

ERRN

Electoral Regulation
Research Network



MELBOURNE LAW SCHOOL



**ELECTORAL REGULATION RESEARCH
NETWORK/DEMOCRATIC AUDIT OF AUSTRALIA JOINT
WORKING PAPER SERIES**

**Political Funding and Disclosure Schemes:
Approaches to Compliance and Enforcement**

Bradley Edgman

(Australian Electoral Commission)

WORKING PAPER NO. 8 (NOVEMBER 2013)

The Role of the Regulator

A central objective of all election financing and disclosure schemes is to instil public confidence in the integrity of electoral and political processes by regulating the financial relationships of political parties, candidates, donors and other participants in elections. This can be approached through public disclosure of financial activities and donations in particular, the capping and banning of donations and expenditure, and controls on participation in election campaigns through registration schemes and authorisations of electoral material. Public funding, by delivering a measure of financial independence to political parties and candidates, is also advanced as assisting in the achievement of this objective.

Schemes also can look towards promoting democratic choice and participation. Aspects of this are often referred to as 'levelling the playing field'. This objective is primarily pursued through caps and bans on donations and expenditure. These financial limits moderate the extent of involvement available to those who are comparatively much better resourced thereby opening up opportunities for broader and more diverse involvement across all stakeholders in elections. Public funding again can play a role by assisting smaller political parties and independent candidates mount election campaigns.

The success of a scheme in achieving its particular goals is dependent upon two factors: the design of the scheme; and compliance with the scheme. The design of a scheme is the responsibility of the Parliament while compliance is a matter for the regulator.

The argument can be advanced that, as regulation of financial activity and disclosure are legal obligations, the responsibility for compliance rests entirely with those captured by the legislation. The extension of this argument is that there is little to nothing to be demanded of a regulator other than to identify failures and then penalise them as offences. The countervailing view is that responsible public administration obliges regulators to be actively engaged in facilitating compliance. This expectation of a more active role for regulators, then, obliges them to implement a strategy for maximising compliance.

Compliance Profiles

Any approach to formulating an effective compliance strategy requires some understanding of the compliance profiles of those with legislative responsibilities. In the very broadest of

senses they can be categorised into ‘the willing’ and ‘the unwilling’, but, for the purposes of this paper, can be better understood by being broken down into four categories.

1. *Willing and Able*

Persons falling into this category can be described as those who:

- know that they have a legislative obligation;
- are prepared to meet that obligation without any level of coercion; and
- have the ability to fully discharge that obligation.

2. *Willing but Unable*

Those who fall into this category are essentially the same as those who are willing and able – that is, they are prepared to meet their obligation without coercion – except they:

- don’t know that they have a legislative obligation;
- don’t correctly understand what that obligation entails; and/or
- don’t have the ability to fully discharge the obligation.

Clearly, an objective for regulators is to facilitate moving as many from this category to the *willing and able* category.

3. *Unwilling but Complies*

For persons falling within this category, deterrence can be seen to be the prime, if not sole, motivator for their compliance.

Deterrence can manifest itself in many guises, but, a central influence is the perception that enforcement action will be taken against those who refuse to take seriously their responsibility to discharge their legal obligations.

4. *Unwilling and Avoids Complying*

The population within this category is not predominantly made up of those who refuse outright to discharge their obligations. Persons willing to openly defy their legal obligations are quite rare. Most persons falling into this group are less forthright and instead seek to ‘play’ the system by passing themselves off as *willing but unable*. They surreptitiously

challenge the regulator to identify their failure to comply, but when caught, will proffer an explanation that seeks to absolve them of guilt and will then act to resolve the outstanding obligation. As a result it is often not a clear-cut matter to definitively distinguish the unwilling from the willing.

Elements of a Compliance Strategy

Considering the above profiles is useful in that it immediately identifies that being willing to comply is not sufficient for someone to be assured of discharging their legal responsibilities. They must also be *able* to comply. Identifying and acting upon initiatives that will facilitate compliance can be the most important element when formulating a compliance strategy. How a regulator addresses this part of its compliance strategy also can significantly influence their approach to enforcement.

Assisting the ‘willing’ to comply

Awareness of legal obligations

The biggest hurdle for some is simply to know that there are legal restrictions on their actions and/or that those actions have the effect of placing upon them a disclosure obligation. While informing registered political parties and candidates is relatively straightforward as these are known, it becomes far more difficult in the cases of donors and third party campaigners whose actions are often invisible to the regulator at the time they take place.

Informing persons of the circumstances in which legal obligations arise and what their responsibilities are can be the biggest challenge for the regulator and often the most difficult to meet. It also can be the most difficult to manage, particularly when considering the appropriateness of options for response when breaches are identified.

The reality of persons simply not being aware of their legal obligations raises concerns with a policy of strict pursuit of prosecution action in every instance of an identified offence. Such an approach can run the risk of being seen as unreasonable, such that it could damage the public standing of the regulator and, potentially, perceptions of the competence of the legislation in delivering on its objectives. In assessing the potential for such risks the regulator needs to consider their compliance strategy beyond only immediate actions and so have a focus on longer term outcomes.

Education

Face-to-face training and briefings offer particular advantages in informing persons of their legal obligations because they provide greater freedom for a two way dialogue to take place. Offers of briefings have their greatest potential to be taken up when initiated in response to some trigger, such as upon a party's registration, the appointment of new office holders, at wider candidate briefings, or in conjunction with party conferences. Such opportunities present themselves much more rarely with third parties and donors as they are usually unknown to the regulator before their legal obligation has arisen.

There are natural limitations to the opportunities for face-to-face training and so other options need to be explored. Online training offers considerable potential in this regard allowing anyone to familiarise themselves with the requirements of a scheme at their convenience. It can also be preferred by some because it presents them with a less confronting option by allowing them to engage in training in private (or to be first used to gauge whether more comprehensive training may be required). At another level it can be used by the regulator as a form of guarantee that persons should be aware of their responsibilities. In the case of New South Wales there is now a legislated requirement that persons seeking to become official agents satisfactorily complete online training before they can be appointed.

Guidance

It cannot be assumed or expected that legislation will serve to inform persons fully of the details of their obligations. Guidance for the prospective audience needs to be readily accessible and easily understood and can include:

- handbooks/guides on legislative requirements;
- self-explanatory forms (to the extent this is practical without 'crowding' the form with text);
- helpdesk services;
- publishing policies with respect to administering the legislation; and
- publishing 'rulings' reached on specific sets of facts.

A goal with all forms of guidance is to make compliance as simple an exercise as possible. It is the reality that in many instances compliance relies upon volunteers and persons with no particular aptitude for administration, law or bookkeeping. This can present a difficult balancing act between comprehensive guidance that risks being intimidating and

impenetrable (such that many may dismiss using it at all) and more concise, direct guidance that reaches a wider audience, so providing the majority with what they need to know (but risking, in particular sets of circumstances, some not fully appreciating that their obligations may be somewhat different from the norm).

This exercise can be further frustrated and confounded by complex legislation (and significant variation between the State and federal schemes). There is natural appeal to those advocating or making law to have the legislation tailored to cater for special circumstances rather than settle for a one-size-fits-all outcome. Whether necessary or simply desirable, nonetheless every exception, exemption or special case complicates the law and the greater the number of these, the greater the likelihood that comprehension and, ultimately, compliance will be compromised. Striking an appropriate balance is as important for lawmakers as it is for regulators when considering how best to deliver the desired outcome.

Enablers

Beyond informing persons of their obligations, the most fundamental aspect of assisting the willing to comply is to provide them with the means to discharge those responsibilities. This includes:

- maximising accessibility to the means of satisfying their obligations, including offering electronic options for lodgement of disclosures;
- retaining hard copy options for those without internet access/skills;
- being responsive to the requirements of those seeking to comply; and
- seeking feedback as an alert to possible improvements required.

Convincing the ‘unwilling’ to comply

The more successful the regulator is in facilitating compliance the more difficult it will become for those unwilling to comply to pass themselves off as being unable to comply. This then exerts pressure on them to comply fully or risk being considered to have wilfully flouted their legislative obligations. That is, it will move reluctant compliers into the *unwilling but complies* category.

Ultimately, however, enforcement activity is an essential element in any effective compliance strategy. Public perceptions of effective enforcement will help dislodge persons from the *unwilling and avoids complying* category and to move into the *unwilling but complies*

category at their own initiative (and over time these perceptions will reduce the need for active enforcement as compliance rates rise). Having persons voluntarily comply delivers the most timely outcome and so should be the primary aim of the regulator.

Legislative Strategies for Compliance

The Traditional Approach to Enforcement and Compliance

The legislative approach to compliance fundamentally influences how effective a compliance strategy ultimately can be irrespective of the efforts of the regulator. For instance, many challenges in schemes currently operating stem from the fact that what currently is in place is not schemes that proactively enforce compliance, but rather, ones that punish non-compliance.

That is not to say that this model is not effective: it is a question of whether it is suited to the particular regulatory environment. For instance, enforcing late payment of tax that was either overlooked or avoided essentially restores the equilibrium, especially as interest charged restores the full value of the loss. Indeed, penalties imposed have the potential to deliver a premium. But, it is not a model ideally suited to all circumstances.

There are two elements to political funding and disclosure laws. Firstly, disclosure is designed with the threat of public sanction at the ballot box as a central plank in the compliance strategy. In concert with this passive strategy of having public accountability leverage ethical as well as legally compliant behaviour, the second element is enforcement through offences and penalties for breaches of disclosure rules and of caps and bans on donations and expenditure.

Both elements are enforcement operating as a post-event activity. This was identified as a weakness of the scheme in the Electoral Reform Green Paper on Donations, Funding and Expenditure issued by the Commonwealth government in November 2008 which stated at paragraph 6.75:

The timeliness of disclosures is also a key factor. If the intent behind disclosure regimes is to inform electors, then this purpose is defeated if disclosure is not timely.

The Joint Standing Committee on Electoral Matters (JSCEM) then examined this matter and reached the following conclusion at paragraph 3.13 of its November 2011 Report on the funding of political parties and election campaigns:

Due to comparably weak penalties and enforcement provisions that accompany the Commonwealth disclosure scheme, this *ex post facto* approach to reporting and enforcement is not conducive to the transparency and accountability that the funding and disclosure regime is intended to facilitate.

The lag in public disclosures that exists under the Commonwealth scheme means the annual disclosures of political parties covering the September 2013 election period will not be released until February 2015. As observed by the JSCEM this lag along with the often relatively minor penalties that attend offences undermine the effectiveness of the scheme and thus the deterrence these provisions are designed to accomplish.

Risks from Ineffective Enforcement

It is important to consider the implications for a scheme from ineffective enforcement and from proposals for reform that do not adequately address the issue of effective enforcement. Beyond the obvious risk that they ultimately may prove futile in their operation they also carry the risk of exacerbating the problems they seek to solve.

The following hypothetical based on third party expenditure caps, but using figures drawn from recent Australian experiences, illustrates this point in the context of third party expenditure caps having been designed to ‘level the playing field’.

There are two third parties both with \$20m available to spend arguing opposing sides of an issue that is central to an election campaign. The election is run subject to a \$1m cap on campaign expenditure by third parties. Enforcement of the expenditure cap is via prosecution of an offence carrying a maximum \$10,000 fine.

One of the third parties abides by the cap and limits their spending to \$1m. The other doesn't, and spends their \$20m (less \$10,000 held back in anticipation of the fine) and overwhelms the debate.

The effect of this expenditure cap has been to further, and deeply, ‘un-level’ the playing field because it has hushed only one voice and so amplified the other. It will, because of ineffectual means for the enforcement of compliance, have delivered the opposite of what it purported to achieve.

Beyond the particular failure demonstrated in the above example there are yet broader and potentially more serious implications from ineffective enforcement when regulation such as expenditure caps becomes an integral component in the integrity of elections. Consider the ramifications of expenditure caps in the context of an election as tight as the federal poll held in 2010. For just one candidate to flout the cap and gain an advantage that successfully influences the campaign in their favour could see a different government formed. The very outcome of the entire election could be hijacked by one individual who has the means to fund the excess expenditure and the audacity to commit the offence.

The *In and Out scandal* from Canada provides a case study that serves as a demonstration of the practical impediments to enforcement despite what ostensibly appears to be a robust scheme carrying a strong penalty targeted at the very motivation for infringing expenditure rules.

Court action was commenced following the 2006 poll in relation to spending outside candidate expenditure cap rules. The offence carries the penalty of a candidate being prevented from holding a seat in Parliament for 5 years from the date of conviction. However, in the time it took for this case to be finalised two further elections were held. So despite first impressions, on this experience the operation of this enforcement regime can only be regarded a failure when measured against the objective of protecting an election outcome from those unwilling to comply with the cap scheme.

The case was resolved in March 2012 with the outcome being a plea deal resulting in a fine of \$230,000.

In short, the apparent merit of a measure cannot of itself guarantee its success if enforcement is neither effective nor timely. The task of developing the practical machinery of a scheme's operation is not only the key, but, often the more difficult component to successful reform. Beyond just punishing breaches, the protection of electoral integrity requires prevention, demanding proactive measures that compel compliance at the time the activity takes place.

An Alternative Approach to Enforcement

An approach of preventative design in an election funding and disclosure scheme offers the potential to be far more effective in meeting many of the major challenges to enforcement

and compliance. When compared to the traditional approach, proactive measures can be characterised as providing a solution of speed bumps rather than speed cameras.

The following example illustrates how incorporating preventative design into a scheme can deliver proactive compliance. It builds on the registration of third parties, which is a feature in some schemes here and overseas, by enlisting it as a tool in enforcing compliance with campaign expenditure caps (which addresses the enforcement gap identified in the hypothetical above).

Media outlets, before accepting political advertisements, could be required to first verify that a person or entity is registered to do so (i.e. to incur expenditure above a threshold) and that their cumulative spend remains under the cap at the point it is to be incurred. This would require checking registered details via a website (which could extend to identifying who is authorised to incur expenditure on behalf of the third party) and to input the value of the advertising through a secure logon issued to the media outlet. Only if these conditions are met should the media outlet be legally entitled to run/place the advertisement.

Penalties would need to apply to media outlets that do not abide by these procedures.

Of course there would need to be a detailed evaluation of all the potential implications from the operation of a model along the lines of the above example if such an approach was to be seriously considered for implementation, including questions of constitutionality and whether it represents an unreasonable shifting of the compliance burden from the regulator to the participants. Nevertheless it does demonstrate the potential from adopting a different strategy for enforcing compliance.

The concept of preventative design can be extended beyond expenditure caps and bans, such as with the initiative that exists in some jurisdictions to place restrictions on donors and recipients of donations. These restrictions exist as either outlawing the receipt of donations from specified sources (e.g. overseas, particular industries) or placing caps on the sum of donations able to be made and received. The following example of preventative design is derived as an extension to a scheme that currently operates in New Zealand where donations

can be exempt from disclosure if donated anonymously via the New Zealand Electoral Commission. These donations are passed onto the intended recipient political party by the NZEC which does not reveal the identity of the source donor.

Donation caps can be proactively managed if all donations to a campaign must be made through the regulator (electoral body). The regulator will pass on those funds only once it is satisfied that it has verified the identity of the donor and that the donation does not exceed prevailing caps.

Conclusion

In the context of protecting the integrity of electoral contests, the most effective protection against prohibited behaviour is through prevention of that behaviour. A strategy of prevention also can play its part in informing those who are unaware that their activities carry legislative obligations and can prevent them from committing an offence. Well-designed preventative schemes can also provide the regulators with more timely identification of those with legal obligations.

At their best, proactive measures could serve to maximise the outcome of the original legislative intent by helping:

- avoid inadvertent failures in compliance;
- prevent deliberate flouting of legislative restrictions and responsibilities; and
- provide the regulator with early identification of those with potential obligations.

Election funding and disclosure schemes, and proposals for new or amended schemes, that fail to adequately address compliance and enforcement as part of their fundamental design risk falling short of meeting their objectives and may even threaten to compound the concerns they seek to address.