

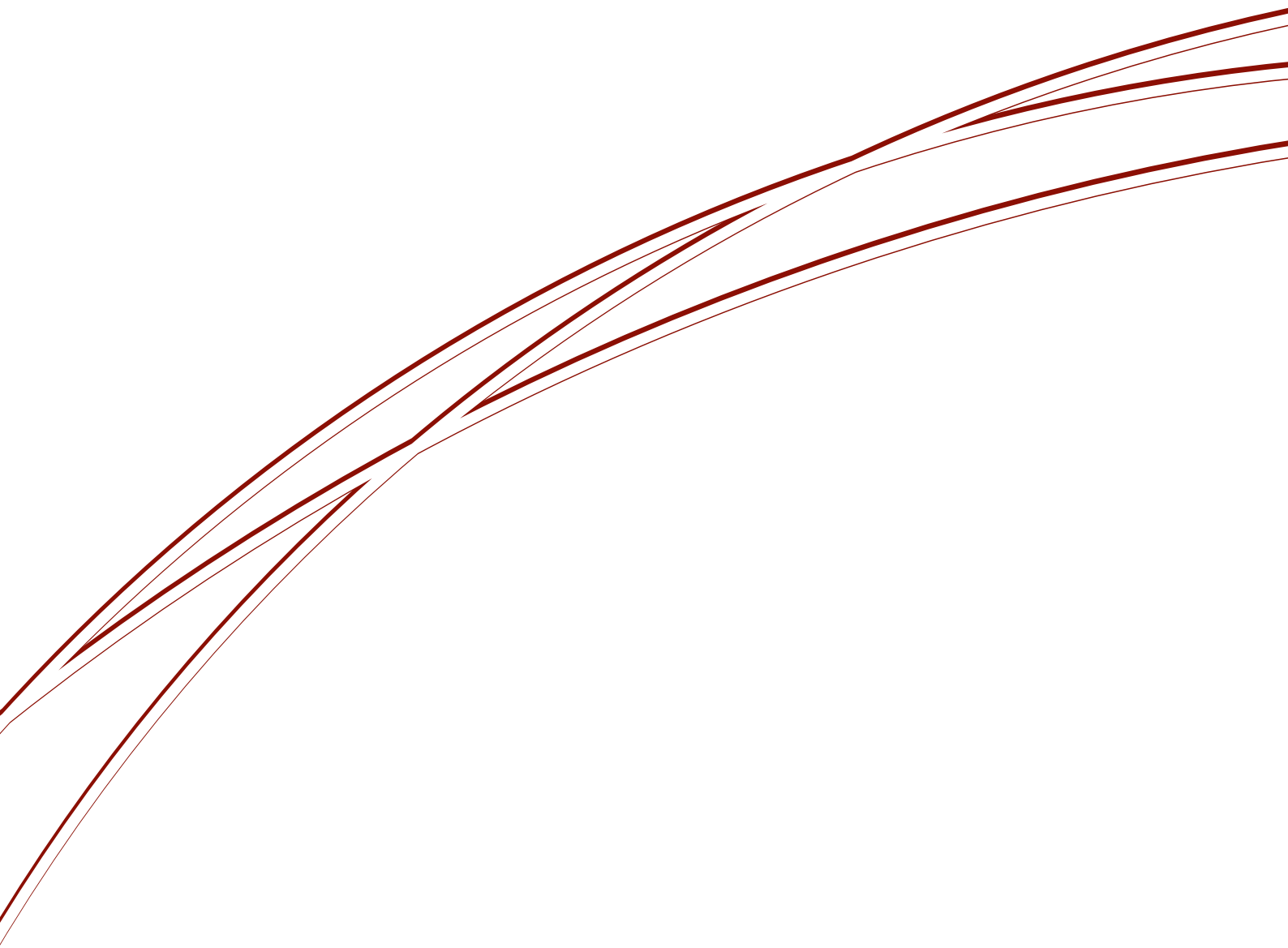
The logo for the Independent Commission Against Corruption (ICAC) New South Wales, featuring the letters 'I·C·A·C' in a stylized, serif font with dots between the letters.

INDEPENDENT COMMISSION  
AGAINST CORRUPTION  
NEW SOUTH WALES

The word 'Vote' is written in a large, red, sans-serif font on a white background, which is part of a larger graphic of a ballot paper.

**ELECTION FUNDING,  
EXPENDITURE AND  
DISCLOSURE IN NSW:  
STRENGTHENING  
ACCOUNTABILITY AND  
TRANSPARENCY**

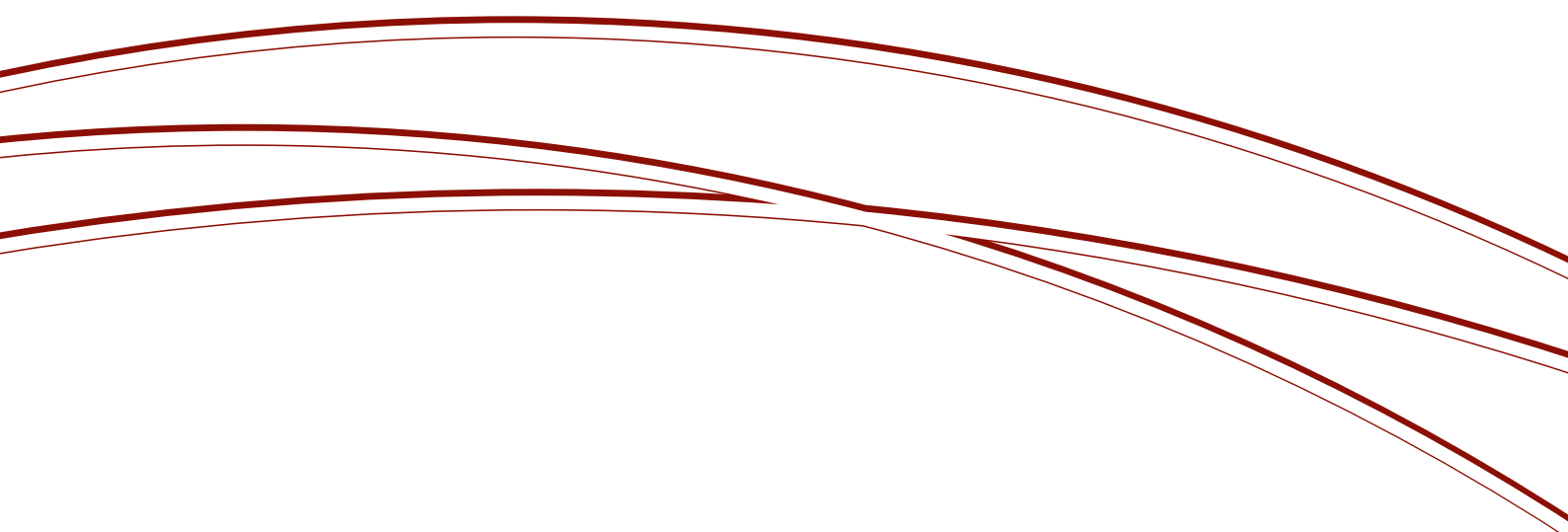
**DECEMBER 2014**



**ICAC**

INDEPENDENT COMMISSION  
AGAINST CORRUPTION

NEW SOUTH WALES



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**DECEMBER 2014**

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## Preamble and summary of recommendations

As part of the research for this report, the NSW Independent Commission Against Corruption (“the Commission”) consulted widely with experts in the field of political funding, expenditure and disclosure laws. These experts included academics, regulators and other interested individuals. By way of example, the Commission met with the Panel of Experts – Political Donations that was established by the Hon Michael Baird, NSW Premier, in response to public concern over the influence of political donations on the integrity of government decision-making. Meetings were also held with the Institute for Democracy and Electoral Assistance (IDEA) about methods that regulators can adopt to increase transparency in disclosure regimes and enforce penalties. The Commission also drew on publications that IDEA has produced on international electoral regimes. In addition, the Commission met with representatives from the Australian Prudential Regulatory Authority (APRA), in regard to its regulatory framework, as well as the Chair of the former Election Funding Authority (EFA) and representatives from the NSW Electoral Commission (NSWEC)<sup>1</sup> to discuss the current regulatory regime.

The Commission also undertook its own extensive research into the electoral laws of NSW and analysed electoral regimes in other jurisdictions. It conducted comparative analyses between NSW and other jurisdictions (at both a state and federal level), including the United Kingdom (UK), Canada, the United States (US), and comparative analyses at the state, territory and federal level in Australia. Each model presents particular strengths; analysis of the risk-based UK electoral regime presents a compelling case for reform of the regulatory model, while the US electoral regime generally has both experience and best practice in transparency and disclosure.

While there are some common elements across jurisdictions, the Commission observed that there were significant differences with regard to the timeliness of disclosures and the importance of this in promoting transparency, and the incentives that exist in some regimes to encourage voluntary compliance by parties to avoid closer scrutiny and sanctions that escalate with the seriousness of the offences.

Based on examination of best practice jurisdictions, the Commission has made a number of recommendations. The recommendations affect electoral funding, disclosure, election expenditure and party registration operations at both the macro- and micro-level in the context of NSW state elections. Consolidated electoral legislation that combines existing laws may be the most appropriate means of implementing the recommendations, thus avoiding ad hoc and piecemeal amendments to various Acts. This approach would help avoid legislation that is so complex that it works against compliance and creates loopholes. This is a decision that the NSW Government is best placed to make after the report of the Panel of Experts – Political Donations is provided to the Hon Michael Baird, NSW Premier.

The Commission focused on four key areas of the election funding and electoral expenditure framework. First, the regulatory system emphasises administration rather than regulatory oversight and governance of political parties. The NSWEC is required by legislation to undertake onerous administrative activities at the expense of close supervision of party compliance. Secondly, the senior officers of the parties are not accountable for internal governance and control, nor are the parties required to establish effective internal controls. Thirdly, there are few sanctions and penalties for failures of parties to exert effective internal control, further undermining party accountabilities. Finally, limited transparency constrains civil society’s oversight of the electoral financing

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<sup>1</sup> The *Electoral and Lobbying Legislation Amendment (Electoral Commission) Act 2014* abolished the EFA on 1 December 2014 and conferred its functions on the NSWEC.

arrangements. Incomplete, delayed and difficult-to-access disclosure information impedes civil society's ability to offer effective oversight over electoral funding arrangements.

The Commission's recommendations address each of these four areas. Collectively, the Commission's recommendations reduce the administrative burden on the NSWEC by removing the requirement for donor disclosures and administration fund reimbursements. The need for a change in the NSWEC's focus and methods of regulation is addressed. Senior officers of political parties are to be held accountable through the registration process and internal governance arrangements agreed with the NSWEC. Failure to maintain effective internal governance will result in conditions being placed on the Administration Fund with potential loss of public funding. Transparency is to be enhanced by increasing timeliness, accessibility and intelligibility of disclosures.

The Commission's recommendations are as follows.

### **Recommendation 1**

That the NSW Government amends the *Election Funding, Expenditure and Disclosures Act 1981* ("the EFED Act") to convert administration funding from a reimbursement scheme to a grant, contingent on the internal governance capability of political parties.

### **Recommendation 2**

That the NSW Government amends the EFED Act to abolish donor disclosure of donations, effectively making recipient disclosure of donations the only disclosure required.

### **Recommendation 3**

That the NSWEC replaces the matching of donor and recipient disclosures with best practice electronic analyses and forensic audit and investigation practices.

### **Recommendation 4**

That the NSWEC conducts a root and branch review to identify the gaps between its organisational capabilities and the demands of best practice regulation of election funding.

### **Recommendation 5**

That the NSW Government amends the *Parliamentary Electorates and Elections Act 1912* ("the PE&E Act") and the EFED Act to provide that, at the point of registration (and on an ongoing basis), agreement be reached between political parties and the NSWEC on how a given political party will demonstrate satisfactory governance standards and mechanisms of accountability.

### **Recommendation 6**

That the NSW Government amends the PE&E Act and the EFED Act to make it a requirement for the roles and responsibilities of senior party office holders to be made public and updated on a regular basis.

### **Recommendation 7**

That the NSWEC develops risk metrics and conducts a regular risk assessment of political parties to determine potential areas of non-compliance with legislative requirements which require regulatory action.

### **Recommendation 8**

That the NSW Government amends the PE&E Act and the EFED Act to require the NSWEC to make public the results of the risk assessments of political parties proposed in recommendation 7.

### **Recommendation 9**

That the NSW Government amends the PE&E Act and the EFED Act to empower the NSWEC to conduct

comprehensive random audits of low-risk parties and targeted audits of high-risk parties.

### **Recommendation 10**

That the NSW Government amends the PE&E Act and the EFED Act to provide a range of mid-level sanctions that can be imposed on political parties by the NSWEC.

### **Recommendation 11**

That the NSW Government amends the PE&E Act and the EFED Act to provide that the results of political party audits and the imposition of penalties on parties and their senior party office holders by the NSWEC be made public.

### **Recommendation 12**

That the NSW Government amends the PE&E Act and the EFED Act to provide that the NSWEC and political parties with moderate compliance risks enter into agreements, which attach governance activities or remedy conditions as required on parts of the Administration Fund, prior to the money being made available to the eligible parties.

### **Recommendation 13**

That the NSW Government amends the PE&E Act and the EFED Act to require the NSWEC to audit the effectiveness of the implementation of the agreed governance activities or remedies, publish the audit results and, if the agreed activities or remedies are not effectively implemented, seek the return of part of the Administration Fund.

### **Recommendation 14**

That the NSW Government amends the PE&E Act and the EFED Act to attach criminal and civil sanctions to failures of senior party office holders to meet their internal party governance responsibilities.

### **Recommendation 15**

That the NSW Government amends the PE&E Act to provide power to the NSWEC to deregister a political party for extreme cases of non-compliance.

### **Recommendation 16**

That the NSWEC adopts a mandatory electronic disclosure system, which allows for online, real-time reporting by political parties, candidates, groups, members of parliament and third-party campaigners in the lead-up to an election.

### **Recommendation 17**

That the NSW Government amends the EFED Act to improve the timeliness of the disclosure of political donations. In particular, consideration should be given to the implementation of quarterly disclosure obligations and the implementation of a real-time electronic disclosure regime during a set period prior to polling day.

### **Recommendation 18**

That the NSW Government amends the EFED Act to require the recipients of donations to disclose a donor's occupation and employer (if applicable) in relation to reportable political donations.

### **Recommendation 19**

That the NSW Government amends the EFED Act to require the terms and conditions of loans to be disclosed, along with repayment transactions.

### **Recommendation 20**

That the NSW Government amends the PE&E Act and the EFED Act to require registered political parties and third-party campaigners to disclose complete audited financial statements annually, and for those statements to be published online.

### **Recommendation 21**

That the NSW Government amends the EFED Act to require third-party campaigners to disclose all electoral expenditure and which (if any) political parties, candidates or issue agendas they are supporting or opposing.

### **Recommendation 22**

That the NSWEC makes available on its website, in various electronic formats, the analysis of political disclosures of donations and expenditures by political parties, groups, candidates, members of parliament and third-party campaigners in NSW that enhance the intelligibility of data and facilitate the analysis of disclosure information by civil society.



# Chapter 1: A culture of non-compliance

A situation in which citizens believe elections can be bought or that there is some quid pro quo for helping a candidate win must be seen as seriously damaging to the proper functioning of a democratic government. A corrupt member of parliament can be voted out of office if elections are free and fair. But if there is a loss of trust in the election process, then the whole system of representative government is weakened.

For this reason, all democracies have rules that define fair play in elections. The aim of laws that govern the raising and expenditure of funds for electoral purposes is twofold: first, to limit the corrupting effect of private financing of candidates and parties and, secondly, to promote concepts of equality and fairness for all who seek office. To these ends, most liberal democracies legislate a mixture of caps on donations, disclosure of funding sources, limits on electoral expenditure, bans on donations from some groups and disclosure of expenditures.

NSW has all of these elements in its legislation. Almost uniquely in the world, property developers and other groups in this state are banned from making any donations at all – the result of a long string of corruption scandals. Donor limits are low compared to many other democracies. Election spending is also tightly capped. Public funding to parties is set at a much higher level than anywhere else in Australia in order to reduce the pressure to seek private money.

After nearly a decade of legislative amendments, NSW now has some of the most restrictive election donation and expenditure rules of any democracy. But restrictive rules do not make regulation effective. If the framework of enforcement, scrutiny by civil society, incentives and penalties does not support compliance with the rules, then rules alone will be ineffective.

Although the NSW regulatory framework contains many elements of an effective enforcement system, the component parts of the system are assembled in such a way

as to reduce the effectiveness of the framework in practice; for example:

- registration of parties requires a bare minimum standard of governance, which is subject to minimal checks
- compliance is largely determined by checking paper reports but this comes at the expense of risk-focused regulatory action
- penalties for breaching rules have been set at a low level
- prosecutions have been hampered by a short limitation period for commencement of proceedings
- until recently, the former EFA was dominated by political appointments
- disclosure of relatively small donations is mandatory but not until well after an election
- the rules in NSW are restrictive by Australian standards but the difference in rules between NSW and other jurisdictions in the country has created opportunities for what is effectively a regulatory arbitrage, resulting in the recycling of donations through different jurisdictions.

Some of these weaknesses have been rectified. Recent changes to rules and sanctions have addressed some of the shortfalls that hindered compliance and enforcement actions. Most recently, there have been increases in maximum penalties for existing summary offences relating to political donations and electoral expenditure. The limitation period for commencing proceedings for summary offences has also been increased, which will facilitate prosecution. Importantly, limits on political donations have meant that third party campaigners and branches of political parties operating in other jurisdictions are no longer an effective conduit for

circumventing donation laws in NSW. In addition, a new separate indictable offence has also been created relating to schemes to circumvent the donation or expenditure prohibitions or restrictions. For serious matters, a member of parliament may now (if convicted) lose their seat.

But the NSW regulatory framework still falls well short of an effective system. With a few exceptions, the focus and remedies to date have centered on a simplistic enforcement model of regulation. The model requires the regulator to monitor compliance, investigate breaches and punish transgressions. It is built on the premise that the regulator can detect many of the serious breaches, that these can be prosecuted, and that the deterrence created by the application of serious sanctions will cause others to comply with the rules.

Such enforcement activities are at the apex of any regulatory framework. All political actors must know that, ultimately, they can be held to account for transgressions. In effect, tightening the rules and increasing sanctions might then be portrayed as increasing control of election behaviours.

In practice, however, regulatory models that consist only of detection and punishment, in the absence of a range of earlier regulatory responses, are largely ineffective. Over at least the past two decades, regulatory activities in most arenas have shifted to a more sophisticated mix of interventions. While detection and punishment sit at the apex of all regulatory systems, regulators spend more time avoiding reaching the point of prosecution. The goal of regulators is to develop a willingness and capability to comply with the rules by the regulated entity. To achieve this, regulators examine the risks to compliance by those being regulated and utilise a mix of enforceable direction, guidance and education to increase the likelihood of compliance. When operating effectively, the regulator spends most of its resources on informal supervision, guidance and education. Only when the risk of non-compliance escalates does the regulator escalate its response; and always with the intention of returning to a low level of intervention and a regulated entity that is willing and able to comply.

This model is commonly known as the regulatory pyramid or responsive regulation. It is an approach that is particularly suited to financial regulation and is typical of prudential regulators such as APRA. It is also the model that underpins the UK Electoral Commission's (UK EC) approach to the regulation of election financing. But it is not the approach in NSW. NSW now has tight rules and strong sanctions at the apex, but almost nothing else. The interventions and remedies available in most regulatory frameworks are largely absent in NSW electoral finance regulation.

## Regulatory reform

The political parties of NSW and the rest of Australia are notable for the diversity of organisational forms that compete for seats in parliament or compete to govern outright: from independents to relatively centralised structures and decentralised grassroots arrangements. The diversity of organisational forms can be seen as part of the richness and strength of the fabric of democracy.

For this reason, the Commission does not favour fundamentally changing the arrangements and institutions that are involved in the conduct of elections in NSW, including the internal structure of parties. Enacting legislation that places restrictive requirements on the internal operations of political parties is inconsistent with the nature of parties and their role in democracy.

Yet, there is no doubt that the internal party governance arrangements achieved by the current regulatory framework in NSW fall short of what is desirable in terms of holding parties and their senior officers accountable for non-compliance. There is neither a willingness nor a capability to comply; as such, a culture of non-compliance has developed. There have been few prosecutions and, therefore, little deterrence at the apex of the regulatory pyramid, and there are few other options available to the NSWEC apart from those at the base to ensure compliance.

The NSW system stands in stark contrast to the best practice approach that has been adopted by the UK EC. In the UK, the regulator oversees parties with a light and informal touch unless the regulator starts to develop concerns about the willingness and capability of the party to comply. The system balances the rights of private associations to be free of government intervention with the responsibilities that flow from electoral law compliance requirements and receipt of substantial public funds.

Central to this approach is the development of assurance that the parties are willing and able to comply with requirements. As is the case in prudential regulation, effective regulation such as the UK system makes the parties themselves central to the regulatory system by focusing on the development of strong internal governance arrangements and the accountability of senior party officials. While senior party officials ought not to be held responsible for rogue candidates who breach requirements when robust internal governance arrangements are in place, they ought to be held responsible when the absence of these arrangements allows such conduct to flourish.

In many ways, the parties themselves – rather than the NSWEC – are best placed to detect breaches of requirements because of their access to numerous internal party information networks. The UK model motivates party

officials to tackle non-compliant behaviour and to promote a culture where wrongful conduct is not tolerated. First, this is achieved through the placing of specific obligations and corresponding penalties on senior party officials and, secondly, through linking compliance with penalties, such as limiting access to public funding.

In some cases, the NSW system already contains the mechanisms that would be required to implement a model similar to the UK EC approach. For example, access to public funding by parties is already tied to compliance, albeit in a minimal form. Similarly, although this is not compulsory, the former EFA recommended that parties adopt a constitution that includes their internal governance arrangements. Strengthening these mechanisms would enhance the party's control of its activities.

The implementation of such a regulatory model would, however, require the NSWEC to significantly develop its capabilities in risk analysis; that is, information technology (IT) skills, forensic analysis, intelligence gathering and strategic investigation. It would also need to shift its focus from administration to regulation by reducing proportionally the effort put into its current compliance-based auditing program, which is heavily focused on matching donation disclosure forms and checking receipts for claims on public money.

In preparing the recommendations in this report, the Commission has drawn on election finance regulatory best practice in the UK, US and Canada. The Commission has also drawn on examples from the field of prudential regulation. Prudential regulation faces many of the same challenges as election funding regulation; that is, money is fungible and easily secreted and moved, the stakes are high, the risk appetite is high, and the rules are complex. The organisations involved in the financial services industry are also complex and significant problem behaviours can exist in small pockets and away from scrutiny.

As in the area of financial regulation, a key challenge is detecting accounts holding illegal money, corrupt decisions for donations, or pockets of illegal or high-risk behaviour in regulated entities. Yet, for the entity itself, knowledge and control of such behaviour should be a central focus of internal controls and governance, similar to the requirements placed on board directors.

To this end, regulators, particularly in prudential regulation, focus much of their efforts on assessing and regulating the internal controls and governance of the regulated entities. Rather than detecting breaches themselves, regulators develop a degree of assurance that an entity is able to govern itself. Such regulatory assurance is almost entirely absent from the NSW regulatory framework. The Commission makes a number of recommendations to address this issue, including:

- clear nomination for, and public reporting of, accountabilities and key leadership roles at party registration
- principles of governance to be agreed on at the time of party registration and at regular periods, and made public
- assessment of the non-compliance risks posed by the functioning of these internal governance systems
- public reporting of the effectiveness of internal party controls and governance mechanisms
- the development of a range of regulatory responses to the assessed level of risk, including conditions placed on access to public money.

## Enhanced transparency

Reporting and transparency are central to most regulatory frameworks. Presented with the right information, stakeholders are better placed to hold an entity to account than the regulator. The stakeholders are able to draw inferences and bring to bear a range of knowledge that a bureaucracy cannot. All incorporated entities have numerous reporting requirements. For example, financial data, along with other significant information, must be reported in annual reports, profit warnings and other material matters must be reported in a timely way, and governance systems are also reported on.

Similarly, NSW donations and electoral expenditure are subject to stringent reporting requirements. The disclosure and public reporting of electoral donations and expenditure empowers civil society. The range of bodies that makes up civil society – including the media, unions and interest groups – plays a central role in keeping parties and candidates honest. With the right information, they are able to scrutinise electoral funding both for the honesty of disclosure and potential relationships between donations and government decision-making.

The current system of disclosure is cumbersome, with NSW being one of the few democracies in the world that requires both the donor and recipient to disclose the donation. The result of the largely paper-based system, which has a late disclosure deadline,<sup>2</sup> is not only that the NSWEC's resources are consumed by matching pieces of paper from the parties and donors, but that real-time disclosure is impossible. Civil

<sup>2</sup> The NSW Government has enacted a special provision for the 2015 state election that provides a requirement for any party, elected member, group, candidate or third-party campaigner to publicly disclose donations received from 1 July 2014 to 1 March 2015 within seven days after the end of this period.

society's role in holding the parties to account is largely stymied by these limitations of disclosure.

Consequently, the Commission believes that transparency of electoral expenditure and donations in NSW could be improved through a number of reforms. These include real-time disclosures at certain periods of the election cycle and requiring the donation recipients to collect employment information from donors to allow for additional analysis of money flows. There is also scope for the NSWEC to improve the accessibility of the various disclosures that are available on its website.

## NSWEC capabilities

To some extent, all regulators must undertake a degree of baseline monitoring of their regulated entities regardless of their other work in risk-assessment, forensic analysis, investigation, prosecution and day-to-day supervisory activities. There is no doubt that the type of election financial regulation for which the NSWEC was established requires a degree of paper-based compliance monitoring. The NSWEC undertakes important work in checking the paperwork relating to disclosures, audits and claims for public money.

But with finite resources, such paper-checking activities come at the expense of other regulatory activities, including assessing non-compliance risk, intelligence gathering, forensic analysis, developing internal capabilities of parties to manage their finances, and in investigating and prosecuting serious violations. Large volumes of legislated administrative work tend to weaken the strategic capability of any regulator.

In NSW, the legislated administrative workload is substantial. The NSWEC is required to deal with the double-disclosure system referred to above. Donation disclosure requirements are set at a relatively low dollar value, increasing the volume of disclosures and the volume of double-matching that is undertaken. Much of this involves paper-based processing (although there has been a recent increase in electronic disclosure management capabilities within the NSWEC). The result is that the administrative burden is large in comparison to other democracies. In fact, the system in NSW is almost unique. Many other jurisdictions rely on electronic disclosure, generated by recipients only, and violations are detected by electronic analyses of anomalies and audit, rather than manual double-matching.

Some jurisdictions are now turning to the application of data analysis and data mining technology as a means of detecting subtle and complex patterns of non-compliance. A sophisticated model is used by the Reports Analysis Division (RAD) at the US Federal Election Commission. Rather than just publishing disclosure information for review, RAD performs forensic analysis using data mining and analytics software that helps to detect non-compliance, improve

accuracy and verify information about the filer and the transaction. The software identifies and tracks suspicious and/or potentially illegal transactions, such as donation splitting, multiple donations from the same address, mathematical discrepancies, failures to itemise, and large donations to many candidates from a single donor on a specific date. Suspicious or irregular transactions that fit specific quantitative or qualitative criteria are flagged for further analysis by auditors.

The NSWEC has recently installed new software with data analytics features, which should make detection of suspicious or irregular transactions easier. The NSWEC now employs a wide array of compliance analysis tools to trigger closer examination for potential non-compliance activity. Ideally, these tools will help streamline detection to help identify non-compliance trends, allow regulators to more efficiently allocate resources towards areas of concern, and free up auditor time and energy to allow for a broader, more strategic focus.

One disadvantage of a dual disclosure focus is that the NSWEC has to spend considerable time following up on failures by donors to disclose donations, which is resource-intensive given that donors often do not understand their disclosure responsibilities.

Despite some advantages, the focus on dual disclosure as a primary safeguard against non-compliance with election funding and spending laws is a time-consuming and inefficient process that few regulators of political funding in other jurisdictions perform. The opportunity lost in strategic regulatory work is hard to justify. For this reason, the Commission recommends that no donor disclosure is required.

The NSWEC is further burdened by overseeing the administrative money provided to eligible parties. Unlike all other jurisdictions in Australia, parties in NSW are able to be reimbursed for administration expenses up to defined limits.<sup>3</sup> The Administration Fund was introduced on 1 January 2011 to reimburse eligible parties and independent members of parliament for their administration and operating expenses. This funding, which compensates for losses incurred by donation restrictions, effectively doubles the amount of public money provided to NSW parties relative to other Australian jurisdictions.

As the scheme is based on reimbursement, the NSWEC scrutinises every invoice submitted by eligible parties to

<sup>3</sup> Not all political parties are eligible for the Administration Fund. A party is eligible for payments where, amongst other things, it endorsed candidates who were elected at the previous state election. Parties that are not eligible for payments from the Administration Fund may be eligible for payments from the Policy Development Fund.

claim from the Administration Fund. Whilst this procedure can serve as a corruption control by guarding against false expenses claims, it is a protracted process that has limited effectiveness. Parties have numerous expenses to claim from the Administration Fund and most (if not all) eligible parties receive the full amount to which they are entitled. If one receipt is found to be incorrect by the NSWEC, parties have many other receipts they can submit in its place to receive the full amount of funding.

As there is no enforced deadline, a party can request administration funding months or years after a lodgement period has expired. Even with late applications, the NSWEC still has to reimburse the party within a set period of time, which puts pressure on NSWEC resources.

The NSWEC is expending taxpayer resources to administer the verification of claims and payment from the Administration Fund even though eligible parties generally will receive the full amount regardless of the NSWEC's checking. Even though taxpayers pay both for the parties to administer themselves and the NSWEC to administer the fund, in the end, parties receive the full amount even if their internal controls are unsatisfactory.

If the NSWEC is to rebalance the administrative and regulatory functions, disclosure should be entirely electronic, generated by recipients only, together with automated analytics that can flag matters requiring forensic analysis or further investigation. The Administration Fund should be a grant to parties rather than a reimbursement scheme. As a grant, it can then be made conditional on the effectiveness of the internal governance and administration of the parties, for which the taxpayer money was provided in the first place. Accordingly, the Commission recommends that parties access the Administration Fund via a grant, to which conditions to rectify governance problems may be attached.

With such a long-term emphasis on paper-based administration, the regulator's capabilities could be expected to have developed around such activities. For the NSWEC to shift its regulatory focus to electronic disclosure, electronic forensic analysis, risk assessment, intelligence gathering, investigation and prosecution, supervision of party governance and value-adding to disclosures will require a substantial realignment of internal capabilities. Following the recent reconstitution of the NSWEC and its board to provide more independence from government, an opportunity is presented to conduct a root and branch examination of its capabilities as a regulatory agency. Accordingly, the Commission has recommended that a comprehensive review be undertaken of the NSWEC's capabilities. The Commission also notes that the NSWEC has already commenced a review of staff in its Funding and Disclosure Branch.

## Recommendation 1

**That the NSW Government amends the *Election Funding, Expenditure and Disclosures Act 1981* ("the EFED Act") to convert administration funding from a reimbursement scheme to a grant, contingent on the internal governance capability of political parties.**

## Recommendation 2

**That the NSW Government amends the EFED Act to abolish donor disclosure of donations, effectively making recipient disclosure of donations the only disclosure required.**

## Recommendation 3

**That the NSWEC replaces the matching of donor and recipient disclosures with best practice electronic analyses and forensic audit and investigation practices.**

## Recommendation 4

**That the NSWEC conducts a root and branch review to identify the gaps between its organisational capabilities and the demands of best practice regulation of election funding.**



## Chapter 2: Better practice regulation of electoral financing

Risk-based regulation maximises the impact of the limited resources available to regulators by prioritising and solving important problems.<sup>4</sup> Under such an approach, resources are directed to where they are needed most and will have the greatest impact. This type of approach aims to prevent non-compliance by continuously analysing and treating risks before they become a problem, but at the same time minimising regulatory interference in well-functioning entities.

The application of such best practice regulation to election financing is illustrated by the approach developed by the UK EC. Soon after its inception through the *Political Parties, Elections and Referendums Act 2000* (“the PPERA Act”), the UK EC discovered that excessive bureaucracy and administrative burdens were overwhelming it, as is the case for the NSWEC. With some 400 registered political parties under its regulatory jurisdiction, the UK EC acknowledged that it simply did not have the resources to monitor or audit each of the parties to the same extent. A report commissioned by the Chancellor of the Exchequer<sup>5</sup> proposed a new way of reducing the administrative burden of regulation through a risk-based approach and prioritisation of regulatory activities.<sup>6</sup>

The PPERA Act was amended to implement a risk-based approach while also strengthening the UK EC’s ability to regulate by adding new supervisory and investigatory powers and a range of civil sanctions.<sup>7</sup> The implementation of this

new regulatory framework dramatically shaped how the UK EC operates, with risk-based regulation now forming the core of its activity.<sup>8</sup> This approach strategically prioritises regulatory activities according to a risk-based framework shaping how the UK EC directs advice, prioritises audit activities, and monitors political finance and campaign activity.<sup>9</sup>

For the UK, these electoral reform measures were introduced at the tail-end of regulatory reforms that had swept across other Anglosphere jurisdictions including the US (1975) Australia (1984) and Canada (1989–2000). Having the advantage of observing others’ earlier forays into political finance regulation, and with significant development in the understanding of effective regulation, the new UK regulator was able to learn from regulatory successes and failures to implement a best practice model.

### The regulatory pyramid

One of the key lessons adopted by the UK EC was that regulation is more effective if it is responsive to the risk of non-compliance posed by the regulated entity, and that effective response requires a mix of solutions ranging from persuasion and civil penalties to criminal prosecution and party deregistration. Pyramid approaches to regulation are widely used by regulators, including the Australian Taxation Office,<sup>10</sup> the Australian Competition and Consumer Commission (ACCC) and the Australian Securities and

4 MK Sparrow, *The regulatory craft: Controlling risks, solving problems, and managing compliance*, Brookings Institution, Washington DC, 2000.

5 The Chancellor of the Exchequer is the UK government’s chief financial minister.

6 P Hampton, *Reducing administrative burdens: Effective inspection and enforcement*, 2005, accessed at [www.fera.defra.gov.uk/aboutUs/betterRegulation/documents/hamptonPrinciples.pdf](http://www.fera.defra.gov.uk/aboutUs/betterRegulation/documents/hamptonPrinciples.pdf)

7 UK EC, *Better regulation of party and election finance*, 2010, accessed at [www.electoralcommission.org.uk/\\_\\_data/assets/pdf\\_file/0014/100139/Report-on-Enforcement-Policy-Consultation.pdf](http://www.electoralcommission.org.uk/__data/assets/pdf_file/0014/100139/Report-on-Enforcement-Policy-Consultation.pdf)

8 UK EC, *Prioritising our regulatory activity: Audit, advice and campaign monitoring*, 2012, accessed at [www.electoralcommission.org.uk/\\_\\_data/assets/pdf\\_file/0006/107097/Prioritising-Our-Regulatory-Activity-updated-May-2012.pdf](http://www.electoralcommission.org.uk/__data/assets/pdf_file/0006/107097/Prioritising-Our-Regulatory-Activity-updated-May-2012.pdf)

9 Ibid.

10 J Braithwaite and V Braithwaite, “An evolving compliance model for tax enforcement”. In Neal Shover and John Paul Wright (ed.), *Crimes of privilege: Readings in white-collar crime*, Oxford University Press, New York, 2000, pp. 1–19.

Investments Commission (ASIC).<sup>11</sup> As depicted in Figure 1, the model is pyramid-shaped, as persuasion and guidance (bottom tier) should be used more frequently to encourage compliance than moderate and severe penalties (middle and top tiers). The range of responses allows the regulator to escalate and de-escalate regulation, as required.

**Figure 1: An example of a pyramid of sanctions for enforcement<sup>12</sup>**



Effective enforcement depends not only on the willingness of the regulated participants to comply, but also on the range of regulatory tools established by legislation. Strong rules without strong enforcement are a major threat to the

<sup>11</sup> C Wood, M Ivec and J Job, and V Braithwaite, *Applications of responsive regulatory theory in Australia and overseas*, Regulatory Institutions Network Occasional Paper 15, Australian National University, 2010 accessed at [www.regnet.anu.edu.au/sites/default/files/ROP15.pdf](http://www.regnet.anu.edu.au/sites/default/files/ROP15.pdf)

<sup>12</sup> I Ayres and J Braithwaite, *Responsive regulation: Transcending the deregulation debate*, Oxford University Press, New York, 1992, p. 35.

effectiveness of the regulatory regime as a whole. As an example, since the UK EC has a wide range of regulatory actions and powers to achieve compliance, parties often comply voluntarily. The enforcement pyramid provides regulators with the right range of tools to escalate and de-escalate regulatory responses as needed to encourage compliance.

Regulators that have powers at their disposal only at the base and apex of the pyramid, as is the case in the NSW system, can respond to compliance problems only with responses that are often too soft or too severe. As there is a limited selection of middle-range responses, there is limited incentive for the parties to comply with regulations, as an escalation to severe sanctions following a minor offence is unlikely.

At the base of the pyramid is persuasion, which includes education. The regulator, in constant contact with the parties, assesses whether they are willing and capable of complying with regulations. Parties that are willing and have the internal capability to comply will continue to engage in self-regulation. There is an incentive for parties to establish effective internal controls, as they receive minimal interference from the regulator. If a party exploits the situation, non-compliance begins with warning letters, increases to supervision and moves to sanctions. If a party is not willing to comply or capable of complying with regulations, the regulator escalates enforcement by using collaborative capacity-building and undertaking close supervision. Where such supervision has not effectively reduced the risk, heavy sanctions are applied which may include civil and criminal penalties.

Under very rare circumstances, when continued non-compliance is serious, where risk is unacceptable and all other regulatory strategies and tactics have failed to induce compliance, deregistration should be an available option to the regulator. For a more detailed discussion of the UK EC's regulatory approach and the enforcement pyramid, refer

to case study 1. This approach has also been used by other better practice regulators, including APRA (see case study 2). Both case studies are presented at the end of this chapter.

## The process of responsive regulation

Much of the current legislation in NSW focuses on discrete elements such as thresholds for donations, penalties for non-compliance, deadlines, defined periods, limits on expenditure, and so on. Effective regulation, however, is better seen as a process that brings together and integrates the disparate elements. Broadly, the party registration step can be tied to agreement of the accountabilities of senior members and the internal governance arrangements of parties. These governance arrangements become central to the regulator's assessment of the risk of non-compliance, driving the choice of appropriate regulatory intervention. Interventions include the option to place conditions on the public money provided to parties for the purpose of internal administration. The regulators' interventions are assessed and the risk of non-compliance reassessed. The process is cyclical, driven by the risk of non-compliance and the impact of interventions.

Each of the steps of the regulatory process is described in more detail below.

### Party registration

As private associations, political parties are not subjected to the same level of regulation as corporate entities. Viewed as private associations in NSW and around the world, parties can, as a general principle, raise the funds they need to maintain freedom of participation in the democratic process. The prevailing view is that there is no place for government interference in their internal governance or their freedom of association. As a consequence, senior officers of the parties are largely unaccountable and internal governance is their business alone.

Juxtaposed against the private association status of political parties is the requirement for them to abide by complex disclosure, electoral expenditure and election funding arrangements. These arrangements have arisen as a result of public concern about the political activities of parties, a history of failure to comply with the rules and the need for regulators to be able to hold the parties and their officers to account. Non-compliance has the potential to cause significant public harm, and it is reasonable to expect that any organisations in receipt of taxpayer money should be tightly regulated. Generally, these organisations would be incorporated entities with a legal structure that makes clear who is accountable for mandated internal governance and control.

Despite restrictive rules and significant public funding, political parties or their senior officers in NSW are not accountable in the same way as corporate entities. NSW laws do not require political parties to be incorporated entities or deemed incorporated. Imposing mandatory incorporation would create a barrier to the entry of very small parties and have a chilling effect on their membership and, consequently, on citizen participation in the democratic process.

In NSW, the major parties (namely, the Australian Labor Party, the Liberal Party and the National Party) are classified under common law as unincorporated or voluntary associations. Several NSW minor parties are either registered as a companies under the *Corporations Act 2001* or as incorporated associations under the *Associations Incorporation Act 2009*. In common with many other jurisdictions (for example, Canada, the UK and France), the doctrine of party agent is applied in NSW. That is, party agents – who do not necessarily have to be senior office holders – are held accountable for compliance with election funding rules.

The former EFA examined the possibility of deeming parties as incorporated entities for the purposes of election funding as a means of making them and the senior officers more accountable. Deeming is legislatively possible for some purposes; for example, limiting the conditions imposed on the parties to only those who were directly relevant to accountability and internal controls. Deeming, however, creates an uncertain status and would require the NSWEC to act as a corporate regulator. Deeming parties as bodies corporates would do little to overcome the problem of infringing upon their rights as private associations or to offset the negative effects of incorporation. An alternative to incorporation or deeming is to tighten the accountability and internal governance requirements of parties at the point of registration.

Registration requirements vary considerably between countries. In the UK, party registration is not compulsory, but where a party does register, it must pay a lodgement fee and provide details of its financial structure and its constitution. The UK EC recommends that a registered party's constitution should set out its organisational structure (for example, branches, affiliated organisations, headquarters, and so on), its governance arrangements (for example, decision-making procedures, appointments of officers, and so on) along with its aims and objectives. Two types of registration exist; registration for major parties and registration for minor parties. The latter is not bound by the same vigorous financial controls. Nonetheless, during the registration process parties are informed that those that do not meet regulation standards will face fines or more serious enforcement action.



In contrast, registration requirements in NSW are minimal. Parties must be established on the basis of a constitution, have a minimum number of members (750) who are on the NSW electoral roll,<sup>13</sup> and agree to comply with disclosure requirements under the EFED Act. Registration, however, is particularly valuable to major parties because it confers a number of rights, including the promotion of the party through the ballot paper.

As they are eligible for benefits provided under the EFED Act, it is appropriate that, in return, parties should meet some basic conditions for continued registration. As part of registration, the roles and responsibilities of the most senior levels of leadership can be defined, updated at regular intervals if there are personnel changes, linked to legal accountability, and made public by the NSWEC. This will achieve a similar effect to incorporation with significantly less infringement on the private voluntary association status of parties or limitation of democratic processes.

The Australian Securities Exchange (ASX) sets the principles of good governance against which corporate entities report.<sup>14</sup> This set of principles is just as applicable as a set of requirements for the registration of parties. Because they are principles, the freedom of parties to self-organise is largely preserved. Parties are able to determine how they might meet these principles and must reach agreement with the regulator on an acceptable governance framework in order to be registered.

The principles provide a basis for:

- setting out the respective roles and responsibilities of the most senior levels of leadership and management within parties, and how their performance will be monitored and evaluated
- structuring decision-making at the top level to add value according to size, composition, skills and commitment of the party
- promoting ethical and responsible decision-making
- safeguarding the integrity of financial reporting by having formal and rigorous processes in place that can be independently verified
- making timely and balanced disclosures in a transparent way
- respecting the rights of the regulator and the general public to seek accountability

<sup>13</sup> Parties contesting local government elections require a minimum of 100 members.

<sup>14</sup> ASX Corporate Governance Council, *Corporate governance principles and recommendations*, 3rd Edition, 2014, accessed at [www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf](http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf)

- establishing and regularly reviewing a risk management framework.

By agreeing to incorporate the above principles at the point of registration, parties in NSW would be required to provide details of their leader, party officers, agents and auditors. In the event that administration of funding is converted from a reimbursement scheme to a grant, parties should also be required to satisfy the NSWEC that any grant will be expended on administration and that auditable accounts of administration expenditure are kept. Importantly, legal responsibilities for election funding compliance and governance would shift from the party agent to senior party office holders within the party.

## Recommendation 5

**That the NSW Government amends the *Parliamentary Electorates and Elections Act 1912* (“the PE&E Act”) and the EFED Act to provide that, at the point of registration (and on an ongoing basis), agreement be reached between political parties and the NSWEC on how a given political party will demonstrate satisfactory governance standards and mechanisms of accountability.**

## Recommendation 6

**That the NSW Government amends the PE&E Act and the EFED Act to make it a requirement for the roles and responsibilities of senior party office holders to be made public and updated on a regular basis.**

## Party compliance assessment

Risk assessment examines the capability and the willingness of a party to comply with regulations. This involves a consideration of the regulator’s objectives and potential risks that may block the achievement of these objectives. There are several risk factors that influence whether a party is willing and able to comply with regulations. Some of these risks include:

- past history of non-compliance
- lack of adequate staff, systems or procedures to govern a party
- lack of understanding of the regulations
- complex party structure with multiple accounting units.

The principles of good governance provide a framework to assess risk and can be used to assign a risk rating to parties. Together with other sources of data, including cooperation of party management and staff, the regulator is able to make an informed judgment of a party’s ability to govern and manage finances. These data are analysed to develop

a risk profile that highlights important problems of potential non-compliance that would require regulatory action. The likelihood and potential consequence of each of these risks are considered to determine which risks require closer attention from the regulator.

To illustrate, the UK EC constructs party profiles that are based on considerations about the operational scale (for example, level of elected office held), financial data (for example, reported income) and compliance record (for example, late submission of statutory returns) of the party.<sup>15</sup> Each of these individual risk areas is scored to determine the requirement of a regulatory audit. For example, a party with a small operational scale, a low level of income, and a good compliance record has a low likelihood to be audited. Such a party is able to handle the volume of donations it receives and is not facing funding pressures. As the party has a small operational scale and budget, non-compliance is unlikely to have a significant impact on public confidence and the fairness of elections. However, a party with a large operational scale, financial debt and a mixed record of compliance represents a much larger risk and is much more likely to be subjected to a regulatory audit.

## Recommendation 7

**That the NSWEC develops risk metrics and conducts a regular risk assessment of political parties to determine potential areas of non-compliance with legislative requirements which require regulatory action.**

## Recommendation 8

**That the NSW Government amends the PE&E Act and the EFED Act to require the NSWEC to make public the results of the risk assessments of political parties proposed in recommendation 7.**

## Responsive regulatory action

The risk assessment informs which areas of a party's internal capabilities require regulatory action. Each party receives regulatory intervention tailored to their risk profile, with the objective being to shift parties down to a low level of risk (see Figure 2).

Parties that meet the principles of good governance will receive a low risk rating and be rewarded with minimal intervention by the regulator. As the party's internal capabilities are strong, the party can self-manage, with the regulator focusing on provision of education and guidance.

Parties with moderate internal capabilities receive greater scrutiny and regulatory intervention. Parties that are unwilling to comply with regulations and do not have the internal capabilities are rated as high risk and subjected to greater regulatory action, which may include moderate fines, civil and criminal punishment and partial or complete withdrawal of the Administration Fund. The severity of the fines and other sanctions applied naturally involves some discretion.

## Figure 2: A risk-based enforcement pyramid of tiered strategies for party regulation



## Regulatory audit

The level of risk determines the frequency and type of audit. The function of audit is to reassess the internal capabilities of the party and to determine the effectiveness of any past regulatory intervention. While each party is subject to a yearly risk assessment, which audits the internal capabilities of a party (for example, financial systems in place and clear accountabilities), additional audits are conducted based on the level of risk.

Audit resources are primarily directed towards moderate and high-risk parties in order to bring these parties back into the range of an acceptable level of risk. High-risk parties receive frequent targeted audits and are scrutinised closely to determine the effectiveness of regulatory interventions. The ultimate aim is to shift risky parties down to a point where they are capable of self-compliance.

In line with the UK EC model, low-risk parties receive random audits. Random audit ensures continued compliance with regulations. If a regulator directs its resources only to high-risk parties, low-risk parties may become less compliant as non-compliance is unlikely to be detected. Random audits

<sup>15</sup> UK EC, *Prioritising our regulatory activity: Audit, advice and campaign monitoring*, 2012, accessed at [www.electoralcommission.org.uk/\\_data/assets/pdf\\_file/0006/107097/Prioritising-Our-Regulatory-Activity-updated-May-2012.pdf](http://www.electoralcommission.org.uk/_data/assets/pdf_file/0006/107097/Prioritising-Our-Regulatory-Activity-updated-May-2012.pdf)

are also useful for assessing the effectiveness of risk profiling criteria and for identifying new and emerging risks.

## Recommendation 9

**That the NSW Government amends the PE&E Act and the EFED Act to empower the NSWEC to conduct comprehensive random audits of low-risk parties and targeted audits of high-risk parties.**

## Escalating interventions

The process of responsive regulation can work only if the NSWEC has available to it a suite of sanctions that it is able to tailor to the different levels of risk. For the regulatory pyramid to function, the regulator must be able to create incentives for the parties to reduce their risk and increase their willingness and capability to comply. The educational assistance and guidance offered at the base of the pyramid will be embraced by the parties if the alternative is escalating intervention, increasing risk of sanctions and increasing use of directions from the regulator. The options available to the regulator need to create an environment in which the party is willing to take the necessary steps to comply in order to be “left alone”.

The most significant flaw in the NSW system at this time is that almost no mid-level interventions are available to the NSWEC. Currently, issuing directions and stop notices, public naming and shaming or withholding public money are not feasible options for the NSWEC. Also, at the apex of the pyramid, even though prosecution for serious offences is theoretically possible, only a few have ever been successful. The parties have no strong incentive to engage with the NSWEC or to voluntarily improve their internal controls. As a result, the education and assistance currently offered by the NSWEC to the parties is largely shunned, governance remains weak and the culture of non-compliance continues.

## Low risk, limited regulatory response

If a party has good control of its electoral financing activities and does not represent a risk to the electoral process, then it should be free to run its affairs without government interference; that is, as a voluntary private association. The appropriate regulatory response to parties identified as low risk is minimal involvement. While a basic level of regular audits and evaluation of governance systems is required to allow the regulator to fully understand the capability and willingness of the party to comply, the supervision of the party is minimal.

In fact, minimal supervision is an essential incentive for parties to develop effective compliance capabilities. The combination of minimal intervention and low risk rating, along with the knowledge that a worsening risk profile will bring much closer supervision and greater intervention

by the regulator, creates an effective incentive for parties to comply and ensures that they have a genuine interest in taking advantage of education, training and guidance provided by the regulator. Education can help a party to understand emerging trends and maintain a high standard of responsiveness and engagement.

Such education and training, along with informal close supervisory relationships between party and regulator should represent the bulk of the regulator’s activities at the bottom tier of a properly functioning regulatory pyramid.

In NSW, the current regulatory framework does not create incentives for parties to engage with the regulator in such a positive way. There is no appreciable benefit flowing from engagement, and no looming threat of escalation for failure to engage. It is not surprising, then, that attendance at training seminars has been poor.<sup>16</sup> Similarly, no voluntary compliance agreement has ever been reached between a party and the former EFA.<sup>17</sup> For the parties, there is no benefit, only cost, of such an engagement.

## Escalating responses targeting parties with moderate risk

Unless legislation requires them to, parties are not compelled by the regulatory framework to work with the NSWEC on issues relating to risk or internal governance. The major flaw in the current regulatory framework is the absence of any real incentive for parties to move to the bottom of the pyramid by establishing strong governance systems and, as such, to engage with the regulator at the base of the regulatory pyramid. There is an almost complete absence of effective mid-level regulatory actions available to the NSWEC in response to parties with moderate governance risks.

Effective mid-level regulatory action is arguably the key to the responsive regulatory framework because it encourages low risk parties to comply or face escalating penalties and regulatory action. It encourages parties with moderate risk profiles to “get their house in order” to be able to minimise regulatory intervention. Currently, the range of sanctions and levers available to the NSWEC is either too weak (appropriate for minor non-compliance) or too strong (suited for major non-compliance).

Other regulators, including the UK EC and APRA, take a distinctly hands-on approach to working with parties with

16 K Schott, A Tink and J Watkins, *Interim Report – Political Donations*, 2014, accessed at [www.dpc.nsw.gov.au/\\_\\_data/assets/pdf\\_file/0010/166195/Interim\\_Report\\_-\\_9\\_Oct.pdf](http://www.dpc.nsw.gov.au/__data/assets/pdf_file/0010/166195/Interim_Report_-_9_Oct.pdf)

17 The former EFA verbally advised the Commission on 23 October 2014 that it had not, to date, entered into a Compliance Agreement with any person (which includes parties) as it is empowered to do under s 110B of the *Election Funding, Expenditure and Disclosure Act 1981*.

moderate risk, using a collaborative supervisory approach, working hand-in-hand with the regulated entities to identify and execute a strategy for risk reduction, and achieve desired compliance outcomes. If mid-range responses by the NSWEC were to be effective, the NSWEC would have a range of mid-level options available that might include:

- more regular risk profiling
- more frequent random audits and scrutiny, combined with targeted audits
- moderate fines for moderate violations
- close supervision
- reputational penalties (for example, incurred penalties are published)
- formal non-compliance warnings and stop notices
- conditions on grants for administration and organisation.

The UK EC, for example, publishes on a monthly basis a list of offences, including the name of offenders, on its website.<sup>18</sup> Other measures can include formal non-compliance warnings and moderate fines. Of the options available, one of the most important is the ability of the regulator to tie the public money provided to parties to effective internal control. In many democracies, conditions placed on public funding are used to rectify the problem behaviour of parties. In theory, this is the situation in NSW, with access to public funding contingent on compliance; in practice, the money has never been withheld.

## Recommendation 10

**That the NSW Government amends the PE&E Act and the EFED Act to provide a range of mid-level sanctions that can be imposed on political parties by the NSWEC.**

## Recommendation 11

**That the NSW Government amends the PE&E Act and the EFED Act to provide that the results of political party audits and the imposition of penalties on parties and their senior party office holders by the NSWEC be made public.**

## Using administration grants as leverage

In NSW, the amount of public money to eligible parties was increased to compensate for funds lost through restrictions on donations and to help with the administration costs of

<sup>18</sup> UK EC, accessed at [www.electoralcommission.org.uk/\\_\\_data/assets/pdf\\_file/0009/151659/Cases-publication.pdf](http://www.electoralcommission.org.uk/__data/assets/pdf_file/0009/151659/Cases-publication.pdf)

complying with newly enacted donor and expenditure caps. Party agents lodge claims for funding to reimburse the party for administration and operating expenses. Some examples of expenses that can be claimed from the Administration Fund include the management of elected members' official activities and the administrative costs of policy formulation.

For the 2011 election cycle, ongoing party subsidies for administration expenses exceeded grants for actual campaign-related expenses by over 25%, totalling nearly \$29 million during the four-year disclosure period (from July 2009 to June 2013). This figure accounts for about \$6.24 per elector/vote. Payments to the parties from the Administration Fund during the 2013–14 financial year alone totalled over \$10 million, with 75% going to the NSW branches of the Australian Labor Party, the Liberal Party and the National Party. Together with public funding for election campaigns themselves, NSW provided a total of nearly \$11 per elector in taxpayer funds to political parties during the 2011 election cycle, compared with an average public funding of about \$3.50 per elector across other Australian states and the Australian Commonwealth over the past election cycle.<sup>19</sup>

As the Administration Fund was implemented to offset limits on parties' funding sources caused by recently imposed donation caps, there is an argument that these subsidies are fair compensation for loss of income. On the other hand, when millions of dollars are provided to parties for their administration and governance, failures in those areas can be seen as indicative of poor value for the public funds expended.

Where the NSWEC has assessed the risk of a party as moderate range, based in part on assessment against the governance arrangements agreed at party registration, formal conditions and accountability measures attached to the Administration Fund are a logical mid-range remedy.

As already occurs in some grants of public funds to private organisations, such as non-government organisations, a portion of the funds can be earmarked for specific governance activities or remedies reducing the risk of non-compliance, agreed jointly by the regulator and the party. The outcome of such activities is subject to assessment. If the outcome has not been achieved, the earmarked portion of the public money may be returned to the government or withheld from the next round of funding.

## Recommendation 12

**That the NSW Government amends the PE&E Act and the EFED Act to provide that the NSWEC and political parties with moderate compliance risks**

<sup>19</sup> K Schott, A Tink and J Watkins, *Working Paper 4 – The Cost of Elections in New South Wales*, 2014, figures calculated from p. 1, accessed at [www.dpc.nsw.gov.au/\\_\\_data/assets/pdf\\_file/0007/165706/Working\\_paper\\_4\\_-\\_Cost\\_of\\_elections.pdf](http://www.dpc.nsw.gov.au/__data/assets/pdf_file/0007/165706/Working_paper_4_-_Cost_of_elections.pdf)



enter into agreements, which attach governance activities or remedy conditions as required on parts of the Administration Fund, prior to the money being made available to the eligible parties.

### Recommendation 13

That the NSW Government amends the PE&E Act and the EFED Act to require the NSWEC to audit the effectiveness of the implementation of the agreed governance activities or remedies, publish the audit results and, if the agreed activities or remedies are not effectively implemented, seek the return of part of the Administration Fund.

### High risk is met with forceful regulatory responses

In NSW, the penalties for violations of funding rules have recently been strengthened. The period in which proceedings can be instituted has also been extended. The prosecution and sanctions regime for rogue party members is now more robust, however, a review of relevant legislation should be considered in order to identify any unforeseen barriers to prosecution and barriers to the imposition of the increased penalties.

The same cannot be said for those responsible for managing the internal governance of the parties. There are no penalties of significance attached to failure to diligently carry out the responsibilities of internal senior party office holders in the NSW system.

For the regulatory pyramid to function effectively, serious consequences must follow willful failure of the leadership of parties to manage election funding, expenditure and disclosure matters. At the apex of the regulatory pyramid, the leadership of parties that consistently fail to achieve compliance objectives should face a range of sanctions in the same way as senior members of corporations can be held accountable.

While senior members of a corporation ought not to be held responsible for rogue operators in their organisation, they can be held accountable if they fail to exercise due diligence or to implement robust internal governance arrangements, thereby allowing rogue operators to flourish.

Furthermore, in the most serious cases, and as a last resort, the NSWEC should be able to deregister parties for cases of extreme non-compliance. Regulators in other jurisdictions have been granted this power as a final option.<sup>20</sup> While this sanction ought to be used only in the most severe cases, its availability would send an important

signal that the NSWEC has the power to escalate and respond to extreme instances of non-compliance.

### Recommendation 14

That the NSW Government amends the PE&E Act and the EFED Act to attach criminal and civil sanctions to failures of senior party office holders to meet their internal party governance responsibilities.

### Recommendation 15

That the NSW Government amends the PE&E Act to provide power to the NSWEC to deregister a political party for extreme cases of non-compliance.

<sup>20</sup> Institute for Democracy and Electoral Assistance, accessed at [www.idea.int/political-finance/question.cfm?id=296](http://www.idea.int/political-finance/question.cfm?id=296)

## Case study 1: The UK Electoral Commission as an example of responsive regulation

The UK EC has designed a regulatory system that prioritises regulatory activity based on the highest areas of risk. This strategy offers a compelling alternative to other systems that generally focus on adding new penalties and more restrictions.

### A risk-based approach to regulation

As the regulator of party and election finance in the UK, the UK EC aims to achieve public confidence that political finance is transparent and that rules are being followed through a risk-based strategy. The regulatory strategy employs risk profiling, allowing regulators to apply a tiered approach, permitting the least risk-prone parties to self-regulate with minimal supervision, while more risk-prone parties receive closer attention through co-regulation or commanding regulation and escalating sanctions.

Traditionally, this strategy has been employed by financial regulators, and its application by the UK EC is considered best practice in the regulation of political finance.

### Risk profiling

The UK EC is charged with regulating 400 registered political parties, each with unique organisational challenges, financial circumstances and political contexts. According to the UK EC, risk profiling is a key element in providing an efficient and effective audit program. By developing a risk profile that captures the particular risks of each regulated party, the UK EC can utilise regulatory resources more efficiently than a rules-based, one-size-fits-all approach.

Risk profiles are developed using a tiered ratings system. The profiles determine which parties carry the most compliance risk and, therefore, could benefit from more formal regulatory intervention, and which are lower risk, requiring only random audits. This system is similar to a credit rating system, in which rating agencies gather a range of information and data to determine the financial health of organisations and their ability to meet their obligations. Criteria used for risk profiling are transparent and publicly available, and the UK EC openly discusses with parties the standards used to assess risk and assign their risk ratings.

To build each party's risk profile, all parties are required to report to the UK EC about donations and loans they receive, and keep accurate accounting records. As regulator,

the UK EC has powers to monitor parties' income and spending and ensure that parties comply with accounting requirements. The UK EC's compliance staff ensure that parties' accounting processes have appropriate systems and procedures in place to ensure compliance.

The UK EC recognises that risks, and risk profiles, are not static. Regulators maintain an open dialogue with parties by regularly discussing their risk profile and aims for improvement.

Audit activities are directed to areas where there is the greatest risk of non-compliance. Where a party or campaigner is struggling to comply with its legal obligations, the regulator offers help where needed and monitors future compliance carefully. Depending on their size, some minor parties that have fewer statutory reporting requirements and limited operational scale may be excluded from risk profiling.<sup>21</sup> The UK EC model also takes into account whether a regulated entity is willing to comply, willing but not able, or is unwilling to comply and adjusts its regulatory strategy accordingly.

### Audit strategy

Once each party's profile is built, parties are briefed on their risk profile. The briefing session includes a discussion of compliance risks and challenges that need to be addressed and the likelihood of audit. Profiles and explanatory information are published on the UK EC website after parties are informed. Regular profile reviews ensure that progress is continuous and that emergent risks are identified and assessed.

Rather than an ad hoc approach with audits determined by random sample selection, risk profiling is an intelligence-led process that helps to identify parties that would benefit most from audit activity.<sup>22</sup>

Parties' profiles are assessed regularly against the following characteristics to determine their risk category:

- **Financials:** Parties are rated based on their reported income, cash flow and past accounting accuracy. These financial indicators reveal whether a party has potential funding pressures that may lead to non-compliance. Additionally, these figures can indicate whether the volume of transactions processed is beyond the operational capability of the party. Parties are assigned a rating of A, B, or C based on their income, levels of debt and accuracy of accounting reports.<sup>23</sup>

21 UK EC, *Prioritising our regulatory activity: Audit, advice and campaign monitoring, 2012*, accessed at [www.electoralcommission.org.uk/\\_data/assets/pdf\\_file/0006/107097/Prioritising-Our-Regulatory-Activity-updated-May-2012.pdf](http://www.electoralcommission.org.uk/_data/assets/pdf_file/0006/107097/Prioritising-Our-Regulatory-Activity-updated-May-2012.pdf)

22 Ibid.

23 Ibid.

- **Compliance record:** This includes late submissions and failures to submit financial information. Parties are profiled from “high”, indicating a good compliance record, to “low”, indicating compliance failures.<sup>24</sup>
- **Operational scale:** Indicators here include the number of “accounting units” held by a party, the level of elected office, how significant a compliance may be, and the number of elections contested by a party. The scale of parties’ operations is rated from 1, indicating low operational scale, to 5, indicating high complexity.<sup>25</sup>

Overall, the profiling system indicates that a party with debts, financial reporting errors, late submissions of financial information, and with many accounting units is high risk, more likely to be audited, and more likely to face regulatory intervention (and possibly sanctions).

In line with responsive regulation, the UK EC has a wide range of enforcement approaches available to it; from education, persuasion, warning notices, civil penalties and criminal penalties to party deregistration. The inclusion of more severe sanctions acts as a deterrent, as there is an incentive for parties to achieve strong compliance and a low risk profile to avoid escalation to stronger penalties. According to the UK EC’s annual reports, implementation of the risk-based model has been so effective that most parties’ compliance records and risk profiles have improved to a point where few require more than a minimum level of audits and supervision.

## Advice and education program

The UK EC seeks to use advice and guidance, rather than enforcement, to secure compliance in the initial stages of interaction with parties. Rather than only focusing on enforcement action when things go wrong, the UK EC’s Advice and Guidance Team takes a proactive approach to helping parties comply with the law.

The regulator offers training to party staff, candidates and agents, and provides both informal advice and formal written opinions on specific matters, if needed. Analysts gather intelligence and media reports to understand emerging trends. Parties that begin to fundraise at a scale beyond the abilities of their compliance infrastructure or experience are selected for advice and guidance. Parties that have undergone significant structural, governance or leadership changes may be issued proactive advice notices to help with transitions. Parties are only compelled to follow the UK EC advice notices where a breach of law has occurred and, if so, remedial steps must be taken.

<sup>24</sup> Ibid.

<sup>25</sup> Ibid.

## Monitoring election campaign activity

UK election laws place restrictions on spending and donations, which require regulatory supervision. In the lead up to elections and referenda, the UK EC performs a targeted program to monitor and assess the level and type of campaign activity against party disclosures. Specific marginal or high-profile campaigns and constituencies are selected for monitoring. Contesting parties are briefed on the UK EC’s plans for raising compliance awareness, observing campaign activity to compare against disclosures, and identifying emerging issues to offer proactive advice.<sup>26</sup> This proactive approach to monitoring election campaign activity emphasises the UK EC’s role as a responsive regulator that works in collaboration with parties to achieve public confidence that political finances are transparent and that rules are followed.

## Enforcement

Regulators work with parties to find common ground to secure a compliance agreement that both can agree to. This reflects the responsive regulation principle that helping regulated parties to “understand what is required of them from the outset, and supporting them to get it right, is the most effective way of securing compliance”<sup>27</sup> and avoiding the prospect of regulatory escalation. Strong sanctions offer an effective deterrent but also help to secure and enforce compliance agreements. Where advice and guidance have not been enough to ensure compliance, regulators can intervene and sanctions may be imposed.

Legislation provides a wide range of civil and criminal sanctions to the UK EC. Both aggravating (for example, the harm caused to the public, dishonesty and a lack of responsibility) and mitigating features (for example, prior good compliance record and voluntarily reporting non-compliance with regulations) may be used in determining discretionary penalties. According to UK EC enforcement policy, sanctions and their likely use include:<sup>28</sup>

- **No sanction** – where a breach is trivial or it is not in the public interest to take further action.
- **Monetary penalties** – these can be fixed or variable depending on the level of non-compliance and whether it is a first or repeat offence.
- **Compliance notice** – where a regulated person or organisation needs to improve their or its capacity to comply with the law; for example, by training staff or changing systems.

<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> UK EC, *Enforcement policy*, 2010, accessed at [www.electoralcommission.org.uk/\\_\\_data/assets/pdf\\_file/0003/106743/Enforcement-Policy-30March11.pdf](http://www.electoralcommission.org.uk/__data/assets/pdf_file/0003/106743/Enforcement-Policy-30March11.pdf)

- **Restoration notice** – where the regulator identifies a need to ensure that a non-compliant organisation or individual makes good a breach by, for example, giving up benefits received as a result of the breach.
- **Stop notice** – where the UK EC considers that a person or organisation is likely to carry out an activity that will breach the law and that is seriously damaging, or could seriously damage, public confidence.
- **Forfeiture notice** – where a regulated organisation accepts a donation (above a certain amount) from an impermissible or unidentified source.
- **Criminal sanctions** – the UK EC does not have powers to impose criminal sanctions, but may refer a breach for criminal investigation or seek prosecution in cases which the UK EC judges to have a significant impact on the transparency of the system. There is also the option to deregister a political party.<sup>29</sup>

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<sup>29</sup> Institute for Democracy and Electoral Assistance, accessed at [www.idea.int/political-finance/question.cfm?id=296](http://www.idea.int/political-finance/question.cfm?id=296)



## Case study 2: The Australian Prudential Regulation Authority as an example of responsive regulation

APRA is an example of a regulatory body that applies risk-based responsive regulation. The steps below demonstrate APRA's approach to regulation.<sup>30</sup>

- (1) **Risk identification:** APRA works with the organisation (for example, bank or superannuation company) to evaluate its ability to comply with financial regulations. To identify potential risks, APRA collects data on an organisation's risk culture, risk appetite, risk management, corporate governance and the alignment of incentives.<sup>31</sup> Additionally, APRA meets with internal audit and senior management to understand their business strategy and risk control capabilities. Together, these data allow an informed judgment to be made about risk controls and how fit-for-purpose they are.
- (2) **Risk assessment and risk rating:** Next, the risks are analysed to determine their significance. Probability and impact of risks are ranked in order to identify a risk priority. The probability of a risk occurring, and its potential impact, is ranked.
- (3) **Risk response:** Following risk assessment, organisations are classified according to four categories:<sup>32</sup>
  - **Normal** – APRA applies routine oversight to the organisation, while the organisation is responsible for detecting and resolving non-compliance (self-regulation). There is an incentive to self-regulate, as both APRA and the organisation have the same goal to avoid financial risk. Non-compliance will be met with closer scrutiny and an escalation of sanctions.
  - **Oversight** – APRA identifies issues that need more oversight and provides closer supervision.
  - **Mandated improvement** – APRA mandates corrective action for the organisation.

- **Restructure** – the organisation requires strong enforcement or a managed exit.

Supervision plans are tailored to the needs of the regulated company. Smaller, self-sufficient organisations with good internal capabilities are less closely supervised by APRA, while larger organisations with higher risk are increasingly supervised more closely. All organisations, however, receive some baseline monitoring to ensure standard processes are followed and compliance requirements are met.

APRA will use anything from education and supervision through to prosecutions and restructuring to make organisations develop internal capabilities to comply. If an organisation's risk assessment results change, APRA increases or decreases supervision accordingly, with the goal being to shift organisations to self-regulation, if possible. Entities in the "mandated improvement" category do not stay there for long, as APRA shifts from an advisory role to pursuing change more aggressively. The mandated improvement category distinguishes between organisations that are willing but not able to change, and those that are not motivated to comply with advice. If the entity's risk profile improves, it drops to the "oversight" category; otherwise, it is escalated to the "restructure" category.

- (4) **Re-assessment and re-evaluation:** Following a risk response, APRA evaluates the effectiveness of the solution. As prevention is better than finding a cure, APRA goes beyond detecting and curing non-compliance to prevent it by continuously analysing new and emerging risks before they occur. For example, APRA stress-tests systems to uncover potential weaknesses in controls and has a team of researchers that analyses potential risks for each industry sector. APRA also analyses the broader regulatory context to understand how the wider context may influence an organisation's ability to comply with regulations.<sup>33</sup>

<sup>30</sup> D Lewis, *Risk-based supervision: How can we do better? An Australian supervisory perspective*, 2013, accessed at [www.apra.gov.au/Speeches/Documents/David%20Lewis%20-%20Risk-Based%20Supervision%20-%20Toronto%20Centre%202013%20June.pdf](http://www.apra.gov.au/Speeches/Documents/David%20Lewis%20-%20Risk-Based%20Supervision%20-%20Toronto%20Centre%202013%20June.pdf)

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

## Chapter 3: Effective transparency: empowering civil society

### The importance of transparency

*A popular government, without popular information, or the means of acquiring it, is but a prologue to a farce or a tragedy; or, perhaps, both.<sup>34</sup>*

Democracy truly works only when civil society (including the voting public, media, academia, think tanks and non-government organisations) has wide access to information and robust transparency to help maintain oversight of political leadership. Transparency has become the centerpiece of control of political finance in most democracies. A regulator has limited resources at its disposal to compel parties, candidates, groups and third-party campaigners to comply with the law through rules, sanctions and influence. Transparency and access to information empower civil society to oversee political leadership in a way that bureaucratic regulators never could.

The hallmark of transparency in political finance is disclosure. Disclosure laws allow both regulators and civil society to track the flow of dollars and allow the public to understand the true context of political communication and advertisements by parties, candidates, groups and third-party campaigners. This makes it possible for civil society to identify and track correlations between donations and political decisions by elected officials, and influence how actors approach political fundraising. Disclosure of sources and expenditures of political campaign funds by parties, candidates, groups and third-party campaigners to achieve open and transparent flows of funds has been an increasingly important feature of many democratic systems across the world. One recent report found that

<sup>34</sup> J Madison, letter to WT Barry, 4 August 1822.

most political systems in other countries have some form of reporting or disclosure requirements.<sup>35</sup>

Although disclosure does not automatically detect violation of political finance laws, it does help make detection easier and it enhances compliance by focusing actors' attention on regulations. Many jurisdictions design disclosure systems not as a means for regulators to monitor financial data for wrongdoing; rather, the objective of most disclosure systems is to make political finance data open and available to help facilitate monitoring, oversight and discussion by civil society.

Donors are more likely to be cautious about who they give money to, and parties and candidates are likely to be more careful about who they take money from, if the transaction is to be published for the world to see. On the other hand, without transparency, both sides are likely to be more aggressive in soliciting transactions that push the envelope on probity and integrity.<sup>36</sup>

In most democracies, civil society plays a critical role in dissecting and analysing disclosed political finance data for impropriety or breaches. The most important audience for disclosure data may be the opposing parties and candidates themselves, who continuously maintain a watchful eye on each other and search for opponents' failures in order to expose them to the public for political gain. Such a system, if properly designed, provides a natural incentive on actors to ensure compliance with political finance rules and avoid even an appearance of

<sup>35</sup> M Ohman, *Political finance regulations around the world*, International Institute for Democracy and Electoral Assistance, 2012, p. 53, accessed at [www.idea.int/publications/political-finance-regulations/upload/Political-Finance-Regulations-Overview-of-IDEA-database.pdf](http://www.idea.int/publications/political-finance-regulations/upload/Political-Finance-Regulations-Overview-of-IDEA-database.pdf)

<sup>36</sup> C Wilcox, *Transparency and disclosure in political finance: Lessons from the United States*, 2001, pp. 9-10, accessed at [www.faculty.georgetown.edu/wilcox/Disclosure.pdf](http://www.faculty.georgetown.edu/wilcox/Disclosure.pdf)

impropriety, knowing that any impropriety would be closely monitored and exposed by opponents. Disclosure laws have also provided an added bonus of enabling academics to study the general influence of money flows on access to policy-makers, legislative trends and policy outcomes.<sup>37</sup>

Advances in IT have made it possible for disclosure systems to reduce many of the administrative costs of transparency, while simultaneously improving transparency outcomes. Web-based online disclosure portals, data processing and analysis tools have made the achievement of transparency and open government more efficient, and have increasingly helped inform civil society of the political and financial context of political communications that influence voter behaviour.

As part of its research, the Commission examined the transparency and disclosure regime in NSW and compared its features with those of other globally recognised better practice political finance systems. This is discussed below and summarised in Table I at the end of this chapter.

## Achieving a better practice disclosure system

Analysis of better practice disclosure models around the world has helped to underscore a number of important characteristics that a disclosure regime must possess to effectively inform civil society. While every disclosure model emphasises some features over others depending on political context, all generally focus on delivering disclosure data using a combination of key criteria to achieve effective transparency and properly inform civil society. These criteria are:

- timely disclosure data
- comprehensive disclosure data
- accessible, searchable and intelligible disclosure data.

From civil society's perspective, each of these features is an essential element of achieving a practical and relevant understanding of the influence of money on political decisions.

<sup>37</sup> Ibid.

## Timeliness of the disclosure data

The objective of many better practice systems is to ensure that civil society has access to the complete and accurate picture of the funding behind parties, candidates, groups and third-party campaigners by the time ballots are cast on election day. This ensures that the advertised political and policy messages of actors can be put in appropriate context, based on an understanding of the financial backing of the various participants. If data are not available until after an election has passed, relevant information that could have helped inform voters will be stale.

At a minimum, most better practice examples now require campaign disclosure reports to be filed on a regular basis (either quarterly or semi-annually) in addition to pre-election and post-election contribution and expenditure reports. In some jurisdictions, large contributions received close to the election are also required to be reported in 24-hour or late contribution reports, even if they are required to be reported again in a subsequent report. This enables civil society to provide the most up-to-date information to voters preparing to cast their ballots.

Many jurisdictions, including the UK, Canada and both federal and state jurisdictions in the US, legislate strict deadlines for disclosure agencies to publish disclosure reports; for example, between 24 and 48 hours of receipt by the agency if received by paper or fax. This requirement placed enormous burdens on disclosure agencies when disclosures were paper-based. Disclosure paperwork was received from hundreds of campaigns, then quickly processed and published in a very short period of time by disclosure agencies. Timely information came at a high cost indeed.

While attaining this goal was once a significant challenge that required extraordinary resources to process data quickly using traditional paper-based systems, processing data is becoming much easier with advances in IT. New online and electronic filing systems have made it possible to achieve near real-time or continuous disclosure without the heavy effort required to achieve timely data in traditional paper-based disclosure systems.

One example of where real-time data is used is in the US state of Illinois. The State of Illinois Board of Elections requires quarterly reports to be filed every three months. Candidates or parties that receive or spend above a

threshold must file disclosure reports electronically with the disclosure agency. In addition, contributions or independent expenditures of \$1,000 or more must be reported in a separate stand-alone disclosure, which must be filed electronically within five days of receiving the contribution or, if the contribution is received in the month preceding an election, within two days.<sup>38</sup> Electronically-filed disclosures are published on the State of Illinois Board of Elections website in near real-time, and disclosure reports are automatically distributed to subscribers of digital RSS feeds (subscribers usually include media, opponents or election observers).<sup>39</sup> Similar real-time systems are found in Massachusetts and New York City, where electronic disclosures and other campaign data are published in rolling, real-time online broadcasts.<sup>40</sup> These speedy, real-time disclosure regimes help to provide voters with a detailed picture of who is funding which parties and campaigns, before election-day.

Parallels also exist between electronic disclosures and the speedy processing of information in other compliance regimes. For example, the Australian Taxation Office employs electronic systems for the online disclosure of tax returns, often without the need for paper forms. Disclosure software is offered free to filers, and data are usually received by the Australian Taxation Office immediately and processed by its officers in as few as 10 days.

These timely disclosure systems operate in stark contrast to the current NSW political disclosure regime, where legislation currently requires data to be published months after an election. By the time disclosures are published, the data are so stale and irrelevant that the transparency value is largely eroded.

Requests for filing extensions by parties and candidates are common in NSW, creating gaps between disclosure filing deadlines for donors and recipients. Until both donor and recipient forms are received, it is impossible to know if either has breached the law by failure to disclose. Frequent extensions of filing deadlines, therefore, complicate the process of matching the donor and party disclosure forms.

Advances in recent years allowed the former EFA to publish paper disclosure forms in an online electronic disclosure portal, but at substantial manpower cost to the organisation. The current NSW system for achieving a searchable online database of disclosure data requires the NSWEC to manually enter data and transpose information from paper-based disclosure forms to an electronic database. This is a time-consuming, resource-intensive task, which could be

38 Illinois State Board of Elections, *Guide to campaign disclosure*, July 2013, pp. 15–16, accessed at [www.elections.il.gov](http://www.elections.il.gov)

39 Illinois State Board of Elections, latest reports filed, accessed at [www.elections.il.gov/CampaignDisclosure/ReportsFiled.aspx](http://www.elections.il.gov/CampaignDisclosure/ReportsFiled.aspx)

40 The Massachusetts Office of Campaign and Political Finance, accessed at [www.ocpf.us](http://www.ocpf.us)

better achieved by requiring disclosure filers to report via electronic online reporting software.

There are a number of off-the-shelf software packages on the market that can be adapted to the NSW context. The benefits of lodging disclosures online are many, but most importantly disclosure data will improve timeliness, require less manual transposition of data, and provide a more legible, searchable database.

The NSW Government has enacted a special provision aimed at improving timeliness of disclosures, specifically for the 2015 state election. The provision provides a requirement for any party, elected member, group, candidate or third-party campaigner to publicly disclose donations received from 1 July 2014 to 1 March 2015 within seven days after the end of this period.<sup>41</sup> This is a step in the right direction, and with the addition of online reporting, NSW might be brought in line with other better practice disclosure systems.

To transition to a better practice system, NSW will require the development of the requisite IT capabilities within the NSWEC, the end of donor disclosure requirements (as addressed in recommendation 2), and legislated shortening of disclosure intervals.

## Recommendation 16

**That the NSWEC adopts a mandatory electronic disclosure system, which allows for online, real-time reporting by political parties, candidates, groups, members of parliament and third-party campaigners in the lead-up to an election.**

## Recommendation 17

**That the NSW Government amends the EFED Act to improve the timeliness of the disclosure of political donations. In particular, consideration should be given to the implementation of quarterly disclosure obligations and the implementation of a real-time electronic disclosure regime during a set period prior to polling day.**

## Comprehensive disclosure data

Without comprehensive and accurate disclosure data, civil society's confidence in the transparency of political finance will be compromised. Building a complete and accurate picture of political finance is undermined if sufficient details are not included to allow civil society to assess the interests of those involved.

In NSW, information about donors' employment and transactions, particularly loans, is incomplete. The nature and aims of third-party expenditures is not transparent. It is difficult to track funds moving between party branches

41 Section 103F of the EFED Act.



and jurisdictions. Each of these makes it difficult for civil society to build a complete picture of political finance and understand the true nature and context of political expenditures.

## Comprehensive donor information

Comprehensive profile information about donors has proven useful in other jurisdictions. For example, during the 2012 US presidential campaign, news outlets compiled data from candidates' disclosures within minutes of disclosure deadlines (aided by accessible electronic data).<sup>42</sup> Members of the media quickly calculated and published statistics on who gave the most in an election cycle, which professions supported each presidential candidate (for example, lawyers, doctors, executives, homemakers and students), which industries supported each presidential candidate (for example, energy, agriculture, legal, government, manufacturing, software and construction), together with the distribution of small and large contributions to each candidate (for example, under \$50 and over \$1,000).<sup>43</sup>

Adding meaning to donor information may necessitate publication of more than just lists of names and addresses of donors. While NSW requires disclosure of basic information on a donor's name and address, date of donation and amount for "reportable political donations", data on a donor's employer and occupation is not disclosed. Information on employer and occupation of donors enables civil society to build a picture of which industries and companies finance parties and campaigns.

## Comprehensive transaction information

Complexities and ambiguity surrounding disclosure of loans and credit facilities is another transparency challenge. Current legislation requires the disclosure of loan transactions or credit facilities of \$1,000 or more from donors, but terms and conditions of loans are not disclosed, nor are repayment transactions, creating incentives to find creative ways of circumventing rules to finance campaigns. Donors can make interest-free loans, for example, to parties and third-party campaigners, but the interest must be declared as a contribution, at prevailing interest rates. Loans secured from financial institutions are not disclosed.<sup>44</sup>

42 *Washington Post*, '2012 presidential campaign finance explorer', 7 December 2012, accessed at [www.washingtonpost.com/wp-srv/special/politics/campaign-finance/](http://www.washingtonpost.com/wp-srv/special/politics/campaign-finance/)

43 *The Guardian*, 'Campaign finance – disclosure day live', 2 February 2012, accessed at [www.theguardian.com/world/2012/feb/01/campaign-finance-super-pacs-disclosure](http://www.theguardian.com/world/2012/feb/01/campaign-finance-super-pacs-disclosure)

44 EFA, *Political donations third-party campaigner*, 5 November 2014, accessed at [www.efa.nsw.gov.au/political\\_donations/Managing\\_Political\\_Donations/political\\_donations\\_third-party\\_campaigner](http://www.efa.nsw.gov.au/political_donations/Managing_Political_Donations/political_donations_third-party_campaigner)

The UK takes a comprehensive approach to disclosure of loans and credit facilities. All lending transactions above a set threshold are disclosed and published online, including the loan status (outstanding or repaid), terms and conditions of each transaction, including the participants and nature of the transaction (loan versus credit facility), the repayment terms, rate of interest and date entered into. All loan transactions are searchable via the UK Electoral Commission's Party and Election Finance (PEF) online portal.<sup>45</sup>

## Comprehensive expenditure information

Facilitating civil society's understanding of how political money is spent may be just as important as how the funds are raised, especially when public funds are involved. Current NSW rules require disclosure of campaign expenditures but administrative and policy development expenditures by parties (which in many cases are mostly publicly funded) are not disclosed.

The UK has adopted an "open book" approach to ensure that all spending by parties and independent groups is transparent and available to civil society. All registered state and local parties' annual financial statements, along with a statement by an independent auditor, are published and available online in PDF format, with redactions of any sensitive information. This helps to provide for greater transparency and accountability, not just for how parties' funds are raised, but also for how parties spend both campaign and administrative funds.<sup>46</sup>

## The challenge of tracking independent expenditure

Third-party campaigners regularly participate in electoral campaigning. Expenditure on such activities is capped and disclosed to achieve transparency and to stop the flow of money and resources between the parties and third-party campaigners for the purposes of circumventing the funding rules. Other jurisdictions address this circumvention by treating third-party campaigners practically the same as political parties in terms of disclosure and limits.

In NSW, different reporting rules apply for third-party campaigners in relation to the type of expenditure incurred. While registered parties report on all electoral expenditure, third-party campaigners report only on activities that are deemed "election communication expenditure".<sup>47</sup> There appears little justification for not bringing third-party

45 UK EC, accessed at [www.pefonline.electoralcommission.org.uk/](http://www.pefonline.electoralcommission.org.uk/)

46 UK EC, accessed at [www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations/political-parties-annual-accounts/details-of-accounts](http://www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations/political-parties-annual-accounts/details-of-accounts)

47 Section 88(1A) of the EFED Act.

campaigner disclosure requirements in line with the broader requirements placed on parties and candidates with regards to all “electoral expenditure”.<sup>48</sup>

Under present NSW disclosure rules, it is also difficult to understand the nature of third-party campaigners’ disclosed political campaign expenditures. It is especially important for civil society to understand whether their expenditures are incurred to support or oppose certain parties or candidates. Ideally, third-party campaigners would be required to produce disclosure reports that identify which parties, candidates or issue agendas their expenditures are aimed at, and whether they are supporting or opposing them.

Efforts by the US Federal Election Commission (FEC) to build a complete picture of all electoral expenses are underscored by its focus on disclosure of independent expenditures. The FEC publishes real-time, online disclosures of independent expenditures (by third-party campaigners) on political campaigns, including payees, dates, amounts and the significant distinction between whether expenditures are to support, or to oppose, a candidate.<sup>49</sup> This disclosure of political expenses, even those outside of the conventional party/candidate campaign medium, completes civil society’s picture of political finance. Analysis of finance expenditure of independent third-party campaigners in the US is also aided by the collection of a broader set of information about every donor to third-party campaigners, including names, addresses, employer and occupation information, dates of contributions, amounts of contributions, and transaction type (for example, in-kind, loan and cash).

## Following the money

Given the complexities of funding arrangements between candidates and parties, tracking the flow of money from donors to campaigners to expenditure is exceedingly difficult. Understanding how party funds are raised, which candidates helped raised them, and where they are spent, is anything but straightforward. In some cases, funds raised by local candidates, acting as intermediary fundraisers, are funnelled directly into the fungible central accounts of the state branch of a party. These funds may be spent disproportionately across state campaigns, with higher sums spent on marginal seats. Ambiguity around “who is giving what to whom” makes transparency very difficult to achieve.

Recently introduced donation caps in NSW have limited the amount donors can donate to a registered party in a financial year. Over a four-year election cycle, a candidate could potentially solicit multiple donations to their party from a single donor without exceeding cap limits. Such

donations could then be funnelled back to their own or another campaign via their party, without it being clear where the money has come from and without disclosing any intermediary involvement in raising the funds. While these caps do not make the source of money or intermediary involvement transparent, they do help limit the amount of money that parties and candidates can obtain from a single donor through collaboration.

If the recipients of donations are required to disclose employer and occupation information relating to donors, the potential for undue influence by groups of individuals is more transparent and detectable through the aggregation of donations from corporations or industries.

## Cross-jurisdictional discrepancies

Another particular challenge is following the money flow between branches of political parties and third-party campaigners that typically conduct operations across state and commonwealth boundaries. Each state, territory and commonwealth jurisdiction has its own set of electoral funding laws. Operating at a national level, parties, third-party campaigners and associated entities could take advantage of discrepancies between the laws of the different state and federal jurisdictions. NSW laws have the greatest discrepancies when compared with the other electoral funding laws of Australia. Relative to other jurisdictions, NSW caps and disclosure thresholds are lower, specific groups are banned from donating, and public funding is higher, thereby creating an environment in which cross-jurisdictional differences may be exploited.

Until recently, the opportunity to take advantage of differences in rules and limits between jurisdictions in Australia was a transparency problem. Money could be shifted through various vehicles, and effectively recycled. Since January 2011, however, a cap has been put on political donations to registered political parties that limits the transfer of money at \$5,000 from a federal branch to a state branch of a political party, and transfers from third-party campaigners and federal associated entities of political parties. The implementation of this reform helps to address concerns about third-party campaigners, associated entities or branches of a party in different jurisdictions being used as a vehicle to conceal the flow of money from prohibited donors. Recent amendments to the EFED Act also address this issue by now making it an offence to enter into, or carry out, a scheme for the purpose of circumventing political donations or electoral expenditure prohibitions or requirements.

## Recommendation 18

**That the NSW Government amends the EFED Act to require the recipients of donations to disclose a donor’s occupation and employer (if applicable) in relation to reportable political donations.**

<sup>48</sup> Section 88(1) of the EFED Act.

<sup>49</sup> Federal Election Commission, accessed at [www.fec.gov/finance/disclosure/ie\\_reports.shtml](http://www.fec.gov/finance/disclosure/ie_reports.shtml)

## Recommendation 19

**That the NSW Government amends the EFED Act to require the terms and conditions of loans to be disclosed, along with repayment transactions.**

## Recommendation 20

**That the NSW Government amends the PE&E Act and the EFED Act to require registered political parties and third-party campaigners to disclose complete audited financial statements annually, and for those statements to be published online.**

## Recommendation 21

**That the NSW Government amends the EFED Act to require third-party campaigners to disclose all electoral expenditure and which (if any) political parties, candidates or issue agendas they are supporting or opposing.**

## Accessibility, searchability and intelligibility of the disclosure data

Political finance data can be of use to civil society only if it is free, open, accessible and searchable. Without these conditions, deriving meaning from the data is difficult. If the data is costly to obtain, difficult to access or hard to search, it is likely that it will not achieve its potential. Disclosure data that is presented in a meaningful and comprehensible way is effective in helping to identify and understand significant details, trends and patterns in electoral expenditure and donations.

The National Institute for Money in State Politics is one organisation that demonstrates how disclosure data can be effectively utilised by civil society to add meaning and intelligibility to the numbers. The institute is a non-partisan, non-profit, organisation in the US that aggregates and publishes a free online database ([www.followthemoney.org](http://www.followthemoney.org)) of election disclosure and lobbyist data across all 50 US states. Detailed analysis of disclosure data by the institute's analysts helps to determine which industries, corporations, third-party campaigners and lobbyists are most influential in politics. The range of detailed charts, graphs and maps illustrates the analytical capabilities of a well-equipped disclosure system.<sup>50</sup>

The institute also combines data from disparate sources (including political donations) to publish a Lobbyist Link database to combine data of registered lobbyists, their

clients and the donations made by both. With a few clicks on a map, users can access a list of lobbyists who are active in their state, their clients, and to whom those clients gave campaign donations.<sup>51</sup>

The current NSWEC online disclosure data portal scores well in some regards. Disclosure information is published in parallel formats: raw database data alongside PDF images of the completed and signed disclosure forms. This provides for increased searchability of data within a database, along with hard evidence and endorsed reports provided by the filer. This is a standard arrangement employed in many disclosure portals in other jurisdictions.

Although the current NSWEC disclosure portal has strengths with regard to accessibility, it could be improved to help make information more legible and intelligible. Presentation of political disclosure data in interactive ways, for example, is one area where the NSW system has significant opportunities for strengthening transparency. While improvements have been made in recent years with regard to the availability of raw data, the current data format still necessitates significant effort by civil society to compile datasets for further analysis and interpretation of donor trends and linkages. For example, analysis across many election cycles, candidates and numerous local and by-elections is cumbersome. Recent advances in database technology have made meaningful delivery of analysis by regulators, such as the NSWEC, a real possibility.

## Recommendation 22

**That the NSWEC makes available on its website, in various electronic formats, the analysis of political disclosures of donations and expenditures by political parties, groups, candidates, members of parliament and third-party campaigners in NSW that enhance the intelligibility of data and facilitate the analysis of disclosure information by civil society.**

<sup>50</sup> Follow the money, accessed at [www.followthemoney.org/](http://www.followthemoney.org/)

<sup>51</sup> Follow the money, accessed at [www.classic.followthemoney.org/database/graphs/lobbyistlink/index.shtml](http://www.classic.followthemoney.org/database/graphs/lobbyistlink/index.shtml)

## Best practice examples: disclosure data

Bringing enhanced transparency features to disclosure data systems highlights the innovative efforts of some jurisdictions to apply practical uses to political finance data and achieve meaningful analysis, which can help civil society to detect corruption and hold elected officials accountable for expenditure of state resources.

The Commission reviewed several best practice examples of systems that provide superior accessibility and intelligibility to disclosure data. Some of these are highlighted below.

The **New York City Campaign Finance Board** publishes a searchable database, which includes simple and advanced searches with a range of filters to sift through disclosure data. Donors' names, addresses, employers and occupations are databased, along with information on the date, amount and type of contribution. Disclosure search results are available for download in standard Excel, PDF and CSV file formats.<sup>52</sup> The board also publishes an interactive online mapping application to geographically plot where contributions originated together with the ratio of small to large contributions for each contest.<sup>53</sup>

The **UK Electoral Commission** publishes on its website extensive statistical analyses and clear visual breakdowns to account for expenditures, political donations, loans and public funding grants for elections dating back to 2001.<sup>54</sup> This includes vital summaries and national and state aggregations to demonstrate the overall fundraising, contributions and expenditures by parties, candidates and third-party campaigners. Disclosure data is represented in easy-to-read charts and graphs and broken down by party, party accounting unit, disclosure period, top donors, donor types, top recipients of public funds, late reporters and top borrowers.<sup>55</sup>

52 New York City Campaign Finance Board, accessed at [www.nycffb.info/searchabledb/](http://www.nycffb.info/searchabledb/)

53 New York City Campaign Finance Board, accessed at [www.nycffb.info/press/news/per-2013-map.htm](http://www.nycffb.info/press/news/per-2013-map.htm)

54 UK EC, accessed at [www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations/donations-and-loans-to-political-parties](http://www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations/donations-and-loans-to-political-parties)

55 UK EC, accessed at [www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations/donations-and-loans-to-political-parties/quarterly-donations-and-loans](http://www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations/donations-and-loans-to-political-parties/quarterly-donations-and-loans)

The **Massachusetts Office of Campaign and Political Finance** offers an online Data Visualisation Beta, which allows users to “visualize campaign finance data using maps and charts”.<sup>56</sup> Users can view real-time graphical analysis of contributions to all elected offices in the state, broken down by geographic, employer/occupation and quantitative variables and expenditures according to vendor, purpose and electoral district.

The **Illinois State Comptroller's Office**, a government department responsible for supervising state accounting and financial reports, publishes an open book online database that “compares state contracts with political campaign contributions”.<sup>57</sup> This publicly available online database combines data from the state's accounting system with disclosure information from the Board of Elections to help trace correlations between political contributions and grants in state contracts.

The **Wyoming Campaign Finance Information System** allows filers to log on to the online web portal to post disclosure transactions and generate reports without paper forms, and digitally sign disclosure reports.<sup>58</sup> Disclosure forms and transaction summaries are automatically generated and published in a clear, legible and searchable PDF format with an itemised list of transactions and detailed financial summary. This allows users to quickly find names and dates within disclosures without tediously browsing through handwritten online images.<sup>59</sup>

56 The Massachusetts Office of Campaign and Political Finance, accessed at [www.ocpf.us/](http://www.ocpf.us/)

57 Open Book database, accessed at [www.openbook.illinoiscomptroller.com/](http://www.openbook.illinoiscomptroller.com/)

58 Wyoming's Campaign Finance Information System, accessed at [www.wycampaignfinance.gov/](http://www.wycampaignfinance.gov/)

59 Wyoming's Campaign Finance Information System, Training Manual, 2013, accessed at [www.wycampaignfinance.gov/WYCFWebApplication/Reports/FormationReportsViewer.aspx?docType=3](http://www.wycampaignfinance.gov/WYCFWebApplication/Reports/FormationReportsViewer.aspx?docType=3)



**Table 1: Better practice data disclosure systems**

Objective	Features	Better practice examples	Web link
<b>Timely</b>	<ul style="list-style-type: none"> <li>■ Filing reports are required on a regular and frequent basis with real-time or continuous disclosure for large contributions in the month preceding an election (at the least).</li> <li>■ Reports are made available to the public as soon as possible after filing, ideally in real-time, continuous reports.</li> </ul>	US Federal Election Commission	<a href="http://www.fec.gov">http://www.fec.gov</a>
		UK Electoral Commission	<a href="http://www.electoralcommission.org.uk">http://www.electoralcommission.org.uk</a>
		Illinois State Board of Elections	<a href="http://www.elections.il.gov/InfoForReporters.aspx">http://www.elections.il.gov/InfoForReporters.aspx</a>
		Massachusetts Office of Campaign and Political Finance	<a href="http://www.ocpf.us">http://www.ocpf.us</a>
<b>Comprehensive</b>	<ul style="list-style-type: none"> <li>■ Data includes contributors' name, address, occupation, employer, and the amount, date, and type of transaction (for example, cash, loan and in-kind).</li> <li>■ Transaction information is sufficiently detailed, including, for example, terms and conditions of loans and credit facilities.</li> <li>■ Parties' audited Statements of Account are disclosed and published ("Open Book" transparency).</li> <li>■ Details of independent expenditures (that is, "third party" expenditures) including the nature of expenditures for or against particular candidates, parties, or agendas.</li> </ul>	UK Electoral Commission Party Election Finance Online	<a href="https://pefonline.electoralcommission.org.uk/search/searchintro.aspx">https://pefonline.electoralcommission.org.uk/search/searchintro.aspx</a>
		US Federal Election Commission Disclosure Portal	<a href="http://www.fec.gov/pindex.shtml">http://www.fec.gov/pindex.shtml</a>
<b>Accessible and Searchable</b>	<ul style="list-style-type: none"> <li>■ Disclosure data is available for download, free of charge, in an open, non-proprietary format, including both images of disclosure forms and a disclosure database.</li> <li>■ Downloadable data are properly parsed into distinctive and identifiable fields.</li> <li>■ Disclosure data is searchable and includes filters to find and access a wide range of variables on specific candidates, parties, and third parties or transactions.</li> <li>■ Reports provide various transaction totals, such as total contributions raised and total loans received.</li> <li>■ The database can generate lists of active candidates, parties and third-parties.</li> </ul>	UK Electoral Commission Party Election Finance Online	<a href="https://pefonline.electoralcommission.org.uk/search/searchintro.aspx">https://pefonline.electoralcommission.org.uk/search/searchintro.aspx</a>
		Wyoming Campaign Finance Information System	<a href="https://www.wycampaignfinance.gov">https://www.wycampaignfinance.gov</a>
		New York City Campaign Finance Board Searchable Database	<a href="http://www.nycffb.info/searchabledb">http://www.nycffb.info/searchabledb</a>
		Massachusetts Office of Campaign and Political Finance	<a href="http://www.ocpf.us">http://www.ocpf.us</a>
<b>Intelligible</b>	<ul style="list-style-type: none"> <li>■ Data is able to be manipulated by civil society in order to assist data aggregation to provide meaningful analysis and track correlations between donations and government decisions.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>■ Government applies data aggregation and analysis to disclosure data to publish intelligible examination of data to provoke civil society discussion on the sources of political finance. Suggestions for data analysis service:                             <ul style="list-style-type: none"> <li>• charts and graphs</li> <li>• data summaries</li> <li>• interactive maps</li> <li>• combinations with other relevant data.</li> </ul> </li> </ul>	National Institute for Money in State Politics	<a href="http://www.followthemoney.org">http://www.followthemoney.org</a>
		National Institute for Money in State Politics "Lobbyist Link"	<a href="http://classic.followthemoney.org">http://classic.followthemoney.org</a>
		US Federal Election Commission - Graphic Presentations	<a href="http://www.fec.gov/portal/graphic_presentation.shtml">http://www.fec.gov/portal/graphic_presentation.shtml</a>
		UK Electoral Commission – Overview of donations and loans	<a href="http://www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations">http://www.electoralcommission.org.uk/find-information-by-subject/political-parties-campaigning-and-donations</a>
		New York City Campaign Finance Board Searchable Database	<a href="http://www.nycffb.info/searchabledb">http://www.nycffb.info/searchabledb</a>
		Massachusetts Office of Campaign and Political Finance	<a href="http://www.ocpf.us">http://www.ocpf.us</a>
		Illinois State Comptroller's Office - "Open Book" portal	<a href="http://www.openbook.illinoiscomptroller.com">http://www.openbook.illinoiscomptroller.com</a>





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