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September 7, 2017

MEMORANDUM

Agenda Document No. 17-40-A

Agenda Item

For the Hearing of September 14, 2017

To: The Commission

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Audit Division

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Lead Auditor

Subject: Audit Hearing for the Freedom Defense Fund (A13-14)

Attached for your information is a copy of the Draft Final Audit Report (DFAR) and Office of General Counsel legal analysis that was provided to the Freedom's Defense Fund (FDF) on June 8, 2017. The FDF Treasurer responded to the DFAR on June 26, 2017, and requested a hearing before the Commission to discuss DFAR Finding 3 (Reporting of Apparent Independent Expenditures). The hearing was granted on July 12, 2017, and has been scheduled for September 14, 2017.

Finding 3 - Reporting of Apparent Independent Expenditures

Finding 3 is based on FDF's failure to comply with 11 CFR §§104.3(b)(3)(vii), 104.4(a) and 104.11 and 11CFR §§104.4(f) and 104.5(g)(1) and (g)(2). The Federal Election Campaign Act ("Act") and related regulations require the filing of independent expenditure reports and provide the disclosure requirements of independent expenditures.

In the Interim Audit Report (IAR) presented to FDF, Finding 3 noted that FDF disclosed disbursements as operating expenditures on Schedule B, Line 21b (Operating Expenditures) totaling \$868,015 which appeared to be independent expenditures and for which no 24/48 hour reports were filed.

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that these expenditures were properly reported as operating expenditures since the primary purpose for the expenditures was to raise funds for FDF. The Treasurer also referred to similar mailings that were not considered to be independent expenditures when the Audit staff audited FDF for the 2008 election cycle.

In the DFAR, the Audit staff acknowledged that some of the 2008 election cycle mailers contained similar language to the language contained in mailers used during the 2012 election cycle. However, the 2008 election cycle mailers were not reviewed for potential independent expenditures; and therefore, were not included in a finding. Further, absent the provision of documentation to support the public dissemination of the mailers, the DFAR concluded that 24/48-hour reports for apparent independent expenditures totaling \$868,015 should have been filed.

In response to the DFAR, the FDF Treasurer stated that FDF had reported disbursements of its direct mail program on Schedule B, Line 21(b) and suggested that these expenditures had been properly reported as solicitation expenses. The Treasurer noted that "...FDF is relying on the FEC Audit of the 2008 Election Cycle activities that verified the proper reporting of those disbursements." The Treasurer further stated that "...in the subsequent 2014 election cycle, expenditures that previously would have been reported as Line 21(b) Operating Expenditures were allocated as Line 24 Independent Expenditures." The Audit staff reiterates that the 2008 election cycle mailers were not reviewed as part of the 2008 audit but the 2012 election cycle mailers were reviewed as part of the 2012 audit. The Audit staff further notes that, to the extent a communication that is the subject of a disbursement constitutes express advocacy, all of the costs associated with producing and disseminating or distributing that communication would be considered independent expenditures.

The FDF Treasurer concluded by stating "...that it properly reported its direct mail expenditures on Line 21(b) throughout the 2012 election cycle..." and asks "can we agree that this is not a failure by the committee to report Independent Expenditures, but rather a disagreement in allocations?" The Audit staff notes that FDF filed amendments that reclassified the \$868,015 as independent expenditures as recommended but that FDF does not accept "...the premise that it failed to properly report those Independent Expenditures."

Attachments:

- Draft Final Audit Report of the Audit Division on the Freedom's Defense Fund
- Office of General Counsel's Legal Analysis dated May 8, 2017
- FDF Response to the Draft Final Audit Report, dated June 26, 2017

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on the Freedom's Defense Fund

(January 1, 2011 - December 31, 2012)

Why the Audit Was Done

Federal law permits the Commission to conduct audits and field investigations of any political committee that is required to file reports under the Federal Election Campaign Act (the Act). The Commission generally conducts such audits when a committee appears not to have met the threshold requirements for substantial compliance with the Act.¹ The audit determines whether the committee complied with the limitations, prohibitions and disclosure requirements of the Act.

Future Action

The Commission may initiate an enforcement action, at a later time, with respect to any of the matters discussed in this report.

About the Committee (p. 2)

The Freedom's Defense Fund is a non-connected committee, headquartered in Arlington, Virginia. For more information, see the chart on Committee Organization, p.2.

Financial Activity (p. 2)

• Receipts	
○ Contributions from Individuals	\$ 3,626,052
○ Other Receipts	54,481
Total Receipts	\$ 3,680,533
• Disbursements	
○ Operating Expenditures	\$ 3,221,626
○ Contributions to Candidates/Committees	107,900
○ Independent Expenditures	376,492
○ Other Disbursements	14,728
Total Disbursements	\$ 3,720,746

Findings and Recommendations (p. 3)

- Misstatement of Financial Activity (Finding 1)
- Disclosure of Occupation and Name of Employer (Finding 2)
- Reporting of Apparent Independent Expenditures (Finding 3)
- Recordkeeping for Communications (Finding 4)

¹ 52 U.S.C. §30111(b).

Draft Final Audit Report of the Audit Division on the Freedom's Defense Fund

(January 1, 2011 - December 31, 2012)



Table of Contents

	Page
Part I. Background	
Authority for Audit	1
Scope of Audit	1
Part II. Overview of Committee	
Committee Organization	2
Overview of Financial Activity	2
Part III. Summaries	
Findings and Recommendations	3
Part IV. Findings and Recommendations	
Finding 1. Misstatement of Financial Activity	5
Finding 2. Disclosure of Occupation and Name of Employer	6
Finding 3. Reporting of Apparent Independent Expenditures	8
Finding 4. Recordkeeping for Communications	13

Part I

Background

Authority for Audit

This report is based on an audit of the Freedom's Defense Fund (FDF), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 52 U.S.C. §30111(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 52 U.S.C. §30104. Prior to conducting any audit under this subsection, the Commission must 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. 52 U.S.C. §30111(b).

Scope of Audit

Following Commission-approved procedures, the Audit staff evaluated various risk factors and as a result, this audit examined:

1. the disclosure of individual contributors' occupation and name of employer;
2. the disclosure of debts and obligations pertaining to independent expenditures;
3. the consistency between reported figures and bank records;
4. the completeness of disbursement records;
5. the disclosure of independent expenditures; and
6. other committee operations necessary to the review.

Part II

Overview of Committee

Committee Organization

Important Dates	
• Date of Registration	June 7, 2004
• Audit Coverage	January 1, 2011 - December 31, 2012
Headquarters	Arlington, Virginia
Bank Information	
• Bank Depositories	One
• Bank Accounts	Three checking accounts
Treasurer	
• Treasurer When Audit Was Conducted	Scott Mackenzie
• Treasurer During Period Covered by Audit	Scott Mackenzie
Management Information	
• Attended Commission Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Treasurer

Overview of Financial Activity (Audited Amounts)

Cash-on-hand @ January 1, 2011	\$ 46,043
Receipts	
○ Contributions from Individuals	3,626,052
○ Other Receipts	54,481
Total Receipts	\$ 3,680,533
Disbursements	
○ Operating Expenditures	3,221,626
○ Contributions to Candidates/Committees	107,900
○ Independent Expenditures	376,492
○ Other Disbursements	14,728
Total Disbursements	\$ 3,720,746
Cash-on-hand @ December 31, 2012	\$ 5,830

Part III

Summaries

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

The Audit staff's comparison of FDF's reported financial activity with its bank records revealed that, for 2011, FDF understated its reported disbursements by \$52,357, and overstated its ending cash-on-hand balance by \$62,220. In response to the Interim Audit Report recommendation, the FDF Treasurer stated that FDF would amend its reports to correct the discrepancies. However, as of the date of this report, no amended reports have been filed.

(For more detail, see p. 5.)

Finding 2. Disclosure of Occupation and Name of Employer

During audit fieldwork, a review of all contributions from individuals requiring itemization indicated that 2,911 contributions totaling \$378,639 lacked adequate disclosure of occupation and name of employer. FDF did not demonstrate "best efforts" to obtain, maintain and submit this information. In response to the Interim Audit Report recommendation, the FDF Treasurer provided a schedule containing missing occupation and name of employer information. He stated that FDF had obtained approximately 95% of the missing information and would amend its reports to include this information. The Audit staff reviewed this schedule and concurred that FDF has obtained more than 95% of the missing information, but as of the date of this report, no amended reports have been filed.

(For more detail, see p. 6.)

Finding 3. Reporting of Apparent Independent Expenditures

During audit fieldwork, the Audit staff reviewed disbursements to verify that the independent expenditures that FDF disclosed on Schedule E (Itemized Independent Expenditures) were reported accurately. FDF disclosed independent expenditures totaling \$385,619. The Audit staff identified additional disbursements disclosed as operating expenditures on Schedule B, Line 21b (Operating Expenditures) totaling \$868,015 which appear to be independent expenditures and for which no 24/48 hour reports were filed.

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that these expenditures were properly reported as operating expenditures since the primary purpose for the expenditures was to raise funds for FDF. The Treasurer also referred to similar mailings that were not considered to be independent expenditures when the Audit staff audited FDF for the 2008 election cycle.

The Audit staff acknowledges that some of the 2008 election cycle mailers contained similar language to the language contained in mailers used during the 2012 election cycle. However, the 2008 election cycle mailers were not reviewed for potential independent expenditures; and therefore, were not included in a finding.

(For more detail, see p. 8.)

Finding 4. Recordkeeping for Communications

During audit fieldwork, the Audit staff reviewed disbursements to verify the accuracy of the information and proper classification of transactions disclosed on reports. FDF reported 13 expenditures totaling \$90,814 on Schedule B, Line 21b (Operating Expenditures) with purposes of “direct mail – creative” and “direct mail – postage.” Documentation that was provided by FDF was insufficient to make a determination pertaining to the purpose for these expenditures and verification as an operating expense. In response to the Interim Audit Report, the FDF Treasurer stated that FDF is attempting to obtain the missing documentation from its vendors, however, it asserts that these expenses have been properly reported as operating expenditures. Absent the provision of records, the Audit staff considers the matter a violation of the recordkeeping requirements at 11 CFR §104.14(b)(1).

(For more detail, see p. 13.)

Part IV

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

Summary

The Audit staff's comparison of FDF's reported financial activity with its bank records revealed that, for 2011, FDF understated its reported disbursements by \$52,357, and overstated its ending cash-on-hand balance by \$62,220. In response to the Interim Audit Report recommendation, the FDF Treasurer stated that FDF would amend its reports to correct the discrepancies. However, as of the date of this report, no amended reports have been filed.

Legal Standard

Contents of Reports. Each report must disclose:

- the amount of cash-on-hand at the beginning and end of the reporting period;
- the total amount of receipts for the reporting period and for the calendar year;
- the total amount of disbursements for the reporting period and for the calendar year; and
- certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 52 U.S.C. §30104(b)(1), (2), (3), (4), and (5).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff reconciled FDF's reported financial activity with its bank records for calendar years 2011 and 2012. The reconciliation determined that FDF misstated disbursements and ending cash-on-hand for 2011. The following chart outlines the discrepancies between FDF's disclosure reports and its bank records. The succeeding paragraphs explain why the discrepancies occurred.

2011 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash-on-Hand @ January 1, 2011	\$43,781	\$46,043	(\$2,262) Understated
Receipts	\$1,324,490	\$1,312,365	\$12,125 Overstated
Disbursements	\$1,293,431	\$1,345,788	(\$52,357) Understated
Ending Cash-on-Hand @ December 31, 2011	\$74,840	\$12,620	\$62,220 Overstated

The understatement of disbursements resulted from the following differences:

• Contributions to candidates/committees not reported	\$ 51,650
• Vendor payment not reported	2,900
• Unexplained differences	<u>(2,193)</u>
Net Understatement of Disbursements	\$ 52,357

The \$62,220 overstatement of the ending cash-on-hand balance primarily resulted from the misstatements described above.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff provided work papers and discussed the reporting errors that caused the misstatements. The FDF Treasurer stated that amended reports would be filed to correct the misstatements.

The Interim Audit Report recommended that FDF amend its reports to correct the misstatements for 2011 as noted above.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that FDF would amend its reports to correct the discrepancies. However, as of the date of this report, no amended reports have been filed.

Finding 2. Disclosure of Occupation and Name of Employer

Summary

During audit fieldwork, a review of all contributions from individuals requiring itemization indicated that 2,911 contributions totaling \$378,639 lacked adequate disclosure of occupation and name of employer. FDF did not demonstrate “best efforts” to obtain, maintain and submit this information. In response to the Interim Audit Report recommendation, the FDF Treasurer provided a schedule containing missing occupation and name of employer information. He stated that FDF had obtained approximately 95% of the missing information and would amend its reports to include this information. The Audit staff reviewed this schedule and concurred that FDF has obtained more than 95% of the missing information, but as of the date of this report, no amended reports have been filed.

Legal Standard

A. Itemization Required for Contributions from Individuals. A political committee other than an authorized committee must itemize any contribution from an individual if it exceeds \$200 per calendar year, either by itself or when combined with other contributions from the same contributor. 52 U.S.C §30104(b)(3)(A).

B. Required Information for Contributions from Individuals. For each itemized contribution from an individual, the committee must provide the following information:

- the contributor's full name and address (including zip code);
- the contributor's occupation and the name of his or her employer;
- the date of receipt (the date the committee received the contribution);
- the amount of the contribution; and
- the calendar year-to-date total of all contributions from the same individual. 52 U.S.C. §30104(b)(3)(A) and 11 CFR §§ 100.12 and 104.3(a)(4)(i).

C. Best Efforts Ensures Compliance. When the treasurer of a political committee shows that the committee used best efforts (see below) to obtain, maintain, and submit the information required by the Act, the committee's reports and records will be considered in compliance with the Act. 52 U.S.C. §30102(i).

D. Definition of Best Efforts. The treasurer and the committee will be considered to have used "best efforts" if the committee satisfied all of the following criteria.

- All written solicitations for contributions included:
 - a clear request for the contributor's full name, mailing address, occupation, and name of employer; and
 - the statement that such reporting is required by Federal law.
 - Note: The request and statement must appear in a clear and conspicuous manner on any response material included in a solicitation.
- Within 30 days of receipt of the contribution, the treasurer made at least one effort to obtain the missing information, in either a written request or a documented oral request.
- The treasurer reported any contributor information that, although not initially provided by the contributor, was obtained in a follow-up communication or was contained in the committee's records or in prior reports that the committee filed during the same two-year election cycle. 11 CFR §104.7(b).

Facts and Analysis

A. Facts

A review of all contributions from individuals requiring itemization indicated that 2,911 contributions totaling \$378,639, or 41% of total contributions from individuals required to be itemized by FDF, lacked disclosure of occupation and name of employer. The majority of the contributor entries (2,669 of 2,911) that lacked the required information were blank on the Schedules A (Itemized Receipts) filed with the Commission.

The Audit staff reviewed the contribution records provided by FDF to determine if it had utilized "best efforts" to obtain, maintain and submit the missing information.

- FDF did not provide documentation showing it made follow-up best efforts for 282 contributions totaling \$26,841 (\$378,639 - \$351,798).
- FDF had the required information for 2,629 contributions totaling \$351,798; however, this information was not subsequently disclosed on the Commission disclosure reports.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff provided schedules and discussed the omission of occupation and name of employer information from the disclosure reports. The FDF Treasurer commented that he had obtained some of the missing occupation and name of employer information. In its response to the exit conference, FDF provided a work paper demonstrating that FDF had obtained most of the missing occupation and name of employer information. FDF also provided copies of letters that it had sent to contributors to obtain the missing occupation and name of employer information. This additional documentation demonstrated that FDF had obtained occupation and name of employer information for \$256,451 of the errors; however, amended disclosure reports were not filed.² This amount is included in the \$351,798 noted above.

The Interim Audit Report recommended that FDF demonstrate that it complied with the “best efforts” requirements by amending its reports to disclose the missing information relating to the 2,629 contributions totaling \$351,798 (\$95,347 + \$256,451).

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that FDF had obtained approximately 95% of the missing occupation and name of employer information and would amend its reports to include this information. FDF provided an attachment containing this information. The Audit staff reviewed this schedule and concurred that FDF had obtained more than 95% of the missing information, but as of the date of this report, no amended reports have been filed.

Finding 3. Reporting of Apparent Independent Expenditures**Summary**

During audit fieldwork, the Audit staff reviewed disbursements to verify that the independent expenditures that FDF disclosed on Schedule E (Itemized Independent Expenditures) were reported accurately. FDF disclosed independent expenditures totaling \$385,619. The Audit staff identified additional disbursements disclosed as operating expenditures on Schedule B, Line 21b (Operating Expenditures) totaling \$868,015 which appear to be independent expenditures and for which no 24/48 hour reports were filed.

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that these expenditures were properly reported as operating expenditures since the primary purpose for the expenditures was to raise funds for FDF. The Treasurer also referred to similar mailings that were not considered to be independent expenditures when the Audit staff audited FDF for the 2008 election cycle.

² FDF’s database contained the occupation and name of employer information for an additional 420 contributions totaling \$95,347.

The Audit staff acknowledges that some of the 2008 election cycle mailers contained similar language to the language contained in mailers used during the 2012 election cycle. However, the 2008 election cycle mailers were not reviewed for potential independent expenditures; and therefore, were not included in a finding.

Legal Standard

- A. Definition of Independent Expenditures.** The term “independent expenditure” means an expenditure by a person for a communication expressly advocating the election or defeat of a clearly identified candidate that is not made in coordination with any candidate or authorized committee or agent of a candidate. No expenditure shall be considered independent if the person making the expenditure allows a candidate, a candidate’s authorized committee or their agents, or a political party committee or its agents to become materially involved in decisions regarding the communication as described in 11 CFR 109.21(d)(2), or shares financial responsibility for the cost of production or dissemination with any such person. 11 CFR §100.16.
- B. Disclosure Requirements – General Guidelines.** An independent expenditure shall be reported on Schedule E if, when added to other independent expenditures made to the same payee during the same calendar year, it exceeds \$200. Independent expenditures made (i.e., publicly disseminated) prior to payment should be disclosed as memo entries on Schedule E and as a debt on Schedule D. Independent expenditures of \$200 or less need not be itemized, though the committee must report the total of those expenditures on line (b) of Schedule E. 11 CFR §§104.3(b)(3)(vii), 104.4(a) and 104.11.
- C. Last-Minute Independent Expenditure Reports (24-Hour Reports).** Any independent expenditures aggregating \$1,000 or more, with respect to any given election, and made after the 20th day but more than 24 hours before the day of an election, must be reported and the report must be received by the Commission within 24 hours after the expenditure is made. A 24-hour report is required each time additional independent expenditures aggregate \$1,000 or more. The date that a communication is publicly disseminated serves as the date that the committee must use to determine whether the total amount of independent expenditures has, in the aggregate, reached or exceeded the threshold reporting amount of \$1,000. 11 CFR §§104.4(f) and 104.5(g)(2).
- D. Independent Expenditure Reports (48-Hour Reports).** Any independent expenditures aggregating \$10,000 or more for an election in any calendar year, up to and including the 20th day before an election, must be disclosed within 48 hours each time the expenditures aggregate \$10,000 or more. The reports must be filed with the Commission within 48 hours after the expenditure is made. A 48-hour report is required each time additional independent expenditures aggregate \$10,000 or more. The date that a communication is publicly disseminated serves as the date that the committee must use to determine whether the total amount of independent

expenditures has, in the aggregate, reached or exceeded the threshold reporting amount of \$10,000. 11 CFR §§104.4(f) and 104.5(g)(1).

E. Definition of Expressly Advocating. The term “expressly advocating” means any communication that;

- Uses phrases such as “vote for the President,” “re-elect your Congressman,” “defeat” accompanied by a picture of one or more candidate(s), “reject the incumbent,” or communications of campaign slogan(s) or individual word(s), which in context can have no other reasonable meaning than to urge the election or defeat of one or more clearly identified candidate(s), such as posters, bumper stickers, advertisements; or
- When taken as a whole and with limited reference to external events, such as the proximity to the election, could only be interpreted by a reasonable person as containing advocacy of the election or defeat of one or more clearly identified candidate(s) because:
 - the electoral portion of the communication is unmistakable, unambiguous, and suggestive of only one meaning; and
 - reasonable minds could not differ as to whether it encourages actions to elect or defeat one or more clearly identified candidate(s) or encourages some other kind of reaction. 11 CFR §100.22(a) and (b).

F. Formal Requirements Regarding Reports and Statements. Each political committee shall maintain records with respect to the matters required to be reported which shall provide in sufficient detail the necessary information and data from which the filed reports may be verified, explained, clarified, and check for accuracy and completeness. 11 CFR §104.14(b)(1).

Facts and Analysis

A. Reporting of Apparent Independent Expenditures

1. Facts

During audit fieldwork, the Audit staff reviewed disbursements to ensure that independent expenditures were disclosed correctly on Schedule E. FDF disclosed independent expenditures totaling \$385,619 on Schedule E. However, FDF also made media-related expenditures totaling \$868,015 and disclosed them as operating expenditures on Schedule B, Line 21b (Operating Expenditures), when it appears that they should have been reported as independent expenditures on Schedule E.

According to vendor invoices, FDF was billed \$868,015 for mailers. The invoices contained the mailer identification codes, the quantity of pieces mailed, the date that the pieces were mailed, and the cost of each mailing. A review of the mailers that were made available indicated that they contained language expressly advocating the election or defeat of a clearly identified candidate, which is Federal Election Activity that is required to be reported on Schedule E as defined under 11CFR §100.22(a).

A breakdown of the analysis for these expenditures is as follows:

**Apparent Independent Expenditures Reported as Operating Expenditures
(Copy of Communication Made Available)**

FDF made 137 apparent independent expenditures totaling \$868,015 for which it provided supporting documentation such as invoices and the associated mailers for each invoice. All of these communications contained language expressly advocating the election or defeat of a clearly identified candidate, as defined under 11 CFR §100.22(a).

The majority of the mailers advocated the defeat of Barack Obama in the 2012 general election. Some of the mailers included statements directly advocating defeat such as, “Barack Obama must be defeated,” and “It’s going to take a Herculean effort to defeat Barack Obama...this bully must be exposed and defeated.” Other mailers contained language such as, “we conservatives need to start attacking Barack Obama’s re-elect efforts NOW...if we’re going to...do what’s necessary to make Barack Hussein Obama a one-term president.” and “It goes without saying that Barack Obama must be defeated...Together, you and I must take Barack Obama and his liberal-progressive hacks head-on. This is the only way that they will be defeated!”

2. Interim Audit Report & Audit Recommendation

At the exit conference, the Audit staff presented schedules of apparent independent expenditure reporting errors. In response to the exit conference, the FDF Treasurer stated that FDF’s position would be that these expenditures were fundraising expenditures and not independent expenditures.

The Interim Audit Report recommended that FDF provide documentation and evidence that apparent independent expenditures totaling \$868,015 did not require reporting as independent expenditures. Absent such evidence, it was further recommended that FDF amend its reports to disclose these disbursements as independent expenditures on Schedule E and submit revised procedures for reporting independent expenditures.

3. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that these expenditures were properly reported as operating expenditures since the primary purpose for the expenditures was to raise funds for FDF. The Treasurer explained that these direct mail pieces were sent to “like-minded individuals” who had previously contributed to FDF or another conservative committee and that the purpose of these mailings was not to influence their vote, as FDF already knew with nearly 100% certainty how these individuals would vote. FDF’s goal was to solicit a contribution. The Treasurer acknowledged that the mailers may contain language such as “Barack Obama must be defeated,” but stated that this language was used to touch a raw nerve in the reader to solicit a contribution and not to persuade them to vote FDF’s way.

The Treasurer also referred to similar mailers that were not considered to be independent expenditures when the Audit staff audited FDF for the 2008 election cycle. The Treasurer claimed that since the Audit staff determined that the mailers were properly reported for the 2008 election cycle, the Audit staff should not determine that the similar 2012 mailers were reportable as independent expenditures.

The Audit staff acknowledges that some of the 2008 election cycle mailers contained similar language to the language contained in mailers used during the 2012 election cycle. However, the 2008 election cycle mailers were not reviewed for potential independent expenditures; and therefore, were not included in a finding.

B. Failure to File 24/48- Hour Reports for Independent Expenditures

1. Facts

During audit fieldwork, the Audit staff reviewed independent expenditures reported by FDF, as well as the apparent independent expenditures noted above, to determine whether additional reporting of 24/48-hour reports was required.³ As noted above, the Audit staff identified apparent independent totaling \$868,015 which may also require filing of 24/48-hour reports.

2. Interim Audit Report & Audit Recommendation

At the exit conference, the Audit staff presented schedules of independent expenditure reporting errors. The FDF Treasurer stated that FDF's position would be that these expenditures were fundraising expenditures and not independent expenditures.

Absent documentation and evidence that apparent independent expenditures totaling \$868,015 did not require reporting as independent expenditures (per Part A above), the Interim Audit Report recommended that FDF provide documentation to support the date of public dissemination for the communications to determine whether a filing of a 24/48-hour report was required.

3. Committee Response to the Interim Audit Report

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that FDF has reported and filed 24/48-hour reports for expenditures for broadcast media and targeted voter contact mail totaling \$385,619. Further, the Treasurer stated that the expenditures totaling \$868,015 have been properly reported as as operating expenditures.

Absent the provision of documentation to support the public dissemination of the mailers, the Audit staff maintains that 24/48-hour reports for apparent independent expenditures totaling \$868,015 should have been filed.

³ The date the expenditure is publicly distributed serves as the date that the independent expenditure is made for purposes of the 24/48-hour reports. FDF provided a master list of all mailers that included the mail date for each mailer on the list.

Finding 4. Recordkeeping for Communications

Summary

During audit fieldwork, the Audit staff reviewed disbursements to verify the accuracy of the information and proper classification of transactions disclosed on reports. FDF reported 13 expenditures totaling \$90,814 on Schedule B, Line 21b (Operating Expenditures) with purposes of “direct mail – creative” and “direct mail – postage.” Documentation that was provided by FDF was insufficient to make a determination pertaining to the purpose for these expenditures and verification as an operating expense. In response to the Interim Audit Report, the FDF Treasurer stated that FDF is attempting to obtain the missing documentation from its vendors, however, it asserts that these expenses have been properly reported as operating expenditures. Absent the provision of records, the Audit staff considers the matter a violation of the recordkeeping requirements at 11 CFR §104.14(b)(1).

Legal Standard

- A. Formal Requirements Regarding Reports and Statements.** Each political committee shall maintain records with respect to the matters required to be reported which shall provide in sufficient detail the necessary information and data from which the filed reports may be verified, explained, clarified, and check for accuracy and completeness. 11 CFR §104.14(b)(1).
- B. Preserving Records and Copies of Reports.** The treasurer of a political committee must preserve all records and copies of reports for 3 years after the report is filed. 52 U.S.C. §30102(d).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff reviewed disbursements to verify the accuracy of the information and proper classification of transactions disclosed on reports. FDF reported expenditures totaling \$90,814 for which documentation was insufficient to make a determination pertaining to whether these disbursements were correctly reported on Schedule B, Line 21b (Operating Expenditures).

The Audit staff's analysis resulted in the following:

Disbursements – Invoices Provided – Not Able to Associate with Copies of Communications (\$90,814)

Disbursements totaling \$90,814 were paid to two direct mail vendors and were disclosed on Schedule B with purposes of “direct mail – creative” and “direct mail – postage.” For these disbursements, FDF provided invoices but did not provide information about the related mail communications. Without a copy of the associated communications, the Audit staff is unable to determine how FDF

should have reported these disbursements. During audit fieldwork, the Audit staff requested copies of the mail communications. To date these records have not been provided.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff presented a schedule of the disbursements for which further records were necessary to verify the accuracy of FDF's reporting. The Audit staff requested copies of the mail communications. The FDF Treasurer stated that he would contact the vendors to find the missing mail communications, or find out if the invoices had incorrect mailer job identifiers, and would provide the Audit staff with any documentation that was obtained.

The Interim Audit Report recommended that FDF provide, in sufficient detail, the necessary information from which the reported operating expenditures totaling \$90,814 may be verified or explained. Such records should have included:

- Copies of communications that can be associated to the vendor invoices, and
- If the communication has already been provided, information associating each communication with an invoice(s).

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, the FDF Treasurer stated that FDF is attempting to obtain the missing documentation from its vendors, however, it asserts that these expenses have been properly reported as operating expenditures. Absent the provision of records, the Audit staff considers the matter a violation of the recordkeeping requirements at 11 CFR §104.14(b)(1).



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

May 8, 2017

MEMORANDUM

TO: Patricia C. Orrock
Chief Compliance Officer

Thomas E. Hintermister
Assistant Staff Director
Audit Division

FROM: Lisa J. Stevenson *LJS*
Acting General Counsel

Lorenzo Holloway *LH*
Assistant General Counsel
Compliance Advice

Margaret J. Forman *MJF*
Attorney

SUBJECT: Proposed Draft Final Audit Report on the Freedom's Defense Fund (LRA 1030)

I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Draft Final Audit Report ("proposed DFAR") on the Freedom's Defense Fund ("FDF"). The proposed DFAR contains four findings: Misstatement of Financial Activity (Finding 1), Disclosure of Occupation and Name of Employer (Finding 2), Reporting of Independent Expenditures (Finding 3) and Recordkeeping for Communications (Finding 4). We concur with the findings, and comment on Finding 3. If you have any questions, please contact Margaret J. Forman, the attorney assigned to this audit.

II. FUNDRAISING COMMUNICATIONS AS INDEPENDENT EXPENDITURES

In Finding 3 of the proposed DFAR, the Audit Division noted that FDF disclosed independent expenditures totaling \$385,619 on Schedule E; however, FDF also made apparent media-related expenditures totaling \$868,015 that were disclosed as operating expenditures on Schedule B, Line 21b. The Audit Division concluded that these media-related expenditures should have been disclosed on Schedule E as Independent Expenditures.

FDF raises two arguments. First, FDF argues that it disclosed the expenditures as operating expenditures because the primary purpose of the communications was for fundraising. FDF states that its purpose was not express advocacy because it was not trying to sway anyone; rather, it already knew how the recipients of the communication would vote.

Contrary to FDF's position, the regulation defining express advocacy does not permit an examination of the speaker's subjective intent or purpose, nor does it permit an examination of the likelihood that the recipient of the communication will be swayed by the communication. *See* 11 C.F.R. § 100.22; *see also* Express Advocacy; Independent Expenditures; Corporate and Labor Organization Expenditures, 60 Fed. Reg. 35291, 35295 (Jul. 6, 1995) (“[T]he subjective intent of the speaker is not a relevant consideration” under section 100.22). We, therefore, concur with the Audit Division that the costs associated with these communications should have been disclosed on Schedule E as Independent Expenditures. The Commission has arrived at this conclusion in previous audits. *See* Final Audit Report on National Campaign Fund, at 9, 12-13 (approved Oct. 22, 2012); Final Audit Report on Legacy Committee Political Action Committee (“Legacy PAC”), at 8, 10 (approved Jul. 31, 2012). We previously noted in OGC's comments on the audit of the Legacy PAC that the communicator's subjective intent is not a factor the Commission considers when determining whether a communication constitutes express advocacy. *See* Memorandum from Christopher Hughey, OGC to Patricia Carmona, OC, Draft Final Audit Report on The Legacy Committee Political Action Committee (LRA 815) at 3-4 (Jan. 24, 2012). Thus, to the extent that a communication that is the subject of a disbursement constitutes express advocacy, all of the costs associated with producing and disseminating or distributing that communication would be considered independent expenditures.

Second, FDF argues that similar communications were not considered independent expenditures in the 2008 audit of FDF. In response to this argument, the Audit Division notes that the 2008 involved media buys and the current audit involves mailers. However, a media buy and a mailer can each be a communication for the purpose of determining whether a communication is an independent expenditure. 11 C.F.R. § 100.16. We, therefore, recommend that the Audit Division clarify the distinction that it is drawing between the communications in the 2008 audit and the communications in this audit.



DRAFT FINAL AUDIT REPORT RESPONSE

Freedom's Defense Fund



JUNE 26, 2017
SCOTT B. MACKENZIE
Treasurer

Finding 1. Misstatement of Financial Activity

Audit Finding

The audit team reviewed the financial activity of Conservative Majority Fund, and compared the entries reported to the FEC with the bank records; and their findings were as follows:

2011 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ 1/01/2011	\$43,781	\$46,043	(\$2,262)
Receipts	\$1,324,490	\$1,312,365	\$12,125
Disbursements	\$1,293,431	\$1,345,788	(\$52,357)
Ending Cash Balance @ 12/31/2012	\$74,840	\$12,620	\$62,220

Committee Response

The committee has amended its reports to correct the discrepancies.



Finding 2. Disclosure of Occupation and Name of Employer

Audit Finding

The audit team reviewed all contributions from individuals requiring itemization and found that 2,911 contributions totaling \$378,639 lacked adequate disclosure of occupation and name of employer.

Committee Procedures

- All written solicitation requests by the committee included a Reply Form containing the donor's full name and mailing address.
- Each reply form states the following: *Federal Law requires us to obtain and report the name, mailing address, occupation and name of employer of individuals whose contributions aggregate in excess of \$200 in a calendar year.*
- Space is afforded on the Reply Form for the donor to provide the occupation and employer information.
- In the event the donor fails to offer the requested information, the committee, within thirty (30) days of receipt of the contribution, sends the donor a letter requesting the missing information.
- Once the donor information is obtained the committee amends its reports to display the required information.

Summary

Although the committee did obtain over 95% of the missing information, it had not amended its reports at the time the Interim Audit Report was issued. This has been rectified with the committee filing amended reports to include the missing information.



Finding 3. Reporting of Apparent Independent Expenditures

Audit Finding

The audit staff reviewed disbursements to verify that the Independent Expenditures were reported accurately. Freedom's Defense Fund (FDF) disclosed independent expenditures totaling \$385,619 and these disbursements were for broadcast media and production, as well as some targeted voter contact (non-solicitation) mail. The audit staff identified additional disbursements disclosed as operating expenditures (Schedule B, Line 21(b)) totaling \$868,015 that they assert should have been reported as independent expenditures (Schedule B, Line 24).

Background

Freedom's Defense Fund filed its initial Statement of Organization on June 1, 2004 and it was received and processed at the FEC on June 7th. When FDF was founded, its purpose was to raise money and make contributions to conservative federal and to a lesser extent, non-federal candidates. During the 2008 election cycle, the committee began making independent expenditures in addition to making candidate contributions; and this practice has continued at a greater pace each election cycle.

The primary fundraising tool utilized by FDF has been direct response solicitation mail (direct mail). Close to 100% of the money raised by FDF has been a result of its small donor direct mail program.

Direct Mail

Reaching potential donors through direct mail has a track record of success going back to the 1964 Goldwater for President campaign. At the start of any direct mail program, the organization must prospect for potential donors. This generally requires renting lists of like-minded conservative individuals who share the values and principles being promoted by FDF (love of country; respect for our Constitution; less government intrusion, etc.). The lists rented by FDF are lists of individuals who have made contributions to conservative candidates and/or organizations within a certain time frame (generally 6 – 24 months).

Individuals who respond to FDF's "prospect" mailings are combined into the committee's "house" file. Whereas the response percentage of a successful prospect mailing is generally in the 1 to 2 percent range, a house file mailing can generate a response rate of 10% or more.

Targeting donors for prospect mailings can be viewed as macro-targeting, while house file mailings might be described as micro-targeting. And as house file mailings focus on a smaller universe, with generally higher average contributions, they can be expected to generate large amounts of net contributions for use by the organization.

As previously stated, direct mail has been the primary source of FDF's funding since its inception.



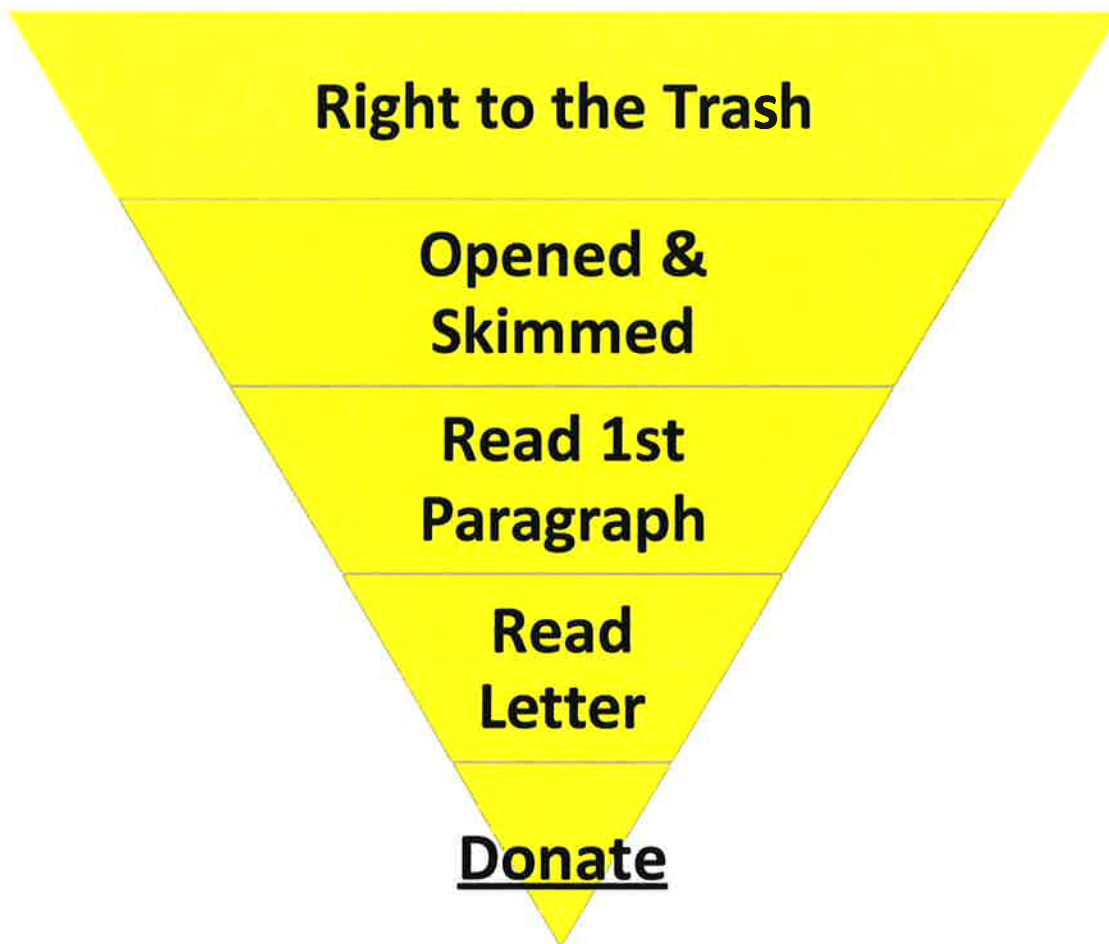
Direct Mail: Solicitations v. Voter Persuasion

FDF has utilized two (2) types of mail over the past several election cycles. The first and most prevalent is solicitation mailings (commonly referred to simply as “direct mail”); utilized to raise funds for the organization. The second is voter persuasion mail (often referred to as voter contact mail); whose purpose is to convince the recipient to vote for, or against a clearly identified candidate.

The committee has always reported its direct mail (solicitation mailings) expenses as operating expenditures on Schedule B, Line 21(b) as the purpose of these disbursements are justly classified as solicitation expenses. Conversely, voter contact mail (persuasion mailings) attempts to convince the recipient to vote in a certain way and **does not** request a contribution; therefore, these disbursements are reported on Schedule B, Line 24 as independent expenditures.

Direct Mail Pyramid

Regardless the type of direct mail being discussed, there is an inevitable pyramid that affects all mailings, but in this instance, we will center the discussion on direct mail solicitations.



As the direct mail pyramid demonstrates, a large segment of the population receiving a direct mail piece, throw it away without even opening it. Consequently, it is the responsibility of the package designer to develop a “hook” that will entice the recipient to open the package. That “hook” might be the design of the carrier envelop; a phrase or quote printed on the carrier envelope; or simply a return address from a prominent signor who might be an elected official or celebrity.

Once the direct mail package is opened, emotionally charged passages are highlighted with the purpose of pushing the reader to the end of the letter and eliciting a reaction that will result in spurring that individual toward contributing.

As stated, FDF sends its direct mail to like-minded individuals who have previously contributed to FDF or another conservative group or committee. The purpose of these mailings is **NOT** to influence their vote – we know with nearly 100% certainty how they will vote – our goal is to solicit a contribution to FDF.

Moving an individual to act, particularly when that effects their checkbook, is not easy. Therefore, it is imperative to tell a heart-felt story or create an emotionally charged letter with language that touches a raw nerve in the reader (sometimes referred to as “red meat”). So, when an FDF direct mail piece says: “Barack Obama must be defeated” we are supplying “red meat” to the reader, not trying to persuade them to vote our way – that’s a given.

Definition of Independent Expenditure

The term “independent expenditure” means an expenditure by a person for a communication expressly advocating the election or defeat of a clearly identified candidate...

§100.22(b)(2) Expressly advocating

Reasonable minds could not differ as to whether it encourages actions to elect or defeat one or more clearly identified candidate(s) or encourages some other kind of action. [emphasis added]

The FDF direct mail program was **NOT** designed to encourage the recipient to elect or defeat one or more clearly identified candidate(s) – it was to *encourage some other kind of action* – contributing to FDF.

Further, the FEC PAC Guide on page 11 states:

The committee may solicit contributions through...mass mailings...

Nowhere in the PAC Guide, the Regulations or the Act does it state that fundraising solicitations via the mail are to be reported as independent expenditures.



Package Differences

The look and feel of a direct mail piece versus a voter contact mailing are drastically different. The primary components of a direct mail piece are:

- Carrier Envelope;
- Solicitation Letter;
- Reply Form; and
- Return Envelope.

Another aspect of a direct mail piece is the repeated plea for donations using language like the following:

...And that is why a group like Freedom's Defense Fund is so important and so worthy of your immediate support of \$35, \$50, \$100, \$250, \$500, \$1,000 or even \$5,000 at this time.

Only then will we be able to provide the help these front-line conservative candidates need to run winning campaigns.

...with so much on the line I really need you to take urgent action by Thursday, March 31st ...

Sometimes FDF offers the donor an incentive:

If you rush back \$45 or more ...I will send you a copy of my new book as soon as it is released...

Again, the stated purpose of an FDF direct mail piece is to generate contributions to the committee so that help can be provided to “front-line conservative candidates”. And when “urgent action” is requested – that action refers to sending a contribution to FDF.

A voter contact mailing by contrast is generally an oversized postcard with pictures and/or graphics to quickly inform the recipient that candidate “A” is a wholesome, red-blooded American, while candidate “X” is a “red”. The oversized postcard by-passes the direct mail pyramid because there is nothing to open, and even if the piece goes directly to the trash, a well-designed piece may have the intended impact during the few seconds it is in the receiver’s hand.



FEC Audit of the 2008 Election Cycle

The 2008 Election Cycle activities of Freedom's Defense Fund were audited by the Federal Election Commission. The audit staff and the committee disagreed on the amount of the disbursements that should have been reported as independent expenditures. However, all those expenditures had to do with media ad buys and NOT with FDF's direct mail program.

If the audit staff determined that the committee's direct mail program was properly reported on Schedule B, Line 21(b) for the 2008 election cycle; how is it that the audit staff can claim that for the 2012 cycle, FDF should have reported \$868,015 related to its direct mail program on Schedule B, Line 24 as independent expenditures?

FDF makes every attempt to comply with the Act and Regulations, but in this instance, it appears that the audit staff is applying a different standard. Should the Commission decide that committees like FDF should ignore the purpose of an expenditure, and focus only on language, regardless of the action being encouraged – FDF will certainly conform. However, to retroactively apply a different standard should not be the Commission's policy.

Committee Response

The committee has reported disbursements of its direct mail program on Schedule B, Line 21(b) and strongly suggests that these expenditures have been properly reported as solicitation expenses. Further, FDF is relying on the FEC Audit of its 2008 Election Cycle activities that verified the proper reporting of those disbursements.

The committee recognized prior to the current audit that the FEC was taking a different approach to communications via the mail than it had during the 2008 and prior election cycles. Therefore, in the subsequent 2014 election cycle, expenditures that previously would have been reported as Line 21(b) Operating Expenditures were allocated as Line 24 Independent Expenditures.

The committee believes that it properly reported its direct mail expenditures on Line 21(b) throughout the 2012 election cycle. Given the thorough review by the Audit Staff and their reclassification of over \$850,000 from Line 21(b) to Line 24 Independent Expenditures – can we agree that this is not a failure by the committee to report Independent Expenditures, but rather a disagreement in allocations?

The committee has filed amendments to coincide with the conclusions of the auditors without accepting the premise that it failed to properly report those Independent Expenditures.



Finding 4. Recordkeeping for Communications

Audit Finding

The audit staff identified thirteen (13) expenditures totaling \$90,814 on Schedule B, Line 21(b) with purposes of “direct mail – creative” and “direct mail – postage” and determined that the documentation provided was insufficient to determine whether the expense was properly reported as an operating expense or whether it should have been reported as an independent expenditure.

Committee Response

The committee has contacted the vendors in question without obtaining the desired documentation. As the overriding issue of this finding is similar to Finding #3; the committee, asserts that its direct mail expenses were properly reported as operating expenditures and not independent expenditures. However, amendments have been filed to coincide with the auditor’s conclusions without accepting fault.



In Summary

The audit staff has identified four (4) areas of concern and FDF has addressed each of these.

Finding 1. Misstatement of Financial Activity

The committee has amended its reports to reflect the changes identified by the audit staff.

Finding 2. Disclosure of Occupation and Employer

The initial disclosure reports filed by FDF identified 2,911 itemized contributions totaling \$378,639 of itemized contributions, that lacked full disclosure of the contributor's occupation and name of employer. The committee utilized "best efforts" procedures and received the missing data on more than 95% of those previously missing the required information. The committee has amended its FEC Reports to reflect the added information.

Finding 3. Reporting of Apparent Independent Expenditures

This is where the committee and the audit staff have our greatest area of disagreement. FDF reported the disbursements related to its direct mail solicitation program as operating expenditures on Schedule B, Line 21(b) and the audit staff has concluded that \$868,015 of these disbursements should have been reported as independent expenditures. The committee points to its 2008 Election Cycle Audit as evidence that these expenses have been properly reported. However, the committee has amended its reports to reflect the changes identified by the audit staff.

Finding 4. Recordkeeping for Communications

The committee was unable to gather the documentation requested by the audit staff. The committee has amended its reports to reflect the changes identified by the audit staff.

Finally, due to a serious medical condition of the Treasurer, the amended reports promised at the time of the Interim Audit Response are just now being filed.

Request for Commission Hearing:

Per the Commission's ruling that a committee being audited may request a hearing prior to the Commission's adoption of the Final Audit Report; I, Scott B. Mackenzie as the Treasurer of Freedom's Defense Fund request such a hearing. The topic I wish to discuss is Audit Finding #3: Reporting of Apparent Independent Expenditures.

