

**PUBLIC ACCOUNTS COMMITTEE**

*Seventh Report - Construction Contracts*

**MR J.B. D'ORAZIO** (Ballajura) [10.29 am]: I present for tabling the seventh report of the Public Accounts Committee entitled "Inquiry Into Contracts Entered Into Between Consolidated Constructions Pty Ltd and Main Roads WA and the Public Transport Authority", together with all the written submissions to the committee.

[See papers Nos 2772 and 2773.]

Mr J.B. D'ORAZIO: Before I begin, I welcome the pupils from Ballajura Primary School, which is in my electorate, who are in the public gallery today. It is nice to have them here. This morning I am presenting the report of the Public Accounts Committee into the collapse of Consolidated Constructions Pty Ltd and, more particularly, into the relationships in the contracts entered into between Main Roads WA, the Public Transport Authority and Consolidated Constructions, and the effect of those contracts. The terms of reference of the inquiry were such that the committee was to examine the tender practices adopted by Main Roads and the Public Transport Authority and to recommend whether those processes could be improved. The committee was also asked to determine whether the outcome could have been any different had an improved tender process been in place, and any other matter.

I will first provide the basis of the contracts. The first contract was between Consolidated Constructions and Main Roads WA for sealing 16 kilometres of road between Port Hedland and Marble Bar, together with all associated works. This was a \$7.6 million contract, for which the work has been completed. However, the collapse of Consolidated Constructions in February resulted in subcontractors being paid up to only December last year. The committee undertook hearings in Karratha, Marble Bar and Perth, and received a number of submissions. The committee was extremely interested in the fact that the small subcontractors were the ones who had made losses due to the processes that were followed.

The \$7.6 million contract between Main Roads and Consolidated Constructions was entered into in 2003. Consolidated Constructions then subcontracted \$6 million of this work to Carr Civil Contracting Pty Ltd. Carr Civil proceeded to employ a number of subcontractors to complete this job. As indicated by Carr Civil principal Mark Blayney, there were problems from the start because of personnel issues and the question of whether the company had the capacity to do the job, given that he had bought the company only in 2002 and the biggest job that he had previously handled had been for \$1 million. There were further problems in that when the job was started, Carr Civil had only \$300 000 of working capital. Interestingly, this would normally not have been a problem, because even if Carr Civil had a problem, the principal contractor, which was Consolidated Constructions, would have had to bear the cost. When Consolidated Constructions went into liquidation in February this had a double effect, because Consolidated Constructions owed Carr Civil \$1.1 million at that stage. That meant that Carr Civil was unable to pay its subcontractors. Interestingly, at that point Carr Civil was exposed by between \$2 million and \$3 million, so the \$1.1 million would not have made much difference to the position of the subcontractor and the third tier subcontractors. That is where the problem was.

A lot of the people who worked on this project were under the impression that they had some sort of guarantee because Main Roads was involved. Main Roads had asked Consolidated Constructions for statutory declarations stating that the subcontractors had been paid. That obviously caused a problem, in that the basis and wording of the statutory declarations were changed to provide only conditional declarations. The words used in the statutory declarations were changed to say that it was Consolidated Constructions' belief that the payments had been made.

Mr M.G. House: It was a qualified statutory declaration.

Mr J.B. D'ORAZIO: It was a qualified statutory declaration. That caused a problem. As a member of the committee, I feel very sorry for the small subcontractors in the regions. I understand that small businesses in country areas rely on this sort of work and to not be paid for this work has had a devastating effect on them. I am not sure whether the process that occurred would have helped them, but there must be some recognition that circumstances in the country are different from those in the metropolitan area. Some of these small businesses that rely on this work take people at face value. Members might say that is not appropriate but, from talking to some of these subcontractors, that is how things work in country towns.

The committee found that the contracts that Consolidated Constructions Pty Ltd had with both Main Roads WA and the Public Transport Authority of Western Australia did not result in the collapse of Consolidated Constructions. Consolidated would have been in trouble regardless of what happened with these contracts. In fact, Consolidated indicated to the committee that these contracts probably would have made a profit and would have been completed on time and on budget if Consolidated had not had other problems. Consolidated's problems were with other work areas based in New South Wales, other problems in this State and its administration costs.

It is interesting to note that there is a process for Main Roads to assess the main contractor in a project. Although Consolidated had some risks, it passed the criteria used in the assessment of whether it could do the work. However, the requirement that is placed on companies constructing more than \$1.5 million worth of work did not apply to the subcontractor, although it intended to do some \$6 million worth of work. The committee found that this area should be strengthened. One of the committee's recommendations is that if a subcontractor to the principal contractor is to do any work worth more than \$1.5 million, the subcontractor be subject to the same Main Roads requirements as the main contractor. In this case, that would have highlighted the inability of Carr Civil Contracting Pty Ltd to do this work and may have obviated the grief experienced by some small subcontractors.

The committee, as I said, found that Carr Civil did not have the capacity to do this work. It had been operating in the industry for only a year and its biggest job, apart from this contract, had been worth \$1 million. As I said, it had a working capital of \$300 000. Although Main Roads followed all the necessary processes, there was one area that the committee highlighted could be improved. There was an accusation that Main Roads gave a commitment to small subcontractors that Main Roads would cover the cost or guarantee payments to these small subcontractors. Main Roads disputed that and the committee was unable to determine whether there was a firm undertaking that they would be covered or whether there was a guarantee that statutory declarations would be obtained from Consolidated that subcontractors were paid. Again, that was an area of concern to the committee, as some subcontractors were of the opinion that they had a guarantee. However, Main Roads staff indicated to the committee that they told the subcontractors that Main Roads required a statutory declaration from Consolidated that all the subcontractors had been paid before Main Roads would release the money. On that basis, there seemed to be no requirement for Main Roads to bear any responsibility for what ultimately happened.

Contracts with the Public Transport Authority for the construction of Armadale and Gosnells railway stations were worth \$13.2 million. These contracts had hardly commenced. Only \$500 000 worth of work had been carried out on one station and \$70 000 worth of work had been carried out on the other station. Therefore, the problem in that case for the subcontractor was not as great as it was for those in a market contract. However, in the State's view, the collapse of Consolidated has resulted in new contracts being awarded at a cost to the State of an extra \$3.4 million for the completion of those contracts. That is, therefore, a problem. One thing that the committee found was that the Public Transport Authority had accepted a cash retention from Consolidated Constructions instead of requiring a bank guarantee, and that may have the effect of costing the State some hundreds of thousands of dollars. As I said, depending on the arrangements, only a very small amount of work had been completed and the actual effect of this process is not clear. However, the score or the assessment done by the Public Transport Authority of Western Australia was again in line with the normal processes. It followed normal processes but it did not go down the path of asking for a bank guarantee, and that was its error. Despite that happening, if it had carried out even more rigorous checks, the contract would still have gone to Consolidated Constructions Pty Ltd because it was a long-term company, it offered a discount to the tender price if it got both stations, it was the lowest tenderer and it had worked on previous stations and contracts. There was no question of that company not being able to do the work or it being inappropriate for it to get the job. The only problem, as we saw it, was with the Public Transport Authority and the fact that it should have asked for a bank guarantee rather than cash retention as part of the contract.

The committee made five recommendations. The first one was that if a subcontractor contracts to a principal contractor for more than \$1.5 million, which is the same criterion used by Main Roads Western Australia to assess the main contract, it should be subject to the same conditions as the main contractor. That then gives some protection, and the appropriate steps can be taken when a company such as Carr Civil Contracting Pty Ltd becomes involved, which did not have the financial ability or the experience to undertake a project worth \$6 million.

The committee also recommended that agencies such as Main Roads and the Public Transport Authority review their respective pre-qualification processes and the financial due diligence assessment, with a view to conducting more rigorous and timely financial checks on prospective tenderers. I will put this into context. In 25 years, only three contracts have fallen over with state government tendering through Main Roads and the Public Transport Authority. It rarely happens, and it is unfortunate in this case that the circumstances have lined up as they have. However, let us be vigilant and try to streamline the process.

The committee also recommended that the State Supply Commission be involved to make sure that the practices are best practice.

Under the next recommendation, where contracts are entered into by Main Roads or the Public Transport Authority, or for that matter any other state authority, there should be a clear indication that the responsibility for third-tier subcontractors is with their contractor, and that the State is not liable. As was indicated to many of us, some small businesses had the impression that because it was a Main Roads contract, there was no possibility

that they were going to have a problem. When we looked through the process, as I indicated earlier, we found that when Carr Civil went into voluntary administration it was owed only \$1.1 million on the contract with Main Roads, yet it had a deficiency of some \$3 million; therefore, some of those small businesses were already going to be in trouble, whatever happened to the contract with Main Roads.

In the final recommendation, the committee encouraged that preferential treatment be given to the small subcontractors who had lost a lot of money over the problem with the Marble Bar Road. Some small contractors are owed thousands of dollars, and a couple are owed hundreds of thousands of dollars. The committee thinks that they should be supported by being given preferential treatment for any work being done in the regions, so that they can pick up on some of their losses, because their losses can be quite devastating to the local community. Having said that, 33 of the 37 companies who were creditors of Carr Civil have entered into a deed of arrangement with Carr Civil, so they obviously have an accepted settlement arrangement. They have made a commercial decision. However, I still think that the State has some responsibility in those regions to make sure that those small contractors can continue working. When we went to Marble Bar it was quite obvious that the circumstances for business there are different from those in Perth. One of the comments made that intrigued me was that the contractors were too scared to take their equipment off the road because the job was part of the community; they were all working together to make sure it would be finished. A person could not go to the pub at night and say that he took his equipment off the road because he thought he was not going to get paid, because the community would then put pressure on him to make sure that that job, which was so vital to the community, was completed. I understand that feeling; it is different from completing a job in the metropolitan area, and we need to understand that when we talk about the processes.

I would like to thank the members of the committee and the committee staff, Andrea McCallum and Simon Kennedy. The committee worked very hard on this report. Again, it has been a difficult report to produce, trying to balance the various competing interests in this inquiry. In the end, Main Roads and the Public Transport Authority both conducted themselves appropriately. In hindsight, one could always say that greater financial scrutiny would have been beneficial, but in the circumstances, the actions taken by those agencies, other than the cash retention problem with the Public Transport Authority, were more than acceptable. I commend all those who made submissions to the committee, and the committee members for their hard work and support. The recommendations and findings of this report are unanimous.

**MR M.G. HOUSE** (Stirling) [10.45 am]: I add my support to the recommendations of this report, and the remarks made by the chairman of the committee, which are accurate. The recommendations made by the committee will help to overcome similar problems in the future. From that point of view the committee's work has been good, and we have been able to resolve future issues.

I will enlarge a little on the point the chairman made about this job and the situation in which local contractors found themselves. For many years people have wanted the road between Marble Bar and Port Hedland sealed. It was really important to their communities. Even when some of the small contractors suspected that they might be facing financial difficulty as a result of not being paid, they did not want to withdraw from the job because of its importance to the community. That came through to us very strongly in the evidence given to the committee. In that sense, I can express some real sympathy because, as someone who lives in a small country town, I understand those sentiments. However, I must stress that the committee members are not trained investigators, and sometimes when people are giving evidence it is very difficult to be absolutely certain that they are telling the facts as they are. I say that in relation to the evidence given by Consolidated Constructions and Main Roads. There was a bit of "we said", "they said", and "maybe this was said and maybe it was not". That must be weighed as evidence. The point I am trying to make is that the small contractors - I use this term in the nicest possible way - are unsophisticated businesspeople when compared with the big operators in the city. Most business deals in the bush are done very much on a trust, handshake and word-of-mouth basis. I am not the only member in this House who would do business on that basis in the country. Very seldom are people let down by those with whom they do business in this way. Mostly they try to do the right thing. In this case a large company knew it had financial difficulties when it went into the contract. It saw an opportunity to get through those difficulties and to pay its creditors correctly, but that did not happen and the company collapsed. The consequence of that was that many small contractors - people who have worked all their lives to buy a truck, grader or front-end loader, which to them was a huge investment - had their investment put at risk by a large company that did not pay them.

The reports shows how all the mitigating circumstances add up, and it is very hard for us as a committee to make recommendations other than those we have made, which I think are correct. However, members must have some real sympathy for those small contractors and the fact that they put their trust in a large company that eventually let them down. That is how the recommendations of this report will resolve a future problem, and this should not happen again. I stress that some people are seriously out of pocket. In a couple of cases assets in the form of trucks, graders and other equipment are at risk. As the chairman said, those people have told the committee that

they entered into deeds of arrangement because that is the only way they could salvage enough to keep themselves going. In the future, large government departments need to make very certain that, before they pay those larger companies, the small contractors have been paid - not that they may be paid, but that they have been paid.

I will make a final point about the qualified statutory declaration. The evidence presented to the committee and the so-called statutory declaration regarding people being paid show that the words in the statutory declaration were changed. There is no question about that. One would have to believe that at that stage the company knew exactly what it was doing when it qualified that so-called statutory declaration. To that extent I have a great deal of sympathy for those small contractors. I hope the Parliament and the committee has been able to resolve some of the problems the small contractors faced so that this type of situation will not occur in the future. Finally, the committee worked well together as an all-party committee made up of Labor, Liberal and National Party members in the interests of trying to resolve the issues with which it dealt.

**MS J.A. RADISICH** (Swan Hills) [10.50 am]: I rise to speak on the report that the chairman tabled. I agree with the comments that have been made by the member for Ballajura, who was the chairman of the committee, and the member for Stirling, who was the deputy chairman. The saddest part of the investigation from the Government's point of view is the impact on small business contractors. As the chairman mentioned, many small business contractors gave evidence to the committee and committee members felt greatly for them upon hearing their stories.

The committee considers that its role is to make sure that this type of situation does not occur again. The committee has recommended that changes be made to the current procedures and that new procedures be put in place to ensure that government agencies are able to do whatever they can to ensure that similar small business owners are not affected in the same way in the future.

I am particularly interested in the recommendation that significant subcontractors must undergo the same level of pre-approval or pre-qualification checks as principal contractors undergo to win government contracts. In this case Carr Civil Contracting Pty Ltd, as the principal subcontractor of Consolidated Constructions Pty Ltd, was clearly not equipped to take on the significant proportion of the project; that is, \$6 million of a more than \$7 million project. The recommendations will put an increased onus on government agencies to conduct more rigorous checks of all the tiers of contractors that exist, whether it is the principal contractor or the second or third tier contractor, etc. There is a very strong obligation on the principal contractors to disclose who are their subcontractors and to disclose that information in their contracts with the government agencies to ensure that sufficient information is available for the Government to conduct those checks.

Inherent difficulties exist in any type of risk assessment procedure or economic analysis of particular companies that intend taking on tendered works. These types of companies generally conduct works projects more than those companies that supply goods and services, and they operate in a very dynamic commercial environment. The information revealed by an assessment at one point in time could have changed within just a few days of that assessment being conducted. Although the onus is very much on government agencies to ensure that all possible risks are assessed and that the economic health of the company concerned is verified, information can change, and it can change rapidly, as can be seen in the case of Consolidated Constructions. The committee noted that from information from the Dun and Bradstreet Pty Ltd assessments that even over the course of a three-month contract the dynamic risk of a company can change considerably, even during the time a contract is being undertaken.

If the agencies had undertaken even more thorough or timely checks, the committee has no doubt that they would still have awarded the contracts to those contractors, which I believe is a key point in the debate. I do not believe that we can expect agencies to act on any better information than the very best information available to them at any given point in time. The committee chairman made a fair and accurate comment earlier about things being different in the bush. We regularly hear from our country colleagues in this place that things are different in regional and rural parts of Western Australia. I would also argue that they are a bit different in the outer metropolitan area, but that is another debate. The fact is that people in the Marble Bar area were trying to look after their community. They were trying to help out their fellow local businesspeople. They were doing the right thing, knowing that there were possibly some troubled times ahead. They were trying to stick together, do the work and get the job done. It is saddening, which is probably not a strong enough way of putting it, that they have been essentially ripped off in that process. It is unbelievably unfair. I was told at an early age that life is not fair. I believe that what the committee can do is to try to have put in place procedures and processes to ensure that the most fair outcomes can happen in the future. As for what we can do for affected subcontractors, the committee's view is that they should be given preferential treatment in any future contracts that the Government awards in their local area, particularly with reference to the Government's buy local policy, to ensure that they can have some opportunity of recouping the losses that they have suffered.

I support all the recommendations that the committee has made in its report, in particular recommendation 1 on the pre-qualification processes applying to second-tier contractors. I thank my colleagues and the staff of the committee who have worked together throughout the inquiry and lend my support to the report.

**MR J.L. BRADSHAW** (Murray-Wellington) [10.57 am]: I also support the recommendations of the committee's report. It is important to have the recommendations in place to prevent people from losing money, as happened in this case. The committee's inquiry certainly opened my eyes to what happens with major contracts. A contract for \$7.6 million of work was awarded to Consolidated Constructions Pty Ltd, of which it offloaded \$6 million of work to Carr Civil Contracting. It made me wonder why, if Carr Civil was getting \$6 million worth of work, it did not tender for the whole contract. However, that is by the by. It is important, therefore, to investigate the second-tier contractors to see whether they are up to scratch and able to handle that amount of work. That is one of the recommendations of the committee.

I was concerned about two issues. I was concerned about the statutory declaration being sought by Main Roads of whether subcontractors were being paid. The statutory declaration had added to it "to the best of my knowledge". I believe that the words "to the best of my knowledge" in a statutory declaration make the statutory declaration virtually void. I cannot see how it can be called a statutory declaration when it contains a qualification "to the best of my knowledge". I therefore have grave problems with the fact that Main Roads was prepared to accept such a statutory declaration. Main Roads' answer was that it did not realise the statutory declaration had been changed. However, there is a big difference between saying that subcontractors have been paid and that they have been paid to the best of one's knowledge.

I was also concerned about other evidence that emerged, which was mentioned by the member for Stirling, that some of the subcontractors were told by Main Roads that their payments were guaranteed and that they would be paid. That evidence was not backed up by Main Roads. Therefore, there is some conflict between who is right and who is wrong. It is always very difficult in circumstances in which nothing has been put in writing to determine who is right and who is wrong. However, I do not think the subcontractors were telling us a furphy when they said they believed the money would be passed on to them. I do not know whether Main Roads told the contractors that the money would be passed on to them because it was given some comfort from the statutory declarations, even though, in the end, the statutory declarations were pretty ordinary because they contained those qualifications. I feel very sorry for the subcontractors who have lost out. I take issue with some of my colleagues, who indicated that things are different in the country. If people lose money, it hurts. It does not matter whether they live in the metropolitan area or the country. It is unfortunate that these events have happened. These events have shown that it does not matter how well a company has performed in the past or for how long it has been in operation, we can never be sure of what is around the corner and whether it will survive. Consolidated Constructions had been around for many years and had done great work, but it collapsed and left behind a lot of people who were owed money.

I thank the committee staff, Andrea McCallum, the principal research officer, and Simon Kennedy. I also thank my colleagues on the committee for their hard work and dedication in producing the report. I thank members for the opportunity to speak on the report.