



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

March 15, 2001

MEMORANDUM

TO: RON M. HARRIS
PRESS OFFICER
PRESS OFFICE

FROM: ROBERT J. COSTA *RJC*
ASSISTANT STAFF DIRECTOR
AUDIT DIVISION

SUBJECT: PUBLIC ISSUANCE OF THE FINAL AUDIT REPORT ON
MICHIGAN REPUBLICAN STATE COMMITTEE

Attached please find a copy of the final audit report and related documents on Michigan Republican State Committee which was approved by the Commission on February 8, 2001.

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

*Ron / Shawn
Sorry this report
got lost in
the name.
RJC*

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REPORT OF THE AUDIT DIVISION
ON
Michigan Republican State Committee

Approved February 8, 2001



FEDERAL ELECTION COMMISSION

999 E STREET, N.W.

WASHINGTON, D.C.

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FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

**REPORT OF THE AUDIT DIVISION
ON THE
MICHIGAN REPUBLICAN STATE COMMITTEE**

EXECUTIVE SUMMARY

The Michigan Republican State Committee (MRSC) registered with the Comptroller General of the United States on April 17, 1972.

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 of any political committee whose reports fail to meet the threshold level of compliance set by the Commission.

The period covered by the audit was January 1, 1997 through December 31, 1998. The findings of the audit were presented to the MRSC at an exit conference and later, in an Interim Audit Report. The MRSC's responses to those findings are included in the Final Audit Report.

The following is an overview of the findings contained in the Final Audit Report.

SHARED EXPENSES PAID FROM NON-FEDERAL ACCOUNTS — 11 CFR §§100.8(a)(1), 104.10(b)(4), 106.5(a), (d), (e), (f) and (g), and 106.6(e)

The MRSC maintains an account entitled "Michigan Republican State Committee Administrative Account" (Administrative Account). According to the MRSC, funds expended from the Administrative Account do not impact federal, state, or local elections, therefore, it considers such transactions to be non-campaign related. Receipt and disbursement transactions are not included in its federal or state disclosure reports. Approximately \$383,281 in expenses were identified that are subject to allocation between the federal and non-federal accounts. These expenses were administrative in nature and associated with a State Convention, State Committee Meetings, RNC Meetings/Conferences, as well as, the day-to-day operations of the MRSC.

A review of a second non-federal account, "Michigan Republican State Committee State Account" (State Account) identified \$648,165 in apparent allocable administrative expenses.

The Interim Audit Report recommended that the MRSC reimburse the Administrative Account \$49,827 and the State Account \$88,516 for the federal share of allocable expenses paid from these accounts and file memo Schedules H4 disclosing the shared expenses.

In response, the MRSC made a reimbursement of \$3,484 to the Administrative Account and \$72,408 to the State Account for the federal share of expenses it acknowledged were allocable. The MRSC also demonstrated that \$51,848 represented solely non-federal expenses paid from these accounts.

The Audit concluded that \$39,603 is still due to the Administrative Account and \$16,108 is still due to the State Account.

MISSTATEMENT OF FINANCIAL ACTIVITY - 2 U.S.C. §434(b)(1), (2) and (4).

A comparison of the Committee's reported activity to its bank account records revealed misstatements in beginning cash, ending cash, total receipts and total disbursements disclosed on the MRSC's 1997 and 1998 reports.

In response to the Interim Audit Report recommendations the MRSC filed amended reports which corrected the misstatements.



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***REPORT OF THE AUDIT DIVISION
ON THE
MICHIGAN REPUBLICAN STATE COMMITTEE***

I. BACKGROUND

A. AUDIT AUTHORITY

This report is based on an audit of the Michigan Republican State Committee (the MRSC), undertaken by the Audit Division of the Federal Election Commission (the 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 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 January 1, 1997 through December 31, 1998. During this period, the MRSC reported a beginning cash balance of \$219,740; total receipts for the period of \$9,182,235; total disbursements for the period of \$8,908,230; and an ending cash balance of \$510,311.¹ The Commission previously audited MRSC's financial activity relative to the 1993-1994 and the 1995-1996 election cycles.

C. CAMPAIGN ORGANIZATION

The MRSC registered with the Comptroller General of the United States as the Michigan Republican State Committee on April 17, 1972. The MRSC maintains its headquarters in Lansing, Michigan.

The Treasurer of the MRSC for the period covered by the audit was William H. Gnodtke. The current Treasurer of the MRSC is Mr. Chris Bachelder. Mr. Bachelder became Treasurer on March 21, 2000.

¹ All figures in report are rounded to the nearest dollar. Reported figures do not foot due to mathematical discrepancies in MSRC's calculations.

To manage its financial activity, the MRSC maintained four federal accounts and two non-federal accounts as well as several certificates of deposits. The federal accounts consisted of a checking account for 100% federal activity, an allocation account for shared federal and non-federal activity, a payroll account, and an account entitled the "Slate Card" account which had limited financial activity during the period covered by the audit.² The two non-federal accounts had deposits totaling \$11,517,994 and withdrawals totaling \$11,672,822 for the period covered by this audit³. The MRSC also maintained an account for activity they considered as not impacting federal, state, or local elections. Bank activity for this account included deposits totaling \$776,971 and withdrawals totaling \$757,750 during the period covered by this audit. In addition to these accounts, the MRSC maintained a money market account for an appeal bond relating to a court judgment from Michigan's 46th Judicial District. Also, correspondence related to a checking account entitled the Michigan Reapportionment Fund was addressed to MRSC headquarters.⁴

D. AUDIT SCOPE AND PROCEDURES

Due to the volume of records related to the MRSC's financial activity, the Audit Division requested in a letter dated March 8, 2000 that the MRSC provide records relative to receipts and disbursements in a computerized format. A response letter from MRSC's Counsel stated "...the MRSC does not have the present capability to convert its existing data into either of the format specifications that you request and maintain an acceptable level of reliability." Alternatively, the MRSC provided the Audit staff with numerous hardcopy print-outs relative to most of the receipts and disbursements. As a result, the scope of testing for several categories covered by this audit were limited because the aggregation of receipts and disbursements could not be calculated using the available records. Although the MRSC's records met the minimum requirements of the Act, the Audit staff notes that substantive testing normally undertaken could not be performed relative to the following reviews: (1) The receipt of contributions in excess of the statutory limitations; (2) Proper disclosure of contributions from individuals, political committees and other entities, including the itemization of contributions when required; and (3) Proper disclosure of disbursements including the itemization of disbursements when required.

The audit included testing of the following general categories:

² The MRSC closed three other non-federal accounts during the period covered by this audit. The remaining balances for these accounts were transferred to the main non-federal operating account.

³ This non-federal activity represents unadjusted and unaudited bank account figures.

⁴ According to the MRSC, the Michigan Reapportionment Fund was established in 1989 for the purpose of making expenditures to influence the reapportionment process. Advisory Opinions 1981-35, 1982-14 (requested by the MRSC), 1982-37 and 1990-23 address receipts and expenditures relative to reapportionment activities. The Commission has maintained that funds received and disbursed from a reapportionment account are not contributions or expenditures and thus not subject to disclosure requirements, limitations or prohibitions of the Act or Regulations.

1. The receipt of contributions or loans in excess of the statutory limitations;
2. The receipt of contributions from prohibited sources;
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. Proper disclosure of campaign debts and obligations;
6. The accuracy of total reported receipts, disbursements and cash balances as compared to bank records (see Finding II.B.);
7. Adequate recordkeeping of campaign transactions;
8. Proper reporting and funding of allocable expenses (see Finding II.A.); and,
9. Other audit procedures that were deemed necessary in the situation.

II. AUDIT FINDINGS AND RECOMMENDATIONS

A. SHARED EXPENSES PAID FROM NON-FEDERAL ACCOUNTS

Section 106.5(g)(1) of Title 11 of the Code of Federal Regulations states, in part, committees that have established separate federal and non-federal accounts under 11 CFR 102.5(a)(1)(i) shall pay the expenses of joint federal and non-federal activities as follows: (i) pay the entire amount of an allocable expense from its federal account and transfer funds from its non-federal account to its federal account solely to cover the non-federal share of that allocable expense; or (ii) establish a separate allocation account into which funds from its federal and non-federal accounts shall be deposited solely for the purpose of paying allocable expenses. Once a Committee has established a separate allocation account for this purpose, all allocable expenses shall be paid from that account for as long as the account is maintained.

Section 104.10(b)(4) of Title 11 of the Code of Federal Regulations states, in part, a political committee that pays allocable expenses in accordance with 11 CFR 106.5(g) or 106.6(e) shall also report each disbursement from its federal account or its

separate allocation account in payment for a joint federal and non-federal expense or activity.

The rules regarding the percentages to be used in the allocation of shared expenses for administrative and generic voter drives; exempt activities; and direct fundraising costs are described respectively under sections 106.5(d), (e) and (f) of Title 11 of the Code of Federal Regulations. Administrative and voter drive percentages are calculated on the ratio of the federal offices expected on the ballot to total federal and non-federal offices expected on the ballot in the next general election to be held in the committee's state. State and local party committees in states that do not hold federal and non-federal elections in the same year shall allocate the costs of generic voter drives according to the ballot composition method based on a ratio for that calendar year. Exempt activities are allocated according to the proportion of time or space devoted in a communication to federal candidates or elections as compared to the total time or space devoted in a communication to all federal or non-federal candidates or elections. Fundraising costs shall be allocated based on the ratio of funds received into a federal account to its total receipts from each fundraising program or event.

BACKGROUND

The Audit staff reviewed disbursements from the MRSC's federal and non-federal accounts to evaluate compliance with 11 CFR 106.5(g) and to determine if the federal account paid the proper share of allocable expenses. It is the opinion of the Audit staff that payments were made from both the "Michigan Republican State Committee Corporate Administrative Account" (Administrative Account) and the "Michigan Republican State Committee State Account" (State Account) to defray allocable expenses associated with joint federal and non-federal activities such as state party conventions, meetings, and conferences. The Audit staff notes that expenses similar to those identified during the period covered by this audit were also addressed in findings in the previous two audits of the MRSC.

It should also be noted that the State of Michigan does not permit corporate or labor union contributions to be used for non-federal elections. However, on August 21, 1979, the Michigan Secretary of State issued a declaratory ruling concerning corporate expenditures at a state political party convention. A corporation proposed spending funds for expenses related to a state convention. The expenses included but were not limited to hotel rooms, food, beverages, telephone and travel, and were to be made for the purpose of influencing the decisions of the delegates to the convention with respect to the adoption of certain resolutions and the election of individuals to office within the state party. In part, the declaratory ruling stated that since none of the offices at stake at this particular convention were public offices and none of the resolutions to be adopted were ballot questions, the expenditures in question were not prohibited and also did not need to be reported or recorded as expenditures under the Act (reference to the state of Michigan law).

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A Manual For Political Party Committees published by the Michigan Department of State Bureau of Elections, April 1990, commonly referred to as the "green book," at page 14 states political party committees may accept funds from an incorporated source if the corporation clearly designates the funds for the committee's administrative expenses. These funds must be deposited in a separate account maintained by the committee solely for administrative purposes. Finally, another manual published by the Michigan Department of State Bureau of Elections in February 1990, for independent political and ballot question committees, at page 8, states a Ballot Question Committee may receive corporate funds or be entirely funded by a corporation. At page 40 of this manual, it states a corporation is allowed to spend corporate funds to support or oppose ballot questions. The corporation must register a Ballot Question Committee within 10 calendar days after it spends \$500 or more in a calendar year to support or oppose ballot issues.

1. Michigan Republican State Committee Corporate Administrative Account

According to the MRSC, the Administrative Account was composed mainly of corporate contributions and was considered a non-campaign account that did not impact federal, state, or local elections. Therefore, receipt and disbursement transactions were not included in the MRSC's federal or state disclosure reports. The MRSC provided the Audit staff with a computerized disbursement file totaling \$740,191 for this account which included a classification of the purpose for each disbursement. In addition, the MRSC provided materials relative to some of the events for which disbursements from the Administrative Account were made.

a. Expenditures Related to Non-Federal Activity

The MRSC paid for certain legal expenses from the Administrative Account which were not considered allocable expenses by the Audit staff. These expenses included the continuing legal fees relative to the appeal of a libel suit brought against the MRSC by a former elected state official. The MRSC also paid \$11,203 from this account to an entity entitled the "McManus Administrative Account". According to documentation, "...the purpose of the McManus Administrative Account was to defray those expenses associated with defending the legal sufficiency of Michelle McManus' nominating petitions qualifying her for the primary election ballot for the First Congressional District in 1998." Based on the available documentation, the Audit staff considered this expense outside the purview of the Act.⁵

Also paid from the Administrative Account were certain disbursements totaling \$171,498 that were categorized by the MRSC as "contributions."

⁵ Advisory Opinion 1996-36 (requested by the MRSC) addresses receipts and expenditures relative to legal action contesting an individual's access to the ballot. The Commission has maintained that, in certain cases, funds received and disbursed for such purposes are not subject to disclosure requirements, limitations or prohibitions of the Act or Regulations .

These disbursements included \$90,000 to an organization entitled the Michigan State Chamber Foundation as well as to other local organizations. In addition, disbursements were made from the Administrative Account to a state party committee in Missouri and to a non-federal candidate committee in Maryland. These "contributions" made from the Administrative Account were not considered allocable expenses by the Audit staff.

As in prior audits of the MRSC, the Audit staff identified other expenses paid from the Administrative Account as related solely to non-federal activities. Specifically, transfers to the MRSC's building fund for mortgage payments and expenses relative to a training session conducted for campaign managers of non-federal candidates were deemed as related to non-federal activities. Also expenses for good will gestures such a memorial and sympathy gifts given to family and acquaintances of MRSC staff were not considered allocable expenses. In all, the MRSC paid a total of \$356,910 from the Administrative Account for expenses which the Audit staff has deemed to be for non-federal activities.

b. Expenditures Related to Shared Federal and Non-Federal Activities

During the 1997-98 election cycle, as in prior election cycles, expenses were paid from the Administrative Account relative to the Mackinac Republican Leadership Conference, the annual Michigan Republican State Convention, various MRSC state committee meetings, along with several activities with the Republican National Committee. Expenses related to these events included mileage reimbursements, banquet and lodging expenses, badge holders, printing costs, as well as sound and lighting. The Audit staff identified the existence of a federal component with each of these activities.

The Mackinac Republican Leadership Conference, a biennial event, was held the weekend of September 19, 1997. Expenses paid from the Administrative Account, totaling \$125,342 were categorized by the MRSC as related to the 1997 conference. Attendees to this event included federal officeholders such as United States Senator Spencer Abraham, United States Congressman Newt Gingrich, United States Congressman John Kasich, in addition to the Republican National Committee Chairman Jim Nicholson and major donors to the MRSC. According to an article in *The Grand Rapids Press*, the conference is held every other year in non-election years to build enthusiasm for GOP campaigns. Other news articles that covered the Mackinac Republican Leadership Conference described various national and state issues that were discussed including the use of federal funds for Michigan highways and the 1998 re-election of Michigan Governor John Engler. Based on the existence of both a federal and non-federal component to the Mackinac Conference, the Audit staff considered the expenses relative to the event to be allocable expenses. The Audit staff notes that new articles were used to gain further information about the event because the available MRSC's records relating to the Mackinac Conference contained limited details.

During the period covered by the audit, the MRSC categorized \$45,268 (\$40,268 in 1997 and \$5,000 in 1998) in expenses paid from the Administrative Account for the annual state conventions. The 1997 state convention included district caucuses to elect chairmen as well as the selection of the state party chair and six vice chairs. According to the MRSC, agenda items for the 1998 state convention also included the elections for various party positions, a fundraiser hosted by United States Senator Abraham, an agenda item entitled the "Congressional Report", and the nomination of general election candidates for several non-federal offices. Based on the existence of both a federal and non-federal component to the state conventions, the Audit staff considered the expenses relative to the state conventions to be allocable expenses.

The MRSC also categorized expenses totaling \$66,749 in 1997 and 1998 relative to periodic state committee meetings and certain meetings held by the Republican National Committee. According to the minutes taken from several MRSC state committee meetings, agenda items often included a report by the National Committee person, an item entitled the "U.S. Senate Update", and an item entitled "Congressional Comment". Meetings relative to the Republican National Committee included the Midwest Leadership Conference held on August 22-24, 1997. According to registration materials, one of the goals for this event was to "...increase our majorities in both the U.S. House and Senate...".

The Audit staff maintains that these expenses represent activities that benefited the Party as a whole and, therefore, have both federal and non-federal components. Accordingly, the costs for these activities should be allocated between the federal and non-federal accounts using the Administrative/Generic Voter Drive percentage. There was no evidence provided which demonstrated that the expenses identified by the Audit staff were related solely to State and local elections, solely to Federal elections, or that any candidate's election or defeat was advocated.

At the conclusion of fieldwork, the Audit staff had identified \$405,981⁶ (\$188,756 in 1997 and \$217,225 in 1998) in disbursements that appeared to be for shared federal and non-federal activities. At the Exit Conference, the Audit staff provided MRSC officials with schedules that detailed those disbursements identified as relating to both federal and non-federal activity. During the 10 day period following fieldwork, the MRSC provided documentation relative to \$27,470 of the disbursements identified by the Audit staff. According to the MRSC, the documentation supported that the identified disbursements paid from the Administrative Account did not have a federal component. Based on review of this documentation, \$22,700 (of the \$27,470) in expenses related solely to non-federal activities. Therefore, based upon the Audit staff's review, it appears that expenses totaling \$ 383,281 (\$405,981 - \$22,700) related to shared federal and non-federal activities. The Audit staff calculated that \$49,827

⁶ This figure represents disbursement activity for the events mentioned above as well as certain expenses totaling \$168,723 categorized by the MRSC as "Office Miscellaneous" or "Accounting and Legal" that was considered by the Audit staff as allocable.

(\$383,281 x 13%⁷) represented the federal share for which payment from the MRSC's federal account to the Administrative Account was required.

2. Michigan Republican State Committee State Account

Disbursements made from the MRSC's State Account were also reviewed by the Audit staff. According to the MRSC, the State Account was used as the main non-federal operating account and included transfers to the MRSC allocation account for the non-federal portion of shared expenses.

The Audit staff's review of disbursements paid from the MRSC's State Account identified 21 disbursements totaling \$648,165 made for allocable expenses. These expenses included consulting fees for 1997, lighting expenses relative to the state convention, expenses for GOTV phone calls, and expenses relative to absentee voter slate pieces. The Audit staff calculated the federal share of these possible allocable expenses as \$88,516.

At the Exit Conference following the conclusion of fieldwork, the Audit staff provided the MRSC with a schedule of those disbursements from the State Account considered to be possible allocable expenses. The MRSC did not provide comments or documentation regarding these disbursements.

In the Interim Audit Report, the Audit staff recommended that the MRSC:

- Demonstrate that the identified disbursements paid from the Administrative Account (\$383,281) and the State Account (\$648,165) are not expenditures as defined at 11 CFR §100.8(a); or,
- file Schedules H4 (Joint Federal/Non-Federal Activity Schedule) disclosing as memo entries the shared expenditures paid from these accounts; and
- using funds from its federal account(s) reimburse the Administrative Account \$49,827 and the State Account \$88,516 and provide evidence of such reimbursement.
- If the MRSC lacked the funds to reimburse the non-federal account, then disclose the amount owed on Schedule D (Debts and Obligations) as a debt, until such time that funds are available to make the reimbursement.

⁷ The allocation percentage for administrative expenses during the 1997-1998 election cycle was 13%. This percentage represents the ratio for the number of federal offices to total number of federal and non-federal offices on the 1998 Michigan general election ballot.

As part of its response to the recommendations contained in the Interim Audit Report, the MRSC explained that the Michigan Campaign law excludes party administrative expenses from its coverage, and suggested that the same is true under Federal law. Included in the MRSC response is a discussion of various Advisory Opinions issued by the Commission. The MRSC correctly pointed out that in Advisory Opinion 1982-14, the Commission concluded that the influencing of the reapportionment decisions of a state legislature, although a political process, is not considered election-influencing activity subject to the requirements of the Act. Also referenced was Advisory Opinion 1993-9 which addressed the proposal to establish a building fund, maintained as a "separate segregated" account into which only designated contributions would be deposited. Also, included was a reference to Advisory Opinion 1983-37 in which the Commission determined that the Massachusetts Democratic State Committee could establish a fund that would not be subject to the Act's limitations, prohibitions, or disclosure requirements. The monies in this fund could be used only for the purpose of defraying legal costs of defending legal actions brought by candidates against the Massachusetts Democratic State Committee and would have to be maintained separately from funds used for federal elections. Finally, the MRSC cited Advisory Opinion 1996-39 in which the Commission determined that a legal fund could defer expenses of defending the legal sufficiency of the nominating petitions qualifying a candidate for the primary election ballot.

Using the above cited opinions, and the analogy to Michigan law, the MRSC concluded that the FEC has determined that such activities do not influence any Federal election to trigger compliance with the FECA. Therefore the above cited activity is beyond the scope of the FECA. The MRSC contended that, with the exception of certain items, "the disbursements from the Account were not made for the purpose of influencing any election for Federal office."

Although the MRSC may be correct with respect to Michigan law, Federal law takes a different view. The Act, Commission regulations, and past Advisory Opinions exclude from coverage specific types of expenses, and only those. Coverage of the Act goes beyond those things that meet the definition of an "expenditure". Section 434(b)(4) of Title 2 of the United States Code states that political committees are required to report for the reporting period and for the calendar year the total amount of all **disbursements** and all **disbursements** in a number of categories. Likewise, the requirement that certain transactions be individually itemized on the disclosure reports of committees such as the MRSC, speaks in terms of disbursements. Most relevant to this situation, Commission regulations also use the term disbursement when speaking about the need to allocate expenses between federal and non-federal accounts for those committees that, as the MRSC does, fund activity in connection with both federal and non-federal elections. Section 106.5 of Title 11 of the Code of Federal Regulations, "Allocation of expenses between federal and non-federal activities by party committees," uses the terms disbursements, costs, and expenses rather than expenditure. Therefore, the fact that many of the disbursements discussed above do not, in the opinion of the MRSC,

meet the definition of expenditure, is not relevant to the need for allocation between the federal and non-federal accounts.

The response then addressed specific types of expenses paid from the Administrative Account in an effort to demonstrate that the payments questioned in the Interim Audit Report were not subject to the requirements of the Act.

Conventions, Meetings, And Conferences

The Audit staff identified \$237,359 in expenses associated with the annual state convention, various committee meetings and conferences which appeared to require allocation between the MRSC's federal and non-federal accounts as administrative expenses. In addition, evidence gathered establishes that there was at least some federal content at many of the events. The MRSC, in its response, asserted that the Audit Division preliminarily determined that these expenses were made for the purpose of influencing an election for federal office based on newspaper articles. Citing *Common Cause v FEC*⁸ and various Michigan campaign finance law cases, the MRSC argues that the FEC should ignore second hand accounts in newspaper articles as reliable evidence that the MRSC conducted electioneering activity during the conventions, meetings, and conferences. Clearly, newspaper articles are not the evidentiary material of choice. However, requests for materials from the MRSC produced nothing and the newspaper accounts of the proceedings at some of the meetings and events were the only available information. It is significant that the MRSC response did not dispute any of the newspaper accounts referenced in the Interim Audit Report. Finally, the newspaper accounts were used only to establish that the events were not entirely focused on non-federal efforts. In many cases the costs of the events are allocable as administrative expenses.

The MRSC cited numerous court cases establishing the "express advocacy" test. It also refers to the interim report where the audit staff "indicates that these expenses represent activities that benefit the Party as a whole and therefore have both federal and non-federal components. The MRSC suggests that the 'benefit the Party as a whole' standard does not replace the 'express advocacy' test." The relevant requirements are in 11 CFR 106.5 that require committees that make disbursements in connection with both federal and non-federal elections to allocate expenses in various categories including administrative expenses.

In the Audit staff's opinion, the "express advocacy" test that MRSC references may be relevant for determining whether certain expenditures are contributions to specific candidates for Federal office, but not relevant for determining whether a disbursement is an administrative expense or a generic voter drive expense. Generic voter drive expenses include activities that urge the general public to register to vote, vote or support candidates of a particular party, or are associated with a particular

⁸ No. 85-968, Slip Op. (D.D.C. June 25, 1986) reprinted in Federal Election Campaign Finance Guide (CCH), ¶9235.

issue without mentioning a specific candidate. Administrative and generic voter drive expenses are required to be reported and allocated between the federal and non-federal accounts without the express advocacy and clearly identified candidate test having been met.

Next the MRSC contended, based on its reading of the Advisory Opinion 1978-46, that unless there is fundraising related to a campaign for Federal office or any communication expressly advocating the election or defeat of a clearly identified candidate for Federal office, the activity and attendant expenses cannot be regarded as for the purpose of influencing a Federal election. The MRSC concludes that the lack of fundraising and electioneering at internal political party gatherings, the expenses associated with the State Convention, MRSC meetings, and the 1997 Mackinac Conference, are not "expenditures" for the purpose of the Act.

The MRSC also cites Advisory Opinions 1986-6, 1982-35, 1983-37, to support the proposition that internal political party gatherings, even though they may directly influence Federal elections, are not subject to the FECA. According to the MRSC, in the present situation, there is no allegation, nor can there be, that the State Convention, MRSC meetings, and the 1997 Mackinac Conference, all of which are internal political party gatherings, somehow influenced Federal elections.

Most of the advisory opinions cited by the MRSC were issued by the Commission prior to the effective date (January 1, 1991) of the Commission's regulations for allocating expenses that jointly benefit both federal and non-federal candidates and elections.⁹ As noted above, these regulations provide for the allocation of expenses by political party committees that make disbursements in connection with both federal and non-federal elections. The allocable expense categories include administrative expenses, fundraising costs, exempt activities expenses, and the cost of generic voter drives. More specifically, party committees that make disbursements in connection with federal and non-federal elections shall allocate expenses for administrative expenses not attributable to a clearly identified candidate, including rent, utilities, supplies, and salaries. Advisory Opinion 1993-21. The Commission's Explanation and Justification for 11 CFR §106.5 contains the following guidance regarding administrative expenses:

"Please note that all administrative expenses must be allocated between federal and non-federal accounts, if incurred by a committee that makes disbursements in connection with both federal and non-federal elections, and that chooses to pay any portion of such disbursements from its non-federal account."

⁹ Advisory Opinions 1992-5 (candidate's participation in cable television program), 1993-9 (preemption of Michigan State law with respect to the prohibitions on corporate donations to the MRSC's building fund), 1996-39 (legal fund could defer expenses in defending legal sufficiency of nominating petitions) were issued after 1/1/91.

The \$237,359 in expenses for various meeting and conferences questioned in the Interim Audit Report fall into the general category of administrative expenses and therefore are subject to the requirements of the Act. Further as explained above, based on the information available, the events had federal as well as non-federal components. These types of expenses were also allocated by the Commission in the audit report covering the 1994 and 1996 election cycles.

Audit And Legal Expenses

With respect to the audit expenses questioned in the Interim Audit Report (\$33,429), the MRSC contended that payment of such expenses are subject to the Act only in the case where they (1) directly further the election of any designated candidate for Federal office, (2) assist the political committee in its compliance with the Act or (3) assist the MRSC to complete its FEC reports. According to the MRSC, "the purpose of the audits is ... to verify to the officers and members of the MRSC that the financial statements are appropriately stated and that the MRSC staff is conforming with generally accepted accounting principles." The MRSC then concluded that there is no basis to designate payments from the Administrative Account for these audit expenses as subject to the Act.

Expenses related to an audit of the MRSC accounts, both federal and non-federal, fall clearly into the administrative expense category, and pursuant to 11 CFR §106.5 (a)(2)(i) are allocable between the federal and non-federal accounts.

Regarding legal expenses questioned by the Audit staff (\$5,987), the MRSC restated the first two criteria cited with respect to audit expenses being subject to the Act and added a third: such expenses are associated with compliance or audit matters under the Act. The MRSC cited examples of legal expenses which the Commission determined as not subject to the requirements of the Act, such as legal defense: (1) to a charge of slander; (2) of a civil action alleging violation of the Appropriations Act, Hatch Act, an infringement of constitutional rights; and (3) of a congressman charged with both criminal conduct and violations of rules of the House of Representatives.¹⁰ In addition, according to the MRSC the FEC in Advisory Opinion 1990-6 acknowledged that state laws concerning the manner of qualification of candidates, dates and places of elections, voter registration, voting fraud and candidates' personal financial disclosure are outside the scope of the FECA.

The MRSC's General Counsel states that he reviewed the reimbursed legal expenses questioned by the Audit staff and to the best of his knowledge an insignificant amount of reimbursed expenses could qualify as 'expenditures,' which he estimated to have been, at most, 5% or \$299 which should be reimbursed from the federal

¹⁰ The Committee cited Advisory Opinions 1983-21, 1981-13, 1980-4, 1979-37, and 1990-6.

account. The remainder, \$5,688 in reimbursed expenses did not concern federal candidates or the Act. No documentation beyond an affidavit signed by the Committee's General Counsel was provided.

While it is true the Commission, in advisory opinions, has concluded that certain types of activity and the legal expenses related thereto are not subject to the Act's recordkeeping, reporting and other requirements, the type of activity was clearly defined (e.g., a possible denial of access to the primary ballot of the state of Massachusetts involving a party rule, AO 1982-35). Moreover, for such activity a segregated fund would have to be established and maintained apart from other political committee funds. For example in Advisory Opinion 1983-37, the Commission concluded that "[t]o the extent monies in the fund will be used only for the purposes described, and will be maintained separately from funds used for federal elections, the Party's legal expense fund would not be subject to the Act's limitations ..."

Given that the legal expenses at issue are not identified or documented as being for a purpose indistinguishable from any approved by the Commission, the Audit staff views the expenses as administrative expenses, and like the audit expenses discussed above, are subject to the requirements of the Act and Commission regulations.

The MRSC presented almost identical explanations for these types of expenses when questioned in the audit report covering the 1994 and 1996 election cycles. The Commission determined that those expenses were allocable between the federal and non-federal accounts.

Consulting Fee for Non-Electioneering Services

The Audit staff identified a \$3,000 payment to George Herstek as an allocable expense paid from the Administrative Account. According to the MRSC, Mr. Herstek's services concerned assistance with voter registration, prevention of voter fraud, ballot integrity, and maintaining the purity of elections. The MRSC asserts that these matters are not covered in the Act and there is no evidence to justify treatment of any portion of this consulting fee for non-electioneering services as an "expenditure" under the Act.

To support this position, the MRSC provided a copy of a letter to Mr. Herstek, outlining the terms of his services. The MRSC also cited Advisory Opinion 1990-6 and FEC Regulations Explanation and Justification, House Document No. 95-44, which addresses electoral matters as interests of the states and not covered under the Act.

The Audit staff views the expense as an administrative expense, and like the audit and legal expenses discussed above, is subject to the requirements of the Act and Commission regulations.

MRSC Staff Social Outings

The Audit staff identified as shared expenses, payments for meals for the MRSC staff. Thirteen payments, totaling \$1,021 are being challenged by MRSC. The payments were made to restaurants and to individuals for reimbursement for meals. MRSC states that no fundraising or electioneering activities in connection with any federal election occurred during these "social gatherings." According to the MRSC, the Commission agrees that expenses associated with its staff's social gatherings are beyond the scope of the Act. The MRSC cites Advisory Opinion 1981-26 to support its position. The MRSC contends that Advisory Opinion 1981-26 concluded that expenses paid for a social event to honor an incumbent Congressman were not reportable because the event was not a fund-raiser nor an attempt to influence the Congressman's reelection.

The Audit staff views the expenses as administrative expenses and subject to the requirements of the Act and Commission regulations.

Miscellaneous Disbursements

The MRSC asserted that 52 expenses for holiday cards, gifts, charities, State committee meetings, recruitment of Michigan precinct delegates, staff retreat, publications to the MRSC's paid members and similar types of expenses, totaling \$93,740 do not constitute expenditures under the Act. The reasoning for this position apparently is that these expenses were either non-electioneering expenses or were not related to federal campaigns.

The Audit staff reviewed the MRSC's specific explanations and documentation relating to these disbursements and allowed that seven totaling \$323 were disbursements for sympathy gifts which, as previously stated were not considered allocable expenses and eight totaling \$51,525 were disbursements for publications that only referred to non-federal candidates. The other expenses, in the Audit staff's opinion are properly classified as administrative expenses. Thus the amount of these miscellaneous disbursements viewed as administrative expenses is adjusted to \$41,892 (\$93,740 - \$323 - \$51,525) and the amount reimbursable by the federal account is reduced by \$6,740 (\$41,892 x .13%).

As explained above, party committees that make disbursements in connection with federal and non-federal elections shall allocate expenses for administrative expenses not attributable to a clearly identified candidate, including rent, utilities, supplies, and salaries. Advisory Opinion 1993-21. The types of administrative expenses cited are illustrative and cannot be viewed as inclusive.

As stated, it is the opinion of the Audit staff that expenditures for activities such as independent reviews of committee accounts, consulting fees, legal fees,

staff social outings, holiday cards, gifts, etc., clearly fall within the general category of "administrative expenses" as noted at 11 CFR §106.5 (a)(2)(i).

Expenditures Not Being Challenged by MRSC

The MRSC acknowledged that there were additional expenditures totaling \$24,494 which relate to shared federal and non-federal activities at the administrative ratio (13%). The MRSC also acknowledged the previously mentioned \$299 in legal expenses. The MRSC calculated the total amount owed by the federal account as \$3,484 ($(\$24,494 \times 13\%) + \299). The response states, that as an act of good faith, MRSC's federal account reimbursed this amount to the Administrative Account. Copies of two non-negotiated checks totaling \$3,484 were included with the response.

Michigan Republican State Committee State Account

As previously stated, the Audit staff's review of disbursements paid from the MRSC's State Account identified 21 disbursements totaling \$648,165 made for allocable expenses. In its response to the Interim Report, the MRSC conceded that 11 of these disbursements totaling \$556,988 were indeed for shared expenses. According to the MRSC, the remaining 10, totaling \$95,177¹¹ were exclusively for matters to which no federal share is applicable. These 10 disbursements were made to Hill Research Consultants (HRC).

To support that the payments to HRC were for non-federal purposes, the MRSC provided an affidavit from David B. Hill, Ph.D., owner of HRC, in which Dr. Hill stated: "To the best of my recollection, all of the services rendered by HRC to the MRSC during the 1997-1998 election cycle related solely to state (non-federal) elections." Evidence in the form of contracts, invoices, or other vendor generated documents detailing the particulars of the disbursements was not provided.

The response states, that as an act of good faith, the MRSC's Federal account reimbursed \$72,408 ($\$556,988 \times 13\%$) to the MRSC's State account. A copy of the non-negotiated reimbursement check was provided in the response.

In the Audit staff's opinion, the MRSC has not demonstrated that the payments to HRC were solely for non-federal purposes and therefore the disbursements totaling \$91,177 are allocable expenses.

Conclusion

In conclusion, the MRSC did not comply with the recommendations of the Interim Audit Report. It made a partial reimbursement to the Administrative Account of \$3,484 and the Audit staff agrees that \$51,848 ($\$323 +$

¹¹ The Audit staff agreed that \$4,000 of this amount was for expenses related to State only activities and this \$4,000 was not included in the Audit staff's total of expenses requiring allocation.

\$51,525) in expenses are not allocable thus reducing the reimbursable amount by \$6,740. The amount still due from the federal account to the Administrative account is \$39,603 (\$49,827 - \$3,484 - \$6,740). In addition, the MRSC made a partial reimbursement to the State Account of \$72,408. The amount still due from the federal account to the State Account is \$16,108 (\$88,516- \$72,408).

B. MISSTATEMENT OF FINANCIAL ACTIVITY

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

The Audit staff's reconciliation of the MRSC's reported financial activity to its bank activity revealed material misstatements with respect to reports covering calendar years 1997 and 1998.

In 1997, the MRSC overstated its reported beginning cash on hand by approximately \$188,746. This overstatement was primarily due to the MRSC not correcting its beginning cash on hand based on a 1996 comprehensive amendment filed in Oct. 1999.

In 1998, the MRSC understated disbursements by \$252,216. This net understatement was primarily due to the MRSC not reporting the following disbursements: four wires totaling \$201,680, payroll tax payments totaling \$163,993 as well as service charges and other disbursements totaling \$10,429. The \$201,680 amount for wires not reported by the MRSC included a transfer to the National Republican Senatorial Committee (\$100,000), two disbursements to media companies totaling \$78,680, and a transfer from the MRSC Slate Card Account to the MRSC State Account (\$23,000). The Audit staff also identified a disbursement to the Lansing State Journal in the amount of \$117,612 which was reported on Schedule H4 of the 1998 October Quarterly Report but could not be traced to the MRSC's bank activity. Ending cash on hand for 1998 was overstated by \$431,660 primarily due to the items noted above and adjustments carried forward from prior periods.

At the Exit Conference, the MRSC was provided schedules which detailed the reporting errors discussed above. In addition, the Audit staff advised the MRSC to perform reconciliations between its bank activity and reported activity prior to filing reports. This recommendation was made due to the existence of material misstatements for financial activity in each calendar year from 1993 to 1998. MRSC officials agreed to file amended reports to correct the errors noted above for the period covered by this audit and stated that computer software has been purchased to help them prevent future reporting misstatements.

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In the Interim Audit Report, the Audit staff recommended that, the MRSC file amendments to correct the misstatements noted above. The amendments were to include a Summary and Detailed Summary page as well as the supporting schedules for each of the necessary reporting periods. In addition, the Audit staff recommended that the MRSC file amended Summary Pages for all reports filed subsequent to the period covered by this audit to correct the misstatements in reported cash balances.

In response to the Interim Audit Report, the MRSC filed amended reports that materially corrected the public record.

02.07.025.2729

22.07.025.2730



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

January 26, 2001

MEMORANDUM

TO: Robert J. Costa
Assistant Staff Director
Audit Division

THROUGH: James A. Pehrkon
Staff Director

FROM: Lois G. Lerner
Acting General Counsel

BY: Kim Leslie Bright *KL*
Associate General Counsel

Lorenzo Holloway *LH*
Assistant General Counsel

Susan L. Kay *SLK for LGL*
Attorney

SUBJECT: Proposed Final Audit Report on Michigan Republican State Committee
(LRA #605)

I. INTRODUCTION

The Office of General Counsel has reviewed the proposed Final Audit Report for the Michigan Republican State Committee ("the Committee") submitted to this Office on December 11, 2000. The following memorandum summarizes our comments on the proposed Report.¹ We concur with the findings in the proposed Report that are not discussed in the following memorandum. If you have any questions, please contact Susan Kay, the attorney assigned to this audit.

¹ The Office of General Counsel recommends that the Commission consider this document in open session since the report does not include matters exempt from public disclosure. See 11 C.F.R. § 2.4.

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II. SHARED EXPENSES PAID FROM NON-FEDERAL ACCOUNTS (Finding II.A.)

The cover memorandum to the proposed Final Audit Report directs this Office's attention to the issue of shared expenses paid from two Committee accounts, the Michigan Republican State Committee Corporate Administrative Account ("Administrative Account") and the Michigan Republican State Committee State Account ("State Account"). The Audit Division contends that the Committee made expenditures from these accounts that should have been allocated pursuant to 11 C.F.R. § 106.5. This Office agrees with the Audit staff's conclusion.

The disbursements at issue from the Administrative Account include expenses related to the annual Michigan Republican State Conventions, the Mackinac Republican Leadership Conference², state committee meetings and activities with the Republican National Committee. These expenses included mileage reimbursements, banquet and lodging expenses, badge holders, printing costs and sound and lighting. The Audit staff also considered audit, legal and consulting expenses as allocable, as well as staff social expenses and certain miscellaneous disbursements such as holiday cards and gifts. According to the Audit staff, similar disbursements from the Administrative Account made by the Committee during the 1993-94 and 1995-96 election cycles were considered to have been allocable expenses.

The Committee maintains that its Administrative Account is a non-campaign account not subject to the Federal Election Campaign Act ("FECA") because it did not impact federal, state, or local elections. In support of this argument, the Committee references Commission advisory opinions that allow for the establishment of specific non-campaign accounts in which funds may be maintained that are not subject to the FECA. See Advisory Opinion ("AO") 1982-14 (Commission determined that receipts and disbursements from a reapportionment account would not constitute contributions or expenditures since influencing reapportionment decisions is not considered election-influencing activity subject to the FECA); AO 1983-37 (Commission determined that a legal defense fund could be maintained so long as it was maintained separately from funds used for federal elections); AO 1993-9 (Commission held that creating a building fund is not done for the purpose of influencing an election); AO 1996-39 (Commission determined that a legal fund could be established by a candidate committee for purposes of defending the legal sufficiency of the nominating petitions qualifying a candidate for the primary election ballot). According to the Committee, its Administrative Account is entitled the same status as these accounts.³

² This is a biennial event. Attendees at the September 1997 Conference included Senator Spencer Abraham, Congressman Newt Gingrich, Congressman John Kasich, Republican National Committee Chairman Jim Nicholson and major donors to the Committee.

³ The Commission has concluded, in the context of advisory opinions, that certain types of activities and legal expenses are not subject to the requirements of the FECA. See AOs: 1982-14, 1983-37, 1993-9, 1996-39. However, these advisory opinions appear to be limited to their particular circumstances. In

The Committee made the same arguments in response to the earlier audits. However, the Commission approved the Final Audit Reports for those audits that required allocation of similar expenses. Although the Committee claims that the Administrative Account was not established to be used in connection with any election activity, it appears that disbursements were made from this account for shared purposes. A party committee that makes disbursements in connection with nonfederal elections and also makes disbursements in connection with federal elections is required to allocate all of its administrative disbursements not directly attributable to a clearly identified candidate. See 11 C.F.R. § 106.5(a)(2). The Explanation and Justification for 11 C.F.R. § 106.5 states "... all administrative expenses must be allocated between federal and nonfederal accounts, if incurred by a committee that makes disbursements in connection with both federal and non-federal elections, and chooses to pay any portion of such disbursements from its non-federal account." Explanation and Justification for 11 C.F.R. § 106.5(a), 55 Fed. Reg. 26063 (January 26, 1990).

The Audit staff also identified shared expenses from one other non-federal account, the State Account. According to the Committee, this account was used as the main non-federal operating account and included transfers from the State Account to the Committee's allocation account for the non-federal portion of shared expenses. The expenses at issue included consulting fees, lighting for the state convention, expenses for GOTV phone calls, and expenses for absentee voter slate pieces. The Committee conceded that a majority of these expenses were shared (\$556,988 out of \$648,165). The disbursements that the Committee did not concede were made to a consulting company.⁴ Based on this Office's conversation with the Audit staff, it appears that these expenses should also be allocated since the consulting provided appears to have been for general party building activity. This Office advises the Audit staff to include in the proposed Final Audit Report any additional information available that indicates that these disbursements were for general party building activities.

addition, a separate fund would have to be established and maintained apart from other political committee funds used for federal elections.

⁴ According to the Audit staff, the Committee provided an affidavit from the owner of the consulting firm at issue indicating that to the best of his recollection, all services rendered to the Committee during the 1997-1998 cycle related solely to state elections. However, no contracts, invoices or other vendor generated documents detailing the particulars of the disbursements were provided.

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FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

February 9, 2001

Mr. Chris Bachelder, Treasurer
Michigan Republican State Committee
2121 E. Grand River
Lansing, MI 48912

Dear Mr. Bachelder:

Attached please find the Final Audit Report on Michigan Republican State Committee. The Commission approved the report on February 8, 2001.

The Commission approved Final Audit Report will be placed on the public record on February 19, 2001. Should you have any questions regarding the public release of the report, please contact the Commission's Press Office at (202) 694-1220. Any questions you have related to matters covered during the audit or in the report should be directed to Wanda Thomas or Tom Hinternister of the Audit Division at (202) 694-1200 or toll free at (800) 424-9530.

Sincerely,

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

Robert J. Costa
Assistant Staff Director
Audit Division

Attachment as stated

cc: Mr. Eric Doster, Counsel

EE.07.025.2735

22.07.025.2736

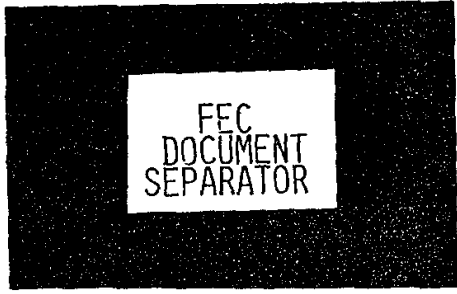
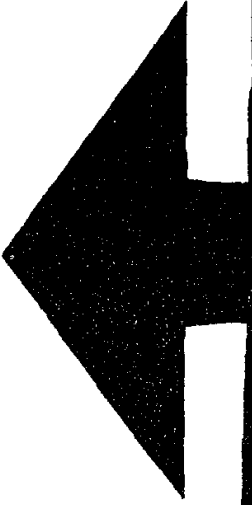
CHRONOLOGY

MICHIGAN REPUBLICAN STATE COMMITTEE

Audit Fieldwork	April 3, 2000 - June 26, 2000
Interim Audit Report to the Committee	September 28, 2000
Response Received to the Interim Audit Report	November 16, 2000
Final Audit Report Approved	February 8, 2001

22-07-025-2737

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FEC
DOCUMENT
SEPARATOR