

Submission No: 5

F2005/29

RECEIVED
29 JUN 2006

27 June 2006

Mr Tony Smith MP
Chair
Joint Committee of Public Accounts and Audit
PO Box 6021
Parliament House
CANBERRA ACT 2600

Dear Mr Smith

INQUIRY INTO AUDIT REPORT NO.31 2005-2006, *ROADS TO RECOVERY*

At last Friday's public hearing on the above Audit Report, the Committee asked some questions about the issues raised in paragraph 2.77 of the Report relating to Warringah Council's compliance with the expenditure maintenance requirements of the initial Roads to Recovery (R2R) Program. Following the hearing, The Hon. Bronwyn Bishop MP indicated to the Deputy Auditor-General, Steve Chapman, that the Committee would appreciate being provided with further information on this issue. For this reason, Mr Chapman has asked that I write to the Committee.

Overview

As the Audit Report notes, cost shifting involving local government has been a significant issue for a number of years. In general, the concern has involved shifting of costs from the Australian and State/Territory Governments to local government. However, in developing the R2R Program, the Government was concerned to address cost shifting in the other direction; that is, Local Government Authorities (LGAs) substituting Commonwealth funds for their own expenditure on roads. Accordingly, provisions were included in the R2R Act, Funding Conditions and Administrative Guidelines requiring LGAs to maintain their own source expenditure, rather than substituting Commonwealth funding for their own, in constructing, upgrading and maintaining roads. Specifically:

- section 7(1) of the *Roads to Recovery Act 2000* (R2R Act) required the Minister to determine the conditions that would apply to payments made under the R2R Act. Section 7(2)(c) of the R2R Act required that the

conditions include a requirement that the level of roads expenditure funded otherwise than under the R2R Act be maintained;

- the R2R Funding Conditions stated that each LGA must maintain the level of roads expenditure which it funded otherwise than under the R2R Act, and provide a statement to DOTARS that it had done so; and
- the format of this certification was included in the proforma Annual Report included in the R2R Administrative Guidelines (see Appendix 2 to the Audit Report). This proforma required that the Chief Executive Officer of each LGA certify that expenditure on roads from the LGA's own sources in the relevant year had been maintained at or above the average of the amounts expended on roads from those sources over the years 1998-99 to 2000-01.

Although it was of fundamental importance to the R2R Program that funds provided by the Commonwealth be additional to existing road funding, the audit found that, in the course of its administration of the R2R Program, DOTARS did not:

- attempt to assess whether or not aggregate local government spending on roads had been maintained since the introduction of the R2R Program; or
- effectively administer the expenditure maintenance requirements for individual LGAs. This was reflected in:
 - A lack of guidance provided by DOTARS to LGAs as to what was meant by the term 'own source expenditure'. This was despite DOTARS obtaining legal advice in July 2001 that for clarity, certainty and fairness any definition or explanation of the term 'own sources' should be included in either the R2R Funding Conditions or in the R2R Administrative Guidelines and applied consistently to all LGAs. As a result, we found that inconsistent approaches were taken by those LGAs that had analysed their own source expenditure prior to certifying they had met the expenditure maintenance requirement.
 - Inconsistent approaches being taken by DOTARS to LGAs that did not certify that they had maintained their own roads expenditure. The Audit Report comments that this demonstrated that the Department did not have in place procedures to address the administration of this Funding Condition.
 - 63 per cent of those LGAs examined by ANAO had not maintained their own source expenditure in at least one year between 2000-01 and 2003-04. As we discussed last Friday, the annual shortfalls were, in most instances, substantial, with the significant majority being greater than \$250,000. As DOTARS relied on certifications, except where LGAs disclosed that they had not maintained their own source expenditure on roads, the Department was unaware of the failings, and their extent.
 - It was not until 2004, after Gatton Shire Council in Queensland disclosed in its 2002-03 R2R Annual Report (submitted in February 2004) that it had not maintained its own expenditure, that DOTARS investigated what action, if any, it could take in such circumstances. The outcome was that funds could not be recovered, nor could further payments be withheld. This issue has been addressed in developing the Auslink Roads to Recovery Funding Conditions.

Warringah Council was referred to on page 91 of the Audit Report in this context so as to illustrate certain aspects of DOTARS' approach to the expenditure maintenance requirements.

Warringah Council

The audit approach for this issue involved comparing the calculated average to the relevant LGA's expenditure on roads from its own sources in each year of the Program. In general, our audit analysis focused on the years 2000-01 to 2003-04 as the R2R Annual Reports and associated certifications from LGAs were not due at the time audit fieldwork was completed in August 2005. However, in Warringah Council's case, the 2004-05 R2R Annual Report was submitted on 16 August 2005, ahead of the due date of 30 September 2005. Accordingly, information from this report was also available to us.

Warringah Council's own source expenditure on roads was calculated by deducting the following items from the total road expenditure by Council:

- road grants received from State Government and the Australian Government (including Roads to Recovery);
- Financial Assistance Grants; and
- fees and charges.

Using this data, Warringah Council's average own source expenditure on roads between 1998-99 and 2000-01 was calculated to be \$906,985.

As outlined in the following table, comparing Warringah Council's actual own-source expenditure to the average revealed that Council did not meet the expenditure maintenance requirement in any year of the R2R Program. Accordingly, Warringah Council is included in Table 2.6 (page 93) of the Audit Report as one of the ten LGA's in our sample that had not maintained its expenditure in any year of the Program. In aggregate, the shortfall was \$2,669,293.

Financial Year	Warringah Council's expenditure on roads funded otherwise than under the R2R Act	Average Level of Expenditure 1998-99 to 2000-01	Difference
2000-01	\$327,000	\$906,985	-\$579,985
2001-02	\$168,632	\$906,985	-\$738,353
2002-03	\$490,000	\$906,985	-\$416,985
2003-04	\$420,000	\$906,985	-\$486,985
2004-05	\$460,000	\$906,985	-\$446,985

Warringah Council submitted its R2R Annual Report for 2000-01 to DOTARS on 27 September 2001. In this report, Council certified that it had maintained expenditure on roads from its own sources at or above the average of the amounts expended on roads from its own sources over the years 1998-99 to 2000-01. As is evident from the above table, Council should not have certified that it had maintained its own source expenditure in this year.

Warringah Council's 2001-02 R2R Annual Report was submitted to DOTARS on 30 September 2002. In this Annual Report, Council did not certify that it had maintained its own source expenditure. Instead, Council advised DOTARS that it had deleted the expenditure maintenance statement from the certificate as the level of Council's expenditure on roads had not been maintained. In addition, Council provided DOTARS with a summary of Council's total actual expenditure on roads for the years 1998-99 to 2001-02, and budgeted expenditure for 2002-03. This Schedule indicated that the shortfall in expenditure in 2001-02 was \$738,353.

Council advised DOTARS that the shortfall in expenditure was attributable to the following factors:

- as at 30 June 1999, Council had an accumulated deficit of \$10.9 million, rising to \$12.6 million as at 30 June 2002. To recover from this deficit position, the Council implemented a financial recovery package, to place the Council in a surplus position by 30 June 2003. As at 30 June 2002, the deficit had been reduced from the \$12.6 million to \$0.836 million and, on then current projections, would return to surplus by 30 June 2003; and
- the turnaround in the Council's financial position required: sustainable reductions in costs and expenditures; deferment (for reconsideration from 2004-05 and beyond) of several programmes of expenditure; and elimination of some optional services/programmes.

Council further advised DOTARS that part of the financial recovery resulted from the deferment of an established road maintenance program, so that scheduled works for the year 2001-02 and the overall program have been pushed back by some years until the Council is able to sustain its financial surplus position and allocate more of its own resources to road maintenance. On this basis, Council sought DOTARS' favourable consideration of the continued level of funding under the R2R Program, despite the fact that it had not been able to maintain the level of expenditure on road maintenance in the short term.

As noted in the Audit Report, DOTARS did not respond to this advice from Council.

The Administrator of Warringah Council wrote to DOTARS on 9 September 2003 advising of his appointment. The R2R Annual Report for 2002-03 was signed by Council on this same date, and provided to DOTARS on 1 October 2003. Similar to the 2001-02 R2R Annual Report, Council deleted the expenditure maintenance clause from the certificate on the basis that it had not met this requirement. Advice similar to that provided as part of the 2001-02 Report was appended to the 2002-03 R2R Annual Report. This included a request from Council for a continuation of R2R funding despite the fact that Council had been unable to maintain its level of expenditure on road maintenance.

As noted in the Audit Report, DOTARS did not respond to this advice from Council.

In August 2004 Warringah Council received its final payment under the R2R Program. Shortly thereafter, DOTARS wrote to Council advising that it had now received the full amount to which it was entitled under the Program. Council was advised that it should continue to submit R2R Quarterly Reports (of actual and forecast expenditure for each project) until all R2R funds have been spent as well as

continue to submit R2R Annual Reports until all R2R funds have been acquitted. No mention was made by DOTARS of the statements in the 2001-02 and 2002-03 Annual Reports that the expenditure maintenance requirement had not been met.

Warringah Council's 2003-04 R2R Annual Report was submitted to DOTARS on 30 September 2004. Again, Council deleted the expenditure maintenance clause from the certificate on the basis that it had not met this requirement. Advice similar to that provided as part of the 2001-02 and 2002-03 Reports was appended to the 2003-04 R2R Annual Report. This included a request from Council for a continuation of R2R funding despite the fact that Council had been unable to maintain its level of expenditure on road maintenance.

As noted in the Audit Report, some six and a half months later, DOTARS wrote to Warringah Council concerning the expenditure maintenance requirement. As noted in the Audit Report, DOTARS advised Council as follows:

On 30 September 2004, you submitted your Council's Roads to Recovery Annual Report for 2003-04. In it, you indicated that your council had failed to comply with the expenditure maintenance requirements of the Program. This is a serious breach. The expenditure maintenance requirements exist to ensure that councils do not simply substitute Australian Government funding for their own.

The new Roads to Recovery Program to begin on 1 July 2005 will also have expenditure maintenance requirements. Any breach of these requirements will render your Council non complying and this could impact on your funding under that Program.

On 16 August 2005, Council submitted its 2004-05 R2R Annual Report to DOTARS. This was the final R2R Annual Report for Warringah Council under the initial R2R Program. Again, Council deleted the expenditure maintenance clause from the certificate on the basis that it had not met this requirement. Advice similar to that provided as part of the 2001-02, 2002-03 and 2003-04 Reports was appended to the 2004-05 R2R Annual Report. This included a request from Council for a continuation of R2R funding despite the fact that Council had been unable to maintain its level of expenditure on road maintenance.

As noted in the Audit Report, DOTARS wrote to Council on 26 August 2005 in relation to the 2004-05 R2R Annual Report. DOTARS stated that:

I now note with concern that your council has again failed to comply with the same requirements in 2004-05 for the same reasons. While failure to comply with the expenditure maintenance requirements of the previous programme does not impact on your funding under the present programme, any breach of the current requirements will impact on your programme funding.

The new Auslink Roads to Recovery programme which began on 1 July 2005 has more stringent funding conditions, including expenditure maintenance requirements, than the initial programme. Expenditure maintenance

provisions form Part 2 of the programme funding conditions provided to your council on 3 August 2005.

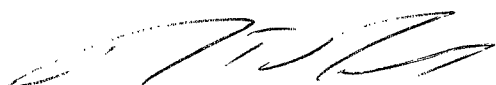
I have noted the reasons given for your council's non compliance with the funding conditions. While being sympathetic to the council's financial situation, I do not agree that these difficulties justify shifting the cost for local roads maintenance and upkeep to the Australian Government.

I would appreciate it if you could examine the new Program funding conditions closely and advise me by 30 September 2005 as to whether your council anticipates complying with the Program expenditure maintenance requirements during the current year and for the four year life of the Program.

As audit fieldwork was completed during August 2005, ANAO does not hold any records subsequent to DOTARS' 26 August 2005 letter to Council. Accordingly, DOTARS would be best placed to advise the Committee whether Warringah Council provided an undertaking to meet the expenditure maintenance requirements of the Auslink Roads to Recovery Program in order to avoid a reduction in its Auslink R2R allocation. We do note, however, that there has been no reduction made to Warringah Council's Auslink Roads to Recovery allocation of \$2,158,766 that was determined by the Minister for Local Government, Territories and Roads on 2 August 2005. This does not include funds to be provided to Council as part of the Roads to Recovery supplement announced by the Government in this year's Budget.

Please do not hesitate to contact me on (02) 6203 7672 or via email brian.boyd@anao.gov.au if we can further assist the Committee on this or other aspects of its inquiry.

Yours sincerely



Brian Boyd
Executive Director
Performance Audit Services Group