

## Audit Report No. 31 2009-10

# Management of the AusLink Roads to Recovery Program

### Introduction<sup>1</sup>

- 9.1 Of the nation's 810,000 kilometres of public roads, more than 650,000 kilometres (80 per cent) are local roads within the responsibility of local government.<sup>2</sup> Approximately one-third of these roads are sealed, with the remainder being unsealed (unformed, formed or gravel roads).<sup>3</sup>
- 9.2 The AusLink Roads to Recovery Program is an administered program within Outcome 1 ('Assisting the Government to provide, evaluate, plan and invest in infrastructure') of the Department of Infrastructure, Transport, Regional Development and Local Government (DITRDLG). Roads to Recovery is the largest investment in local roads ever

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1 The following information is taken from Audit Report No. 31 2009-10, *Management of the AusLink Roads to Recovery Program*, pp. 13-15.

2 AusLink Annual Report 2007-08, p. 23.

3 DITRDLG, *Local Government National Report: 2006-07 Report on the Operation of the Local Government (Financial Assistance) Act 1995*, p. 7. At the time of the ANAO audit the 2007-08 Report had not been presented to the Parliament.

undertaken. In total, over 13 years, \$4.18 billion<sup>4</sup> is to be paid by the Australian Government to local government for expenditure on the construction and maintenance of roads.

- 9.3 There have been four Roads to Recovery (R2R) Programs. The initial Program was established by the *Roads to Recovery Act 2000* (R2R Act) and provided \$1.2 billion over four years. It commenced in early 2001 as a single intervention to address the concern that local government road infrastructure was near the end of its economic life and its replacement was beyond the capacity of local government. The initial program was the subject of an Australian National Audit Office (ANAO) performance audit tabled in March 2006.<sup>5</sup>
- 9.4 A second four-year program commenced in July 2005, as part of the AusLink Land Transport Initiative. The AusLink R2R Standard program was established under the *AusLink (National Land Transport) Act 2005* (AusLink Act or the Act)<sup>6</sup> and provided \$1.23 billion. There was also a separate, but related, AusLink R2R Supplementary Program concurrently in operation from June 2006 to June 2009 that provided \$307.5 million (the third program).
- 9.5 A fourth program commenced under the Nation Building banner<sup>7</sup> on 1 July 2009 and will continue through to 30 June 2014. The Nation Building R2R Program will provide \$1.75 billion.
- 9.6 It is the second and third R2R Programs (the AusLink R2R Programs) that are the subject of this performance audit.

## AusLink R2R Programs

- 9.7 Under the AusLink R2R programs, a total of \$1.537 billion was paid to more than 720 Local Government Authorities (LGAs) between July 2005 and June 2009. The distribution of R2R funds between the States and Territories was determined at the Ministerial level. In arriving at the actual distribution, consideration was given to the historical results from using the Financial Assistance Grants (FAGs) identified for local roads; and population and length of road under the control of the local government,

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4 For the composition of the \$4.18 billion see Figure 1.1 in Chapter 1 of Audit Report No. 31 2009-10.

5 ANAO Audit Report No. 31 2005-08, *Roads to Recovery*, Canberra, 1 March 2006.

6 In June 2009, the *Nation Building Program (National Land Transport) Act 2009* (Nation Building Act) replaced the AusLink Act as the relevant land transport legislation.

7 Programs previously administered under the name 'AusLink' were renamed as *Nation Building* programs in 2008-09. (DITRDLG Annual Report 2008-09, p. 22).

with each of these two statistics weighted equally.<sup>8</sup> In turn, the allocation of funds within each State was determined using the formula applied by State Grants Commissions for FAGs identified for local roads.

- 9.8 Under the Standard Program, each Local Government Authority (LGA) was guaranteed its full life of program allocation by 30 June 2009, subject to the submission of satisfactory documentation such as work schedules and Quarterly and Annual Reports. Almost all LGAs received their full R2R allocation. Larger LGAs generally received an annual allocation capped at one quarter of their life of program allocation. However, subject to meeting certain conditions, smaller LGAs could access their full allocation at the start of the program. LGAs were required to spend all of their Standard Program funds by 31 December 2009.
- 9.9 The May 2006 Budget announced that a further \$307.5 million would be provided in 2005-06 as a supplement to the AusLink R2R Standard Program. Under the Supplementary Program, each funding recipient received a grant equal to one quarter of its life of program allocation under the Standard Program. The funds were distributed and administered under similar funding conditions to those of the Standard Program, with funding recipients being required to acquit their project expenditures by submitting Quarterly and Annual Reports. However, unlike the Standard Program, funding recipients received their Supplementary Program allocations as a one off payment in June 2006, and were required to expend these funds by 30 June 2009.
- 9.10 The focus of the R2R Program is the renewal of local roads to meet social and economic needs. Most of the funds are provided in the form of grants direct to LGAs. These grants, together with other aspects of the program, are administered by a manager and up to three staff in the South East Roads Branch within the Canberra offices of DITRD LG. The small number of staff reflects the following program delivery decisions made at the time the program was first introduced:
- funds were to be paid directly to LGAs;
  - project priorities were the choice of LGAs; and
  - the process by which grants were paid to the LGAs was to be simple, with appropriate audit and accountability systems and arrangements put in place to ensure that there is due recognition by LGAs of the Commonwealth's contribution to local road projects.

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8 Consideration was also given to the long standing concern of South Australia that it received a disproportionately low level of funding under the FAGs identified for local roads.

## The Audit

### Audit scope and objectives<sup>9</sup>

9.11 The audit scope covered the management of the AusLink R2R Standard Program and the AusLink R2R Supplementary Program. The scope did not include management of the Nation Building Roads to Recovery Program, which has only recently commenced. The audit objectives were to:

- assess the effectiveness of the management of the AusLink Roads to Recovery program;
- assess the delivery of the program and management of the funding, including the extent to which the program has provided additional (rather than substitute) funding for land transport infrastructure; and
- identify opportunities for improvements to the management of the program.

9.12 A key part of the audit involved examination of the use of, and accountability for, R2R funds by a representative sample of 41 LGAs from four States/Territories (representing almost six per cent of all funding recipients and eleven per cent of total funding provided under the program). This work included site inspections of more than 560 R2R funded projects, analysis of financial and other reports provided by the 41 LGAs to DITRD LG, and substantiation of the amounts charged to the program for selected projects. To supplement the audit sample, ANAO analysed data in the Department's Infrastructure Management System (IMS).

### Overall audit conclusions<sup>10</sup>

9.13 The ANAO made the following overall audit conclusions:

The R2R Program encompasses the largest investment in local roads undertaken by the Australian Government. By the time the Nation Building R2R Program concludes in June 2014, some \$4.18 billion will have been paid over 13 years to local government for expenditure on the construction and maintenance of roads.

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9 The following information is taken from Audit Report No. 31 2009-10, pp. 15-16.

10 The following information is taken from Audit Report No. 31 2009-10, pp. 16-18.

As part of the AusLink R2R Standard and Supplementary Programs audited by ANAO, more than \$1.5 billion was paid to local government for expenditure on the construction and maintenance of roads in respect of more than sixteen and a half thousand projects. Almost all LGAs received their full R2R allocation under the Standard Program and all LGAs received their Supplementary Program allocations as an up front, once only payment. Accordingly, the key aspect of the programs relating to distribution of funds to local government and LGAs using these funds for road works have been effectively administered.

In terms of the benefits from the R2R Program, a fundamental principle underpinning the program is that the funding provided to LGAs was to be additional to existing road funding. Accordingly, LGAs are required to maintain their own spending on local roads and report their performance in this regard to the department. Over time, the expenditure maintenance obligation placed on LGAs has been made less demanding but still, there have been significant numbers of LGAs that have not maintained their own expenditure in one or more years (and some LGAs have not maintained their own expenditure in any year). In these circumstances, the administrative practice adopted has been to waive the requirement where a satisfactory explanation has been provided and ask that the shortfall be made up in later years; but this often does not occur.

Another key aspect of program design was to pay LGAs quarterly in advance based on LGAs reporting the expenditure to date and forecast expenditure for the next three months in respect to each project they were undertaking under the program. Paying up to three months in advance was seen as necessary so that LGAs did not have to transfer funds from roadworks funded from their own resources.<sup>11</sup> However:

- there have been many instances of LGAs being paid more than three months in advance due to factors such as accelerated funding during the last quarter of each financial year (so as to fully spend the annual program allocation) notwithstanding that these payments did not reflect LGA cash flow needs, and LGAs overstating their actual expenditure and/or submitting unreliable expenditure forecasts;

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11 In practice, DITRDLG scheduled the payments to LGAs for around the middle of the relevant quarter.

- experience with the program has shown that many LGAs do not require payments to be made in advance, such that 54 per cent of all payments made under the Standard Program have been made in arrears (and 90 per cent of LGAs were paid in arrears in one or more quarters); and
- the cost to the Commonwealth of advance payments remains considerable (up to \$16.3 million over the life of the AusLink R2R Standard Program).<sup>12</sup>

Reflecting the judgement that LGAs were best placed to make decisions on road investment at the local level, the grant payment and acquittal processes were designed to be simple. However, there have been a range of important funding conditions where LGA compliance has been less than satisfactory. In this respect, and without detracting from the responsibility of individual LGAs to adhere to the prescribed funding conditions, there would be benefit in the department adopting a range of cost-effective strategies aimed at improving understanding of, and adherence to, program funding conditions and administrative arrangements by LGAs and their auditors. ANAO has made one recommendation to this end.

In addition, in light of experience as to how the program has operated over its first ten years, there would be benefit in the department reviewing key elements of the program design so as to confirm their continuing appropriateness, or otherwise proposing variations (recognising that decisions on program design are a matter for Government). In particular, there is value in consideration being given to:

- the formula that has been used to allocate R2R funding to individual LGAs in light of evidence of capacity constraints that affect the ability of some LGAs to both spend their R2R funds as well as maintain their own source expenditure on roads; and
- paying LGAs in advance rather than in arrears given that many LGAs have not sought payments to be made in advance and a significant proportion of advance payments that have been made have remained unspent by the respective LGAs for considerable periods of time.

DITRD LG has substantially implemented all recommendations made during the previous audit aimed at improving the administration of the program. In light of further experience with the program, ANAO has made a further two recommendations directed towards enhancing the administration of program accountability arrangements and strengthening the program governance framework.

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12 ANAO's audit of the initial R2R estimated the interest cost of payments in advance to be between \$8.4 million and \$19.4 million (ANAO Audit Report No. 31 2005-06, p. 29).

## ANAO recommendations

**Table 9.1 ANAO recommendations, Audit Report No. 31 2009-10**

1.	<p>ANAO <i>recommends</i> that the Department of Infrastructure, Transport, Regional Development and Local Government strengthen the governance framework for the Roads to Recovery program, including by:</p> <ul style="list-style-type: none"> <li>a) better resourcing the existing program of contracted financial audits of Local Government Authorities so that the program of audits is able to be fully delivered; and</li> <li>b) giving greater emphasis to structured risk management and program evaluation.</li> </ul> <p><b>DITRDLG Response:</b> Agree.</p>
2.	<p>ANAO <i>recommends</i> that, in light of the experience to date with the program, the Department of Infrastructure, Transport, Regional Development and Local Government review and advise Ministers on program design arrangements that will promote timely local government expenditure of Roads to Recovery funding on road work that is additional to that which would have otherwise occurred.</p> <p><b>DITRDLG Response:</b> Agree.</p>
3.	<p>ANAO <i>recommends</i> that the Department of Infrastructure, Transport, Regional Development and Local Government improve accountability to the Parliament for the Roads to Recovery Program by setting and reporting in its departmental Annual Report against an effectiveness target for the program.</p> <p><b>DITRDLG Response:</b> Agree.</p>
4.	<p>ANAO <i>recommends</i> that, given the importance to both the Roads to Recovery and Strategic Regional Programs of Local Government Authorities maintaining their own level of expenditure on roads, the Department of Infrastructure, Transport, Regional Development and Local Government:</p> <ul style="list-style-type: none"> <li>a) obtain greater assurance over the accuracy of own source roads expenditure reported to it by Local Government Authorities by requiring these figures to be included in the scope of the Audit Certificate included with each Authorities' Annual Report on the use of program funds; and</li> <li>b) develop a more effective range of sanctions to apply in circumstances where own source expenditure has not been maintained, with a particular focus on those Local Government Authorities that frequently fail to maintain their annual expenditure and/or that do not make up shortfalls in later years.</li> </ul> <p><b>DITRDLG Response:</b> Agree.</p>

## The Committee's review

9.14 The Committee held a public hearing on Monday 21 June 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

- Department of Infrastructure, Transport, Regional Development and Local Government (DITRDLG).

9.15 The Committee took evidence on the following issues:

- expenditure maintenance requirements;
- data quality;
- reporting;
- strategic planning; and
- specificity of recommendations.

### **Expenditure maintenance requirements**

9.16 The ANAO noted that, to deter cost shifting from Local Government Authorities (LGAs) to the Commonwealth under the R2R program, LGAs were expected to maintain the level of their own source expenditure on maintenance and construction of local roads.<sup>13</sup> However, the ANAO noted that DITRDLG has adopted an administrative practice of waiving this expenditure requirement 'where a satisfactory explanation has been provided and [asking] that the shortfall be made up in later years.'<sup>14</sup>

9.17 The Committee noted that DITRDLG has never refused such a request from a LGA and asked DITRDLG to provide reasons for these decisions. The Department explained that the decision is determined on the information supplied by the LGA for the request and admitted that the process could be tightened:

... if the work has not proceeded for a particular reason and it is reasonable or if the council has not expended its money in the six months after receiving it and there is a good enough reason, then the department will be inclined to provide a waiver. It is true that no waiver was refused during the life of the programs that this audit was looking at, but ... we are seriously looking at how those sanctions might be better applied to deal with expenditure maintenance.<sup>15</sup>

9.18 The Committee observed that there had been a distinct improvement in some of the breaches and waivers of expenditure maintenance requirements from 2005-06 to 2008-09. The Committee noted the halving

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13 Audit Report No. 31 2009-10, pp. 22, 129-131.

14 Audit Report No. 31 2009-10, p. 16.

15 Mr Foulds, DITRDLG, p. 4.



of the total deficiency and asked DITRDLG how the improvements had been achieved. The Department told the Committee that implementation of the recommendations from a previous ANAO report had contributed to the improvement.<sup>16</sup> DITRDLG also cited improved communications between the Department's team and LGAs and indicated that LGAs have gained familiarity with the processes and requirements of the program.<sup>17</sup>

## Data quality

9.19 The ANAO found that the reporting of own source expenditure by LGAs has been prone to error for a number of reasons, calling into question the accuracy of DITRDLG figures regarding compliance with expenditure maintenance requirements.<sup>18</sup> The Committee asked the ANAO and the Department to clarify its concerns regarding the accuracy of the figures.

9.20 The ANAO identified the self-reporting nature of the process as a major concern:

... to date those figures only report those councils which are actually acknowledging to the department that they have not met their obligations. ... In general people do not say they have not met something when they have; the error goes the other way.<sup>19</sup>

9.21 DITRDLG identified another concern as the reference amount used by LGAs to determine their own source expenditure requirement.<sup>20</sup> The reference amount is a 'moving average' and changes over time as the LGAs' road expenditure changes.<sup>21</sup> The Department explained that the changes in the reference amount of individual councils distorts the aggregated data:

So in some councils they can be considered to be meeting their expenditure maintenance obligation today by spending much less than they were spending in the first year of the program. What we are saying is that just the percentage of councils that meet the requirement does not tell the full story because the requirement has got easier over time, but also the way that councils can report

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16 Mr Foulds, DITRDLG, p. 4.

17 Mr Foulds, DITRDLG, p. 4.

18 Audit Report No. 31 2009-10, pp. 136-40.

19 Mr Boyd, ANAO, p. 5.

20 Mr Farmer, DITRDLG, p. 5.

21 Mr Farmer, DITRDLG, p. 5.

against that has got easier as well, so that does not give you the full picture.<sup>22</sup>

- 9.22 The Committee asked what DITRDLG has done to improve the accuracy of the data collected on own source expenditure. The Department told the Committee that it has taken steps to more precisely define the reporting requirements for the current R2R program.<sup>23</sup> DITRDLG has also adjusted the formula used to calculate its own source revenue figure. The figure was previously calculated by averaging the previous four years own source expenditure or taking the highest and lowest figure.<sup>24</sup> The Department now provides LGAs with a third option which includes an escalation factor to accommodate those councils experiencing a loss of revenue:

If a council's own source revenue declines, the ready reference amount can be adjusted downwards accordingly. The Department's view is that it would be unfair to require a council to maintain its own source expenditure on roads at a fixed level if its own source revenue is declining.<sup>25</sup>

- 9.23 The Committee expressed some concern that allowing LGAs to choose the method of calculating the reference amount could open the system to abuse. DITRDGL reminded the Committee that the aim of the program was to facilitate road works in regional areas by providing funding to LGAs through a simple process that was not onerous for councils to administer.<sup>26</sup> The Department assured the Committee that appropriate checks are in place:

It does provide flexibility, and the department does actually check off on the choice made by a council. It is not arbitrary. We agree that that is the approach that a council will take.<sup>27</sup>

## Reporting

- 9.24 The ANAO noted that in 2008-09 the Portfolio Budget Statement (PBS) required DITRDLG to report against the key performance indicator of 'efficient and effective management' of the R2R Program.<sup>28</sup> The target was
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22 Mr Farmer, DITRDLG, pp. 5-6.

23 Mr Foulds, DITRDLG, p. 6.

24 Mr Foulds, DITRDLG, p. 6.

25 Mr Foulds, DITRDLG, p. 6.

26 Mr Foulds, DITRDLG, p. 7.

27 Mr Foulds, DITRDLG, p. 7.

28 Audit Report No. 31 2009-10, p. 108.

that the program be 'administered in accordance with relevant legislation, published guidelines and ANAO guidance'.<sup>29</sup> The ANAO found that DITRDLG's 2008-09 Annual Report did not mention this indicator.<sup>30</sup>

- 9.25 The Committee asked DITRDLG why this information had not been included in the 2008-09 Annual Report and whether or not it would be included in the 2009-10 Annual Report. The Department was unsure why it had not been included in the 2008-09 Report and assured the Committee the information will be included in the 2009-10 Report.<sup>31</sup>
- 9.26 The Committee notes with some concern that the indicator is included in the 2009-10 Report but that there is no clear indication of how the indicator was measured. The Committee also notes that although it has been reconfigured, the information included in the 2009-10 Report is similar to the information included in previous reports and does not address the concerns raised by the ANAO.
- 9.27 Overall, the ANAO found that the Annual Program Reports to Parliament were neither timely nor effective and recommended that the Department improve accountability to the Parliament by 'setting and reporting in its departmental Annual Report against an effectiveness target for the program.'<sup>32</sup> The Committee asked DITRDLG what steps have been taken to implement this recommendation and improve the standard of reports to Parliament.
- 9.28 DITRDLG advised the Committee that it is undertaking a review of the administrative arrangements and, in the course of that review, will develop an effectiveness target for the program. The Department added that the review will be completed by April 2011 and the results will be included in the Annual Report for 2010-11.<sup>33</sup>

## Strategic planning

- 9.29 Committee Members cited anecdotal evidence indicating that there is a flurry of road maintenance work in communities just before the end of the financial year suggesting that LGAs are not taking a strategic approach to the delivery of road works. The Committee asked DITRDLG if there was evidence of a planned approach by LGAs. The Department pointed out that local roads are of immediate concern to LGA constituents and that the

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29 Audit Report No. 31 2009-10, p. 108.

30 Audit Report No. 31 2009-10, p. 109.

31 Mr Farmer, DITRDLG, p. 10.

32 Audit Report No. 31 2009-10, pp. 110-12.

33 Mr Foulds, DITRDLG, p. 3; Mr Farmer, DITRDLG, p. 11.

evidence indicates that LGAs are concerned to use their funding effectively:

The councils have a very strong vested interest in the quality of the road network in their council area. I would say that they have a very strong interest in spending the money wisely.<sup>34</sup>

## Specificity of recommendations

- 9.30 The Committee raised a general concern with the ANAO regarding the specificity of its recommendations. Members of the Committee voiced the opinion that more detailed recommendations would provide better guidance for departments.
- 9.31 The Auditor General replied that the ANAO has found it more effective to deliberately focus on a number of key issues arising from each audit.<sup>35</sup> The Auditor General told the Committee that the ANAO has also become 'outcomes orientated in our recommendations rather than articulating a particular process'.<sup>36</sup> Using the example of the R2R Program, he demonstrated to the Committee that the development and implementation of new policy and procedures requires lengthy consultation with all stakeholders to ensure an effective result.<sup>37</sup> This needs to be undertaken by the department concerned if workable solutions to the issues identified by an audit are to be put in place.<sup>38</sup>

## Conclusion

- 9.32 The Committee acknowledges that there has been a distinct improvement in the noncompliance figures with regard to expenditure maintenance requirements for the R2R Program. However the inconsistencies identified by the audit in the quality of data used to measure the efficiency and effectiveness of the program are of concern to the Committee.
- 9.33 The Committee notes that DITRDLG has agreed to implement all of the ANAO recommendations and notes the Department's assurance that future Annual Reports will provide the Parliament with a more accurate

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34 Mr Farmer, DITRDLG, p. 12.

35 Mr McPhee, ANAO, p. 8.

36 Mr McPhee, ANAO, p. 8.

37 Mr McPhee, ANAO, p. 8.

38 Mr McPhee, ANAO, p. 8.

assessment of the Program. The Committee will keep this matter under review.

