUTHORITY**

This report is based on an audit of the Democratic Party of Illinois (the Committee) undertaken by the Audit Division of the Federal Election Commission in accordance with the provisions of the Federal Election Campaign Act of 1971, as amended (the Act). The audit was conducted pursuant to Section 438(b) of Title 2 of the United States Code which states, in part, that the Commission may conduct audits and field investigations of any political committee required to file a report under Section 434 of this title. Prior to conducting any audit under this subsection, the Commission shall perform an internal review of the reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act.

**B. AUDIT COVERAGE**

The audit covered the period from January 1, 1993 through December 31, 1994. The Committee reported a beginning cash balance of \$104,880; total receipts for the period of \$967,643; total disbursements for the period of \$1,045,489; and an ending cash balance of \$27,033.<sup>1</sup>

**C. CAMPAIGN ORGANIZATION**

The Committee registered with the Federal Election Commission, on May 4, 1983, as the Democratic State Central Committee of Illinois. On July 2, 1990, the Committee filed an amended Statement of Organization and changed its name to the Democratic Party of Illinois. The Committee maintains its headquarters in Chicago.

<sup>1</sup> The Audit staff rounded all figures in this report to the nearest dollar. There was a material misstatement of financial activity in 1993 and 1994 (see Finding II.B.).

Illinois. The Committee used three bank accounts for its federal activity and five custodial bank accounts maintained by a fundraising firm in California.<sup>2</sup>

**C. KEY PERSONNEL**

The Treasurer of the Committee during the audit period was Mr. Stewart Winstein. The current Treasurer is Mr. John Gianulis.

**D. AUDIT SCOPE AND PROCEDURES**

The audit covered the following general categories:

1. The receipt of contributions or loans in excess of the statutory limitations;
2. the receipt of contributions from prohibited sources, such as those from corporations or labor organizations (see Finding II.A.);
3. proper disclosure of contributions from individuals, political committees and other entities, to include the itemization of contributions when required, as well as, the completeness and accuracy of the information disclosed;
4. proper disclosure of disbursements including the itemization of disbursements when required, as well as, the completeness and accuracy of the information disclosed;
5. review of expenditures made on behalf of federal candidates;
6. proper disclosure of campaign debts and obligations (see Finding II.A.);
7. accuracy of total reported receipts, disbursements and cash balances as compared to campaign bank records (see Finding II.B.);
8. adequate recordkeeping for campaign transactions (see Finding II.C.);
9. proper disclosure of the allocation of costs associated with administrative expenses and activities conducted jointly on behalf of federal and non-federal elections and candidates; and,
10. other audit procedures that were deemed necessary in the situation (see Finding II.D. & E.).

<sup>2</sup> In Advisory Opinion 1991-18, the Commission concluded that a custodial account(s) set up by this fundraising firm, acting as an agent for a committee, is an account of that Committee.

During our testing of contributions solicited and deposited by a fundraising firm, an agent of the Committee, the Audit staff noted that the documentation made available consisted of bank statements and computer-generated schedules of the contributions (see Finding II.A.). As such, the Audit staff was unable to verify the accuracy of the contributor information contained on the computer schedules because no third party documentation existed (i.e., copies of contributor checks and/or contributor response cards).

During our testing of the Committee's disbursements, the Audit staff noted several instances where the only available documentation was a canceled check (without a notation as to purpose). In these instances, the documentation did not contain support for the addresses and/or purposes disclosed on the Committee's reports; thus, the Audit staff was unable to verify the accuracy of such information.

The Audit staff determined that the available documentation satisfied the minimum recordkeeping requirements of 11 CFR §102.9. However, in many instances the results of our tests were dependent on the accuracy of the documentation generated by the Committee.

The Committee did not make available any documentation that supported its calculation of ratios used to calculate the federal and non-federal portions of disbursements made for allocable fundraising activity. As a result, the Audit staff was unable to verify the accuracy of the ratios used to allocate the fundraising expenses for each event. (See Finding II.D.).

Unless specifically discussed below, no material non-compliance was detected. The Commission may pursue further any of the matters discussed in this report in an enforcement action.

## **II. AUDIT FINDINGS AND RECOMMENDATIONS**

### **A. TRANSACTIONS WITH GORDON AND SCHWENKMEYER, INC.**

#### **1. Background**

Gordon and Schwenkmeyer, Inc. (GSI) is a fundraising and telemarketing firm located in El Segundo, California. Its two principals are Mr. Michael Gordon and Ms. Kris Schwenkmeyer. Both individuals are former employees of the Democratic State Central Committee of California.<sup>3</sup> They founded and incorporated GSI in 1985.

<sup>3</sup> See Report of the Audit Division on the Democratic State Central Committee of California, Finding II.A. The Commission approved the report on August 29, 1996.



The Committee entered into a contract with GSI for the purpose of raising funds through a telephone solicitation program(s).<sup>4</sup> The contract specified that GSI would act as an agent on behalf of the Committee and solicit contributions from contributors contained on lists provided by the Committee. The Committee provided two different types of contributor lists: a list of "prior" contributors, and, a list of "potential" contributors. GSI billed the Committee using two separate fee structures: one for telemarketing programs targeted at "proven" donors and another for programs targeted at "prospective" donors.<sup>5</sup>

The contract also specified that GSI would open a custodial checking account(s) into which GSI would deposit all of the donations received through each of the telephone solicitation programs. During the audit period, GSI maintained five custodial bank accounts<sup>6</sup> for the contributions received from five different federal telemarketing programs. GSI identified the programs as: IDP, ID2, ID3, ID4 and BU2. The Audit staff notes that IDP and ID2 were the names of the "prospecting" programs. GSI deposited contributions received through the respective programs into different accounts according to which program generated the donation.

The Audit staff determined that GSI transferred monies from the custodial accounts into its corporate account.<sup>7</sup> In most instances, the transfers occurred shortly after GSI deposited contributions into the custodial accounts. Apparently, GSI monitored the cash balances in the custodial accounts and transferred monies from its corporate account back to the custodial account before GSI made periodic payments to the Committee representing the net proceeds of the programs. The contract provided that GSI would prepare and provide a financial statement to the Committee every thirty days; however, the contract did not specify dates on which GSI would make payments to the Committee.

GSI used the prospecting programs (IDP and ID2) to expand the Committee's contributor base. The initial cost of these prospecting programs exceeded the proceeds due to the high volume of calls made and the low number and amount of

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<sup>4</sup> The effective coverage dates of the contract were from April 1, 1991 through July 1, 1992. The Committee did not provide any documentation that detailed subsequent extensions or other revisions to the original contract

<sup>5</sup> "Prospecting" (as referred to in this report) was the process by which the fundraiser (GSI) attempted to expand the contributor base for its client (the Committee)

<sup>6</sup> GSI closed one of the bank accounts in May 1993. There was a minimal amount of activity in the account

<sup>7</sup> The contract did not specify that GSI would transfer funds from the custodial accounts to GSI's corporate account for any reason

contributions received. Apparently, GSI would eliminate individuals from the prospecting list who did not contribute and the remaining contributors would be added to the proven donors list. Further, the prospecting programs resulted in debts being incurred by GSI, on behalf of the Committee, because the expenses of the program consistently exceeded the revenue and the contract did not contain any provisions for up front funding (a deposit or advance payment by the Committee).<sup>8</sup>

The contract also specified how the Committee and GSI would resolve any outstanding debts (owed by the Committee to GSI) should the contract expire or be terminated. It stated, in part,

"...if, at the time of termination of this Agreement, GSI is still owed money for services performed hereunder, GSI shall retain the right to continue to solicit donations on behalf of COMMITTEE and GSI may retain moneys obtained from such solicitations, until GSI is paid in full for its services rendered hereunder. Additionally, GSI may add to the amount due it from COMMITTEE any sums due it for the continued solicitation provided for in this Section..."

An unsigned rider attached to the written agreement provided to the Audit staff states, in part,

"that the only funds available to GSI as compensation per this AGREEMENT will be those received as a direct result of its efforts pursuant hereto and which are deposited in the custodial account. GSI expressly recognizes that COMMITTEE has no liability for payment to GSI whatsoever."

For the period under review, the Audit staff completed a reconciliation of the bank activity in the custodial accounts. We determined that the total beginning cash balance of the custodial accounts was \$13,115. During the audit period, GSI received and deposited into the custodial accounts contributions totaling \$383,080. In addition, GSI issued refunds of program costs to the Committee totaling \$18,675.<sup>9</sup> Disbursements from the custodial accounts included \$290,270, transferred from the custodial account(s) to GSI's corporate account, for program operating costs; and, \$430 for miscellaneous bank service charges. Further, GSI forwarded "net proceeds" from the

<sup>8</sup> In Advisory Opinion 1991-18, the Commission concluded that for GSI to begin prospecting on behalf of the New York State Democratic Committee (NYSDC), NYSDC would have to make a payment to GSI prior to GSI beginning the prospecting program, in an amount equal to GSI's normal expenses and expected profit. In doing so, NYSDC would avoid receiving a prohibited contribution from GSI.

<sup>9</sup> According to GSI, these refunds are offsets to operating expenditures. The reasons for the offsets are unknown.

programs to the Committee totaling \$121,800; \$71,500 designated for its federal account and \$50,300 designated for its non-federal account. The schedules provided by GSI did not indicate the reasons for designating certain contributions to the non-federal account. As a result of the above transactions, the total ending cash balance of the custodial accounts at December 31, 1994, was \$2,929.

The Audit staff also determined that the Committee owed a net outstanding debt to GSI on January 1, 1993, totaling \$33,431. The outstanding debt balance at December 31, 1994, was \$239.

Except for a portion (\$63,500) of the "net proceeds" received, the Committee did not disclose on its FEC reports, the majority of its transactions with GSI. (See Finding II.B.).

## 2. Apparent Prohibited Contributions from GSI

Section 441b(a) of Title 2 of the United States Code states, in part, that it is unlawful for any corporation to make a contribution or expenditure in connection with any election to any political office and that it is unlawful for any political committee knowingly to accept or receive any contribution prohibited by this section.

Section 441b(b)(2) of Title 2 of the United States Code states, in part, that the term "contribution or expenditure" shall include any direct or indirect payment, distribution, loan, advance, deposit, or gift of money, or any services, or anything of value to any political party in connection with any election to any of the offices referred to in this section.

Section 116.3(b) and (c) of Title 11 of the Code of Federal Regulations states, in part, that a corporation in its capacity as a commercial vendor may extend credit to a political committee or another person on behalf of a political committee provided that the credit is extended in the ordinary course of the corporation's business and the terms are substantially similar to extensions of credit to nonpolitical debtors that are of similar risk and size of obligation. In determining whether credit was extended in the ordinary course of business, the Commission will consider whether the commercial vendor followed its established procedures and its past practice in approving the extension of credit; whether the commercial vendor received prompt payment in full if it previously extended credit to the same political committee; and whether the extension of credit conformed to the usual and normal practice in the commercial vendor's trade or industry.

### a. Extension of Credit on Prospecting Accounts

The terms of the agreement between the Committee and GSI outlined the fees which GSI would receive as compensation for the services

provided. Further, the agreement stipulated that the source of these fees was limited to funds deposited in the custodial accounts(s) as a result of GSI's solicitation efforts.

The manner in which GSI conducts fundraising activities resulted in the majority of the costs being incurred up front. Apparently, GSI paid these costs from its own funds and obtained subsequent reimbursement as GSI received contributions. As a result, the Committee would have an initial outstanding debt to GSI which would be liquidated as GSI received additional contributions. The Committee did not disclose on its FEC reports, any debt owed to or from GSI during the audit period.

The Audit staff reviewed copies of the billing invoices provided by GSI for each solicitation program and the bank activity of each custodial account from inception in 1991 through December 31, 1994. GSI billed the Committee \$787,639 for the period April 1, 1991 through December 31, 1992 and GSI transferred \$754,208 (total program costs less refunds of program costs) to their corporate account as payment. The net debt (for all solicitation programs in operation) owed to GSI on December 31, 1992 was \$33,431. Billings from January 1, 1993 through December 31, 1994 totaled \$238,403 and net payments to GSI totaled \$271,595, resulting in a net debt owed by the Committee of \$239.

When each solicitation program is examined separately, the unreported activity includes Committee debt owed to GSI and net proceeds due (but not yet paid) to the Committee. GSI accounted for each program separately and did not use profits from one program to pay the operating shortfall of another program. At the beginning of the audit period, the amount of unreported debt owed to GSI as a result of the prospecting programs was \$48,912 (IDP \$37,588 + ID2 \$11,324) and the unreported net proceeds due to the Committee as a result of the other programs totaled \$15,481 (ID3 (\$13,590) + (BU2 (\$1,891))). On December 31, 1994, the unreported debt was \$24,315 (ID2 \$1,611 + ID4 \$22,704), while the unreported net proceeds had increased to \$24,076 (IDP (\$4,055) + ID3 (\$19,446) + BU2 (\$575)). Unlike the prospecting programs' debt position at January 1, 1993 [\$48,912 owed to GSI], as of December 31, 1994, GSI owed the Committee \$2,444 ((\$4,055) + \$1,611) in net proceeds resulting from the IDP and ID2 programs. In the table below, positive amounts represent Committee debt owed to GSI; negative amounts represent unreported net proceeds due from GSI to the Committee.

Program	January 1, 1993	December 31, 1994
IDP	\$ 37,588	(\$ 4,055)
ID2	11,324	1,611
ID3	(13,590)	(19,446)
ID4	-0-	22,704
BU2	<u>(1,891)</u>	<u>( 575)</u>
	\$ 33,431	\$ 239

Based on the above, an apparent prohibited contribution existed in the amount of \$48,912, the outstanding debt or extension of credit by GSI for the prospecting programs at January 1, 1993.

b. **Use of Offsets (Refunds of Program Costs) from GSI to Fund Activity in Custodial Accounts**

As previously noted, GSI deposited the contributions received from the various fundraising programs into the custodial account(s) and then transferred the funds into its corporate account. GSI described the purpose of these transfers as "program costs." Occasionally, GSI transferred monies back into the custodial account(s). GSI described the purpose of these transfers as "refunds" of program costs. The Committee did not provide documentation from GSI which demonstrated that the Committee was due these refunds. In addition, these "refunds" appeared to liquidate obligations arising from several of the custodial accounts. The Committee received refunds of program costs totaling \$18,675 (\$17,575 in 1993 and \$1,100 in 1994.)<sup>10</sup> Absent a demonstration to the contrary, it appears that an additional apparent prohibited contribution resulted in the amount of \$18,675.

3. **Disclosure of Debts - GSI**

Section 104.3(d) of Title 11 of the Code of Federal Regulations states, in part, that each report filed under 11 CFR 104.1 shall, on Schedule D, disclose the amount and nature of outstanding debts owed by the reporting committee.

Section 104.11 of Title 11 of the Code of Federal Regulations states, in part, that debts owed by a political committee which remain outstanding shall be continuously reported until extinguished. These debts shall be reported on separate schedules together with a statement explaining the circumstances and conditions under which each debt was incurred or extinguished.

During the audit period the Committee did not report any debt to GSI on Schedule D (Debts and Obligations, Excluding Loans) as required. The Committee filed semiannual reports for the 1993 calendar year and quarterly reports, along with Pre-General and Post General reports for the 1994 calendar year.

The Audit staff determined the beginning and ending outstanding debt balances, along with the total amount incurred and total amount paid for each reporting period, as summarized below:

<sup>10</sup> The Committee did not disclose these refunds on its reports (See Finding II.B.).

<u>Reporting Period</u>	<u>Outstanding Balance at Beginning of Period</u>	<u>Amount Incurred this Period</u>	<u>Payment this Period</u>	<u>Outstanding Balance at Close of Period</u>
Mid-Year 1993 (1/1/93 - 6/30/93)	\$48,912	66,598	92,885	22,625
Year-End 1993 (7/1/93 - 12/31/93)	22,625	36,527	48,726	10,426
1st Quarter 1994 (1/1/94 - 3/31/94)	10,426	35,867	49,250	(2,957)
2nd Quarter 1994 (4/1/94 - 6/30/94)	(2,957)	60,520	54,478	3,085
3rd Quarter 1994 (7/1/94 - 9/30/94)	3,085	11,609	13,900	794
Pre-General 1994 (10/1/94 - 10/19/94)	794	26,727	11,305	16,216
Post-General 1994 (10/20/94 - 11/28/94)	16,216	557	800	15,973
Year-End 1994 (11/29/94 - 12/31/94)	15,973	0	253	15,720

The Audit staff did not fully develop this finding prior to the exit conference because the Committee had not provided complete documentation relative to GSI and the custodial accounts. The Audit staff requested additional documentation at the exit conference. In response, the Committee provided billing statements from GSI, financial statements that detailed the monthly activity for each program, and bank statements for each of the custodial accounts.

In the interim audit report, the Audit staff recommended that the Committee take the following action:

- a) provide documentation which demonstrates that an apparent prohibited contribution, totaling \$67,587 (\$48,912 + \$18,675), did not occur; and,
- b) file amended Summary Pages and Detailed Summary Pages (FEC Form 3-X, Pages 1 and 2), along with accompanying Schedules D, for the 1993 and 1994 calendar years, to reflect the unreported debts with Gordon and Schwenkmeyer, Inc. (see also Recommendation #2); and,
- c) provide documentation from Gordon and Schwenkmeyer, Inc. that details any subsequent contract(s), amendment(s), extension(s) or revision(s) to its April 1, 1991 agreement.

In its response to the interim audit report, the Committee did not provide any additional documentation as requested in (a) and (c) above. Instead, the Committee elected to submit commentary from Ms. Barbara Guttman, the Assistant

Treasurer of the Committee, as well as, a letter from Mr. Mike Gordon, president of Gordon and Schwenkmeyer, Inc.

Ms. Guttman and Mr. Gordon both contend that GSI did not make any such impermissible contribution to the Committee. In regards to the apparent extension of credit made by GSI to the Committee (\$48,912), Mr. Gordon explains,

"We do not believe that it is appropriate for auditors to conclude that any such balance - assuming Commission auditors accurately calculated it - represented a contribution to the Party [the Committee]. No basis exists for auditors to isolate an account balance on one day of our nine year relationship with the Party and then allege that such amount represents a contribution to the Party.

"Moreover, we have implemented procedures for our prospecting accounts which preclude any such conclusion that an isolated outstanding balance represents a contribution. More specifically, we currently operate prospecting accounts for approximately thirty clients, including thirteen state party committees.

"We impose a consistent set of practices and procedures for collecting amounts due from these accounts. In each instance, we endeavor to promptly resolve the outstanding balances for the accounts, within discrete time periods, as fundraising proceeds accrue.

"Based on our thirteen years of operation in political and charitable fundraising, we believe that our procedures for administering our account relationship with the Party, as well as our other clients, conform to the usual and normal practice in this industry. We do not treat, and have not treated the Party any differently from our other clients.

"Our review of the Party's account reveals that we obtained payment for the costs of the IDP and ID2 accounts pursuant to our established practices and procedures. More specifically, during the audit period, 1993-1994, we obtained payment for services rendered with respect to the IDP and ID2 accounts within such discrete time periods. In summary, in our experience, the Party has previously maintained, and continues to maintain, a satisfactory account relationship with GSI.

"Finally, pursuant to our agreement with the Party to administer the IDP and ID2 accounts, we have recourse with other Party assets to cover uncollectible shortfall in these accounts "

Ms. Guttman also contends that,

“[f]or the reasons set forth in GSI’s letter... [quoted above] any such fundraising operation did not represent a contribution because it was consistent with 11 C.F.R. §§116.3(b) & (c). In addition, ...such fundraising operations were also consistent with Commission Advisory Opinion 1991-18.”

Mr. Gordon asserts that GSI has implemented procedures that promptly resolve any outstanding amounts owed to them from its clients, including the Committee. However, neither GSI nor the Committee provided any additional documentation, (e.g., an example of an amended contract or correspondence between GSI and any of its clients) that sustains such an assertion. Mr. Gordon states that GSI has recourse with other Committee assets to cover any uncollectible shortfalls in the prospecting accounts. Under this scenario, the apparent extension of credit made from GSI to the Committee was \$33,431, on January 1, 1993 and subsequently reduced to approximately \$7,000, by the close of the reporting period, June 30, 1993. During the audit period the Committee’s contract contained no such clause. In addition, the Audit staff notes that in prior experiences with GSI (see Footnote 3), agreements with other political clients specifically stated that GSI accounted for each program separately and did not use profits from one program to pay the operating shortfall of another program. Absent documentation to the contrary, the Audit staff maintains that the apparent extension of credit, totaling \$48,912 represents an apparent prohibited contribution.

In reference to apparent prohibited contributions, totaling \$18,675, “Use of Offsets (Refunds of Program Costs) from GSI to Fund Activity in Custodial Accounts”, Ms. Guttman explains that GSI, supported by the statements from Mr. Gordon,

“treated the Party’s accounts receivable in the same manner as those of its other political and non-political clients. In this context, any adjustment in the account relationship, via refund, to address mistaken over-charges by GSI, resolve good faith disputes over amounts due, or ensure that receivables were debited against the Party’s account at the appropriate time do not represent an impermissible contribution.”

Although Ms. Guttman and Mr. Gordon assert that GSI’s treatment of the Committee was consistent with how GSI treated its other clients in regards to “Refunds of Program Costs,” neither the Committee nor GSI provided any additional documentation which detailed the basis and/or the calculation of the amounts refunded to the Committee (\$18,675). Absent such documentation or some other demonstration to the contrary, the Audit staff considers the refunds to be contributions. The assertion that GSI consistently applies these procedures to other clients is not persuasive in determining whether or not GSI made a prohibited contribution to the Committee.



As such, the Audit staff maintains that the Committee received an apparent prohibited contribution from GSI totaling \$67,587 (\$48,912 + \$18,675).

In response to Finding II.A.3., Disclosure of Debts, and the recommendation at section (b) above, the Committee filed amended Schedules D that materially corrected the public record. The Audit staff notes that the amounts disclosed on the amended schedules reflect an amount owed to GSI that has been reduced by any outstanding proceeds due to the Committee.

## B. MISSTATEMENT OF FINANCIAL ACTIVITY

Sections 434(b)(1), (2) and (4) of Title 2 of the United States Code state, in relevant part, that each report shall disclose the amount of cash on hand at the beginning of each reporting period, the total amount of all receipts and the total amount of all disbursements for the reporting period and the calendar year.

The Audit staff's reconciliation of the Committee's reported financial activity to its bank activity revealed material misstatements in the Committee's reported financial activity for the 1993 and 1994 calendar years.

### 1. 1993 Misstatements

The Committee reported a beginning cash balance at January 1, 1993, of \$104,880. The Audit staff determined that the Committee understated its beginning cash balance by \$38,425. This net understatement was due to the following: unreported beginning cash balances of five custodial accounts maintained by GSI totaling \$13,115 (see Finding II.A.); and, an unresolved prior period misstatement(s) totaling \$25,310.<sup>11</sup>

The Committee reported total receipts of \$357,172 for the 1993 calendar year. The Audit staff determined that the Committee understated its receipts by \$154,378. This net understatement was primarily due to the following: unreported receipts from GSI totaling \$139,005; and unreported refunds from GSI totaling \$17,575 (see Finding II.A.). An unresolved difference exists in our reconciliation of the Committee's reported receipts totaling \$2,202.

The Committee reported total disbursements of \$446,770 for the 1993 calendar year. The Audit staff determined that the Committee understated its disbursements by \$191,810. This net understatement was primarily due to the following: unreported disbursements from the custodial accounts maintained by GSI totaling \$159,185 (see Finding II.A.); unreported disbursements from the accounts maintained by

<sup>11</sup> The Committee did not provide documentation that detailed its calculation of beginning cash on hand at January 1, 1993. Thus, the Audit staff was unable to determine the reason(s) for the unresolved portion of the misstatement.

the Committee totaling \$37,555; disbursements made from the Committee's non-federal account reported as being made from its federal account totaling \$10,759; unreported transfers from the custodial accounts to the Committee's non-federal account totaling \$8,500; disbursements that were reported twice totaling \$1,270; and, other miscellaneous reporting errors that result in a net overstatement of \$1,401.

## 2. 1994 Misstatements

The Committee reported total receipts of \$610,471 for the 1994 calendar year. The Audit staff determined that the Committee understated its receipts by \$187,261. This net understatement was primarily due to the following: unreported receipts from GSI telemarketing programs totaling \$181,133; and, unreported refunds from GSI totaling \$1,100 (see Finding II.A.); other unreported receipts totaling \$48,779; an understatement in the reported amount of a transfer, dated November 4, 1994, totaling \$8,000; non-federal receipts reported in error as federal receipts totaling \$22,568; receipts that were reported twice, totaling \$28,134; and, other miscellaneous reporting errors that result in a net overstatement of \$1,049.

The Committee reported total disbursements of \$598,719 for the 1994 calendar year. The Audit staff determined that the Committee understated its disbursements by \$197,375. This net understatement was primarily due to the following: unreported disbursements from the custodial accounts maintained by GSI totaling \$131,085 (see Finding II.A.); unreported disbursements from the accounts maintained by the Committee totaling \$40,770; disbursements made from the Committee's non-federal account reported as being made from its federal account totaling \$6,058; unreported transfers from the custodial accounts to the Committee's non-federal account totaling \$41,800; reported disbursements that were later voided but not adjusted for on the reports totaling \$8,595; and, other miscellaneous reporting errors that result in net overstatement of \$1,627.

At the exit conference, the Audit staff provided copies of our 1993 and 1994 bank reconciliation workpapers and discussed the noted misstatements with Committee officials. The Committee officials acknowledged the receipt of the workpapers, but did not offer any specific comments concerning the misstatements. The reconciliation workpapers provided to the Committee did not include our analysis of the custodial accounts maintained by GSI.<sup>12</sup>

In the interim audit report, the Audit staff recommended that the Committee file amended Summary and Detail Summary Pages (FEC Form 3X, Pages 1 and 2), along with accompanying Schedules A and B, as appropriate, for the 1993 and 1994 calendar years to correct the misstatement of financial activity.

<sup>12</sup> The Audit staff forwarded revised workpapers to the Committee with the interim report

In its response, the Committee did not contest this finding. On October 24, 1997, the Committee filed amended disclosure reports which materially corrected the 1993 and 1994 misstatements.

### C. RECORDKEEPING FOR CONTRIBUTIONS FROM INDIVIDUALS

Section 432(c)(3) of Title 2 of the United States Code states, in part, that the treasurer of a political committee shall keep an account of the identification of any person who makes a contribution or contributions aggregating more than \$200 during a calendar year, together with the date and amount of any such contribution.

Section 431(13)(A) of Title 2 of the United States Code states that the term "identification" means, in the case of any individual, the name, the mailing address, and the occupation of such individual, as well as the name of his or her employer.

Section 432(i) of Title 2 of the United States Code states, in part, that when the treasurer of a political committee shows that best efforts have been used to obtain and maintain the information required by this Act, any records of such committee shall be considered in compliance with this Act.

Section 104.7(b) of Title 11 of the Code of Federal Regulations states, in part, that the treasurer and the committee will only be deemed to have exercised best efforts to obtain the required information by either sending a written request to the contributor or making an oral request to the contributor documented in writing. The request must clearly ask for the missing information (i.e., name, mailing address, occupation, and the name of employer), inform the contributor that the reporting of such information is required by law, and the request must be made no later than thirty (30) days after receipt of the contribution.<sup>13</sup>

The Audit staff reviewed contributions from individuals that were greater than \$200, or when combined with other contributions from the same person in the calendar year, exceeded \$200. One hundred sixty-six (166) errors, totaling \$70,628, were identified relative to obtaining and maintaining the required contributor identification; in particular, the occupation and name of employer. The Committee maintained a database for individual contributions which included fields to record the name, mailing address, occupation, name of employer, date, and amount of contribution. There was no occupation or name of employer recorded in the database for sixty-one (61) contributions. Another ninety-seven (97) entries had an occupation and/or name of employer recorded in the database but there was no documentation to support the recorded information. The Committee did not make available any solicitation devices to the Audit staff.

In several instances, the Committee's FEC disclosure reports contained a "Note to Schedule A" that stated,

<sup>13</sup> The effective date of the revised version of this Regulation was March 3, 1994.

"In some instances information was omitted regarding a contributor's occupation and name of employer. The Committee omitted the information from the Report because, despite its 'best efforts', it was unable to obtain the information from the contributors in question. Regarding the Committee's 'best efforts' to obtain the information, the Committee routinely sends a letter to each contributor requesting that they provide their full name, address, employer and occupation. This letter also states that this information is requested pursuant to Federal Election Commission regulations. A sample copy of this letter follows this note."

During fieldwork, the Committee did not provide copies of the above noted letters, nor did it provide documentation which demonstrated that the letters were sent to the contributors.

At the exit conference, the Audit staff provided a schedule of the documentation errors to Committee officials. In response to the exit conference, the Committee provided copies of undated letters that requested the missing contributor information. The Committee indicated that it had sent the letters to contributors who did not provide the requested information. The Committee also stated, "[i]t is, however, our understanding that documentation which supports Occupations/Name of Employer is not required to be maintained."

In summary, the Committee did not provide documentation which demonstrated that the letters had been sent, nor did it provide any contributor information received as a result of the mailing.

Further, the Audit staff notes that the treasurer for a political committee, in accordance with 11 CFR §104.14 and 11 CFR §102.9(c), must preserve a copy of each report to be filed and maintain records: which shall provide in sufficient detail the necessary information and data from which the filed reports and statements may be verified, explained, clarified, and checked for accuracy and completeness; for a period of not less than three years after the report is filed.

It is the opinion of the Audit staff that the Committee did not demonstrate that it had satisfied the best efforts requirements. The Regulations at 11 CFR §104.7(b)(2) also require that missing contributor information must be requested no later than 30 days after receipt of the contribution.

In the interim audit report, the Audit staff recommended that the Committee:

- provide documentation which demonstrates that it had met the best efforts requirements at 11 CFR §104.7(b); and,
- implement procedures to maintain contribution records in accordance with 2 U.S.C. §432(c) and 11 CFR §104.14; and,
- provide evidence of the established procedures.

In its response, the Committee did not provide any additional documentation that demonstrated it had met the best efforts provisions of 11 CFR §104.7(b). Further, for the contributions at issue, the Committee did not demonstrate best efforts under either the previous or the current version of the regulations (see Footnote 13.)

The Committee's response states,

"[t]he committee did meet its best efforts requirements, but we cannot make a complete showing of our compliance because our letters requesting information were sent out without dates..."

Additional documents and commentary submitted by the Committee did provide evidence of new procedures established to obtain or attempt to obtain missing contributor information.

Nonetheless, the Audit staff maintains that the Committee has not demonstrated that it had satisfied the best efforts provision regarding the activity in question.

#### D. DOCUMENTATION OF ALLOCATION RATIOS

Section 104.10(b)(2) of Title 11 of the Code of Federal Regulations states, in part, that in each report disclosing a disbursement for the direct costs of a fundraising program or an exempt activity, as described in 11 CFR §106.5, the committee shall state the allocation ratio calculated for the program or activity and shall explain the manner in which the ratio was derived.

Section 104.14(b) of Title 11 of the Code of Federal Regulations states, in part, that each political committee required to file any report or statement shall maintain all records relevant to such reports or statements [and such records] shall provide in sufficient detail the necessary information and data from which the filed reports and statements may be verified, explained, clarified and checked for accuracy and completeness.

The Audit staff reviewed the allocation ratios reported by the Committee. As a result, we identified twenty three reported allocation ratios where the Committee did not provide documentation which detailed how the Committee calculated the ratio.

At the exit conference, the Audit staff requested that the Committee provide documentation that detailed the calculations.

The Committee responded that several of the questioned ratios were reporting errors. The Committee noted that many of the events were regularly scheduled meetings and others were entirely non-federal events that were incorrectly listed on Schedule H-2. Further, the Committee indicated that there were no exempt activities for the period. In regards to the undocumented fundraising ratios, the Committee stated that "allocations will need to be reviewed further to provide documentation which supports the ratios reported."

The Audit staff reviewed the additional documentation provided by the Committee and determined that twelve fundraising ratios used to allocate the costs of fundraising events remained undocumented.

In the interim audit report, the Audit staff recommended that the Committee provide documentation which supports its calculation of the allocation ratios used to allocate the costs associated with the twelve fundraising events.

In its response, the Committee explains that they could not locate any documentation to support the disclosed percentages. The Committee also notes that most of the events were non-federal events that were paid for with federal monies.

The Audit staff maintains that the allocation ratios are undocumented. Notwithstanding, the allocation ratios used by the Committee appear to be reasonable given the Audit staff's understanding of the events. In addition, the Committee did describe changes made to their reporting programs that, in the opinion of the Audit staff, would remedy the problem in the future.

#### **E. DISBURSEMENTS TO VOLUNTEERS USING CASH**

Section 432(h) of Title 2 of the United States Code states, in part, that each political committee shall maintain at least one checking account and such other accounts as the committee determines. No disbursements may be made (other than petty cash disbursements) except by check drawn on such accounts. A petty cash fund for disbursements not in excess of \$100 to any person in connection with a single purchase or transaction may be maintained by the committee.

Section 432(c)(5) of Title 2 of the United States Code states, in part, that each treasurer of a political committee shall keep an account of the name and address of every person to whom any disbursement is made, the date, amount, and purpose of the disbursement.

Section 102.11 of Title 11 of the Code of Federal Regulations states, in part, that if a petty cash fund is maintained, the treasurer of a political committee shall maintain a written journal of all disbursements, including the name and address of every person to whom any disbursement is made, as well as, the date, amount, and purpose of such disbursement.

During the disbursement review, the Audit staff noted three checks made payable to Petty Cash totaling \$11,000. The descriptions noted on the checks were, "Volunteer Expenses," "GOTV - Volunteer Expenses," and "GOTV - Petty Cash Volunteers." According to the Committee's memo explanation attached to its Schedules H-4:

"Cash disbursements were used for gas, mileage and meals for volunteers on the week-end prior to election day and on election day. Volunteer work consisted of hanging literature promoting the entire ticket on door-knobs.

"Only those people who received \$200 or more and did not provide a break-down of individual disbursements are listed.

"The average cash disbursement was \$45.00. Our in-house records detail the amount, name and address for all cash disbursements. Amounts range from \$10 to 65"

During fieldwork, the Committee did not make available for review, its "in-house records" or any other records that explained the above transactions.

At the exit conference, the Audit staff questioned the above payments. The Committee indicated that the payments were for election day expenses. Further, the Committee explained that some of the individuals provided receipts, however, many of the volunteers had only provided enough receipts to support a portion of the payments received.

The Audit staff informed Committee officials that, in accordance with 11 CFR §102.11, cash expenditures should be made from a petty cash fund and such expenditures should not exceed \$100. Further, the Audit staff explained that the Committee should maintain a written record of each receipt and disbursement from the petty cash fund, and that expenditures in excess of \$100 should be made by Committee check.

In response to the exit conference, the Committee submitted additional documentation that detailed the amounts disbursed to each individual. Based on our review of the information, the Audit staff determined that the Committee made cash disbursements in excess of \$100 to thirty individuals, totaling \$6,935.

In the interim audit report, the Audit staff recommended that the Committee implement procedures to establish a petty cash fund and maintain a written record of such transactions in accordance with 2 U.S.C. §432(h) and 11 CFR §102.11. Further, the Audit staff recommended that the Committee provide evidence of the established petty cash procedures.

In response, the Committee indicated that they no longer maintain a petty cash fund. The Committee stated that "[e]mployees are reimbursed by check upon submitting their receipts." Consequently, cash disbursements are no longer made to volunteers.







FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20542

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COMMISSION  
AUDIT DIVISION

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February 2, 1998

**MEMORANDUM**

**TO:** Robert J. Costa  
Assistant Staff Director  
Audit Division

**THROUGH:** John C. Surina  
Staff Director

**FROM:** Lawrence M. Noble  
General Counsel

**BY:** Kim Bright-Coleman *KBC*  
Associate General Counsel

Rhonda J. Vosdingh  
Assistant General Counsel

Delanie DeWitt Painter *D.D.P.*  
Attorney

**SUBJECT** Proposed Final Audit Report on the Democratic Party of Illinois  
(LRA #513)

**I. INTRODUCTION**

The Office of General Counsel has reviewed the proposed Final Audit Report on the Democratic Party of Illinois ("the Committee") submitted to this Office on December 29, 1997.<sup>1</sup> This memorandum summarizes our comments on the proposed report. This Office concurs with the findings in the proposed report that are not discussed separately in this memorandum. If you have any questions concerning our comments, please contact Delanie DeWitt Painter, the attorney assigned to this audit.

<sup>1</sup> Because the proposed Final Audit Report does not include any matters exempt from public disclosure under 11 C.F.R. § 2.4, this Office recommends that the Commission discuss this document in open session.

## II. GORDON & SCHWENKMEYER (II. A.)

Gordon & Schwenkmeyer, Inc. ("GSI") is a telemarketing firm that operated two kinds of telemarketing fundraising programs for the Committee with different fee structures: one targeted previous Committee "proven" donors, and the other targeted "prospective" donors. According to its contract with the Committee, GSI would open a custodial account for deposit of funds received from the program solicitations and receive its compensation and expenses from the funds in the account.<sup>2</sup> The contract specified that GSI would provide the Committee a financial statement every 30 days and authorized GSI to withdraw accrued fees owed to GSI and costs incurred from the custodial checking account upon presentation of the financial statement to the Committee. The sole source of GSI's compensation was limited by the agreement to the amounts it raised and deposited into the custodial account. The auditors note that GSI maintained five separate custodial accounts for five telemarketing programs, including two accounts related to "prospecting" programs intended to expand the Committee's contributor base. GSI forwarded net proceeds from the programs to the Committee totaling \$121,800 during the audit period.

In the Interim Audit Report, the auditors recommended that the Committee provide documentation demonstrating that prohibited contributions related to the GSI transactions did not occur and provide documentation from GSI detailing any subsequent contract, extension, amendment or revision to the April 1, 1991 agreement.<sup>3</sup> In response, the Committee provided letters from the Committee's Assistant Treasurer and the president of GSI asserting that the transactions were in the ordinary course of business, but did not provide any documentation to support these assertions.

The Audit staff concludes that GSI's extensions of credit related to the two prospecting programs resulted in apparent prohibited contributions from GSI to the Committee. See 2 U.S.C. § 441b(a), 11 C.F.R. § 116.3, Advisory Opinion ("A(O)") 1991-18. The auditors note that most of the costs of these programs were apparently incurred at the outset and were paid by GSI from its own funds, then gradually reimbursed as GSI received contributions to the Committee. Thus, the Committee owed debts to GSI at the outset of the programs and whenever receipts into the account were inadequate to pay costs and GSI fees. The auditors conclude that the amount of the outstanding extension of credit by GSI as of January 1, 1993 totaling \$48,912 is an apparent prohibited contribution to the Committee. 2 U.S.C. § 441b(a).

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<sup>2</sup> The contract provided to the Audit staff covers the period from April 1, 1991 through July 1, 1992 unless sooner terminated. The contract does not specifically provide for automatic extension for the period covered by the audit. The Committee has not provided information concerning any amendments or extensions to the contract. It is possible that the contract was extended by oral agreement, however, based on the available information, it is not clear if this contract was applicable to the period of the audit.

<sup>3</sup> The Interim Audit Report was not submitted to this Office for review and comments. The Interim Audit Report also recommended that the Committee file amended reports to reflect the transactions with GSI. The Committee filed the amended reports.

This Office concurs that the extensions of credit by GSI related to the prospecting programs appear to be prohibited contributions. In AO 1991-18, the Commission considered similar GSI fundraising programs conducted for another state Democratic committee and concluded that, while the solicitation program for proven donors was permissible under certain conditions, a program for prospective donors would result in prohibited contributions by GSI. The Commission stated that it could not approve the prospecting program as delineated in the request because of the "speculative nature of the program" and the "consequent possibilities of shortfall" in the absence of "a record by GSI or similar companies of the implementation of a program of similar structure and size in the ordinary course of business." However, the Commission suggested alternative remedies that could make prospecting programs permissible: the political committee could make "a substantial payment in advance of the program (or the remainder of the program) adequate to cover the expenses of GSI's operations for the program and to ensure against nonpayment of commissions. Alternatively, the Committee and GSI may alter the program to provide for short, defined periods in which full payment is made by the period's end to GSI for the commissions earned "

The Committee and GSI have not provided sufficient evidence that the prospecting programs at issue were permissible under the requirements delineated in AO 1991-18. There is no evidence that the Committee made a substantial payment into each of the prospecting accounts in advance of the program adequate to cover the expenses of GSI's operations for the program and to ensure against nonpayment of commissions. Further, while the contract provides for financial statements and payments to GSI every 30 days, neither the Committee nor GSI has provided evidence that full payment was consistently made to GSI by the end of each defined period for all commission fees and expenses. Indeed, the auditors' summary of debt balances on page 9 of the proposed report indicates outstanding debt balances owed to GSI at the close of all but one of the reporting periods covered by the audit. In addition, the fact that the contract limits the Committee's liability for payments to GSI to the amounts raised by GSI is troubling given the inherently speculative nature of the prospecting programs and the possibility that proceeds would not cover the expenses and GSI fees.

Moreover, GSI's assertions that its programs were in the ordinary course of business under 11 C.F.R. § 116.3 and consistent with its other clients and industry practice are inadequate absent supporting documentation. Adequate documentation might include, for example, contracts, correspondence or other evidence of GSI's prospecting programs for other clients, evidence of similar programs in its industry by other fundraising firms, as well as additional evidence of the agreement and correspondence between the Committee and GSI.

The Audit staff has calculated an apparent prohibited contribution of \$48,912 based on the unreported debt owed to GSI in each account examined separately as of January 1, 1993. An alternative method of calculating the apparent prohibited contribution would have been to calculate the net debt for all of the accounts combined together as of January 1, 1993 (\$33,431). The calculation is based on the Audit staff's experience in previous audits with GSI's business agreements with other clients, which specifically prohibited GSI from transferring funds between

accounts to cover any shortfalls. Thus, the Audit staff assumed that GSI could not "use profits from one program to pay the operating shortfall of another program" in a separate account. See Proposed Final Audit Report at pages 7 and 11. Although this provision is not specifically included in the Committee's contract with GSI, the Audit staff notes that the contract does not specifically permit GSI to transfer funds between the accounts to cover shortfalls

While this is a close issue, this Office concurs that the auditor's calculation is reasonable based on the available information. This Office recommends, however, that the Audit staff clarify this portion of the proposed report to explain more fully how the amount of the apparent prohibited contribution was calculated, and how long the debt was outstanding. The amount of outstanding debt in the prospecting accounts as of December 31, 1994, \$1,611, should also be included in the amount of the apparent prohibited contribution. Further, the proposed report should explain that the remaining debt owed to GSI as of December 31, 1994 is not an apparent prohibited contribution because the debt was not related to the prospecting accounts, but was related to "proven" programs.

GSI transferred funds from the custodial accounts to its corporate account and also transferred "refunds" of program costs from its account into the program accounts. The proposed report concludes that refunds totaling \$18,675 appear to be prohibited contributions from GSI to the Committee. See 2 U.S.C. § 441(b)(1). This Office concurs. The Committee has not provided sufficient documentation that it was owed refunds in the amounts that GSI transferred to the accounts, or of any basis for the refunds. The proposed report concludes that the total amount of apparent prohibited contributions is \$67,587.

Finally, this Office agrees that the Committee did not properly report the majority of the transactions with GSI including the debts it owed to GSI. 2 U.S.C. § 434(b); 11 C.F.R. §§ 104.3, 104.11. However, it appears that the amounts of outstanding reportable debts listed on page 9 of the proposed report were not calculated consistently with the calculation of the amount of apparent prohibited contributions on page 7 of the proposed report. According to the Audit staff, the outstanding debt balance at the beginning of each reporting period, amounts incurred during each period, and any payment to GSI for each reporting period were combined for all of the accounts to determine the total amount of reportable debt for each reporting period. Conversely, the amount of the apparent prohibited contributions was based on the amount of outstanding debt in the prospecting accounts considered separately from any outstanding proceeds due to the Committee in the other accounts. The proposed report concludes that the Committee filed amended Schedules D that materially corrected the public record, but that the Committee reduced the amount of debts on the amended schedules by outstanding proceeds due to the Committee.



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20461

February 12, 1998

Mr. John Gianulis, Treasurer  
Democratic Party of Illinois  
489 Merchandise Mart  
Chicago, IL 60654

Dear Mr. Gianulis:

Attached please find the Report of the Audit Division on the Democratic Party of Illinois. The Commission approved the report on February 6, 1998.

The Commission approved Final Audit Report will be placed on the public record on February 19, 1998. Should you have any questions regarding the public release of the report, please contact the Commission's Press Office at (202) 219-4155 or toll-free at (800) 424-9530. Any questions you have related to matters covered during the audit or in the report should be directed to Rick Halter of the Audit Division at (202) 219-3720 or at the above toll free number.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert J. Costa".

Robert J. Costa  
Assistant Staff Director  
Audit Division

Attachment as stated

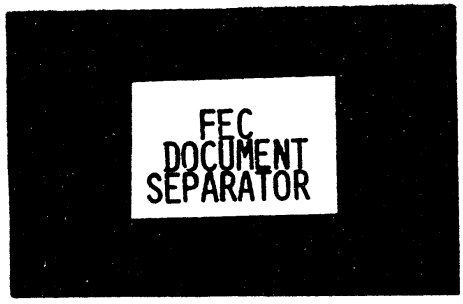
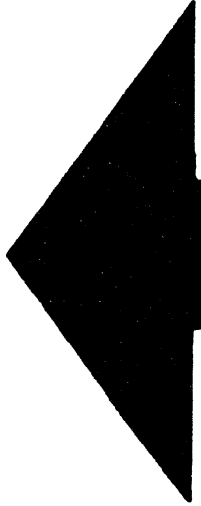
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