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# DRAFT FINAL AUDIT REPORT RESPONSE

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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 7<sup>th</sup>. 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.



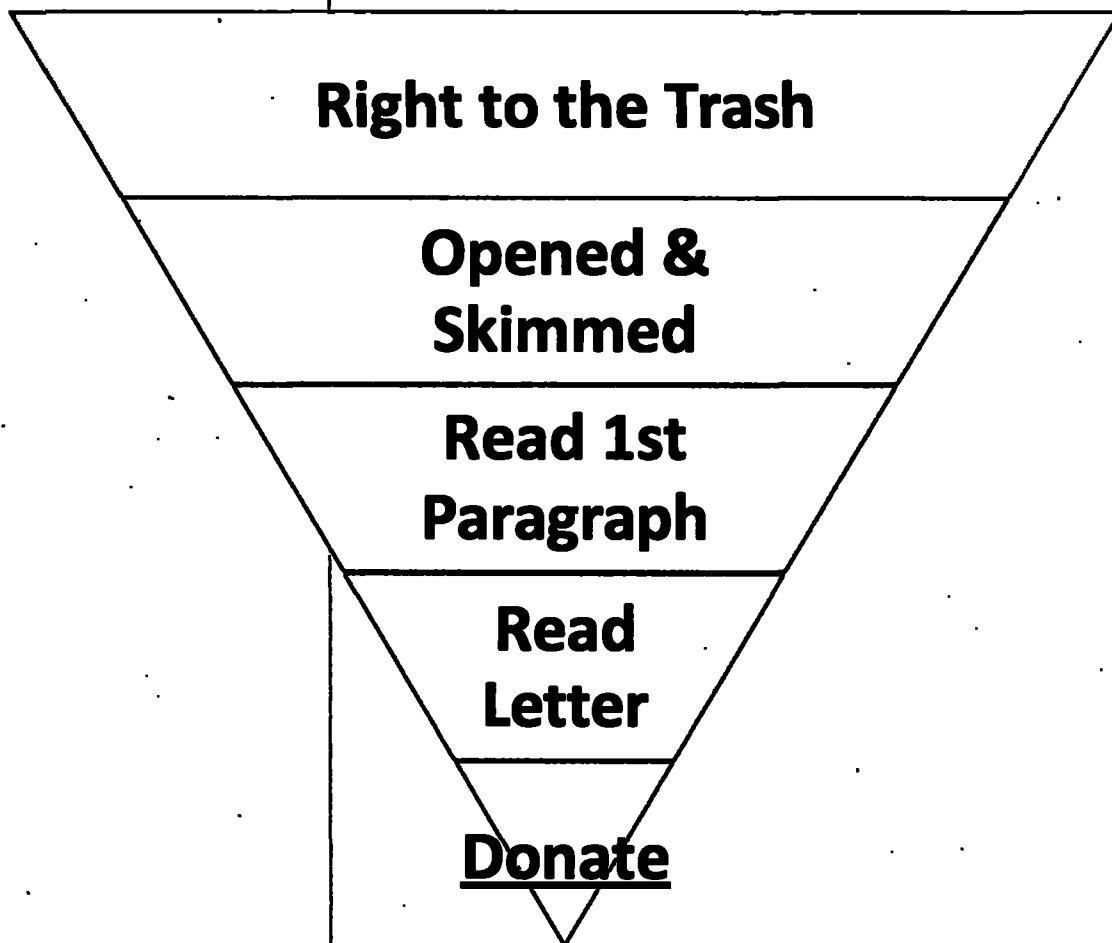
### **Direct Mail: Solicitations v. Voter Persuasion**

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 31<sup>st</sup>...*

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.

