AUSTRALIAN GOVERNMENT RECONSTRUCTION INSPECTORATE SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO NATIONAL NATURAL DISASTER FUNDING ARRANGEMENTS

INTRODUCTION

The Australian Government Reconstruction Inspectorate (the Inspectorate) is pleased to provide its submission to the Productivity Commission inquiry into the efficacy of current national natural disaster funding arrangements.

This submission draws on the Inspectorate's impressions gained from its three years of practical oversight of the implementation of the Natural Disaster Relief and Recovery Arrangements (NDRRA). It has identified a number of issues concerning the administration of the NDRRA and proposes measures that could be implemented to provide more effective funding arrangements in future.

The Inspectorate was established on 7 February 2011 to oversee reconstruction activity undertaken by the Queensland and Victorian Governments following natural disaster events during the summer of 2010-11. This was subsequently extended to include disaster events up to 2013 in Queensland. The Inspectorate's role is to provide assurance that the expenditure of both Commonwealth and state funds on the recovery and reconstruction of public assets is achieving proper value for money.

The Inspectorate has extensive experience in public administration, engineering and financial assurance. It is chaired by former New South Wales Premier and Federal Finance Minister, the Hon John Fahey AC. Other members are Mr Martin Albrecht AC, the former Managing Director and Chair of Thiess; Ms Robyn Cooper, Principal at Crowe Horwath; and Mr David Tune PSM, Secretary of the Department of Finance[1]. It reports directly to the Prime Minister through biannual reports. Secretariat support is provided by the National Disaster Recovery Taskforce in the Department of Infrastructure and Regional Development (the Department). The Inspectorate is scheduled to cease its operations on 30 June 2015 after completing its assessment of reconstruction in Queensland and Victoria.

The Inspectorate conducts regular site visits to inspect reconstruction projects in areas that suffered the greatest damage from the natural disasters. To date, it has visited twenty-two local government areas in Queensland and seven in Victoria. These visits have enabled it to assess at

[1] This submission does not necessarily reflect the views of Mr Tune or the Department of Finance, nor does it indicate a commitment to a particular course of action by that Department. The Department of Finance is understood to be preparing a separate submission to the Productivity Commission.

first hand the damage inflicted and reconstruction progress made, and to discuss issues affecting reconstruction with local councils and State governments.

SUMMARY AND RECOMMENDATIONS

Natural disasters are increasingly common occurrences in Australia, and have resulted in the Commonwealth spending significant sums on recovery efforts. The Australian Government Attorney-General's Department estimates that over the decade to 2015-16, the Commonwealth will provide a total of $10 billion in assistance to states and territories for the restoration of essential public assets damaged by natural disasters.

It is critical that Commonwealth public funding for recovery and reconstruction is strategically invested to achieve optimum long term outcomes for affected communities. The Inspectorate considers that current NDRRA do not adequately meet this imperative. They need to be significantly amended so that they are applied more strategically and consistently, and incorporate stronger accountability requirements to better ensure that Commonwealth funds are well spent.

In particular, the current configuration of Commonwealth funding acts as a disincentive for state, territory and local governments to invest in mitigation measures. There is a need to amend the NDRRA such that they encourage states, territories and local governments more fully recognise the investment, savings and non-financial benefits of mitigation. The NDRRA were originally intended as a financial safety-net for states and territories. Limited programme guidance and accountability has instead led to 'scope creep' and dependence by recipients on the repeated provision of funding by the Commonwealth.

The Inspectorate recommends the following;

- The Commonwealth should negotiate a new formal arrangement that covers all recipient states and territories; this should reflect the recommendations that follow, and oblige jurisdictions to each establish a centralised co-ordinating point that works with the Commonwealth in monitoring and reporting on the use of pre-approved public funds.
- The new arrangements should provide state, territory and local governments with greater incentive to invest in the mitigation of disaster risks which improves communities' ability to resist future such events and to recover more rapidly; this should include a more appropriate balance between Commonwealth, state or territory and local council contributions to projects that gives all parties a clear stake in mitigation.
- The Commonwealth should introduce permanent oversight arrangements that effectively maintain the scrutiny provided by the Inspectorate; the exact format for these could take one of several different forms, and should be made readily 'scalable' so that the deployment reflects the size of a particular disaster and the consequent degree of Commonwealth financial exposure.
- Timely preliminary assessments of eligibility for NDRRA funding should be conducted of all reconstruction projects that state or territory agencies and local councils propose to undertake in the expectation of subsequently receiving NDRRA funding prior to work being undertaken.

- The Commonwealth should have discretion to withhold or limit project funding where a jurisdiction has not fulfilled prudent asset management obligations, notably having taken out insurance on the asset or appropriately invested in mitigation. An audit should be carried out of the insurability of public assets and, where reasonable, states and territories should be obliged to insure public assets to remove them from future eligibility for NDRRA funding. Responsible management could also be made a condition of large scale advance emergency payments.
- Any future substantial upfront payments of Commonwealth funds to meet emergency needs following a disaster should be commensurate with the actual needs of the recipient jurisdiction; the Commonwealth should insist that the funds be expended within the first month or two after the disaster, with acquittal and other forms of scrutiny brought forward accordingly.
- Local councils and state agencies should be required to maintain detailed and updated records of the condition of assets prior to their exposure to natural disasters; this should minimise the risk of cost shifting by helping to verify that Commonwealth funds are being used for 'like-for-like' replacement.
- Clarification of some important NDRRA definitions and parameters, such as clearer guidelines on engineering standards to be used in NDRRA-funded works, and affirmation that the NDRRA excludes any profit charged by state or local government agencies.

MITIGATION AND BETTERMENT

Mitigation

Current national disaster funding arrangements focus on response and recovery at the expense of prevention and mitigation measures that are more cost-effective in the long term. The NDRRA were originally intended to provide a 'safety net' in severe disaster seasons. However, they have tended to encourage state and local governments to rely upon Commonwealth assistance rather than invest in risk mitigation or even to put in place sufficient forward provisioning arrangements to cover recovery costs. The 2010–11 disaster season was in financial and economic terms the largest in Australia's history, with an estimated impact of around $9 billion in lost economic output. The resulting Commonwealth expenditure on recovery and reconstruction efforts is estimated to be $6.6 billion over six years; in contrast, Commonwealth disaster mitigation funding has remained relatively static at some $45-50 million per annum.

The NDRRA generally funds only the 'like-for-like' restoration or replacement of assets to pre-disaster standards. This does not restrict assets from being rebuilt or replaced to a higher standard – it only determines the amount payable by the Commonwealth under the NDRRA. However, this principle has nonetheless tended to discourage states and local government from investing in mitigation.

When the second level threshold for reimbursement in a particular jurisdiction is reached, local governments can have the full cost of like-for-like restorations (usually of a local road) entirely covered under the NDRRA – up to 75 per cent from Commonwealth funding and up to 25 per cent from the state government. This results in many councils in high risk areas lacking an

incentive to use funds prudently or to plan for the future by expending their own resources on mitigation components of projects, as they confidently expect the Commonwealth and the state to continue to fund like-for-like restoration in full after each disaster. For state government assets, the amount contributed by the Commonwealth is still very substantial at 75 per cent. Guaranteeing such levels of funding to rebuild assets on a like-for-like basis, even if they have been repeatedly damaged and repaired, constitutes a poor use of Commonwealth funds.

Although the NDRRA include provision for the funding of investment in the betterment (i.e. improved resilience) of assets, only one such project has been approved to date. States and Territories have commented that the approval process for betterment is complicated, resource intensive and inflexible. Also, the costs attributed to the betterment component for state assets are split 50/50 between the Commonwealth and the state, and for local government assets are split evenly 30/30/30 between the three tiers of government. This has discouraged the inclusion of betterment components in reconstruction projects as the Commonwealth will always reimburse up to 75 per cent of the costs of what is instead reported as like-for-like restoration. Essential public assets are thus still being rebuilt on a 'like for like' basis regardless of improvements in design. A specific example here is the Colleges Crossing bridge in Queensland, which was damaged in the 2010-11 floods, rebuilt and then re-damaged within a matter of months.

The Inspectorate feels that there needs to be a much greater focus on building assets to a more disaster-resilient standard. Such investments should reflect rational, cost/benefit and social investment analyses - but with special provision being made for remote, Indigenous and other communities that may be disadvantaged by a strict cost/benefit approach.

To this end, the Inspectorate considers that the balance between Commonwealth, state and local council contributions to restoration projects needs to be adjusted to ensure that that the NDRRA provide an incentive to include mitigation components that raise assets to a more disaster-resilient standard, such as basic flood proofing in regions where disasters occur regularly. Council should be obliged to contribute to such costs. The share of contributions could be revised to Commonwealth 60 per cent and state or territory 20 per cent, with the remaining 20 per cent being for mitigation upgrading that is itself broken down into Commonwealth 10 per cent, state or territory 5 per cent and local council 5 per cent. This approach should encourage a more rational prioritisation of projects, careful assessment of the total damage and calculation of the council contribution. It would discourage councils from such possibly wasteful practices as re-sheeting local gravel roads annually, or declining to concrete gravel footpaths and bitumen culverts. In the case of state government-owned assets, such as highways, the 20 per cent balance of total cost could also be dedicated to mitigation and met by the Commonwealth and state equally.

Betterment Fund

In 2013, the Commonwealth and Queensland governments committed $40 million each to a joint Betterment Fund to enhance the resilience of assets owned by local governments. This $80 million Fund provides grants of up to $2 million towards betterment proposals from local governments to be implemented in conjunction with restoration works on assets re-damaged by 2013 natural disasters and covered by Category B of the NDRRA. It is managed by the Queensland Reconstruction Authority - QRA, established by the Queensland Government to

oversee that state's reconstruction programme. It imposes far less burdensome requirements on councils seeking support than do other NDRRA process for betterment funding.

Significantly, the Fund appears to have been very well subscribed. Two hundred and twenty projects have received funding. The majority of these involve simple improvements to floodways, bridges and drainage, and most include co-contributions by local governments. Most of these projects are still under way, but it appears to have been effective in encouraging co-contributions from councils and the addition of betterment components that limit future damage and restoration costs.

The Inspectorate concludes from this that with appropriate settings, assert owners will respond to incentives in the NDRRA to increase their investment in mitigation.

OVERSIGHT ARRANGEMENTS

The NDRRA make very little provision for the oversight of Commonwealth funds. They effectively assign considerable responsibilities of interpretation and judgement about eligibility to state, territory and local governments, despite the majority of funding coming from the Commonwealth. The NDRRA is uncapped funding and relies on the state or territory to determine the eligibility of public assets and how they will be restored - this does not encourage robust planning and project monitoring by delivery agents as there is no set budget.

Eligibility of costs and reporting

The NDRRA has largely relied on recipient jurisdictions to determine the eligibility of each essential public asset and how they will be restored, particularly for disasters before 2012. This has resulted in instances of the NDRRA being used to fund restoration works that appear to go beyond the like-for-like repair or replacement to instead deliver substantial upgrades that meet increased community demand or address pre-disaster maintenance shortcomings. Such upgrades should instead be funded from more appropriate programmes. For example, in the case of the Blackbutt Range road repair project in Queensland, while the realignment of the road will increase vehicle capacity and improve safety, some of the works do not appear to be related to repairing landslip damage caused by cyclones. Similarly, the Toowoomba Range crossing project involves work on the Warrego Highway which will also increase capacity and improve safety, but some of which may not be related to damage caused by a natural disaster. The Inspectorate is continuing to assess these two projects.

The 2012 NDRRA Determination included a new requirement for states and territories to seek the Commonwealth's pre-approval for the restoration or replacement of an essential public asset that is estimated to cost over $1 million. However, this process is focussed on establishing the importance of an asset and its need for replacement, not assessing whether it is being replaced like-for-like.

Under normal NDRRA processes, any ineligible costs are unlikely to be identified when state or territory auditors provide the first, and usually only, acquittal for a project. These are acquittals of expenditure only and do not adequately address questions of eligibility. In addition, they are not required until up to two years and nine months after the end of the financial year in which the disaster event occurred. It is much harder to evaluate compliance with the rules or make

adjustments to a project once the job has been finished. This invariably means that any problems that do come to light are likely to be identified well after expenses have been incurred by the delivery agent - indeed, most such acquittals are generated only after the reconstruction project has actually been completed. For example, asset-owners had until 30 June 2012 to repair damage caused by a disaster event in January 2010 and the states could submit claims for reimbursement up to 30 March 2013. Such arrangements leave both the Commonwealth and asset owners significantly exposed. The 2012 Determination seeks to address this issue by specifying that states and territories must submit claims for financial assistance within 9 months of the end of the financial year in which the expenditure took place. It remains to be seen whether this new requirement will be effective in promoting more timely acquittals.

In addition, the NDRRA oblige states and territories to provide only very high level routine data reports on the implementation of their reconstruction programmes. This takes the form of quarterly reports of top-line estimated costs that do not identify individual projects or even specific disaster events.

As the primary funder, the Commonwealth should insist on stronger accountability and reporting requirements that can properly verify whether or not its reimbursements provide value for money by being used in a manner that properly matches policy intent. It should be able to check the eligibility of individual projects and not merely provide general advice before standing back to allow recipients to effectively determine project eligibility themselves.

Oversight arrangements under current National Partnership Agreements (NPAs)

The project-level monitoring undertaken in accordance with the NPAs with Queensland and Victoria has provided unprecedented scrutiny of reconstruction programmes.

In particular, closer monitoring of the 2010-13 Queensland reconstruction programme by the Inspectorate and the Department, along with the assessment of claims by the QRA, have demonstrated how high levels of ineligible works can be curbed. The ANAO found that this oversight has, for a relatively modest investment, been effective in providing the Commonwealth with greater visibility and more timely assurance concerning reconstruction expenditure than would have occurred under the NDRRA alone. It reported that the value for money process applied by the Inspectorate and QRA has identified $1.7 billion in rejected or withdrawn claims, of which the Commonwealth would have been liable to reimburse almost $1.3 billion. In addition, the Inspectorate has identified a further approximately $100 million of ineligible expenditure.

In Victoria, however, the oversight process has encountered significant problems. Although this state does not appear to have raised a major risk of misuse of funds, the state government's interpretation of the NPA has restricted Inspectorate oversight of the 2011 reconstruction programme to just three projects that each exceeded a $5 million threshold. This was the subject of critical comment by the ANAO in its 2013 audit of value for money reviews on flood reconstruction projects in Victoria. The state does not have a central co-ordinating agency to help assess projects and report on recovery progress. Any future agreements with states should provide a clear basis for scrutiny by the Commonwealth and not be left open to being restricted by subsequent interpretation.

New national arrangements

The Inspectorate considers it important that strong oversight arrangements similar to those put in place for the Queensland and Victorian reconstruction programmes continue after 30 June 2015. To allow these to simply expire, with a reversion to usual NDRRA requirements only, would amount to forgoing the important lessons that the Inspectorate's operations have provided. The Commonwealth should make such arrangements a permanent central feature of new and common arrangements it negotiates to apply across all states and territories. These could take the form of a major series of amendments to the NDRRA, a new NPA that covers all states and territories, or a combination of these.

These oversight arrangements could take one of several different forms. One option is to extend assurance arrangements similar to those of the Inspectorate, with a group of senior experts/advisors reporting directly to the Prime Minister (or another senior Commonwealth Minister). Further options would be to establish an ongoing unit within the Department or Emergency Management Australia, or to extend greater powers to the ANAO to work with counterpart state and territory Auditors-General.

These permanent oversight arrangements should be made readily 'scalable' so that they reflect the size of a particular disaster and the consequent degree of Commonwealth exposure. As Commonwealth financial exposure increases with the severity of a disaster, so should the level of oversight that it insists on.

The new nation-wide arrangements should also oblige all jurisdictions that receive significant amounts of NDRRA funds to establish a central co-ordinating point to work with their Commonwealth counterpart in providing pre-approval, scrutinising projects and in providing detailed and timely project-level reporting.

These new arrangements should make provision for the Commonwealth and states and territories to conduct timely preliminary assessments of the eligibility of all works that state and territory governments and local councils propose to undertake in the expectation of later receiving NDRRA funding. Such preliminary assessment could take the form of a broad description of the damage inflicted on the asset, what reconstruction is proposed and a rough estimate of the cost involved. This would also be in the best interests of delivery agents by allowing them to proceed with reduced risk of their works being found ineligible only after they are well advanced or completed. This and other forms of oversight should be applied to all projects, without being restricted by the imposition of a threshold.

FUNDING ARRANGEMENTS

Responsible management of assets

Queensland's very large use of NDRRA funds is not simply the result of its vast geographic expanse and susceptibility to natural disasters. Major tropical cyclones in Queensland usually inflict damage that in total exceeds the second threshold level for the state, with the result that the Commonwealth is obliged to reimburse up to 75 per cent of project costs. Current arrangements have inadvertently resulted in significantly more support being provided to Queensland relative to other states which have a greater level of insurance cover for their assets. By relying primarily

on NDRRA funding, Queensland effectively uses the Commonwealth as its insurer of first resort. The NDRRA appear to have created a structural disincentive to investing in insurance and other risk management measures by any jurisdiction which fully understands how it can make use of their provisions.

The case of the State Library of Queensland on Brisbane's South Bank illustrates this incongruity. Queensland authorities built the State Library in a position that was known to be vulnerable to flood, and relied on the Wivenhoe Dam to provide protection. Much of the building's equipment was installed in the basement area and the Queensland Government did not take out flood insurance. When the Wivenhoe Dam was not able to prevent the flooding of the Brisbane River in 2011, the State Library was inundated and the Queensland Government received NDRRA funding for restoration work.

Asset owners should take prime responsibility for considering foreseeable consequences and managing risks accordingly. The Inspectorate notes that such issues were addressed by the 2011 Senate committee inquiry into the asset insurance arrangements of Australian state governments.

The Inspectorate therefore feels that the NDRRA should be amended to impose stronger asset management obligations on the states and territories as preconditions for assistance. The Commonwealth should have discretion to withhold or limit the amount of funding provided to a project where the recipient has clearly failed to responsibly manage the risk to the asset, such as by not providing for mitigation or insurance. An audit should be carried out of the insurability of public assets and, where reasonable, states and territories should be obliged to insure public assets to remove them from future eligibility for NDRRA funding.

Responsible management could also be made a condition of large scale advance emergency payments, particularly the more discretionary and comprehensive assistance that can be provided under the NDRRA's Category D.

Advance payments

The Inspectorate accepts that in certain circumstances there can be a case on emergency and other grounds for the Commonwealth to extend advance payments under the NDRRA. However, the generosity of advance payments made so far - $4.16 billion and $500 million to Queensland and Victoria respectively - and delays in acquittals left the Commonwealth exposed financially. It had reduced leverage to pull back funds, and both states took approximately two years to expend these funds on reconstruction. The upfront nature of payments also resulted in the Commonwealth forgoing hundreds of millions of dollars in interest.

The Inspectorate feels that it is entirely reasonable for the Commonwealth to insist that any future upfront payments in response to emergencies be commensurate with the actual needs of the state or territory, and that they be expended within the first month or two after a disaster. In addition, the timing of acquittal and other forms of scrutiny should be brought forward accordingly, and the Commonwealth should insist that interest generated is expended on recovery and reconstruction.

Day labour

One of the most important base principles of the NDRRA is that state, territory and local governments normally need to exhaust their own resources in recovery and reconstruction prior to seeking Commonwealth support – the NDRRA is not intended to provide them with an alternative source of ongoing income.

NDRRA Determination clause 5.2.5 (d) therefore specifically excludes state costs attributable to salaries or wages or other ongoing administrative expenditure for which the state would have been liable had the natural disaster event not occurred. Ordinary wages and salaries paid to council employees are therefore normally not eligible for Commonwealth reimbursement, even if they have been diverted from their normal duties to work on recovery.

The major exception to this is the Local Government Value-for-Money Pricing Model Trial (better known as the day labour trial) introduced by the Commonwealth in June 2012. This involves the Commonwealth reimbursing councils' internal labour costs related to the reconstruction of assets where this can be demonstrated to provide better value-for-money than engaging outside contractors. This is in recognition of the unique situation in Queensland in 2011-12, where as a result of the reconstruction programme and growth in the mining industry, a large number of councils had to compete for labour with each other and with the mining sector, resulting in higher costs to the reconstruction programme.

The Inspectorate strongly supports the broader principle provided for in clause 5.2.5 (d) of preventing cost shifting, but feels that this should not be pursed through restrictions on employment status. It also recognises here that the exclusion of day labour could be seen to raise a difficult equity issue, in that it disadvantages councils in areas where disasters are so frequent that they find it economical to engage employees on a permanent basis to work on disaster recovery, but are often obliged by employment regulations to offer employment to long-tern contractors.

The Inspectorate also recognises that the intention of the day labour trial is to explore a means of ensuring better value for money. However, it has real reservations about how the trial is being conducted and whether it is protected from cost-shifting. It is not clear that the trial is necessarily appropriate for all councils. It does not incorporate a minimum threshold for Commonwealth support; and (as with the application of clause 5.2.5. (d) generally) does not provide for any mechanism by which councils should demonstrate that their resources have been exhausted.

Most importantly, the reimbursement of day labour, even on a trial basis, has potential to diminish local councils' sense of responsibility for disaster recovery and to set a precedent for a rebalancing away from local and state or territory governments and towards the Commonwealth. It is important to uphold the underlying NDRRA principle that they should only seek Commonwealth support when their own resources are insufficient. The Inspectorate therefore cautions against any major policy change before the implications of the trial and the broader consequences have been fully considered.

CLARIFYING ELIBILITY

The NDRRA are rules-based arrangements – as such, they need to incorporate clear definitions to ensure that they are administered consistently and in accordance with their intent. In practice, there have been significant difficulties in determining the eligibility and scope of works. Lack of clarity has led to inappropriate cost shifting to the Commonwealth and the use of its funds to 'gold-plate' some assets well beyond what was needed to repair damage caused by disasters. The NDRRA need to be more clearly expressed and provide sufficient detail to allow consistent interpretation.

Pre-existing damage

The NDRRA only cover damage that is the direct result of a natural disaster, making it important to be able to distinguish this from pre-existing damage.

This has been a particularly persistent issue for road reconstruction projects. The Inspectorate is aware of a number of instances of state agencies and councils applying for NDRRA funding where there is evidence that the road incurred significant damage prior to the disaster event or had long been poorly maintained. Additionally, there appear to have been instances of economic pressures leading to flood-affected roads being prematurely re-opened to heavy vehicles, resulting in further damage to saturated road pavements. Many councils do not maintain adequate records of the pre-disaster condition of assets, which are essential in verifying like-for-like restoration.

The Inspectorate feels that state and territory agencies and local councils should be obliged under the proposed new arrangements to maintain adequate records that can be used to assess their claims for the eligibility of reconstruction, and that they should be required to produce these if requested by the Commonwealth. Records should be sufficiently detailed to clearly establish the condition of the asset prior to the disaster and to make clear what maintenance they received. Similarly, consideration should be given to determining whether or not it was economically viable for a flood-affected road to have been closed or weight restrictions imposed to create an appropriate dry-back period.

Engineering standards

Clause 3.6.6 (b) of the NDRRA Determination refers to a requirement that 'the restoration or replacement results in the asset being restored or replaced to its pre-disaster standard, in accordance with current building and engineering standards'. This clause is intended to allow state, territory and local governments a modest level of flexibility to utilise contemporary construction methodologies and building materials in restoring or replacing an essential public asset, without obliging them to replicate what has become obsolete.

In practice, the Commonwealth and states have frequently differed over how to interpret what exactly constitutes 'current engineering standards'. This increases the risks for all parties involved – of large increases in costs for the Commonwealth, and of asset owners potentially being out of pocket for works deemed ineligible well after works commenced. The Queensland Audit Office has reported that lack of clarity has made it difficult for it to audit Queensland's

NDRRA expenditure and determine whether claims included inappropriate enhancement or betterment components.

Profit margins earned by publicly-owned business entities

The NDRRA should not provide any state, territory or local government with windfall gains. This has been an issue in Queensland where RoadTek, a government-owned and operated business, sought to include profit margins amounting to over $50 million in claims for reimbursement by the Commonwealth for reconstruction projects delivered after the 2010-11 natural disasters.

The Inspectorate feels strongly that the payment of this would have clearly amounted to an inappropriate benefit for the Queensland Government, and that the Commonwealth acted entirely appropriately in refusing reimbursement. States, territories and local governments should not make money out of disasters. Funding arrangements should be amended to clearly affirm that any profit earned by publicly-owned business entities from undertaking reconstruction works should not form part of reimbursement claims.