

Assessment of enforcement of political finance laws by KNAB Division of Control of Financing of Political Parties:

Report prepared for the
Corruption Prevention and Combating Bureau,
Riga, Latvia

By

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28 May 2006

Ramboll Management, Denmark, Project funded by EU-PHARE on
Raising the Institutional and Professional Capacity of the Corruption Prevention and
Combating Bureau
(KNAB)

Overview

The Corruption Prevention and Combating Bureau (KNAB) was established in October 2002. The Bureau is an institution of the State Administration under the supervision of the Cabinet of Ministers. The Bureau plays a central and leading role in preventing and combating corruption in Latvia. The work of the Bureau is based on the following three pillars: prevention of corruption, combating of corruption and education of the society on corruption issues. The KNAB is among the strongest and most independent¹ anti-corruption agencies in the Central Eastern Europe. The KNAB's Division of Control of Political Parties Financing (DCPPF) has a permanent staff of 7 including: 4 professional auditors, 2 economists, and 1 lawyer. This is approximately 5 per cent of the KNAB's overall staff. It is important to stress that KNAB staff is non-partisan, highly committed to its work, willing to learn and relatively well paid. However, if the KNAB wants to move beyond administering the law and focus on prevention (inc. education) and serious enforcement, this level of staff is insufficient and should be increased at least by 50 per cent. Additional 3-4 staff could be engaged in educational work and issuing advisory opinions.

The DCPPF's responsibilities include: 1) receiving all financial reports, 2) maintaining and updating the PPF (Political Party Financing) data base², 3) reviewing financial reports in terms of their formal compliance with the legal requirements, 4) desk audit of financial reports, 5) verifying campaign expenditure against spending limits, 6) recommending administrative sanctions. In addition, the DCPPF is supported by the Legal Office which prepares legal opinions for the Head of the KNAB in case of any appeal to the KNAB's decision. The Legal Office also represents the agency at the

¹ To give an example of its non-partisan operation one should point out that the KNAB declared that the ruling party, the ZZS, has violated party financing laws. Although, the KNAB's Head is elected by the Parliament, there were previous attempts by the Government to undermine the functional independence of the KNAB. Thus, the KNAB's independence should not be taken for granted.

² For more details see <http://www.knab.gov.lv/db/>

court sessions dealing with the judicial review of the KNAB's decisions or political parties' deregistration process³. Furthermore, the KNAB has its own investigative unit which can be used in most serious cases requiring further investigation. Finally, any external complaints (including those dealing with the funding of political parties) are coming to the Report Centre (the reports can be submitted by email, telephone, or on-line).

The KNAB maintains one of the most impressive data bases in Europe, with detailed and timely information on donations to political parties. According to the Law on Financing Political Organizations (Parties), the parties submit all the details to the KNAB. The Bureau, within ten days, publishes on the Internet information about the donations received by the parties. Information includes the type of donation, sum, the date of receipt, as well as the natural or legal person who has given the gift or made the donation.

The KNAB has done fairly well in administering the Law on Financing Political Organization (Parties), particularly when it comes to preventing uncontrolled spending by political parties or using mediators to cover up the real sources of funding. Furthermore, the KNAB has developed a comprehensive review process of process of financial information. From March 1, 2005 to March 1, 2006 the agency verified 63 declarations of financial activities of 2004, the sworn auditors' statements and annual reports submitted by political organizations.

Over the last few years the KNAB has successfully imposed administrative sanctions on a number of political parties. In 2003 the Agency ordered some political parties to repay donations in the amount of over 166 800 lats. In 2004 for the violations identified in 2002-2004 political parties were ordered to repay donations in the amount of over 133 230 lats. In the last few months the KNAB has passed 30

decisions on imposing administrative liability and imposing penalties for over 8 800 lats. In addition, 5 parties have been ordered to repay illegally received donations for the total amount of over 15 600 lats, and one party voluntarily repaid the donation in the amount of 2500 EUR, detected by KNAB. The decisions taken by the KNAB resulted in over 241 700 lats from the illegally received financial resources being repaid into the state budget.

Furthermore, over the years the KNAB submitted many amends to the existing legislation. However, the agency recognizes that the current framework requires additional regulations dealing with issues such as: third party advertisement, discounts and rebates, criminal sanctions, personalisation of the responsibility for the financial offences, etc.

RECOMMENDATIONS

Recommendations for action, described more fully in this report, can be divided into three levels of interventions. In general, the process of reforming the current political finance system and enhancing the KNAB's enforcement capacity should be approached as an "evolution" rather than revolution, party because Latvia has a working system which does not need to be abandoned. As the political party financing system is reformed, the agency's powers and effectiveness will gradually increased, thus, it would be even more important to maintain the KNAB's operational and financial independence. In many transition countries, the more effective the control mechanisms are, the more resistant the regulated community (political parties and independent candidates) becomes to accept the strong oversight from an independent body.

Legal Reform

Based on the experience of the neighbouring countries (e.g. Poland and Lithuania), there is a tendency to alter the laws on political finance very frequently. Such constant “reforms of reforms” make it harder to stable enforcement regime and achieve high level of compliance. Thus, the proposed amendments described in this report should be introduced, if possible, as one larger package rather than a chain of separate initiatives.

The KNAB might consider the following amendments to the current laws:

- a. Introducing additional provisions regulating expenditure and in-kind donations (e.g. discounts) and requirements obligating treasurers to verify all the donations received by their parties⁴,
- b. Introducing additional provisions regulating issues such as preventing personal enrichment and embezzlement at the parties’ expense,
- c. Expanding the catalogue of the sanctions for the most serious violations, attach liability not just to organization but also to an individual officer within the organization who has to take responsibility for financing,
- d. Amending the relatively short statute of limitations (12 months) for political finance-related corruption cases, as the current arrangements prevent the KNAB from performing its’ role effectively,
- e. Introducing modest direct and indirect public funding⁵ based on fair and transparent criteria,
- f. Introducing regulations dealing with a third party advertisement and pre-election advertisement⁶,
- g. Introducing rules concerning the funding of internal party contests and rules concerning the declaration of assets by candidates for public office,

⁴ The additional provision could require the contributor to provide the person accepting the contribution (treasurer) with a statement, on a form to be provided by the KNAB, attesting that the funds representing the contribution are the personal funds of the contributor and that the contributor meets all the legal criteria for a legitimate donor.

⁵ This issue is covered by the separate report submitted by the author

⁶ See the chapter below

- h. Measures to control the use of public resources for campaign purposes and rules concerning the use of government resources by incumbents. This is another controversial area in many transition countries – how to regulate the use of public funds such as telephone lines, cars, offices and staff time. Usually, ignoring reports about the systemic abuse of state resources is like ignoring the tip of the iceberg.

Procedural Reforms

- i. Prioritization – the KNAB through its’ actions should try to achieve an equilibrium between the seriousness of violation/importance of a political party (e.g. larger, smaller, and nascent political party) and mechanisms used to enforce the law (alternative dispute resolution, administrative and criminal sanctions).
- j. Pro-active regulator – the Bureau could come up with the mechanism for issuing advisory opinions about how it will interpret the current regulations if the certain issue comes to its attention. This will give political parties necessary guidelines and galvanize certain desirable behaviour. Every political finance system will expand as a result of legal amendments to the law, the KNAB’s own actions and policies, jurisprudence, etc. Having said that, the Bureau should be more proactive in meeting those new challenges (e.g. through setting up guidelines and standards), rather than allow parties to interpret the law and cross thin lines to their own benefit (e.g. the recent issue of discounts).
- k. Real time enforcement - meaningful enforcement for many aspects of political finance must take place during the campaign season. If the KNAB does not take actions against certain kinds of potential violations (which are happening during the campaign period) the public might not accept the fairness of political and electoral process. Furthermore, penalties for substantial violations of the law will come late, if not too late, to ensure the integrity of the elections process.
- l. The Administrative Code provides for civil penalties of up to 5000 LAT per violations of the legal provisions, except for a limited number of criminal offences. Based on the experience of more established agencies, the KNAB should consider introducing its own penalty guidelines to make system for formal (preventing the non-partisan character of the agency),

and make regulatory community aware of which sanctions would be applied. The penalty guidelines can include “baseline” penalties for specific violations, and then have the penalties adjusted based on a variety of aggravating or mitigating factors. Those could include, among others: the sophistication and size of the campaign, actions taken by the campaign to prevent violations, the amount of financial activity during the statement period, etc.

- m. Currently the KNAB is dealing with a large number of lengthy appealing procedures which consume considerable resources of the Legal Department. According to the Head of the Legal Department many of the KNAB’s decisions are first appealed to the Head of KNAB and then to the relevant courts. Although, in many cases the court rulings are favourable to the KNAB, the process is very lengthy. In the long term, the Bureau might consider introducing some innovative measures such as the Alternative Dispute Resolution (ADR) Program which could be applied to the most basic and minor irregularities.⁷
- n. The growing sophistication of the political campaigns might require more robust actions on the KNAB part. Staffing up the Bureau’s own audit team would allow conducting comprehensive field audits. This will significantly increase the ability to detect and investigate major irregularities.

⁷ In the US, cases are accepted into the ADR Program after review by the Office of General Counsel and the ADR Office for suitability. Cases are excluded from ADR consideration if the matter: a) Raises issues requiring a definitive resolution for precedential value; b) Raises issues that bear on Government policy; c) May have an impact on other persons or organizations that are not parties to the proceeding; and d) Would benefit from a full public record of the proceeding. Other internal factors are important in determining a case’s appropriateness for ADR and are addressed on a case-by-case basis. Negotiations in the ADR Program are oriented toward reaching an expeditious resolution through a mutually agreeable settlement that promotes compliance with the Act and the FEC’s regulations. Mediation to resolve a negotiation impasse is available by mutual agreement between the respondent(s) and the Commission’s representative. Resolutions reached through direct and, when necessary, mediated negotiations are submitted to the Commission for final approval. None of the cases handled by the ADR office have yet required mediation, although the Office is committed to calling on the cadre of FEC-designated Mediators when the need arises. The recent ADR Program evaluation concluded that the Program saved respondents legal fees and enabled the Commission to increase significantly the number of cases processed.

Source: The FEC Annual Reports. For more information see www.fec.gov

- o. Introducing donor forms to oblige party fundraisers to ask each donor to sign a declaration that her/his contribution is in line with the regulations.

The third level of intervention would require introducing additional preventive measures, building consensus among regulated community, focusing on advocacy and education:

- p. Education - the KNAB has a positive experience in organizing trainings and consultations for political parties (such training was previously organized in 2005). There are at least three reasons for institutionalizing training program: decreasing number of minor offences resulting from a lack of experience and misunderstandings, ability to promote desirable behaviour and approach to certain issues (educating parties how the more general provisions of the law should be interpreted), promoting transparency and impartiality of the KNAB's own actions (external training promotes customer approach and openness). The KNAB should also devote some attention to the development of the guidelines and training materials – manuals and handbooks for parties and candidates. The expectation that the norms of law be obeyed is premised on knowledge of the law. However, political parties and individual candidates find it difficult to comply with laws and standards if they are not fully aware of them. Known and understood laws and procedures are self-executing for the vast majority of actors. Thus, public education and awareness are particularly critical elements of any serious enforcement strategy.
- q. A fair, flexible, yet workable enforcement process is the core of any political finance law's effectiveness. The experience of other countries shows that many violations of the political finance rules are committed as a result of ignorance, negligence, misunderstanding or mistake. Those offences can be pursued by the KNAB administratively, with the usual

penalty being that the offending transaction is returned, the missing information sent to the KNAB, and the parties are required to pay a small monetary penalty. On the other hand, purposeful and financially large violations of the law committed by offenders who know exactly what the law requires or forbids and flout notwithstanding that knowledge should be subject to criminal prosecution.

- r. Consensus – any successful implementation of a comprehensive reform requires a close cooperation between a regulator and regulated body. One positive example of such a consensus building exercise is the UK Parliamentary Parties' Panel. It meets quarterly and it is made up of the main party treasurers. It focuses on very practical issues and it allows all sides to discuss some serious and detailed problems related to implementation of a general legislation. Such a panel can be a good vehicle of consultation for the KNAB with practitioners.
- s. As the KNAB is facing the growing sophistication of political campaign, financial operations, demand for more complex interventions and internal education and specialization becomes the key. One of the options would be to establish a closer cooperation with the local NGOs and academics working in the field of anti-corruption. There is also a need to use external expertise and research capacity of the existing think tanks. The KNAB could consider asking for opinions/views and conduct internal hearings to discuss and decide on the most important policy decisions (example – recent issue of advertisement discounts).

DETAILED RECOMMENDATIONS

The role and duties of the KNAB are set out in both the Law on Financing of Political Organizations and the Law on Corruption Prevention and Combating Bureau (article 9). In outline KNAB is responsible for overseeing a number of aspects of funding of political parties and election campaigns, including:

- perform investigations in order to discover criminal offences as provided in the Criminal Law if linked to violations of party financing regulations by political organisations (parties) and their associations, provided such violations are not within the jurisdiction of national security institutions;
- review complaints and submissions and carry out investigations initiated by the President of Latvia, the Saeima, the Cabinet of Ministers or the Prosecutor General;
- compile and analyse the processed information provided in financial declarations of political organisations (parties) and their associations, any violations found in the submissions and failure to observe the restrictions provided by law;
- educate the public in the area of financing political organisations (parties) and their associations;
- inform the public of any discovered violations of party financing regulations by political organisations (parties) and their associations) and steps taken to prevent same.

The initial evaluation of the organization's performance has shown that KNAB had successfully passed the first stage of its development. Firstly, the KNAB has an independent status, which seems to be one of the most important preconditions for successful enforcement. Secondly, the KNAB has a significant technical capacity and interest in taking the job seriously. The most important provisions of the Law on

Financing of Political Organizations (Parties) dealing with illegal donations and disclosure have been largely implemented, certain problematic aspects of the law and vague provisions have been recognized, and the need for further and more detailed regulations has been acknowledged by the Bureau. Furthermore, the KNAB has successfully build its own capacity, established a special department with permanent professional staff. In addition the KNAB managed to protect its own functional independence and won a number of important court cases against political parties.

In general, Latvia has a well designed law with some outstanding provisions, the financial information is provided with the press and with the voters in the Internet database, and serious and professional anti-corruption NGOs operate in Latvia often supporting the KNAB's efforts. The KNAB has a dedicated staff willing to learn and exchange it knowledge with other agencies.

Based on the review the literature dealing with political finance in Latvia one could argue that the Latvian political finance system requires consolidation rather than a rapidly transformation. It can be also observed that parties start to "adapt" to new political finance laws. Those with sufficient influences and wealth to employ advisors and lawyers would be best able to devise strategies to sidestep obligations without actually disobeying the rules. In many cases, as it is already happening, the courts will have the final saying on the interpretation of the political finance rules. This is the best example that Latvia has become a consolidated democracy.

This report will now provide detailed analyses of the following issues:

- Prioritization
- Spending limits
- Third party advertisement
- Commercial value
- Sanctions

Prioritization

One must realize that an enforcement agency will never be able to enforce 100% of its cases for many different reasons. Thus, an agency should adopt a system to objectively analyze cases to decide which warrant the use of limited resources. After recognizing that they do not have the sufficient resources or ability to pursue all of the enforcement matters that come before them, some agencies use a prioritization system to focus limited resources on the most significant enforcement cases (so called risk assessment). Such a system can aid the management of a heavy caseload and complex financial transactions. It allows the agency to focus on what it views as the most significant cases. Such a system introduces an objective rating system and allows for prompt dismissal of those cases viewed as less significant. Under such a system, the agency can use different formal criteria to decide which cases to pursue.

For example, the Federal Election Commission introduced its own prioritization system in 1993. [1] Under this system, the Commission ranks enforcement cases based on specific criteria, and assigns only the more significant cases to staff. The FEC uses the following criteria:

- 1) The intrinsic seriousness of the alleged violation;
- 2) The apparent impact the alleged violation has on the electoral process; and
- 3) The topicality of the activity and the development of the law and the subject matter.

If the agency decides to adopt such a mechanism, it should continually review the system and its criteria to ensure the best use of its limited resources.

Furthermore, the operations of political parties are human endeavours, and as such, will never be perfect. Thus, one should allow for a level of imperfection to exist

without penalty. If every minor infraction is pursued to the fullest extent of the law, the truly important cases will get lost in the noise. The Bureau will have to develop a series of standards that cover the sorts of problems that are often encountered. They would allow the KNAB's staff to look at their work and decide what needs to be pursued and what can be written off as unimportant. Regardless of how the standards are established, they provide guidance for the KNAB staff so that they may concentrate on that which is important, and give assurance to the political parties that all violations of the law are enforced, yet with a different level of attention.

Latvia, just like other transition countries and established democracies has political parties with sophisticated accounting systems, staffed by professionals in a number of fields (e.g. lawyers and accountants), and offices all across the country. On the other end of the scale are small and nascent political parties. They have little or no professional help available and the amounts of money that are spent are very modest. Disclosure reports in many cases are rough estimates with no supporting records. This all suggests that different levels of compliance can be anticipated from different parties. The KNAB might want to take it into consideration and keep in mind the following experience from the more established democracies:

- Larger and more professional parties have often learned from their earlier mistakes and are now more careful with their financial reports. One can assume that their illegal funding is conducted through more sophisticated schemes which will not be detected by the simple review of financial report or even desk audit;
- Smaller parties find it difficult to cope with the legal requirements, they often make mistakes, can't prepare formally acceptable financial report, can't pay for a professional audit, and are sanctioned for relatively minor offences.

Thus, without prioritization and the focus on a larger picture, there is a serious danger that the Political Finance Regulator might become an agency which limits its operations

to combating minor (committed usually by smaller parties) and most visible violations adding to public pressure (scandals force agency to act). The KNAB will have to make a policy choice – is the Bureau going to limit itself to administering the law only or enforcing it vigorously. In most cases, without determination on the part of the enforcement agency, the most serious violations would never be detected or investigated.

AUDIT

The current Latvian Law on Financing of Political Organizations states in article 11 that⁸:

(1) No less often than once a year, a sworn auditor shall audit the financial and economic operations of each political organisation (party). The conclusions of the said auditor with respect to the financial and economic operations of the political organisation (party) shall be appended to the said political organisation's (party's) annual report on financial operations, as submitted to the Corruption Prevention and Combating Bureau.

(2) The audit (...) shall be financed by the relevant political organisation (party) from its own resources.

According to Head of the Audit Unit of the Federal Election Commission - Joe Stoltz, "What makes an effective audit function? Some attributes are obvious, while others may be less so. First, is the professional staff. Naturally the people who conduct the audits need to be trained in accounting and auditing as well as in the provisions of the election law. Expertise in other common industries such as banking, media, taxes will be useful. (...) Also, business and individual tax provisions. In my department we have developed three categories of procedures that help provide a "transparent" audit function. First are

⁸ Furthermore, see the Article 37 (Auditing of a party's economic and financial operations)

the criteria for determining which organizations will be audited. Most audit functions will never have the resources to audit every organization that files disclosure reports. I once commented to a gathering of US election officials that if we could audit everyone each year we would be bored to death. They all thought I was joking, but I was serious. It would probably be a poor use of the enforcement body's resources to audit everyone every year. Rather, there should be a selection process that attempts to focus attention on those who have not done a good job with their disclosure, supplemented by a small random sample. The random sample is used to help develop the other selection criteria and to introduce a level of uncertainty into the mix. It does however; need to be an objective process. Whether the enforcement body makes the criteria public or only the fact that such criteria exist is less important than developing and following an objective procedure.”

It is obvious that only a limited number of parties in Latvia can be properly audited. This raises the question as to how a political party is selected for audit. Effectively, the KNAB has two choices: 1) Random Audits; or 2) Audits for Cause. In both cases, the Divisions resources must be taken into account. If audits are to be for cause, a set of criteria need to be developed in order to eliminate bias against any particular party. These criteria, which should be confidential, may include the amounts of a party's receipts and expenditures, the timeliness and accuracy of their reports, etc. Much of the criteria could be developed based on the information that must be filed in financial reports.

Finally, the review process and audit criteria need to be formalized if the audit process is to be comprehensive. With more complete audit criteria, it is hoped that political parties can be more thoroughly audited. The KNAB, with its in-house capacity, could develop a detailed “operational plan”, with the audit program. If needed, the KNAB

should be able to receive a necessary assistance from the Elections Canada, the Federal Elections Commission, and IFES in developing its own Audit Handbook.⁹

⁹ For more information see IFES' website www.moneyandpolitics.net which includes sample audit materials

SPENDING LIMITS

According to the leading Latvian scholar, Janis Ikstens, there are several problems typical of election campaigns in Latvia¹⁰:

- high resource intensiveness of the campaigns, which under the existing plutocratic model of party financing increases the dependency of the parties from the most generous supporters;
- party financing sources that are unknown to wider public and non-transparent flow of financing, which is mediated through nominal donors and significantly hinder the making of a rational choice at the elections for the citizens;
- several poorly considered restrictions imposed upon the activities of political organisations, which in fact criminalise party activities – *restrictions to donations* and *unrealistically low ceiling of campaign expenditures*;
- low efficiency in enforcing the existing legal norms, which undermines the trust of the citizens in the system of public governance, decreases the legitimacy of the regime and does not promote the development of law obedient ethos among the parties.

Furthermore, in the recently conducted public opinion poll in Latvia, in answer to a question about how to regulate pre-election campaign financing, 34.5% of those polled are of the opinion that it is necessary to set a monetary limit on a political party's campaign financing; 23% of those polled support time and size limitations for political advertisements (minutes for TV and radio commercials and square cm for published advertisements); 19% of those polled are of the opinion that political advertisements should be banned in general.¹¹

¹⁰ Election Campaign Regulations in Latvia, by Janis Ikstens, Associate Professor, Vidzeme University College

¹¹ Positions Regarding the Election Campaigns of Political Parties and their Financing, 2003 SKDS

The recently introduced ban on electronic political advertising (TV and radio) is one of the ways of limiting campaign spending escalation and the dependency of parties on their donors. There are several potential benefits of such a ban on political advertising: a) Such a ban is relatively easy to monitor and supervise; b) party expenditures can decline, because the production and airing of political advertising, especially on television, are very expensive. However, the recent experience with the 2005 Presidential Elections in Poland shows that parties will seek out new ways to communicate with voters; such as outdoor and press advertising or massive direct mailing campaigns. The amount of money which parties need to run these kinds of advertising is not necessary smaller. Polish, Russian, and Ukrainian examples show that spending limits have proved in practice to be extremely difficult to enforce. Not only have they failed to curb the political finance “arms race,” but this failure has undermined confidence in the entire system of political finance regulation in those countries.

In Latvia, in the interview with Providus, one of politicians stated that: “If the previous wording of the law ensured that at least 85-90% of the money invested in the campaign appeared in the financial declaration, now, at best, only a half of it will be declared”.¹²

In order to retain the existing system of campaign spending limits for political parties and for candidates, a number of policy considerations still arise:

- Indexation - the limits on the maximum size of expenditure should be applied either by determining a ceiling or by applying an external indicator - for instance, a multiple of the average monthly wage, thus allowing for its automatic actualisation against inflation. An important factor must be taken into consideration where the application of limits is concerned—inflation or, as has been the experience of some of these countries, hyperinflation. In Bulgaria, a 1991 spending limit was applied to the 1997 elections, but by 1997, inflation had reduced the value of the Leva by 3200 percent. Candidates’ maximum allowable

¹² Lolita Cigane and Linda Austere, Election campaign expenditure limits – the baptism of fire, in Report on Corruption and Anticorruption Policy in Latvia, Providus, Riga 2005

expenditure on the campaign, 30,000 Leva, had been reduced to the equivalent of just US\$20;

- Lack of regulations dealing with the Third Party Advertisement (see below);
- Problems with evaluating a “commercial value” and discounts (see below).

THIRD PARTY ADVERTISEMENT

Another important issue related to the cost of party competition and election expenditure is the issue of expenditure by individuals and organisations who, though not political parties, play a part in election campaigns. According to Providus researches, the public organization *The Association for Rural and Regional Development* in March 2005 placed two types of political ads in public and commercial television, and in one of them called to vote for the *TP (Tautas partija)* candidates.¹³ In the opinion of the Committee on Standards in Public Life:

It is simply naive to imagine that organisations that send out explicitly political messages in the midst of election campaigns, or shortly in advance of them, are engaged innocently in generalised, non-partisan promotional propaganda.

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¹³ Cigane and Austere, p. 27

¹⁴ Committee on Standards in Public Life (The Neill Committee), *Fifth Report of the Committee on Standards in Public Life. The Funding of Political Parties in the United Kingdom* (The Stationery Office, 1998), p. 133. In the United States ‘independent expenditure’ is described as: ‘an expenditure for a communication which expressly advocates the election or defeat of a clearly identified candidate and which is made independently from the candidate’s campaign. To be considered independent, the communication may not be made with the co-operation or the consent of the candidate or his or her campaign; nor may it be made upon a request or suggestion of either the candidate or the campaign’. See FEC 1996, See Nassmacher (2001), pp. 37-38. Yet, the intervention of such non-party organisations or ‘third parties’ in elections is not just an American experience. UNISON, Britain’s largest trade union, in the 1997 General Election spent more than £1 million on advertising in promoting the cause of a national minimum wage. See David Butler and Dennis Kavanagh, *The British General Election of 1997* (Basingstoke : Macmillan, 1997), p. 242.

In Poland, prior to the 2000 campaign finance reform, there were no limits on third-party spending. Moreover, its pre-2000 role is difficult to assess, as there was no reporting on this kind of activity. The 2000 and 2001 legislation restricted individuals and groups other than registered candidates and electoral committees from incurring election expenses. The general rule is that individuals or groups may make limited 'independent expenditures' in connection with presidential and parliamentary elections. Third parties are prohibited from spending more than 5000 PLN (\$1250) in presidential elections and 1000 PLN (\$250) in parliamentary elections. Any form of campaigning conducted without committee approval is defined as an independent expenditure, and those who fail to limit their involvement are subject to the penalty of imprisonment for up to two years, the limitation of liberty, or a fine.

In fact, most of the post-Communist countries do not apply direct limits on independent groups spending money on behalf of a political party or presidential candidate during a campaign. The unrealistically low limits on campaign spending and funding restrictions on certain sources encourage parties to create a large number of small front organizations, so-called 'third parties', through which campaign fundraising and expenditure can be channelled.¹⁵

“MARKET AND COMMERCIAL VALUE” AND “DISCOUNTS”

- In Canada - “Commercial value” is defined as “the lowest amount charged at the time that it [the property or service] was provided for the same kind and quantity of property or service or for the same usage of property or money, by

¹⁵ In Ukraine, major weakness of the current legislation relates to the question of third-party spending. As the new law places unrealistically low limits on campaign spending, parties and individual candidates are tempted to create a large number of small front organizations. Different NGOs fund billboard or TV advertising, printing materials, opinion polling, research, etc. According to Ukrainska Pravda, an internet newspaper, over \$1,073,000 was spent on SDPU (o) TV advertising by NGO under the party's control. At the same time, the party's official spending on TV advertising amounted to a mere \$7,900. See Ukrainska Pravda Internet Newspaper, www.pravda.com.ua, 11.03.2002.

- (a) the person who provided it, if the person is in the business of providing that property or service; or (b) another person who provides that property or service on a commercial basis in the area where it was provided, if the person who provided the property or service is not in that business”.
- In Australia - any advertisements broadcast at less than normal commercial rate, broadcasting advertisements for political parties or candidates at no charge or at a rate below what would have applied on purely commercial grounds is a political donation. Donations totalling \$200 or more to a candidate at an election or \$1,500 or more to a political party in a financial year must be separately disclosed.
 - In the United Kingdom - the commercial rate is the rate at which goods or services would be charged if they were purchased from a supplier in a competitive market. A commercial rate includes any discount offered by a supplier that would be offered to any customer making the relevant purchase (e.g., a 5% discount for a large purchase or early settlement). To determine the normal commercial cost of goods/services, the Commission advises that election agents and candidates use the average cost of two or three commercial quotes for the same or similar goods/services.
 - In Poland - in addition to the free time allotted for the broadcast of election programmes, each election committee may broadcast limited, paid election programmes on public and non-public radio and television. Rates charged for this broadcast time cannot exceed 50 per cent of those charged for commercial advertisement and have to be equal for all the entities.

Concept of the “Notional expenditure”

The value of any goods, services or property provided to a party free of charge or at a rate discounted below normal commercial terms, for use in promoting the party or its candidates at an election. Notional expenditure is also a donation to a party. Notional

expenditure is incurred when any goods, services, property or facilities are provided to a candidate or his election agent free of charge, or at a discount of more than 10% of ordinary commercial value, for the purpose of the candidate's election. Controls on notional expenditure only apply where the expenditure is valued at more than £50.

The value of notional expenditure is the difference between the normal commercial cost of goods/services provided and the amount the candidate or their election agent actually paid for them (if anything). Where goods/services have been discounted by more than 10% from normal commercial rates, the difference should be declared as notional expenditure if it is more than £50. Notional expenditure should also be treated as a donation to the candidate if it is more than £50. Notional expenditure is only incurred when a discount is provided *for the purpose of a candidate's election*. Notional expenditure is not incurred where a candidate is provided with a discount on a commercial basis, e.g., when items are bought in a sale or where a discount is offered because of a large order. Common examples of items on which notional expenditure is incurred include:

- the provision of free travel;
- discounted rates for printing election material; or
- free accommodation or office expenses.

Example – Valuing Notional Expenditure

Provision of free travel: if a supporter provides a candidate with free use of a minibus, the candidate's election agent should treat the normal commercial cost of hiring the minibus as notional expenditure, e.g.:

Normal cost of hiring a minibus: £490 per week

Period minibus provided for: 21 days

Total notional expenditure incurred: £1,470

Discounted supply of printed material: a firm supplies a candidate with 50,000 election leaflets at a discounted rate.

Normal cost of printing 50,000 leaflets: £599

Cost charged to candidate: £400

Actual expenditure to be included in return: £400

Notional expenditure to be included in return: £199

Donation to be reported in return: £199

PROPORTIONATE AND EFFECTIVE SANCTIONS

The Council of Europe Recommendations “On common rules against corruption in the funding of political entities and electoral campaigns” in Article 16 state that: “*States should require the infringement of rules concerning the funding of political parties and electoral campaigns to be subject to effective, proportionate and dissuasive sanctions.*” An analysis of the sanctions stipulated by the various laws reveals these main categories:

- 1) Financial sanctions including modest administrative fines;
- 2) Larger fines for serious violations;
- 3) Criminal sanctions for significant violations that undermine the integrity of the elections;
- 4) Loss of reimbursement for election expenses, withdrawal of public funding, ineligibility for future funding;
- 5) Financial benefits transferred or accepted by a party in violation of specified prohibitions are forfeited for the benefit of the state treasury;
- 6) Loss of parliamentary seat, disqualification from standing for future elections, and ineligibility for appointment as public official;
- 7) Dissolution of party; and
- 8) Cancellation of election.

The problem with overly severe penalties is that they may disproportionately damage new and relatively inexperienced single-issue or small local political parties. Taking into account the essential role of political parties in any democracy, the prohibition or dissolution of political parties as a particularly far-reaching measure should be used with utmost restraint. Thus, effective enforcement of political finance regulations requires the law to impose sanctions and penalties, in proportion to the gravity of the offence, serving as deterrence to violators. The Law on Financing of Political Organisations identifies different types of offences and states in article 10 that:

(1) *Where a political organisation (party) has failed to submit an annual report, a declaration of financial operations, or a declaration on planned campaign expenditures within the timeframe referred to in this law, or where the said documents do not include the information required by law, or where the said documents include false information, the relevant political organisation (party) shall be brought to administrative liability (...),*

(2) *Where the Corruption Prevention and Combating Bureau finds that the requirements of the Law are not fulfilled, the director of the Corruption Prevention and Combating Bureau shall be obliged to order the relevant political organisation (party) to transfer unlawfully obtained financial resources, within 30 days' time, to the national budget, and to transfer property to the ownership of the state, (...)*

(3) *Where the Corruption Prevention and Combating Bureau finds that a contribution (donation) has been received, but has not been declared in the relevant political organisation's (party's) annual declaration of financial operations and in information about received contributions (donations), the director of the Corruption Prevention and Combating Bureau shall be obliged to order the relevant political organisation (party) to transfer unlawfully obtained financial resources, within 30 days' time, to the national budget, and to transfer property to the ownership of the state, doing so in accordance with procedures defined by the Cabinet of Ministers.*

(4) *Where the Corruption Prevention and Combating Bureau finds that a political organisation has repeatedly failed to submit the declarations (...) or its annual report, the director of the Corruption Prevention and Combating Bureau shall be obliged, within two weeks' time, to send a written warning to the director of the relevant political organisation (party).*

(5) *Where a political organisation (party) does not carry out the obligations assigned to it by the Corruption Prevention and Combating Bureau, as referred to in the second and third section of this article, or where the political organisation (party) fails, within one month's time after a warning has been sent out, to file the declarations (...) or its annual report, the director of the Corruption Prevention and Combating Bureau shall be obliged, within two weeks' time, to propose that the operations of the relevant political organisation (party) be suspended by the courts.*

(6) Where a political organisation (party) fails to fulfil a court ruling on suspending its operations, or where the political organisation (party) has not reversed violations of the law within the specified time frame, the director of the Corruption Prevention and Combating Bureau shall be obliged, in accordance with the law, to propose that the operations of the relevant political organisation (party) be ended by the courts.

Furthermore, the criminal code regulates such offences as: using intermediaries¹⁶ or vote buying¹⁷. The Code of Administrative violations (Clause 166.34) also states that:

For financing a political party using an intermediary or for the fact of intermediation a person who has used the intermediary or the person who has acted as intermediary is fined with 100 to 200 lats fine.

An analysis of the above sanctions, however, reveals four major limitations:

- a lack of strong sanctions in cases of significant violations related to party and campaign finance;
- sanctions are not established in proportion to the gravity of the offence, in particular, there is a lack of criminal sanctions;
- a narrow circle of possible offenders; the law limits proposed sanctions to only: 1) party, and 2) donor (*intermediaries*);
- a radical sanction of dissolution of party might prove to difficult to defend against the international standards of political rights. Based on the provisions of the European Convention for the Protection of Human Rights, the Council

¹⁶ For financing a political party using an intermediary or for the act of intermediation, if this has occurred in a large scale - a prison sentence of two years, arrest or community service or a fine in the amount ranging from 30 to 200 minimal monthly salaries (90 LVL)

¹⁷ Clause 90 - Impediments to realization of election rights and rights to participate in the referenda For intentional impediments to carry out rights to elect members of parliament of municipalities, to be elected or freely participate in the referenda [...] using violence, deceit, threats, buying or in any other illegal way - imprisonment up to three years or a fine up to 60 minimal monthly salaries. (90 LVL)

of Europe has stated that “enforced dissolution of political parties may only be justified in the case of parties which advocate the use of violence or use violence as a political means to overthrow the democratic constitutional order.”¹⁸

Violations of political finance law can range from very minor infringements, such as marginally late submission of financial reports, to major fraud. Ideally, the law should specify additional violations, such as: *(1) material misrepresentations, including but not limited to fraudulent backup documentation, fraudulent donations and expenditures, (2) failure to report transactions in a disclosure statement, (3) submitting false or incomplete information, (4) failure to respond to the Agency’s requests for documentation or information, (5) conducting political finance activity outside of the reporting account or through cooperation with surrogates, (6) incurring prohibited expenditures; (7) distressing Agency’s staff and external auditors; and (8) abusing state resources.*

Violations which are not specified by the law, but should be punishable by a considerable fine or imprisonment, should also include:

- Utilizing public resources for campaign or party’s activities and receiving any contribution resulting from an abuse of state resources,
- Exercising any form of pressure on legal and natural persons when soliciting contributions for a political party or candidate;
- Preventing the KNAB’s authorized officer or an external auditor from fulfilling the duties of examining the records or auditing accounts kept by the political party; and
- Transferring public resources into legal and natural persons for the purpose of benefiting political associations or election subjects.

¹⁸ At its 41st plenary session on 10-11 December 1999 the Council of Europe Venice Commission adopted guidelines on the prohibition and dissolution of political parties and analogous measures.

It is particularly important that the KNAB establishes sanctions in proportion to the gravity of the offence. The current law suggests that the same sanction (administrative fine from 100 LAT to 5000 LAT), which can have a significant financial implication for an individual but might become a “cost of doing business” for a major party, would be applied regardless of the seriousness of the offence.

If the party is liable only to a fine and this may not exceed 5000 LAT, considering the amounts of money reputedly spent on Latvian elections, this fine would be no more than small change. The problem with the current penalties is that they may promptly become a cost of “doing business”. At the same time the law does not provide any sanctions for candidates, donors and vendors, who are involved in party and campaign finance related offences.

Sanctions should be directed against an individual party official, candidate, donor, and any individual personally involved in the illicit transaction or not fulfilling reporting obligations. In some cases, it is impossible to determine who should be held accountable for violations of the law. To make enforcement more effective the KNAB should be allowed to investigate the involvement of different individuals. There must always be someone who is accountable for violations, whether it is an individual or an organization. If responsibilities for violations are clearly understood and it is made clear who is to be held accountable for which type of infringement of the law, the effect will be a greater likelihood that prosecution will take place.

Practice shows that an effective enforcement can result from monetary fines and limitations on access to public funding rather than from severe criminal penalties. Yet, the criminal penalties might be inevitable in the case of serious electoral fraud and an abuse of state resources. In fact, the KNAB has proposed that parties, which repeatedly offer false

information in their declarations, be subjected not only to administrative, but also to criminal liability.¹⁹

Finally, laws in some countries require that violations be publicized; parties' and candidates' names can be placed on the regulatory body's website or posted, when attempts are being made to collect overdue penalties or public funds payments. This kind of publicity has a very strong deterrent effect, reducing the need for litigation. The KNAB is charged to publicize violations of the Act, and, indeed, media attention to violations is a far more potent deterrent than a monetary penalty the Bureau might assess.

RECOMMENDATION: A more comprehensive system of sanctions should be established. One of the first steps for any agency is to outline clearly what types of violations and sanctions exist, how should the KNAB react to them, and who is to be held accountable for which infringement of the law.

¹⁹ Lase, I. "KNAB un zaļā gaisma", intervija ar Korupcijas novēršanas un apkarošanas biroja priekšnieka vietnieku Valdi Pumpuru ("KNAB and the green light", interview with Valdis Pumpurs, Deputy head of the Bureau for Prevention and Combating of Corruption). www.politika.lv

ADDITIONAL OBSERVATIONS:

Ideally, the KNAB, should come up with guidelines in order to define and clarify the following terms and improve implementation of the existing regulations:

- **Transparency** - Article 9 of the Law states that “Any person shall have the right to approach the Corruption Prevention and Combating Bureau and the relevant political organization (party) to review its annual report, its annual declaration of financial operations, its declaration of campaign expenditures, its declaration of planning campaign expenditures, and its declaration of campaign income and expenditures”. Yet, does it mean that any individual can verify all receipts and invoices which are submitted with financial reports? Without access to full documentation any public control would be meaningless. The article 9 (2) is vague in terms of access to the financial reports as it does not specify if a person has a right to see the original invoices submitted together with the financial reports. Indeed, the KNAB which publishes parties’ accounts and donors' list on the Internet maintains a relatively transparent system. However, a legitimate claim can be made that this way of reporting covers only a part of all campaign finance, as in practice donors seldom report on their donations in-kind. Thus, the KNAB could broadly interpret this provision to allow any person to see documents necessary to verify financial operations of any political party.
- **Limited support offered by other state bodies** – For the last few years the KNAB has examined legitimacy of parties’ financial and economic activities to discover that most of the donors refer to assets that are not examinable. In such cases, the Agency can only effectively enforce regulations with support from other state bodies, including the State Revenue Service.²⁰ Without an effective

²⁰ In the period between Feb. 1, 2003 and Dec. 31, 2003, from 100 requests sent by the KNAB to the State Revenue Service for examination of legality and authenticity, it was confirmed that in 79 cases the income of the donors was inadequate to cover their donations.

cooperation and exchange of information (e.g. regarding the tax status of the donors) the KNAB will not be able to verify financial reports. Yet the weakness that undermines the working of a more effective enforcement system is the lack of full and prompt support for the KNAB's actions on the part of some agencies. One of solutions to this problem would be to sign an official Memorandum of Understanding which would formalize such cooperation and would clearly indicate what the expectations on each part would be.²¹ Signing an official Memorandum of Cooperation with the National Broadcasting Council would also be an option to improve the monitoring of the media advertisement.

- Providing trainings for the media and encouraging the leading research/academic institutions to utilize the Bureau resources, increase public control and encourage citizens to inform the KNAB about discovered irregularities.
- Increasing cooperation with the investigative team – so far only a limited number of investigations into political finance irregularities has been conducted – intermediaries have been detected and sanctioned but the actual masterminds behind the operation have not been prosecuted or even detected.

²¹ In the United States, the Public Integrity Section of the Criminal Division, Department of Justice has developed a working relationship with the Federal Election Commission and its staff, and can help agents and prosecutors quickly obtain the information they need from the FEC. The Department of Justice may refer to the FEC allegations of all but the most aggravated campaign financing violations. Early consultation with the Public Integrity Section assists the Department of Justice, the United States Attorneys' Offices, and the FBI, by helping encourage the referral of appropriate matters to the FEC without the unnecessary expenditure of Departmental resources. Such consultations also enable the Department to discharge its obligations under its 'Memorandum of Understanding' with the FEC. Finally, providing the FEC with information on closed criminal FECA matters in a timely manner has contributed significantly to the external helpful approach the Commission is now taking with respect to shared enforcement responsibilities. Formalizing agreements through memoranda of understanding should be considered a best practice. There are, however, lessons to be learned from the US experience. The Memorandum of Understanding that was adopted in 1977 is currently being revised by both parties. Two issues stand out among those being discussed. The first concerns the timely forwarding of cases to the Department of Justice by the FEC. In the past, some of the cases that would fall under the Department of Justice's jurisdiction have been forwarded after the statute of limitations has expired. The second concerns the ability of the FEC to continue to conduct an investigation while the case is open with the Department of Justice. The conduct of parallel investigations and the terms under which information is shared should thus be clearly addressed. Finally, the US experience highlights the need to revisit such agreements as relevant legislation and the enforcement body itself evolves over time. For more information see the TIDE Manual at www.moneyandpolitics.net

Finally, any additional amendments to the law should include additional provisions which would clarify the following points:

- The law would benefit from additional paragraphs clearly defining illegal expenditure (prohibitions against embezzlement by party officials and candidates, supporting any paramilitary groups, vote buying, etc.). The law should introduce prohibitions against embezzlement by candidates and party officials. A party official or candidate may not utilize private or public funds contributed to her/his party to defray personal expenses; “personal expenses” should mean any expense, such as payments for personal clothing items, rent, mortgage, utilities, vacations, personal expenses of family members, and other expenses that are not related to campaigning for office.
- All candidates should be required to submit a completed Candidate Financial Disclosure form in the form prescribed by the agency. This record shall include income, assets, and liabilities of the candidate.²²
- Another controversial area is how to regulate and control the use of public funds such as office facilities, staff time, cars, etc. by politicians seeking re-election or a new elected office. This is the major issue for many transition countries and Latvia is no exception. In fact, one of the leading NGOs has been monitoring abuse of state resources since 2005 municipal elections.

Consultant has also identified the following problems that require immediate attention in order for the KNAB to enhance its enforcement responsibilities. Based upon the findings of this assessment, consultants also offer the following recommendations for both short- and long-term assistance to the KNAB:

²² All candidates shall be required to submit a Candidate Financial Disclosure form in the form prescribed by the KNAB.

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1. **Effective usage of qualified personnel** – It is imperative that the current staff responsibilities be modified if comprehensive review of financial reports and field audits are to be done in a timely and professional manner. There are two parts to the problem: *First*, responsibility for maintaining the Internet Database (Money and Politics Database) must be transferred expeditiously to the KNAB IT department. Currently, the Bureau senior staff person is responsible for scanning all documents and downloading them into the web site. In addition, the KNAB could consider providing special software to larger political parties which would allow for a faster and more cost effective publication (using an interface to download the data into the MAP data base) and verification of the financial reports. *Second*, it is important for the KNAB to come up with the prioritization program. Currently, significant resources of the DCPFF are devoted to verify if the party received any contribution from natural persons, who in accordance with Article 6.1 of the Law are prohibited to finance parties (i.e. criminals, and the former KGB employees and informers). Currently, qualified and experienced people are spending considerable amount of time to review the donor lists in order to determine possible violations. An alternative solution would be to oblige the financial agent of a party/candidate to verify if a contribution is in line with this provision. The agent would be obliged to certify that such a check has been performed. Furthermore, the KNAB could request the assistance of other state bodies or use electronic data bases to observe these restrictions.
2. **Operational Plan** – The DCPFF is to be commended, indeed, for all the reviews and audits they have conducted so far. With all its experience what it could do, however, is to develop a comprehensive written audit program. This would preserve the institutional memory the KNAB has build over the past

years and allow any new staff members to understand better how the team is operating. Such an internal document would also standardize operations and would protect KNAB against any accusations of being partisan. (See attached audit program of the FEC).

3. **External and Internal Training** – KNAB is reactive rather than pre-active. Without an active training program for the regulated community one can not talk about serious prevention. Also, staff training and the development of Political Party Financing Manual are essential. It is clear that a great deal is needed in this respect and not all can be achieved before the upcoming elections. Our understanding is that KNAB's resources are modest and time is limited, however it could be significant step forward to offer a training program to political entities participating in the upcoming elections. In the longer term, there could be an internal training in various aspects of applying sanctions with which the employees may need assistance in developing penalty guidelines. Such training could be organized in cooperation with the New York City Campaign Finance Board and IFES.

Methodology

To prepare detailed recommendations, during the first stage of the project the author carried out the following activities:

- Reviewed literature related to financing of political parties and anti-corruption activities in Latvia,
- Analysed legal acts of Latvia with respect to financing of political parties and activities of the Bureau,
- Carried out interviews with the employees of the Bureau in order to understand the work specifics of the Bureau and the issues related to the control of funding of political parties.
- Developed suggestions for proposed amendments to legal acts of Latvia in the field of financing of political parties.
- Elaborated guidelines for development and introduction of a methodology for control of financing of political parties.

This report is primarily based on the above research, comparative analyses with neighboring countries, and other established democracies. In addition to the general recommendations the author analyses different approaches, institutional limitations, and specific actions that would enhance the enforcement of the existing regulations.

Interviews and personal communications:

The Bureau

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Documents

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