San Francisco Ethics Commission

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Campaign Finance Audit Report:

Dean Preston for Supervisor 2019

FPPC ID #: 1408942

January 1, 2018 – December 31, 2019

Introduction

Public disclosure of election campaign activity is essential to voters making informed decisions. The Political Reform Act (California Government Code [CA Gov. Code] Section [Sec.] 81000 et seq.) and supporting regulations, and the San Francisco Campaign Finance Reform Ordinance (San Francisco Campaign & Governmental Conduct Code [SFC&GCC] Sec. 1.100 et seq.) and supporting regulations, were established to impose reasonable disclosure requirements to reveal information about election campaign activity. By requiring proper and timely disclosure of campaign activity pertaining to contributions, loans, expenditures, and accrued expenditures, the laws and regulations are designed to inform voters and deter improper practices.

To promote campaign compliance with laws and regulations, the San Francisco Ethics Commission (hereinafter "the Commission") conducted an audit of **Dean Preston for Supervisor 2019: 1408942** (hereinafter "the Committee") covering the audit period January 1, 2018, through December 31, 2019. This Audit Report summarizes the results for the audit.

Authority

The Commission has a duty and responsibility under San Francisco Charter Sec. C3.699-11(4) to audit campaign statements and other relevant documents that are filed with the Commission to ensure compliance with applicable state and city campaign finance laws and regulations. Under SFC&GCC Sec. 1.150(a), all candidate committees whose candidates have received public financing must be audited and committees that have not received public financing may be randomly selected for audit at the discretion of the Executive Director of the Commission.

Objectives and Scope

The objective of the audit was to reasonably determine whether the Committee substantially complied with requirements of the Political Reform Act Sec. 81000 et seq. and supporting regulations, and the San Francisco Campaign Finance Reform Ordinance Sec. 1.100 et seq. and supporting regulations. The audit was performed based on a review of the Committee's filings and records covered by the audit period to determine, among other things:

- Compliance with campaign activity disclosure and record-keeping requirements, and
- Compliance with applicable campaign activity limits, restrictions, and prohibitions.

As a recipient of public financing, the Committee was subject to mandatory audit.

Nothing in this report shall be interpreted to prevent an enforcement action by the Commission or another appropriate agency for conduct in violation of the law, whether or not that conduct is covered by this report.

This report will be forwarded to the Commission's Enforcement Division for review to determine whether any further action may be warranted.

Auditee Information

Background

At all times relevant to the audit, the Committee's primary purpose was to support the election of Dean Preston to the Board of Supervisors, District 5, for the City and County of San Francisco (the City) in the November 5, 2019, election. During the period covered by the audit, the Committee's Treasurer was Albany Aroyan. The Committee was established on August 7, 2018, and remains open as of the time of this report.

Committee Reported Activity

	Total Funds Raised	Total Expenditures Made
Private Contributions	$288,091	
Public Funds Received	$155,000	
	$443,091	**$438,591**

The committee activity totals were taken from disclosure statements filed with the Commission covering the period January 1, 2018, through December 31, 2019.

Unexpended Public Funds

As defined by SFC&GCC Sec. 1.104, "unexpended public funds" shall mean all funds remaining in the candidate committee's account on the 30th day after the candidate controlling the committee is either elected or not elected to office, regardless of the source of the funds, but shall not exceed the amount of public funds provided to the candidate. Funds raised after this date are not unexpended funds. Under SFC&GCC Sec. 1.148(c) and Regulation 1.148-1, candidate committees that receive public funds are required to pay unexpended public funds to the City and deliver to the Commission those funds for deposit in the Election Campaign Fund no later than 30 days after the Commission completes its audit of the committee. Unexpended public funds may be reduced by a limited range of expenses incurred after the election that do not directly affect the outcome of the election, including expenses associated with an audit such as bank fees, treasurer fees, and storage fees, until the Commission completes its audit of the committee.

Per review of documents and records, Auditor determined that the Committee may have unexpended public funds estimated to be approximately $2,363.46. It is recommended that the Committee determine the final amount of unexpended public funds that should be paid to the City and ensure the funds are paid no later than 30 days after the Commission completes the audit.

Audit Respondent

The Audit Respondent identified below was the primary audit contact during the audit and responded to audit inquiries and requests on behalf of the Committee.

Albany Aroyan
584 Castro Street #2230
San Francisco, CA 94114

Audit Findings

The CA Gov. Code Sec. 81000 et seq. and supporting regulations, and SFC&GCC Sec. 1.100 et seq. and supporting regulations, require campaign committees to timely disclose information about election campaign activity and adhere to applicable campaign activity limits, restrictions, and prohibitions.

The following findings were noted during the audit:

Campaign Bank Account Activity

1. Per SFC&GCC Sec. 1.122(b)(1), "…funds in a candidate committee's campaign account may be used only on behalf of the candidacy for the office …or for expenses associated with holding that office," so long as they are "reasonably related to a legislative, governmental, or political purpose." Similarly, CA Gov. Code Sec. 89510(b) deems funds deposited into the campaign account to be "held in trust" for expenses associated with the election of the candidate or for expenses associated with holding office. And under CA Gov. Code Sec. 89512(a), spending is only within the lawful execution of that trust if it is related to political purposes when seeking office, or legislative or governmental purposes when holding office.

   CA Gov. Code Sec. 84211(b) requires committees to report "the total amount of expenditures made" during each relevant reporting period. CA Gov. Code Sec. 84211(i) requires reporting on the total amount of expenditures made to persons who received $100 or more, while CA Gov. Code Sec. 84211(j) requires reporting on the total amount of expenditures made to persons who received under $100. CA Gov. Code Sec. 84211(k) states that committees must also include on each relevant campaign statement the personal information for each person to whom an expenditure of more than $100 was made.

   In general, CA Gov. Code Sec. 82025(a) and (b) state that the definition of expenditure does not include spending where "it is clear from surrounding circumstances" that the payment is for personal and not political purposes, and is unrelated to the candidacy. But CA Gov. Code Sec. 84211(k)(6) notes that for the purposes of Sections 84211(i), (j), and (k), the terms expenditure and expenditures "mean any individual payment or accrued expense," unless it is clear that a series of payments are for a single service or product. This broader definition also matches the language on the Fair Political Practices Commission (FPPC) instructions for Form 460 campaign statements, where Schedule E gives instructions to "Report payments," rather than the more narrow "expenditures," and instructs filers that "For each payment of $100 or more made during the period, report the name and…address[.]" These reporting requirements allow relevant agencies to reconcile all committee activity and monitor for restricted transactions.

   Per review of records and documents provided for audit, Auditor determined the following:

   - A withdrawal entry made from the Committee campaign bank account on October 28, 2019, in the amount of approximately $1,008, and a deposit entry made to the Committee campaign bank account on October 31, 2019,

in the amount of approximately $1,008, were not disclosed on campaign statements filed for the audit period.

The Respondent stated that the withdrawal entry represented a withdrawal made in error by a campaign worker who mistakenly used the campaign account for a student loan payment, and the deposit entry represented a deposit made to rectify the mistaken withdrawal. The Respondent provided documentation supporting the claim that this was a withdrawal made in error by a campaign worker. Auditor could not verify that claim, but the audit also did not find any evidence to contravene that claim. However, even if the withdrawal was made in error, this still represents a potential misuse of campaign funds because a payment was made using funds held in trust in the campaign account, and that payment was not used "on behalf of the candidacy for office…or for expenses associated with holding that office." SFC&GCC Sec. 1.122(b)(1).

The withdrawal of funds from and deposit of funds into the campaign bank account likely should be disclosed in campaign statements to ensure transparency of campaign bank account activity. Per the reporting requirements described above, the withdrawal entry from the campaign bank account on October 28, 2019, likely should have been reported on the Committee's campaign statement on Schedule E (Payments Made). The Committee likely should also have reported the October 31, 2019, deposit entry to the campaign bank account on the Committee's campaign statement on Schedule I (Miscellaneous Increases to Cash).

In response to the finding, the Respondent provided a rebuttal. The Commission has summarized and addressed each point of the rebuttal below and included the rebuttal in the **Appendix**.

Respondent Response #1: The Commission's interpretation of local campaign disclosure requirements should align with the informal FPPC email advice obtained and provided that suggests different disclosure requirements for the transactions in question.

Commission Response

The audit finding is based on the Commission's interpretation of the San Francisco Campaign and Governmental Conduct Code (SFC&GCC) and the Political Reform Act (PRA), as incorporated by SFC&GCC Sec. 1.106, and as applied to elections and behavior occurring in the City and County of San Francisco. The Commission has jurisdiction under the above laws. The Commission recognizes and appreciates the formal and informal guidance provided by the FPPC as a mechanism to promote

compliance with the PRA. For the reasons described below, the Commission stands by the audit finding as included in this report.

First, the Respondent did not seek or obtain a formal opinion from the FPPC on this matter. The Commission would accord a formal opinion with more weight in these circumstances.

Second, the Respondent did not seek or obtain any contemporaneous advice – formal or informal – at or around the time of the Committee's transactions in question. The Committee was therefore not acting in reliance on any advice at the time of the transactions in question. The Commission's audit finding is based on the fact that the Committee did not seek advice, and was not relying on advice, at the time of the conduct in question.

Third, the Commission identified several deficiencies or inconsistencies with the way the Respondent sought advice ex post facto from the FPPC. Upon receiving notice from the Auditor that the transactions in question per campaign bank statements could not be traced to the Committee's campaign statements, and a request for additional supporting documentation, the Respondent contacted the FPPC. The FPPC has jurisdiction to interpret the PRA, but the Commission is not obligated to follow informal advice provided in this case, and can come to its own conclusions in its own audits about the applicability of the SFC&GCC and the PRA, as incorporated into local law. The Respondent also told the FPPC that they sought advice as a means of "in order to discharge my duties as treasurer." And the Respondent phrased questions in the present tense, e.g., "Is the transaction required to be reported" instead of "was the transaction required to be reported[,]" potentially creating the false implication that the Committee sought contemporaneous advice on how to treat an ongoing campaign situation. Indeed, the Respondent made no mention of the audit or the relevant campaign dates (2019) in their outreach to the FPPC.

Further, the Commission believes the Respondent did not properly present the facts to the FPPC when seeking this informal advice. The Respondent initially phrased the transaction as being "due to a bank error." It is the Commission's understanding that a campaign worker of the Committee initiated the transaction, and that although the campaign worker may have done so in error, the bank did not make an error. This is a relevant detail that was potentially misrepresented when seeking advice, which would invalidate any informal advice that relied on it incorrectly.

Respondent Response #2: Documentation was provided supporting the claim that the withdrawal transaction occurred in error.

Commission Response

The audit finding does not conclude one way or another whether the transaction occurred in error. The finding acknowledges circumstantial evidence provided by the Respondent that suggests the transaction occurred in error, and further states that the Auditor did not find evidence to suggest otherwise.

The audit found that an inappropriate transaction occurred. It further found that this transaction was initiated by a campaign worker of the Committee, and, whether in error or not, this violated legal restrictions on the nature of the spending of campaign account funds. The audit does not opine on whether this violation led to significant public harm – such is the realm of any potential future enforcement action, at which point circumstantial evidence would be considered.

Respondent Response #3: The withdrawal transaction was not authorized, did not involve a deliberate act, and was not a payment made by the Committee, and as such, should not be considered when evaluating proper campaign fund usage under SFC&GCC Sec. 1.122(b)(1).

Commission Response

A campaign worker initiated an expenditure for a purpose not "reasonably related to a legislative, governmental, or political purpose[.] It was a transaction affirmatively initiated by a Committee staffer, regardless of whether this act was an error.

The audit noted and appreciated the fact that this expenditure was immediately reversed. This fact is included as part of the audit finding.

The audit does not opine on the harm caused by this transaction. In fact, the audit appreciates that the harm does not appear to be significant. But the degree of harm does not obviate the finding that an inappropriate transaction occurred, and was initiated by a Committee staffer.

Respondent Response #4: The withdrawal and deposit transactions should not be disclosed in campaign statements, per Generally Accepted Accounting Principles (GAAP).

Commission Response

The audit finding is based on the SFC&GCC and the Political Reform Act, and only relies on accounting principles insofar as they are incorporated or referenced in those laws.

The Commission agrees with the Respondent's response that disclosure is required partially to ensure the absence of "financial malfeasance." Further, disclosure is required to provide transparency into a committee's financial activities. To those ends, by not disclosing the transactions at issue, the Committee failed on both counts.

First, though the audit did not include any findings of financial malfeasance, such malfeasance is entirely plausible under the facts at hand. A committee staffer could initiate a payment for personal purposes, and immediately reverse that payment within a few days, effectively securing an interest-free loan for themselves or another third party with an interest in the campaign. Because financial malfeasance is plausible, the transactions should be reported so that regulating agencies can monitor and, as the Respondent put it, "ensure there's no financial malfeasance." Just because we find no evidence of financial malfeasance in this particular case, four years after the transactions in question, it does not mean the Committee did not have to disclose the transactions when they first occurred.

Second, the failure to disclose also raises issues related to transparency. Because the payment was made during one reporting period and reversed during the next reporting period, the failure to disclose this type of transaction could lead to inconsistencies on each campaign statement, where the reported ending cash balance would not match with the combined reported transactions.

Finally, campaign statements provide numerous opportunities to include short explanations for given transactions, thus allowing the Committee to use disclosure as a means of avoiding or resolving confusion rather than creating it.

Respondent Response #5: The withdrawal transaction should not be disclosed in campaign statements, per National Automated Clearing House Association (Nacha) Operating Rules.

Commission Response

The audit finding is based on the SFC&GCC and the Political Reform Act, and only relies on the operating rules of Nacha, a financial services trade association, insofar as they are incorporated or referenced in those laws. The other definitions provided are not relevant in this matter.

Respondent Response #6: The deposit transaction should not be disclosed on Schedule I in campaign statements, as the Schedule I Instructions do not include the type of transactions in question.

Commission Response

Instructions for Schedule I include a list of examples, not an exhaustive list of all types of transactions that require reporting.

If the Committee had properly reported the initial expenditure – which was not reversed during the same reporting period, and therefore changed the Committee's cash position for that reporting period – then its cash position at the beginning of the subsequent reporting period would be materially changed by the refund of the initial expenditure. Therefore, even under the standards that the Respondent sets for themself, the Committee should have disclosed the refund.

Campaign Disclosure Statements

2. Under CA Gov. Code Sec. 84200.5 and Sec. 84200.8, candidate committees are required to timely file pre-election statements. Per review of disclosure statements filed by the Committee, Auditor identified one Form 460 (Campaign Statement) that was not timely filed by the required deadline. See **Table 1** below. Auditor confirmed the Committee paid fees associated with the late filing.

Table 1

Type of Report	Filing Period	Filing Deadline	Date Filed	Days Late
Form 460 3rd Pre-Election	10/20/19 - 10/30/19	11/1/19	11/2/19	1

3. Under SFC&GCC Sec. 1.152(a)(2) and Regulation 1.152(a)-1, candidate committees are required to file Form SFEC-152: Threshold Notice with the Commission disclosing when they have received contributions or made expenditures that in the aggregate equal or exceed $100,000 within 24 hours of reaching or exceeding the threshold. Thereafter, committees are required to file an additional Form SFEC-152 within 24 hours of every time they receive additional contributions or make additional expenditures that in the aggregate equal or exceed $10,000. Per review of transaction data (i.e., monetary contributions, nonmonetary contributions, public funds received, expenditures) reported by the Committee on disclosure statements, Auditor determined that four out of 18 required SFEC-152 notices were not timely filed by the required deadline. See **Table 2** below. Auditor confirmed the Committee paid fees associated with the October 20, 2019, filing.

Table 2

Threshold Level	Date Reached	Date Due	Date Filed	Days Late
$310,000	6/30/19	7/1/19	7/2/19	1
$400,000	9/21/19	9/22/19	9/23/19	1
$410,000	10/4/19	10/5/19	10/7/19	2
$420,000	10/16/19	10/17/19	10/20/19	3

4. Under SFC&GCC Sec. 1.161(b)(3), candidate committees must disclose information related to the distribution of mass mailings on an Itemized Disclosure Statement (Form SFEC-161) within five business days of the mail date. If the mail date occurs within the last 16 days before an election, Form SFEC-161 must be filed within two calendar days of the mail date. Per review of disclosure statements filed by the Committee, Auditor identified five out of 13 Form SFEC-161s that were not timely filed by the required deadline. See **Table 3** below. The Respondent indicated that for the "Teachers" mass mailer, the Committee *"discovered the missing report issue and filed on its own, prior to any contact from SFEC's office, in doing so, it realized that a penalty was likely the outcome, but also understood its obligation to file and therefore ensured that it was done immediately upon discovery."* Auditor confirmed the Committee paid fees associated with the January 10, 2020, filing.

Table 3

Mailer Name	Date Mailed	Date Due	Date Filed	Days Late
He Listens	8/15/19	8/22/19	9/9/19	18
He Listens Drop 2	8/27/19	9/4/19	9/9/19	5
Teachers	10/20/19	10/22/19	1/10/20	80
Realtors Response	10/25/19	10/27/19	10/31/19	4
Midtown	10/28/19	10/30/19	10/31/19	1

Conclusion

Except as indicated in the **Audit Findings** section above, and in our opinion, the Committee substantially complied with the requirements of the Political Reform Act Sec. 81000 et seq. and supporting regulations, and the San Francisco Campaign Finance Reform Ordinance Sec. 1.100 et seq. and supporting regulations.

Appendix
Respondent Response

#1 – RESPONSE TO SFEC STATEMENT REGARDING FINDING#2
(Finding 1. in **Audit Findings** section)

Per SFEC:

Regarding (previously identified) Finding #2, the response appears to be informal FPPC email advice, that was asked retroactively without complete information, does not represent a final decision of the FPPC, does not constitute legal advice, and is not a rule, regulation, or statement binding on the agency.

Response:

Nothing in the response from SFEC speaks to counter the facts presented to FPPC advice staff nor the conclusion reached by FPPC's informal advice service.

1. **Nature of Informal Advice**: The Fair Political Practices Commission (FPPC) provides informal advice as an initial guidance mechanism to promote compliance. While it may not carry the same weight as formal advice or regulations, it's rooted in the FPPC's understanding of their own regulations which is at the center of this matter. Dismissing it entirely is tantamount to sidelining an expert's preliminary analysis.

2. **Good Faith Effort**: Providing informal FPPC advice illustrates a proactive and good faith effort to seek guidance and clarification with state regulations where SFEC has made an allegation of noncompliance.

3. **CA Government Code Section 83114**: Under this provision, the FPPC is empowered to provide written advice regarding one's duties under the Political Reform Act. This includes both formal and informal advice. To dismiss the validity of any guidance from the FPPC is to overlook the authority vested in the FPPC by this section.

4. **Completeness of Information**: The assertion that the advice was sought "retroactively without complete information" requires substantiation. Unless the SFEC can specify which pieces of information were omitted, and to what extent they appear substantial to change the outcome of the advice, this claim remains speculative. Moreover, informal advice is typically sought with an intention to provide a holistic view of the situation, making the assumption of incomplete information unfounded.

5. **Precedential Value**: While it's accurate that informal email advice doesn't have the binding effect of formal opinions, they offer insight into the FPPC's stance on similar issues. It serves as an indication of how the commission interprets its own regulations in comparable situations.

6. **Complement, not Replace**: The informal advice doesn't purport to replace formal decisions, rules, or regulations. Instead, it complements them by providing quicker, more accessible insights. Discrediting it entirely is a narrow interpretation of the tools provided by the FPPC for entities to ensure their compliance.

7. **Appropriateness of Local Agency Dismissal:** It is both unconventional and inappropriate for a local agency to dismiss, outright, the advice – even if informal – from the state agency directly responsible for the formulation, interpretation, and oversight of Form 460 and its associated schedules. The FPPC, by virtue of its state-wide jurisdiction and specific mandate, possesses an intrinsic and comprehensive understanding of its own regulations. For a local agency to sideline or undervalue the FPPC's advice is not only to challenge the state agency's authority and expertise but also to potentially create disparities in the application of regulations across jurisdictions. Such an approach runs the risk of generating inconsistencies, which could undermine the very purpose of standardized campaign disclosure rules set at the state level. It is essential to recognize that the FPPC's guidance, even when labeled informal, is a reflection of the agency's preliminary interpretations, rooted deeply in the principles and nuances of the regulations they oversee. Disregarding this advice could inadvertently lead to misinterpretations or misapplications of the very regulations both agencies seek to uphold.

8. **Overarching Purpose of FPPC Regulations**: The underlying objective of the FPPC and its regulations is to ensure transparency, fairness, and integrity in political practices. The question to SFEC's statement above: does dismissing the informal advice further these objectives, especially when the primary intent behind seeking it was to ensure alignment with state regulations?

In summary, while the informal nature of the FPPC advice is acknowledged, its utility as an initial guidance tool — derived from the very body that enforces these regulations — cannot be discounted. The spirit of seeking and adhering to such advice embodies the principles of due diligence and compliance. It would be counterproductive to diminish its significance in the broader context of ensuring fair political practices.

It is crucial to underscore the boundaries established by the California Political Reform Act. Specifically, **Government Code § 81013** delineates the relationship between state and local regulations concerning campaign financing.

Government Code § 81013 reads:

> *"Any provision of this title which imposes any duty on any local elected officer, candidate for local elective office, or committee formed or existing primarily to support or oppose a candidate for local elective office or local measure shall be controlling. Notwithstanding any other provision of law, the provisions of this title may be superseded by provisions on the same subject which are a part of a local ordinance to the extent that the local ordinance imposes more stringent requirements."*

While it is recognized that the SFEC can develop its own stringent regulations, these must not, under any circumstances, conflict with the state's primary provisions, as interpreted and guided by the FPPC. The FPPC is the designated state agency with the mandate and expertise to provide direction on the Political Reform Act.

SFEC's attempt to supersede or bypass FPPC's advice, without providing a more formal legal basis for doing so, while dismissing the advice of an agency with jurisdictional authority, which stems directly from state-level interpretation, threatens to create an incompatibility with compliance protocols. Such actions by the SFEC not only challenge the uniformity and sanctity of the state's standardized regulations but also introduce unnecessary confusion.

For those subjected to reporting requirements, the SFEC's stance potentially suggests a path of reporting that diverges from FPPC advice. This is problematic as it risks placing filers in a precarious position where they could inadvertently run afoul of state mandates while trying to satisfy what they perceive as local expectations.

Given the potential for such conflicts, it is paramount to align local interpretations with the foundational guidance from the state, ensuring consistent and clear compliance for all stakeholders.

It's essential to recognize that committees and individuals involved in their obligations often consult published audit reports for direction. As such, any allegation made within these reports is likely perceived as instructive by those referencing the information.

#2 – RESPONSE TO SFEC STATEMENT REGARDING FINDING# 2

(Finding 1. in **Audit Findings** section)

Per SFEC:

> *Upon further review of (previously identified) Finding #2, despite the existence of documentation evidencing that the transactions in question occurred, the assertion that the withdrawal entry represented a withdrawal made in error could not be verified. In addition, it appears that even though the deposit entry was made to rectify the withdrawal entry, the withdrawal entry represented a potential misuse of campaign funds.*

Response:

Addressing SFEC's response concerning the documented proof of the erroneous transaction:

1. **Chronological Evidence**: The timeline of events, as evidenced by the emails and bank statement, clearly shows a proactive response to an unexpected transaction. The sequence - spotting the unknown debit, notifying the bank, contacting the vendor, and finally, the bank's reversal of the ACH - all occurring within a short span, underscores the unexpected nature of the transaction.

2. **Explicit Bank Confirmation**: One of the most unequivocal pieces of evidence is the bank's label of the returned ACH as "RETURN ACH UNAUTHORIZED". This label, generated by the bank and not subjectively assigned, clearly classifies the nature of the transaction as unauthorized, which inherently implies it was made in error or without proper consent.

3. **Email Correspondences as Authentic Evidence**: Email communications with the bank and the vendor are time-stamped, objective records of the incident. Their existence on consecutive days following the transaction reinforces the narrative of an error that was promptly addressed.

4. **Purpose and Intent**: The Political Reform Act and the SFEC's rules and guidelines are aimed at capturing and preventing intentional financial improprieties. In this scenario, not only was the transaction inadvertent, but swift corrective actions were also taken. The essence of the regulations is to ensure financial transparency and prevent misuse, not to penalize unforeseen errors that are rectified immediately.

5. **Reasonable Person Test**: From a legal standpoint, a "reasonable person" examining the sequence of events and the supporting documentation would likely conclude that the withdrawal was, in fact, made in error. The SFEC's stance seems to contradict this logical interpretation.

6. **Standard of Proof**: While the SFEC might have rigorous standards for verification, it's essential to question what additional evidence or demonstration they would require to acknowledge an error beyond the time-stamped emails, explicit bank statements, and immediate communication with both the bank and the vendor.

7. **Beneficial Ownership**: If the transaction was intentional, what benefit did the committee derive from it? The very nature of the transaction being reversed almost

immediately highlights that no representative of the committee benefited from the said transaction.

In conclusion, while regulatory bodies like the SFEC exist to enforce rules and ensure transparency, it's essential they also recognize the genuine intent and efforts of entities to rectify inadvertent errors. The provided documentation paints a clear picture of an unforeseen error and a diligent, prompt effort to address it. Disregarding such substantive evidence might seem contrary to the principles of fairness and justice.

#3 – RESPONSE TO SFEC STATEMENT REGARDING FINDING# 2

(Finding 1. in **Audit Findings** section)

Per SFEC:

> *Under SFC&GCC Sec. 1.122(b)(1), "…funds in a candidate committee's campaign account may be used only on behalf of the candidacy for the office …or for expenses associated with holding that office, provided that such expenditures are reasonably related to a legislative, governmental, or political purpose." The law deems funds deposited into the campaign account to be "held in trust" for expenses associated with the election of the candidate or for expenses associated with holding office. An expenditure is only within the lawful execution of that trust if it is related to political purposes when seeking office, or legislative or governmental purposes when holding office. The transactions in question were not related to any of these purposes.*

Response:

This statement is a mischaracterization of the nature of the unauthorized transaction.

1. **Nature of the Transaction**: The unauthorized transaction in question did not involve any deliberate act made by the committee. As noted in the bank ledger the reason for the immediate return of the ACH was the result that it was "unauthorized" by any person with authority on the account. The transaction, by its very nature, is not a payment by the committee, and thus, it should not be considered under the ambit of fund usage meant for candidacy or office-related expenses.
2. **Definition of "Expenditure":**
   - CA Govt Code § 82025 states "*Expenditure means a payment, a forgiveness of a loan, a payment of a loan by a third party, or an enforceable promise to make a payment, unless it is clear from the surrounding circumstances that it is not made for political purposes*."
   - However, the cited section from SFEC discusses the lawful execution of funds "held in trust" for political, legislative, or governmental purposes. It is essential to understand that not all fund movements within the account constitute "expenditures" in the context of this statute. An "expenditure" implies a conscious decision to allocate funds towards a specific purpose.
3. **Immediate Remediation**: The committee promptly noticed the unauthorized transaction and took swift action to rectify it with the bank. The funds were returned to the campaign account, ensuring that there was no misuse of the trust. The quick remediation showcases the committee's commitment to ensuring that campaign funds are only used for lawful purposes.
4. **Trust and Intent**: The foundation of SFC&GCC Sec. 1.122(b)(1) lies in ensuring that campaign funds are utilized in a manner that's in alignment with their intended purpose — supporting the candidacy or associated office expenses. The committee has not deviated from this intent. An error by an external entity should not be misconstrued as a violation of trust or intent by the committee.
5. **Potential for Misleading Interpretations**: Classifying the unauthorized and immediately rectified transaction in question as a "payment" or as an "expenditure" sets a dangerous precedent. It means any unauthorized activity, regardless of the committee's knowledge or intent, can be used to misrepresent the committee's financial

activities, leading to potential misleading interpretations of its financial statements to users who rely upon the information.

In light of the above points, it's evident that the unauthorized transaction does not violate SFC&GCC Sec. 1.122(b)(1). The committee's actions and intentions have consistently aligned with the spirit and letter of the law.

#4 – RESPONSE TO SFEC STATEMENT REGARDING FINDING# 2

(Finding 1. in **Audit Findings** section)

Per SFEC:

> *The withdrawal of funds from and deposit of funds to the campaign bank account likely should be disclosed in campaign statements to ensure transparency of campaign bank account activity.*

Response:

To address the assertion regarding the disclosure of the withdrawal and subsequent deposit in campaign statements, let's draw from both technical accounting practices and California-specific legal requirements:

1. **Nature of the Transactions**: Firstly, it's paramount to clarify the nature of the transactions in question. These were not deliberate actions initiated by the Committee but rather unauthorized actions by a third-party vendor. In accounting terms, they are akin to errors, not expenditures or revenue.
2. **Accounting Materiality Principle**: According to Generally Accepted Accounting Principles (GAAP), the Materiality Principle posits that financial statements should disclose all "material" amounts that might influence a reader's understanding. Given that the erroneous withdrawal was promptly rectified and funds were returned, the net effect on the campaign's financial position was zero. Hence, this transient and self-corrected error might be deemed immaterial and would not influence a reader's understanding of the financial position.
3. **Accrual Basis vs. Cash Basis Accounting**: In accrual-basis accounting, only actual revenues earned or expenses incurred are reported. As the unauthorized withdrawal was neither an expense incurred for a valid campaign purpose nor was the deposit a legitimate revenue, it would be inappropriate to report using the required accounting method.
4. **CA Political Reform Act**: Under California's Political Reform Act, campaign statements aim to disclose the political financial activities of committees to ensure there's no financial malfeasance. However, the unauthorized transaction in question is devoid of any political intent or campaign-related financial activity. Reporting it might, in fact, introduce confusion, detracting from the true intent of transparency.
5. **Potential Misrepresentation**: From an accounting standpoint, reporting these transactions could give rise to a misrepresentation. Anyone reviewing the financial statements might assume there were actual payments made and received for campaign purposes on the specified dates, which was not the case. Such misinterpretations run counter to the very essence of financial reporting — to provide a clear and accurate representation of financial activities.
6. **California Government Code Section 84211**: While this section lays out requirements for detailed campaign statements, it centers on transparency in political contributions and expenditures. The unauthorized withdrawal was not a legitimate campaign expenditure, nor was the subsequent deposit an increase to cash as it lacked the substance of a payment to begin with. Hence, attempting to fit these transactions under this section would be a misapplication of the regulation.

#5 – RESPONSE TO SFEC STATEMENT REGARDING FINDING# 2

(Finding 1. in **Audit Findings** section)

Per SFEC:

> *The withdrawal entry from the campaign bank account on October 28, 2019, likely should have been reported on the Committee's campaign statement on Schedule E (Payments Made).*

Response:

When the bank returns an ACH transaction as unauthorized, as in the case of the unauthorized debit in question, it signifies that the bank is contesting or reversing the transaction after it momentarily appeared as a debit on the committee's account. Even though it temporarily reflected as a debit, from a technical standpoint, the transaction hasn't been "settled" or "paid."

Relating to the regulatory context provided by the **NACHA Operating Rules**:

1. **Settlement Date**: The settlement date is when the transaction is recorded on the books of the Federal Reserve Bank(s). In the committee's case, the return of the unauthorized debit implies that the transaction never reached a finalized settlement stage. Just because a transaction is reflected on a bank statement does not necessarily mean it reached the finalized settlement stage with the Federal Reserve Bank(s). The statement might merely record the events as they transpired – first, the debit and later, the return.
2. **Return Entries**: The bank's decision to return the erroneous debit showcases its right to reverse any ACH entry it determines shouldn't be finalized. In the scenario of the committee, this return action underscores the fact that the initial debit wasn't a finalized or "paid" transaction from the bank's perspective. The appearance of the return entry on the bank statement validates the bank's right and action to reverse an ACH entry it deemed should not be finalized. In this context, the bank statement serves as a record of transactions, including those that were contested and reversed.
3. **Definition of Payment**: Turning to the broader context provided by the Uniform Commercial Code (UCC), we find that a payment has not occurred under the following code definitions:
   UCC § 4-213:
   > *"(2) the time of settlement, is: (iv)with respect to tender of settlement by a funds transfer, when payment is made pursuant to Section 4A-406(a) to the person receiving settlement."*

   UCC § 4A-406:
   > *"(c) For the purpose of determining whether discharge of an obligation occurs under subsection (b), if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges."*

   Given the bank's prompt reversal of the unauthorized debit concerning the committee, it's evident that this unauthorized debit did not satisfy any liability of the committee, nor any other person, and as such, it can't be categorized technically as a "payment." The presence of the unauthorized debit on the bank statement does not make it a "payment"

in the technical sense as per the UCC. As mentioned, "payment" pertains to the satisfaction of a liability. If a debit was reversed (as indicated by the return entry on the statement), it means the liability was not satisfied, and hence it wasn't technically a "payment."

In conclusion, with respect to the committee's situation, even if the unauthorized transaction momentarily appeared as a debit, it wasn't a settled or paid transaction. Such a distinction is essential to ensure the accuracy and transparency of financial reporting, especially within the bounds of the CA Political Reform Act.

#6 – RESPONSE TO SFEC STATEMENT REGARDING FINDING# 2

(Finding 1. in **Audit Findings** section)

Per SFEC:

The Committee likely should also have reported the October 31, 2019, deposit entry to the campaign bank account on the Committee's campaign statement on Schedule I (Miscellaneous Increases to Cash).

Response:

The instructions for Schedule I - Miscellaneous Increases to Cash on Form 460 reads:

Instructions for Schedule I Miscellaneous Increases to Cash

Report any transaction that increases the cash position of the officeholder, candidate, or committee, but is not a monetary contribution, loan, or loan repayment, on Schedule I.

Itemize the sources of $100 or more received during the reporting period.

Examples include:

- *Interest received or credited to checking or savings accounts or other time deposits.*
- *Proceeds from the sale of property, such as paintings, furniture, or other items sold at garage sales or auctions, etc., when the amount received is the "fair market value" of the item. Amounts received over the fair market value are reported on Schedule A. (Report donated items as nonmonetary contributions on Schedule C.)*
- *Proceeds from the sale of campaign property, such as office furniture or equipment.*
- *Refunds received on deposits, such as telephone deposits.*
- *Refunds received from overpayment of bills.*
- *Transfers received from another authorized committee of the same candidate. (Candidates for elective state office should refer to FPPC Campaign Disclosure Manual 1 for information about reporting transferred funds that must be attributed to specific contributors of the committee making the transfer.)*

Report on Line 3 of the Schedule I Summary the lump sum of interest payments received on loans made to others. Do not itemize. This amount is transferred from Schedule H, Column (g).

The instructions for Schedule I clearly lay out that the transaction in question does not meet the criteria for reporting on that schedule:

1. **Nature of Transactions in Schedule I as Per Form 460**: The instructions for Schedule I explicitly outline the types of transactions that should be included. In the context of California's Political Reform Act (Cal. Gov't Code §§ 81000-91014), the transparency required is about substantive campaign activities. The transaction in question does not fall within this scope.
2. **Generally Accepted Accounting Principles (GAAP)**: As established under the Accounting Standards Codification (ASC), only transactions representing actual economic events affecting an entity should be recorded. An unauthorized transaction,

subsequently reversed, does not meet the criteria of representing an economic event (Reference: ASC 250 - Accounting Changes and Error Corrections).
3. **No Genuine Increase in Cash Position**: As per the California Civil Code § 1473, "Payment made by mistake, in any of the following cases, is to be restored, by the party receiving it, to the one from whom it was received." Given that the unauthorized transaction was effectively nullified, the committee's cash position remains unaltered, making the recording on Schedule I unnecessary and inappropriate.
4. **Discrepancy with Given Examples from Form 460**: All of the examples provided under Schedule I, such as proceeds from sales or refunds from overpayments, indicate deliberate transactions. An unauthorized transaction, rectified as per California Civil Code, does not resonate with the spirit of these examples and in fact is counter to its intent.
5. **Purpose and Intent of the Political Reform Act**: The Act's primary intent is to ensure transparency regarding genuine financial activities of political committees (Cal. Gov't Code §§ 81000-91014). Reporting an unauthorized transaction would divert from this principle, providing no substantive information to stakeholders and potentially misleading them.
6. **Consistency with Accounting Principles**: Per the Financial Accounting Foundation (FAF) overseeing GAAP, it's essential that financial statements reflect the genuine economic activities of an entity. Given that the unauthorized transaction was rectified and did not constitute a genuine economic activity, its inclusion would be contrary to these principles.
7. **Reconciliation with Banking Regulations**: As per California Commercial Code - COM § 4401, a bank that pays a check or makes a transfer over a valid and timely stop-payment order may be liable to the account holder. In our case, the bank recognized the error and reversed the unauthorized ACH, effectively acknowledging it as an error, not a substantive transaction.

Considering the referenced legal and accounting standards, reporting the returned unauthorized transaction on Schedule I would not only misrepresent the committee's genuine financial activities but also deviate from the primary principles of transparency and accuracy that underpin both the state's political and accounting regulations.