



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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2010 FEB -1 A 9:55

January 29, 2010

MEMORANDUM

AGENDA ITEM

To: The Commission

Through: Alec Palmer
Acting Staff Director *AP*

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

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

Tom Hintermister *TH*
Audit Manager

By: Rosa Crussiah *RC*
Lead Auditor

Subject: Report of the Audit Division on Friends for Menor Committee (A07-02)

For Meeting of 04-15-10

Attached for your approval is the subject report. The committee declined an audit hearing and provided the attached response to the draft final audit report. The legal analysis for the draft final audit report is also attached. Other documents related to this report can be viewed on Voting Ballot Matters.

Recommendation

The Audit staff recommends that the report be approved.

This report is being circulated on a tally vote basis. Should an objection be received, it is recommended that the report be considered at the next regularly scheduled open session. If you have any questions, please contact Rosa Crussiah or Tom Hintermister at 694-1200.

Attachments:

Report of the Audit Division on Friends for Menor

Legal Analysis on draft final audit report, dated October 8, 2009

Committee response to the draft final audit report, dated December 21, 2009



Report of the Audit Division on Friends for Menor

May 10, 2006 – December 31, 2006

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 Campaign (p. 2)

Friends for Menor is the principal campaign committee for Ron Menor, Democratic candidate for the U.S. House of Representatives from the state of Hawaii, 2nd District and is headquartered in Honolulu, Hawaii. For more information, see chart on the Campaign Organization, p. 2.

Financial Activity (p. 2)

- **Receipts**
 - From Individuals \$ 134,292
 - From the Candidate 110,000
 - From Political Committees 27,225
 - Other Receipts 48
 - **Total Receipts** \$ **271,565**

- **Disbursements**
 - Operating Expenditures & Other Disbursements \$ 245,498
 - Repayment of Candidate Loans 25,500
 - **Total Disbursements** \$ **270,998**

Findings and Recommendations (p. 3)

- Apparent Impermissible Loans (Finding 1)
- Receipt of a Contribution that Exceeds Limits (Finding 2)

¹ 2 U.S.C. §438(b).

**Report of the
Audit Division on
Friends for Menor**

May 10, 2006 - December 31, 2006

Table of Contents

	Page
Part I. Background	
Authority for Audit	1
Scope of Audit	1
Part II. Overview of Campaign	
Campaign Organization	2
Overview of Financial Activity	2
Part III. Summary	
Findings and Recommendations	3
Part IV. Findings and Recommendations	
Finding 1. Apparent Impermissible Loans	4
Finding 2. Receipt of a Contribution that Exceeds Limits	9

Part I

Background

Authority for Audit

This report is based on an audit of Friends for Menor (FFM), 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 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. 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. 2 U.S.C. §438(b).

Scope of Audit

Following Commission approved procedures, the Audit staff evaluated various risk factors and, as a result, the scope of this audit was limited to the following:

1. The consistency between reported figures and bank records.
2. The disclosure of individual contributors' occupation and name of employer.
3. The receipt of loans and contributions from the Candidate.

Part II

Overview of Campaign

Campaign Organization

Important Dates	Friends for Menor
• Date of Registration	May 25, 2006
• Audit Coverage	May 10, 2006 to December 31, 2006
Headquarters	Honolulu, HI
Bank Information	
• Bank Depositories	1
• Bank Accounts	1 Checking Account
Treasurer	
• Treasurer When Audit Was Conducted	Amadeo P. Manuel
• Treasurer During Period Covered by Audit	Amadeo P. Manuel
Management Information	
• Attended FEC Campaign Finance Seminar	No
• Used Commonly Available Campaign Management Software Package	Yes
• Who Handled Accounting and Recordkeeping Tasks	Treasurer

Overview of Financial Activity (Audited Amounts)

Cash on hand @ May 10, 2006	\$ 0
Receipts	
○ From Individuals	\$ 134,292
○ From the Candidate	110,000
○ From Political Committees	27,225
○ Other Receipts	48
Total Receipts	\$ 271,565
Disbursements	
○ Operating Expenditures & Other Disbursements	\$ 245,498
○ Repayment of Candidate Loans	25,500
Total Disbursements	\$ 270,998
Cash on hand @ December 31, 2006	\$ 567

Part III

Summaries

Findings and Recommendations

Finding 1. Apparent Impermissible Loans

FFM disclosed loans and/or contributions from the Candidate totaling \$75,000 that initially could not be verified as coming from the Candidate's personal funds. These funds were all transferred to FFM from the Candidate's business account and potentially resulted in impermissible contributions. The Audit staff recommended that FFM demonstrate that loans were from the Candidate's personal funds. Absent such a demonstration, the Audit staff recommended that FFM refund any impermissible funds and properly disclose the source of these loans. In response to the interim audit report, FFM provided evidence that all but \$20,500 of the \$75,000 were the Candidate's personal funds. The source of the \$20,500 not considered as the personal funds of the Candidate was determined to be three individuals and a corporation. FFM's receipt of these funds resulted in excessive contributions totaling \$8,780 and a prohibited contribution of \$5,500 from a corporation. For the excessive contributions of \$8,780, FFM is prepared to take whatever corrective action is necessary if the Commission determines the contributions are, in fact, excessive. Regarding the prohibited contribution of \$5,500, FFM maintains there is no evidence to demonstrate that any portion of the \$5,500 loan was the source of funds utilized by the Candidate to make loans to his campaign. (For more detail, see page 4.)

Finding 2. Receipt of a Contribution that Exceeds Limits

FFM reported a \$9,000 loan from the Candidate that was made with funds from a trust. A \$10,000 check was drawn on a trust and made payable to the Candidate's spouse. These funds were deposited into a personal account of the Candidate and his spouse. On the same day, a \$9,000 check signed by the Candidate's spouse was made payable to FFM. The memo line of this check identified the purpose as a loan to FFM. The interim audit report stated that depending on who established the trust and the terms thereof, a possible excessive contribution was made by the Candidate's spouse, the beneficiaries of the trust, or the person(s) who established the trust. The Audit staff recommended that FFM provide evidence demonstrating that the Candidate was legally entitled to the funds received from the trust including information regarding the establishment and terms of the trust. Absent such evidence, FFM likely received an excessive contribution and should refund the excessive portion. In response to the interim audit report, FFM stated the source of the funds was the Candidate's spouse. These funds are contributions to the campaign and subject to the contribution limits. As a result, FFM received an excessive contribution of \$8,526 from the Candidate's spouse. FFM has, however, provided an affidavit from the Candidate's spouse to explain the couple's joint intent in making the loan to FFM from their joint checking account. (For more detail, see page 7.)

Part IV

Finding and Recommendation

Finding 1. Apparent Impermissible Loans

Summary

FFM disclosed loans and/or contributions from the Candidate totaling \$75,000 that initially could not be verified as coming from the Candidate's personal funds. These funds were all transferred to FFM from the Candidate's business account and potentially resulted in impermissible contributions. The Audit staff recommended that FFM demonstrate that loans were from the Candidate's personal funds. Absent such a demonstration, the Audit staff recommended that FFM refund any impermissible funds and properly disclose the source of these loans. In response to the interim audit report, FFM provided evidence that all but \$20,500 of the \$75,000 were the Candidate's personal funds. The source of the \$20,500 not considered as the personal funds of the Candidate was determined to be three individuals and a corporation. FFM's receipt of these funds resulted in excessive contributions totaling \$8,780 and a prohibited contribution of \$5,500 from a corporation. For the excessive contributions of \$8,780, FFM is prepared to take whatever corrective action is necessary if the Commission determines the contributions are, in fact, excessive. Regarding the prohibited contribution of \$5,500, FFM maintains that there is no evidence to demonstrate that any portion of the \$5,500 loan was the source of funds utilized by the Candidate to make loans to his campaign.

Legal Standard

A. Contents of Reports. Each report must disclose for the reporting period and election cycle, the total amount of loans made by or guaranteed by the candidate and the identification of each person who makes, endorses or guarantees a loan to the committee. 2 U.S.C. §434(b)(2)(G) and (3)(E).

B. Contribution Defined. A gift, subscription, loan (except when made in accordance with 11 CFR §§100.72 and 100.73), advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office is a contribution. The term *loan* includes a guarantee, endorsement, and any other form of security. A loan is a contribution at the time it is made and is a contribution to the extent that it remains unpaid. The aggregate amount loaned to a candidate or committee by a contributor, when added to other contributions from that individual to that candidate or committee, shall not exceed the contribution limitations set forth at 11 CFR part 110. A loan, to the extent it is repaid, is no longer a contribution. 11 CFR §100.52(a), (b)(1) and (b)(2).

C. Candidate as Agent of Authorized Committee. Any candidate, who receives a contribution, obtains any loan, or makes any disbursement, in connection with his or her campaign shall be considered as having received such contribution, obtained such loan or

made such disbursement as an agent of his or her authorized committee(s). When an individual becomes a candidate, any funds received, loans obtained, or disbursements made prior to becoming a candidate in connection with his or her campaign shall be deemed to have been received, obtained or made as an agent of his or her authorized committee(s). 11 CFR §101.2(a).

D. Personal Use Defined. Personal use is defined as any use of funds in a campaign account of a present or former candidate to fulfill a commitment, obligation or expense of any person that would exist irrespective of the candidate's campaign or duties as a Federal officeholder. 11 CFR §113.1(g). This includes instances where the Candidate receives funds from others and uses the funds to make loans to the campaign, or directly pay for certain campaign or living expenses. 11 CFR §101.2(a) and 11 CFR §113.1(g).

E. Expenditures by Candidates. Candidates for Federal office may make unlimited expenditures from personal funds. 11 CFR §110.10.

F. Definition of Personal Funds. *Personal funds* of the candidate mean the sum of all of the following:

(a) *Assets.* Amounts derived from any asset that, under applicable State law, at the time the individual became a candidate, the candidate had legal right of access to or control over, and with respect to which the candidate had legal and rightful title or an equitable interest;

(b) *Income.* Income received during the current election cycle, as defined in 11 CFR §400.2, of the candidate, including:

- (1) A salary and other earned income that the candidate earns from bona fide employment;
- (2) Income from the candidate's stocks or other investments;
- (3) Bequests to the candidate;
- (4) Income from trusts established before the beginning of the election cycle as defined in 11 CFR §400.2;
- (5) Income from trusts established by bequest after the beginning of the election cycle of which the candidate is the beneficiary;
- (6) Gifts of a personal nature that had been customarily received by the candidate prior to the beginning of the election cycle, as defined in 11 CFR §400.2; and
- (7) Proceeds from lotteries and similar legal games of chance. 11 CFR §100.33

G. Receipt of Prohibited Contributions – General Prohibition. Candidates and committees may not accept contributions (in the form of money, in-kind contributions or loans):

1. In the name of another; or
2. From the treasury funds of the following prohibited sources:
 - Corporations (this means any incorporated organization, including a non-stock corporation, an incorporated membership organization, and an incorporated cooperative);

- Labor Organizations;
- National Banks;
- Federal Government Contractors (including partnerships, individuals, and sole proprietors who have contracts with the federal government); and
- Foreign Nationals (including individuals who are not U.S. citizens and not lawfully admitted for permanent residence; foreign governments and foreign political parties; and groups organized under the laws of a foreign country or groups whose principal place of business is in a foreign country, as defined in 22 U.S.C. §611(b)). 2 U.S.C. §§441b, 441c, 441e, and 441f.

Facts and Analysis

FFM disclosed loans and/or contributions from the Candidate totaling \$75,000 that could not be verified as coming from the Candidate's personal funds. These funds were all transferred to FFM from the Candidate's business account. Based on an examination of bank statements and other records relating to the Candidate's business account, the Audit staff determined the source of the funds was apparently \$54,000 from two corporations and \$21,000 from an unknown source.

During audit fieldwork, the Audit staff noted several deposits to the Candidate's business account that were made on the same day or just prior to the Candidate's transfers of the same or similar amounts to FFM. The average daily balance in the business account was only \$2,700 during the period when transfers to FFM were made.

The funds from the two corporations were from a mortgage lending company (\$29,000) and a housing construction company (\$25,000). Funds from these two corporations were part of three transfers to FFM from the Candidate's business account. During fieldwork, FFM did not provide documentation to establish that the funds were the personal funds of the Candidate.

FFM also did not provide documentation for the Audit staff to determine the source for the \$21,000 deposited in the Candidate's business account and transferred to FFM. This amount included a \$6,000 deposit made on August 25, 2006 for which the deposit slip has a handwritten notation stating "Cash" and no indication as to its source. On the same day, a \$5,000 transfer from this account was made to FFM. For the remaining \$16,000 in deposits, the Audit staff could not identify the source of the receipts based on the examination of the accompanying deposit slips.

The source for these Candidate loans was discussed at the exit conference. In support of his claim that the amounts were from personal funds, the Candidate provided a letter to the Audit staff which emphasized that contributions to his campaign were never deposited into the law firm account.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that FFM provide evidence demonstrating that \$75,000 transferred to FFM came from the Candidate's personal funds. The evidence was to include records to establish that the funds deposited into the Candidate's business account

meet the definition of *personal funds* in accordance with 11 CFR §110.10(a). The records could include the following:

- Documentation such as copies of contracts, agreements, specific terms of service, and/or billing statements illustrating that the \$75,000 was received for services provided by the Candidate's business.
- For the \$21,000 from an unknown source, FFM was to provide documentation such as copies of checks, bank credit memoranda, or any other records necessary to identify the source of amounts deposited and establish the funds as personal funds of the Candidate.
- Records to demonstrate the monthly financial position of the Candidate's business (i.e. net earnings statements, balance sheets)
- Tax returns or other documentation for calendar year 2006 to establish that the Candidate's business is a sole proprietorship for which the Candidate has legal entitlement to any assets or income.

Absent such evidence, the Audit staff recommended that FFM refund the apparent impermissible amounts (\$75,000) to the original source(s) and amend its reports to properly disclose the source of the loans. FFM was to provide evidence of all repayments of these funds (legible copies of the front and back of the negotiated repayment checks).

In response to the interim audit report, FFM provided a legal service agreement and a counsel retention agreement to establish that all but \$5,500 of the \$54,000 from the two corporations was income for services provided by the Candidate's law firm. Therefore, the Audit staff considered \$48,500 to be the personal funds of the Candidate.

The remaining \$5,500 not considered to be personal funds of the Candidate was from a separate loan extended by the mortgage lending company to the Candidate. For this arrangement, FFM provided a promissory note between the Candidate's law firm and the CEO of the mortgage lending company and asserted that the loan agreement was "negotiated...as part of discussions for the provision of legal services by the candidate to the company."² FFM also provided a declaration from the Candidate stating the purpose of the \$5,500 loan was to "cover general overhead expenses related to [the Candidate's] law practice" and was made "in recognition of [the Candidate's] agreement to represent and perform work on behalf of [the mortgage lending company] in Hawaii, and to foster a positive working relationship between [the Candidate] and his client going forward." The promissory note and the declaration by the Candidate do not establish that the loan was made in exchange for the provision of legal services. Since the proceeds of the loan for \$5,500 have not been established as the Candidate's personal funds, FFM received a prohibited contribution of \$5,500 from the mortgage lending company.

FFM provided the following documents to clarify the source of the \$21,000 and as evidence that the funds were the personal funds of the Candidate. For the \$6,000 cash deposit into the Candidate's business account, FFM documented that the funds

² Although the promissory note was made between the Candidate's law firm and the CEO of the mortgage lending company, the loan proceeds were actually paid by the incorporated mortgage lending company.

represented payment for legal services provided to the same housing construction company as noted above. The Audit staff considered these funds to be the personal funds of the Candidate.

For the remaining \$15,000, FFM provided records indicating the \$10,000 was a personal loan from FFM's Treasurer and spouse. The source of the remaining \$5,000 was a personal loan from another individual. The documentation provided for these personal loans did not indicate that loans were for income earned by bona fide employment, investments, bequests, or customarily received gifts. As such, the proceeds of these loans were not the Candidate's personal funds and resulted in FFM's receipt of excessive contributions from three individuals totaling \$8,780.³ Moreover, FFM's Treasurer and his spouse subsequently waived repayment by the Candidate for \$8,000 of the \$10,000 loan amount in exchange for legal services provided by the Candidate's law firm. A copy of a receipt indicating the repayment of \$3,900 by the Candidate was also provided for the \$5,000 personal loan from the other individual. The repayments on both of these loans by the Candidate totaling \$11,900 (\$8,000 + \$3,900) are considered contributions to FFM. FFM has not filed amended reports to disclose the source of these loans or to report the repayments made by the Candidate as contributions.

Response to Draft Final Audit Report

FFM was provided a copy of the draft final audit report on December 3, 2009 that included the conclusions stated above. In response, the FFM argued that the \$5,500 business loan from the mortgage lending company was permissible because there was no evidence to demonstrate that any portion of \$5,500 was utilized by the Candidate to make loans to FFM since the Candidate's business account maintained a sufficient balance of other permissible funds. FFM also reiterated that neither the Candidate nor the mortgage lending company intended that the proceeds of the loan to be used for campaign purposes. Rather, the Declaration by the Candidate stated the loan proceeds were deposited into the business account to cover law practice related expenses. Such intent was also provided in the aforementioned promissory note which specifies that "repayment of this loan is to be secured by accounts receivable of the Law Offices of Ron Menor." In its response, FFM also indicated that the \$5,500 loan has already been paid in full with interest.

Concerning the \$15,000 in loans resulting in excessive contributions from three individuals, FFM stated that if the Commission determines that these amounts exceeded applicable contribution limits then FFM believes the receipt of these excessive amounts occurred inadvertently and FFM is prepared to work with the Commission to implement whatever corrective actions are necessary. FFM indicated that these loan amounts have been paid in full with interest or the Candidate performed legal services in lieu of repayment of their loans.

³ One of the three individuals also made other contributions totaling \$80 to FFM. The excessive amount from all three individuals is calculated as \$8,780 (Contributions from these three individuals totaling \$15,080 less their combined contribution limit of \$6,300 (\$2,100 x 3)).

Conclusion

With respect to the \$5,500 loaned by the mortgage lending company to the Candidate, the Audit staff maintains that FFM did not establish that the loan proceeds were the personal funds of Candidate. Rather, the loan was used to cover business expenses of the candidate during the campaign. In past Commission opinions regarding funds donated or paid to a candidate during the campaign for personal expenses it was determined that such funds would be subject to the limits and prohibitions of the Act and Commission regulations⁴. The same analysis for funds received by a candidate for personal expenses while campaigning would be applicable to the Candidate's business expenses in this case.

In addition, the Audit staff performed further analysis of the Candidate's business account and it was determined that sufficient unobligated funds were not available to make a transfer of the Candidate's personal funds to FFM and pay other obligations of the Candidate's business without the \$5,500 loan from the mortgage lending company. In fact, without the funds from the mortgage lending company, the business account would have been overdrawn within four days of when the Candidate made the loan to FFM on September 8, 2006.⁵ Therefore, the funds received from the mortgage lending company are considered the source of the Candidate loan to FFM. Based on these facts, the Audit staff concludes the \$5,500 loan from the mortgage lending company results in a prohibited contribution that was accepted by the Candidate on behalf of FFM.

The Audit staff also maintains the \$15,000 in loans from the three individuals were also not the Candidate's personal funds and resulted in FFM's receipt of excessive contributions from three individuals totaling \$8,780.

Finding 2. Receipt of a Contribution that Exceeds Limits

Summary

FFM reported a \$9,000 loan from the Candidate that was made with funds from a trust. A \$10,000 check was drawn on a trust and made payable to the Candidate's spouse. These funds were deposited into a personal account of the Candidate and his spouse. On the same day, a \$9,000 check signed by the Candidate's spouse was made payable to FFM. The memo line of this check identified the purpose as a loan to FFM. The interim audit report stated that depending on who established the trust and the terms thereof, a possible excessive contribution was made by the Candidate's spouse, the beneficiaries of the trust, or the person(s) who established the trust. The Audit staff recommended that FFM provide evidence demonstrating that the Candidate was legally entitled to the funds received from the trust including information regarding the establishment and terms of

⁴ See Advisory Opinions 1976-70, 1976-84, 1978-40, and 1982-64. See also MUR 5922.

⁵ Records did not actually indicate when the \$5,500 from the August 31, 2006 promissory note was deposited. Funds from the mortgage lending company were deposited into the Candidate's business account on September 5, 2006 and September 8, 2006. Without the funds from the mortgage lending company, the Candidate's business account would have been overdrawn when the Candidate loaned funds to FFM on September 5, 2006.

the trust. Absent such evidence, FFM likely received an excessive contribution and should refund the excessive portion. In response to the interim audit report, FFM stated the source of the funds was the Candidate's spouse. These funds are contributions to the campaign and subject to the contribution limits. As a result, FFM received an excessive contribution of \$8,526 from the Candidate's spouse. FFM has, however, provided an affidavit from the Candidate's spouse to explain the couple's joint intent in making the loan to FFM from their joint checking account.

Legal Standard

A. Authorized Committee Limits: An authorized committee may not receive more than a total of \$2,000 per election from any one person.⁶ 2 U.S.C. §441a(a)(1)(A) and 11 CFR §110.1(a) and (b). The Bipartisan Campaign Reform Act of 2002 (BCRA) includes provisions that indexes the individual contribution limit for inflation. The limit for individuals' contributions to candidates for the 2006 election cycle was \$2,100.

B. Handling Contributions That Appear Excessive. If a committee receives a contribution that appears to be excessive, the committee must either:

- return the questionable contribution to the donor; or
- deposit the contribution into a campaign depository and keep enough money on account to cover all potential refunds until the legality of the contribution is established. 11 CFR §103.3(b)(3) and (4).

C. Refund or Disgorge Questionable Contributions. If the identity of the original contributor is known, the committee must either refund the funds to the source of the original contribution or pay the funds to the U.S. Treasury. AO 1996-5.

D. Definition of Personal Funds. *Personal funds* of the candidate mean the sum of all of the following:

(a) *Assets.* Amounts derived from any asset that, under applicable State law, at the time the individual became a candidate, the candidate had legal right of access to or control over, and with respect to which the candidate had legal and rightful title or an equitable interest;

(b) *Income.* Income received during the current election cycle, as defined in 11 CFR §400.2, of the candidate, including:

- (1) A salary and other earned income that the candidate earns from bona fide employment;
- (2) Income from the candidate's stocks or other investments;
- (3) Bequests to the candidate;
- (4) Income from trusts established before the beginning of the election cycle as defined in 11 CFR §400.2;

⁶ Person refers to an individual, partnership, or any group of persons, not including the federal government. 11 CFR §100.10.

- (5) Income from trusts established by bequest after the beginning of the election cycle of which the candidate is the beneficiary;
- (6) Gifts of a personal nature that had been customarily received by the candidate prior to the beginning of the election cycle, as defined in 11 CFR §400.2; and
- (7) Proceeds from lotteries and similar legal games of chance. 11 CFR §100.33

Facts and Analysis

FFM reported a \$9,000 loan from the Candidate that was made with funds from a trust. A check for \$10,000 was drawn on a trust and made payable to the Candidate's spouse. This check was deposited into a joint personal account of the Candidate and his spouse. On the same day as this deposit, a \$9,000 check from this joint personal account was deposited into the FFM campaign account. The check to FFM was signed by the Candidate's spouse and included a notation "loan to campaign" on the memo line. It is noted that the balance in this joint personal account on the day prior to the deposit of funds from the trust was not sufficient to allow for the transfer of the \$9,000 to FFM. In addition, the average daily balance of the joint personal account for the period audited was only \$2,600.

During audit fieldwork, FFM did not provide documentation regarding the terms of the trust or the identity of the beneficiary of the trust or the person(s) that established the trust. It was also not known what relationship the Candidate's spouse had with the trust or the trustees. Therefore, absent evidence that the Candidate was entitled to the funds, the Audit staff considered the source of the funds for the loan to FFM to be either the Candidate's spouse or the trust. Given the above, it appeared that either the Candidate's spouse or the person(s) who established the trust made an excessive or potentially prohibited contribution to FFM.⁷

At the exit conference, the Audit staff discussed this issue with FFM's treasurer. No additional documentation that demonstrates the Candidate was entitled to the funds from the trust was provided.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that FFM:

- Provide evidence demonstrating that the contribution was not excessive or prohibited. Such evidence was to include documentation demonstrating the Candidate's entitlement to the funds from the trust and the purpose of the \$10,000 check issued to the Candidate's spouse from the trust account. FFM also was to provide information regarding the person(s) who established the trust and the beneficiary of the trust.
- Absent such evidence, FFM was to refund the excessive portion of the contribution or, if determined to be a prohibited contribution, FFM was to refund the entire contribution. Alternatively, FFM was to make a disgorgement to the U.S. Treasury. FFM was to provide evidence of contribution refunds with copies of the front and back of negotiated refund checks.

⁷ The amount from the trust account may be considered a prohibited contribution depending on the identification of the beneficiary.

- If funds are not available to make the necessary refunds, FFM was to disclose the contributions requiring refunds on Schedule D (Debt and Obligations) until funds become available to make such refunds.

In response to the interim audit report, FFM states that the source of the \$10,000 was the Candidate's spouse. FFM also explained that it was their understanding that under Federal law a Candidate's spouse could contribute or lend an unlimited amount of his/her personal funds to the Candidate's campaign. However, funds given to or loaned to a candidate from any person, including a relative or friend of the candidate, are not considered the personal funds of the Candidate. Instead, the \$9,000 is a contribution from the Candidate's spouse to FFM and subject to the contribution limits. Therefore, FFM received an excessive contribution of \$8,526 from the Candidate's spouse.⁸

Response to Draft Final Audit Report

FFM was provided a copy of the draft final audit report on December 3, 2009 that included the conclusions stated above. In response, FFM requested that the Commission consider whether a portion of the \$9,000 loan be construed as coming from the Candidate himself pursuant to the presumptive reattribution regulations at 11 CFR 110.1(k)(3)(ii)(B)(1). FFM provided an affidavit from the Candidate's spouse indicating that she issued and signed a \$9,000 check to FFM under the direction of the Candidate who is a co-owner of the joint account.

Conclusion

The Audit staff maintains that the source of the funds loaned to FFM was the Candidate's spouse and resulted in an excessive contribution to FFM. As acknowledged by FFM, the funds from the trust were those solely of the Candidate's spouse. In addition, the joint personal account would not have had sufficient funds to loan to FFM without the deposit of funds from the trust. The Audit staff also maintains that the affidavit from the Candidate's spouse does not establish that the Candidate's personal funds were the source of the funds loaned to FFM.

⁸ The Candidate's spouse made other contributions totaling \$1,626 to FFM. The excessive amount is calculated as \$8,526 (\$9,000 loan + \$1,626 other contributions - \$2,100 contribution limit).



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

October 8, 2009

MEMORANDUM

TO: John D. Gibson
Chief Compliance Officer

Joseph F. Stoltz
Assistant Staff Director
Audit Division

THROUGH: Robert A. Hickey *R.A.H.*
Staff Director

FROM: Christopher Hughey *pch*
Deputy General Counsel

Lawrence L. Calvert, Jr. *L.L.C.*
Associate General Counsel
General Law and Advice

Lorenzo Holloway *L.H.*
Assistant General Counsel
Public Finance and Audit Advice

Allison T. Steinle *ATS*
Attorney

SUBJECT: Proposed Final Audit Report on Friends for Menor (LRA 732)

I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Final Audit Report ("FAR") on Friends for Menor ("the Committee"). Our comments address: (1) Apparent Impermissible Loans; and (2) Receipt of a Contribution that Exceeds Limits. If you have any questions, please contact Allison T. Steinle, the attorney assigned to this audit.

II. FINDING 1 – APPARENT IMPERMISSIBLE LOANS

The candidate reported making a total of \$110,000 in loans to the Committee. Finding 1 involves \$75,000 of these loans, which were drawn from the candidate's business account,¹ that had not been verified as coming from the candidate's personal funds. The proposed FAR concludes that two legal services agreements and a loan agreement are sufficient to establish that \$60,000 of the \$75,000 in loans were from the candidate's personal funds. However, the proposed FAR concludes that the remaining \$15,000 in loans were not the candidate's personal funds, but rather excessive contributions resulting from a \$10,000 personal loan from the Committee's treasurer and his spouse and a \$5,000 personal loan from an individual.

We begin our analysis of this finding with the law that governs candidates who finance their own campaigns. Candidates may make unlimited expenditures from their own personal funds to finance their own campaigns. 11 C.F.R. §§ 100.33, 110.10. Personal funds include any income earned during the election cycle, including any salary or income from bona fide employment, investments, bequests, or customarily received gifts. 11 C.F.R. § 100.33. However, funds that do not qualify as the candidate's personal funds are regarded as coming from a source other than the candidate. For example, candidates who receive contributions or obtain loans from others for use in connection with their campaigns are considered to be acting as agents of their authorized committees, and the individual or entity that is the source of the funds is considered to have made a contribution to the committee. 2 U.S.C. § 432(e)(2); 11 C.F.R. § 101.2(a). This includes instances where the candidate receives funds from others and uses the funds to make loans to the campaign, or directly pay for certain campaign or living expenses. *See* 11 C.F.R. §§ 101.2(a), 113.1(g). The central issue in this finding is whether the funds that flowed into the business account were the personal funds of the candidate that he could use in connection with the campaign in an unlimited amount, or were contributions from others that the candidate accepted as an agent of his campaign.

The proposed FAR does not explain what legal standard the Audit Division has applied to determine whether certain funds in the business account were contributions from others that the candidate accepted as an agent of his campaign. Therefore, for each source of funds deposited into the business account, we suggest that the FAR provide a more detailed explanation of why the Audit Division has concluded those funds were or were not the personal funds of the candidate, consistent with the legal standard set forth above.

Of the \$75,000 in loans the candidate made to the Committee, \$15,000 of these loans were made using funds from a \$10,000 personal loan to the candidate from the Committee's treasurer and his spouse and a \$5,000 personal loan to the candidate from an individual. Both of these loans were deposited into the business account. We understand that the proposed FAR concludes that the proceeds from the two personal loans were not the candidate's personal funds

¹ The Committee has stated and the Audit Division has confirmed that the candidate's business, a law practice, is a sole proprietorship. If the candidate's business was incorporated or an LLC treated as a corporation for tax purposes at the time it made the loans to the Committee and had not made a proper distribution to the candidate, the business would be the entity making the loans to the Committee in violation of 2 U.S.C. § 441b(a).

because there was nothing indicating that they were income earned from bona fide employment, investments, bequests, or customarily received gifts. *See* 11 C.F.R. § 100.33. If this is correct, then we concur with the Audit Division, but suggest that it clarify its analysis to explain why it has concluded that the proceeds from the loans were not the candidate's personal funds.

The remaining \$60,000 in loans at issue were made by the candidate to the Committee using funds received by the candidate's business account from two corporations. The proposed FAR concludes that the payments from the corporations to the Committee were bona fide income made in consideration for the candidate's provision of legal services and therefore the candidate's personal funds, which he could lend to the Committee in an unlimited amount. The deposits of funds from the two corporations to the business account were made on the same day or just prior to the candidate's loans of similar amounts to the Committee. We address these loans separately because they raise additional issues.

The candidate's business received \$30,000 from a mortgage lending company and \$36,000 from a housing construction company, for a total of \$66,000 from the two corporations. The Committee has provided legal services agreements establishing that \$60,500 received from the two corporations (\$24,500 from the mortgage lending company and the entire \$36,000 from the housing construction company) was bona fide income made in consideration for legal services and therefore the personal funds of the candidate.

The legal services agreement between the mortgage lending company and the candidate's law practice provided for the mortgage lending company to pay a flat fee of \$24,500. The remaining \$5,500 the candidate received from the mortgage lending company appears to be the proceeds of a \$5,500 loan to the candidate's law practice from the mortgage lending company. The Committee has provided a loan agreement for \$5,500 that appears to be between the law practice and the president and CEO of the mortgage lending company personally. However, the loan amount was actually paid by the incorporated mortgage lending company, which made three \$10,000 payments for a total of \$30,000 in payments to the candidate's business.

The Committee asserts that the proceeds of the \$5,500 loan also were the candidate's personal funds because the loan agreement was "negotiated . . . as part of discussions for the provision of legal services by the candidate to the company." *See* Committee Response at 2. However, we have no documentation, other than the Committee's unsworn statement in its response to the IAR, that the loan was actually negotiated in exchange for the provision of legal services. The legal services agreement between the mortgage lending company and the candidate did not mention this, or any, loan. In addition, the promissory note provided by the Committee does not mention the legal services agreement or the provision of legal services. Thus, we believe that, if this \$5,500 loan is considered to be part of the \$60,000 the candidate lent to the Committee, the Committee has not adequately documented that the loan was made in exchange for the provision of legal services, and therefore has not adequately documented that this amount was the candidate's personal funds. Because the Committee has not adequately documented that the proceeds of the loan were the candidate's personal funds, if the candidate then made those proceeds available to the Committee in connection with the campaign, the loan should be treated as a prohibited corporate contribution from the mortgage lending company.

However, there is an accounting question as to whether the candidate in fact made this \$5,500 available to the Committee in connection with the campaign. The three \$10,000 payments made by the mortgage lending company, along with a \$15,000 payment from the housing construction company, funded a \$9,000 loan and a \$30,000 loan to the Committee.² In other words, the candidate made a total of \$39,000 in loans to the Committee using \$45,000 in funds derived from the corporations, leaving \$6,000 in the business account. While this \$6,000 was not used by the candidate in connection with the campaign, it would be impossible to determine the source of the funds left in the business account.³ The source may have been the \$5,500 loan from the mortgage lending company, the fees from the mortgage lending company or housing construction company that were the personal funds of the candidate, or some combination thereof.

To assist the Commission in resolving this issue, we suggest that the Audit Division raise and consider the following points. On the one hand, if the Commission adopts an accounting rule that gives the Committee the benefit of the doubt and assumes that only permissible personal funds of the candidate were transferred to the Committee, then in future cases candidates could circumvent the contribution prohibitions and limitations simply by depositing a minimum amount of personal funds in the account alongside prohibited or excessive contributions and never loaning their committees more funds than the minimum amount in the account. For example, a candidate with \$2,000,000 in personal funds in an account could easily launder a \$1,500 prohibited contribution through that account to his or her committee by claiming the source was the \$2,000,000 in personal funds rather than the \$1,500 prohibited contribution. On the other hand, if the Commission concludes that it will assume the source of the funds was at least partially from a prohibited or excessive source, this may inadvertently limit the ability of candidates to use legitimate personal funds from their business accounts to make loans on behalf of their campaigns. While either of these options has significant drawbacks, there appear to be no other courses of action available. Consequently, we generally recommend that the Audit Division adopt one of these rules and raise the issue with the Commission in its cover memorandum to the FAR, noting that the Commission will have to choose between the competing interests discussed above. We also note that if the candidate had already committed some of the funds in the business account, then they were not available as personal funds for him to loan to the Committee. Moreover, if some of the funds were already committed, the candidate could not use the additional \$5,500 to "free up [the \$24,500] for campaign purposes . . ." Cf. Advisory Opinion 1982-64 (Ron Hein for Congress) (applying the same analysis for funds received by a candidate for living expenses while campaigning).

² On September 5, 2006, the candidate deposited a \$10,000 check from the mortgage lending company, and made a \$9,000 loan to the Committee on the same day. On September 8, 2006, the candidate deposited the other two \$10,000 checks from the mortgage lending company and a \$15,000 check from the housing construction company, and made a \$30,000 loan to the Committee on the same day.

³ Specifically, it is our understanding that in this case it would be impossible for the Audit Division to apply generally accepted accounting principles such as LIFO or FIFO to accurately determine the source of the \$6,000 left in the business account. LIFO and FIFO are based on the chronology of transactions, and because it is not possible to know the exact chronology of the transactions here, the Audit Division cannot pinpoint which transaction was the source of the cash balance left in the business account on September 8, 2006.

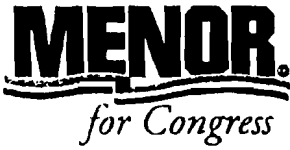
If the Commission concludes that the candidate in fact made the \$5,500 loan from the mortgage lending company available to the Committee in connection with the campaign, we conclude that the loan was a prohibited corporate contribution that was accepted by the candidate on behalf of the Committee. If the Commission concludes that the source of the funds loaned to the Committee was entirely personal funds and not the \$5,500 loan, we concur with the Audit Division that \$60,000 of the \$75,000 in loans were from the candidate's personal funds. However, we note that even if the Commission concludes that the \$5,500 loan was not the source of funds loaned to the Committee, the \$5,500 loan could still become an excessive contribution if the candidate used these funds to pay for certain campaign or living expenses while he was campaigning. *See* 11 C.F.R. §§ 101.2(a), 113.1(g).

III. FINDING 2 – RECEIPT OF A CONTRIBUTION THAT EXCEEDS LIMITS

Finding 2 involves a \$9,000 loan from a joint checking account held by the candidate and his spouse that had not been verified as coming from the candidate's personal funds. The loan was made with a check signed only by the candidate's spouse with a notation in the memo line reading "loan to campaign," using funds deposited into the joint checking account from an unknown trust account. The proposed FAR concludes that the candidate's spouse made an excessive contribution to the Committee.

When one party signs a check from a joint account, the Commission generally will consider the contribution to be made from the contributor who signed the check. *See* 11 C.F.R. §§ 100.51(b), 110.1(k). Because the spouse signed the check drawn from the joint checking account, the presumption is that the contribution from the joint checking account was made by the spouse. *Id.* The Committee could rebut this presumption by showing that candidate intended to make the contribution. However, the Committee explicitly states that the spouse intended to use her own funds to make the loan to the campaign for purposes of supporting her husband's candidacy. *See* Committee Response at 4. Therefore, we concur that the candidate's spouse made an excessive contribution to the Committee.⁴

⁴ Because the Audit Division initially was unable to determine the source of the funds deposited in the joint checking account, there remained a possibility that the \$10,000 contribution from the candidate's spouse had been a contribution in the name of another. *See* 2 U.S.C. § 441f. The Committee, however, now states that the source of the funds deposited in the joint checking account was proceeds from the sale of stock by the candidate's spouse, and submitted tax returns indicating that the candidate and his spouse had reported and paid capital gains tax on this payment. *See* Committee Response at 4. Accordingly, we conclude that there is no indication that the \$10,000 contribution from the candidate's spouse was a contribution in the name of another.



December 21, 2009

Joseph F. Stoltz
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Audit Division
Federal Election Commission
Washington, D.C. 20463

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Honolulu, HI 96813

Telephone:

(808) 524-7773

Re: Draft Audit Report

Dear Mr. Stoltz:

We have had an opportunity to review the above-referenced draft audit report. Please be advised that based on our review, we continue to have strong objections to the findings and recommendations contained therein, and therefore would respectfully request that the report be amended to reflect our concerns. The reasons for our objections are discussed below.

I. The \$5,500 Business Loan Received By The Candidate and Deposited Into His Law Firm Account Was Not A Prohibited Contribution.

In its draft audit report, the Audit Division questioned the permissibility of a \$5,500 business loan that was furnished to the Candidate by a mortgage lending company, and rendered a finding that the loan constituted a "prohibited contribution." However, such a finding presupposes that the proceeds from this loan, which were deposited into the Candidate's law account, were the source of funds for the loans that the Candidate made to his campaign. In other words, as the Commission's Office of General Counsel indicated on page 3 of its Memorandum attached to the draft audit report, the business loan should be treated as a prohibited corporate contribution "if the candidate then made those proceeds available to the Committee in connection with the campaign . . ." (Emphasis added).

The problem with the Commission's finding is that there is no evidence to demonstrate that any portion of the \$5,500 loan was utilized by the Candidate to make loans to his campaign. The Office of General Counsel acknowledged this fact. On page 4 of its Memorandum, it concluded that based on generally accepted accounting principles, it is impossible for the Commission to accurately determine that loan proceeds from the mortgage lending company were the source of the loans that were deposited into the campaign account.

Friends for

Menor

Campaign Committee

Absent clear evidence showing that the Candidate utilized funds from the business loan to finance his campaign, it would be unfair and prejudicial to the Candidate for the Commission to render a finding that the loan was "prohibited" under federal elections law. Furthermore, we would respectfully submit that the campaign committee is entitled to the benefit of the doubt regarding this issue for several reasons. First of all, the Candidate and the mortgage lending company never intended that the proceeds of the loan were to be used for campaign purposes. The Candidate attempted to make clear in the Declaration that he submitted to the audit staff in response to the interim draft audit report that he deposited the loan proceeds into his law account, to cover law practice related expenses. As the committee has stated previously, the plain language of the promissory note specifies that "[r]epayment of this loan is to be secured by accounts receivable of the Law Offices of Ron Menor." The parties included this language to make clear that funds were being loaned to the Candidate in connection with his law practice.

In this regard, it should be noted that on page 4 of its Memorandum, the Office of General Counsel indicated that out of the \$45,000 in funds (which included the \$5,500 business loan) that were deposited into the campaign account), the Candidate made a total of \$39,000 in loans to the Committee, leaving \$6,000 in the law account which were not used in connection with the campaign. The fact that the Candidate retained in his law account almost the exact same amount that he had borrowed from the mortgage lending company demonstrates that the proceeds from the business loan were being held in reserve for the Candidate's law practice, and not for campaign purposes, and the proceeds from the loan were in fact not used for campaign purposes.

II. The Commission Should Consider Amending The Finding of The Audit Division Concerning the \$9,000 Loan from the Candidate's Joint Checking Account.

The Audit Division concluded that the \$9,000 loan from the Candidate's joint checking account to the campaign was impermissible because it exceeded limits that are applicable to personal loans or contributions from the Candidate's spouse. The audit staff rendered this finding because the Candidate's spouse signed the check drawn from the joint checking account, and the Committee stated in its written response to the interim draft report that the spouse intended to make a personal loan to the campaign.

While it is true that the spouse intended to make a loan to the campaign, we would respectfully ask the Commission to consider whether a portion of the \$9,000 loan check could be construed as coming from the Candidate himself, pursuant to the applicable rule cited in the draft audit report. As is stated on page 5 of the draft report, the Committee can rebut the presumption that a contribution from a joint checking account was made solely by the spouse "by showing the Candidate intended to make the contribution."

In the instant case, there clearly was an intent on the part of the Candidate to make a loan to the campaign from the joint check account. In this regard, we are furnishing to the Commission an Affidavit from the Candidate's spouse indicating that she issued and signed a check in the amount of \$9,000 payable to the campaign because the Candidate directed and asked her to do so. (See Affidavit of Patricia Menor attached hereto and made a part hereof.) The Candidate of course was legally entitled to direct that funds in the joint account be used for campaign purposes as a co-owner of the account. Therefore, based on the Commission's own rule, it should consider an amendment to the audit staff's findings to reflect the fact that the \$9,000 loan was based on a joint and mutual decision on the part of Candidate and his spouse to use monies from the joint bank account for the campaign.

There is another important matter that we need to bring to the Commission's attention. It appears that the audit staff has attributed an additional \$1,626 in contributions to the Candidate's spouse. We have reviewed our records and have been unable to verify that she made any contribution in this amount. The Committee would appreciate clarification on this point.

In light of our strong objections to the findings and recommendations in the draft audit report, the committee had considered requesting a hearing on this matter before the Commission. However, given the considerable time and expenses that would be involved in contesting the findings and in the interests of bringing closure to this audit, which was initiated close to three years ago, we have decided to forego a hearing request and to have the Commission render a decision based on the record.

With respect to the remaining loans totaling \$15,000 which the Audit Division has questioned, we would like the Commission to know that if it determines that these loans exceeded applicable limits, this occurred inadvertently and we are prepared to work with the Commission to implement whatever corrective actions are necessary.

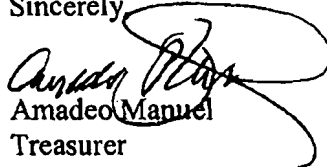
III. Status of Loans from the Candidate to the Campaign.

For the information of the Commission, the bulk of the loans delineated in the draft audit report have been fully paid. The \$5,500 loan from the mortgage lending company and the \$5,000 loan from another individual have already been paid in full with interest. Moreover, the Candidate performed legal work for the campaign treasurer and his spouse in lieu of a repayment to them for the loan that they made. Finally, the Committee is prepared to refund to the Candidate's spouse amounts loaned from the joint checking account if the Commission deems it appropriate, and amend its reports as necessary to reflect the foregoing.

Letter to FEC
Draft Audit Report
Page 4

We hope that this written response has been helpful. As always, please feel free to contact us should you need additional information.

Sincerely



Amadeo Manuel
Treasurer
Friends for Menor

Attachment

AFFIDAVIT OF PATRICIA MENOR

STATE OF HAWAII)
) SS:
CITY AND COUNTY OF HONOLULU)

PATRICIA MENOR, being duly sworn on oath, deposes and says:

1. Affiant is a resident of the City and County of Honolulu and is the spouse of Ron Menor.

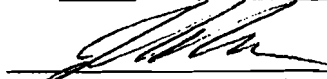
2. Her husband was a candidate for a seat in the United States House of Representatives in the Second Congressional District during the 2006 elections.

3. In furtherance of her husband's campaign, Affiant issued and signed a check in the amount of \$9,000. payable to his campaign committee from a joint account held by her and her husband. Affiant agreed to issue the check after her husband directed and asked her to do so because the campaign needed additional funds. Affiant was also instructed by her husband to make a notation on the check that the amount being withdrawn from their joint checking account was a loan from them to the campaign committee.


FURTHER AFFIANT SAYETH NAUGHT.


_____ PATRICIA MENOR

Subscribed and sworn to before me
this 21st day of December, 2009.



Notary Public, State of Hawaii
Print Name: Jessica E Weaver
My Commission Expires: August 20, 2010
NOTARY PUBLIC CERTIFICATION
Jessica E. Weaver First Judicial Circuit
Doc. Description: Affidavit of
Patricia Menor

No. of Pages: 1 Date of Doc. 12/21/09


Notary Signature Date

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CASE INDEX FORM

CASE NO. & NAME: Friends for Menor (A07-02)

STAFF ASSIGNED: Tom Hintermister & Rosa Crussiah

TELEPHONE: Audit - 202-694-1200

<u>DATE</u>	<u>DOCUMENT</u>
1/5/2007	Doc 1- RAD Referral
4/1/2007	Doc 2- Audit Scope Worksheet
4/20/2007	Doc 3- Memo to Revise Audit Scope
4/25/2007	Doc 4- Certification for Revised Scope
3/12/2008	Doc 5- Legal Analysis
7/2/2008	Doc 6- Addendum to Legal Analysis
2/10/2009	Doc 7- Interim Audit Report
4/3/2009	Doc 8- Cmte Response to Interim Report
10/08/09	Doc 9- Legal Analysis on Draft Final Audit Report
12/03/09	Doc 10- Draft Final Audit Report (FAR)
12/21/09	Doc 11- Cmte Response to Draft FAR

The above documents can be found at the following server location:
\\Ntsrv1\ voting ballot matters\Audit\Friends for Menor

If you have any questions, please contact (*Tom Hintermister*) at 694-1200.