Western Australian
Auditor General's Report

Assessment of Progress to Improve Payment Security for Government Construction Subcontractors

Report 31: December 2016

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WESTERN AUSTRALIAN AUDITOR GENERAL'S REPORT

Assessment of Progress to Improve Payment Security for Government Construction Subcontractors

Report 31
December 2016

THE PRESIDENT
LEGISLATIVE COUNCIL

THE SPEAKER
LEGISLATIVE ASSEMBLY

ASSESSMENT OF PROGRESS TO IMPROVE PAYMENT SECURITY FOR GOVERNMENT CONSTRUCTION SUBCONTRACTORS

This report has been prepared for submission to Parliament under the provisions of section 25 of the *Auditor General Act 2006*.

Performance audits are an integral part of the overall audit program. They seek to provide Parliament with assessments of the effectiveness and efficiency of public sector programs and activities, and identify opportunities for improved performance.

The objective of the audit was to assess progress to improve the security of payments made to subcontractors by contractors on WA State government construction projects and compliance with the *Building and Construction Industry Training Fund and Levy Collection Act 1990*.

I wish to acknowledge the assistance of the staff at the agencies involved in this audit.

COLIN MURPHY
AUDITOR GENERAL
22 December 2016

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Auditor General's overview

It is unusual for me to report on similar issues twice in one year. However, I agreed to a request by Parliament to conduct this audit after my report on payment of construction subcontractors at the Perth Children's Hospital in June 2016. My decision reflects the importance of the building and construction industry to Western Australia and acknowledges reforms underway to improve the security of payment of construction subcontractors.

When contractors become insolvent, subcontractors can be at a disadvantage. The pyramid nature of subcontracting, where primary subcontractors award work to other subcontractors, makes those subcontractors at the bottom of the pyramid extremely vulnerable.

In 2013, the Small Business Development Corporation completed an investigation of this area. It made 17 recommendations to improve tendering, risk management and payment processes to reduce the risk of non-payment, and to provide for better dispute resolution processes.

I have followed up on the implementation of these recommendations. However, as my report shows, even though processes across the board have improved, none of these are a guarantee that subcontractors will be paid.

I recognise there has been progress in agencies working together to introduce change in the industry. This cooperation is necessary to bring about further improvements identified in this report and for the implementation of Government initiatives. Given the progressive state of work taking place, I consider it likely this is an area I will revisit.

Executive summary

Introduction

The objective of this audit was to assess progress to improve the security of payments made to subcontractors by contractors on State government construction projects and compliance with the *Building and Construction Industry Training Fund and Levy Collection Act 1990*.

The audit focus was based on a request from Parliament's Estimates and Financial Operations Committee (EFOC) that the Auditor General assess the implementation of the Small Business Development Corporation's (SBDC) 2013 report[1] recommendations.

Overview

The construction industry is a key driver of economic growth in WA. In 2015-16, construction accounted for 10% of WA's employment and $31.3 billion of our gross state product[2]. It provides employment, housing and infrastructure.

In the past, construction companies employed large workforces. But, in the last 3 to 4 decades the industry has become more dependent on contractors managing projects and subcontracting work. Now, almost all larger projects use subcontractors to provide services.

A serious and ongoing issue within the industry is non-payment of subcontractors – a problem first recognised over 40 years ago[3]. The collapse of a WA government contractor in May 2016 and complaints of non-payment by subcontractors has brought attention back to the topic, despite a government investigation into the issue in 2013.

Subcontractors' complaints about non-payment for work done on WA government projects under the Building the Education Revolution program from October 2008 to October 2012[4] saw the WA government request the Small Business Commissioner to investigate the claims. The claims included that Building Management and Works (BMW – a unit in the Department of Finance) had not responded to their complaints.

The SBDC's 2013 report directed 13 recommendations at BMW, mostly to improve:

- processes for prequalifying and risk assessing tenders for government contracts prior to awarding of contracts
- administration of payments to contractors and obtaining statutory declarations from contractors that they have paid their subcontractors
- management of subcontractor complaints about non-payment.

It also included 4 recommendations aimed at construction contracts in both the private and public sector. This included a recommendation to improve dispute resolution legislation in the construction industry.

Appendix 1 provides further details of the recommendations. Government accepted all recommendations in June 2013 though it has not reported on their implementation.

1 Small Business Development Corporation Commissioner, Final Report: Construction Subcontractor Investigation (March 2013).

2 WA Department of State Development, Western Australia Economic Profile, November 2016, p 1.

3 CH Smith QC, Inquiry into the Building Industry in Western Australia, 1973 as cited in the Report on Operations and Effectiveness of the Construction Contracts Act 2004 (WA), Professor Philip Evans, August 2015, p.12.

4 ibid. p. 1.

Although the SBDC recommendations were mainly intended for BMW, we also used them in this audit to assess practices used by the Department of Treasury (Treasury) and the Housing Authority (Housing), as they contract construction projects. Housing awarded the most construction contracts from the end of June 2013 to 1 July 2016 (1,153) followed by BMW (527) and Treasury (5).

Treasury's contracts are all large strategic projects valued over $50 million. These are one-off projects for which Treasury appoints a head contractor specifically for the project. It does not appoint contractors to panels through a prequalification process that assesses their suitability to undertake future projects.

Non-payment of subcontractors can arise because of factors such as disputes over work quality, different interpretations of contract arrangements, poor accounting practices and contractor insolvency. To compound the problem, the rate of contractor insolvencies in the building and construction industry is high compared to other sectors of the economy[5]. The SBDC recommendations focus primarily on measures that protect subcontractors when contractors become insolvent.

As part of ongoing reforms, the State Government announced on 5 December 2016 that it would introduce a new code of conduct for WA's building and construction industry to prevent anti-competitive behaviour and improve workplace safety.

Another way the industry is supported, is through the *Building and Construction Industry Training Fund and Levy Collection Act 1990*. This Act establishes a fund to contribute to the training of workers for WA's construction industry. Funding is by way of a 0.2% levy on construction work over $20,000 and on variations over $25,000. In 2015-16, the fund received $29.4 million in levies paid by the industry on construction projects. The Act requires a project owner to pay the levy. For most government projects, this will be the contractor. If a building permit is required for construction work, the levy must be paid before a permit can be issued.

Audit conclusion

There has been substantial progress towards implementing the SBDC recommendations.

BMW has addressed all 13 of its SBDC recommendations. The Building Commission has addressed the recommendation that it review the *Construction Contracts Act 2004* (CCA) and the first of 2 proposed packages of change to the legislation have been passed by Parliament.

Treasury and Housing have improved many of their processes since the release of the SBDC report, though both require greater consistency and thoroughness in their pre-award assessments of financial capacity. Both agencies also need to improve the identification and documentation of strategies needed to mitigate the risk of contractors not completing the work.

All agencies generally have adequate procedures to ensure compliance with the *Building and Construction Industry Training Fund and Levy Collection Act 1990*. But, we saw scope for the Building and Construction Industry Training Fund (BCITF) to improve liaison with agencies to ensure easy identification of government projects in its system.

5 ASIC Australian insolvency statistic series 1A July 2013-December 2015.

Key findings

Processes are generally better

- The key processes that help ensure security of payments to contractors have improved, particularly within BMW. Treasury and Housing, which were not the focus of the SBDC review, have also reviewed and improved their processes though not to the same extent as BMW.
- BMW adequately assess the financial capability and business risk associated with the tenderers who contract for their construction projects and use weighted assessment criteria in their contract award process. However, Treasury and Housing do not have a standard tender assessment process for financial information and financial capacity assessments.
- Improvements are needed in how Housing and Treasury assess and document risk mitigation strategies when business risks associated with engaging a contractor were identified.

  Housing could not show that it implemented strategies to mitigate the risk of appointing a contractor. Treasury has risk mitigation strategies for each contract, but there needs to be a clearer mapping of a specific strategy to the specific business risk of each contractor.

  We acknowledge that for projects delivered through public-private partnerships, the private party bears significant financial risk and management responsibility. However, as a matter of good practice, there should be a clear trail between risks identified in early documents and strategies to address overall risks to the project.
- All 3 agencies have processes that help ensure security of payment to contractors, including requiring contractors to provide a statutory declaration that payments to subcontractors have been made. All 3 agencies undertake spot checks of payments and follow up concerns. Mostly, these processes were reasonable, though Treasury and Housing need to be more transparent about their processes.
- The Government has mandated the use of project bank accounts for all BMW projects valued between $1.5 million and $100 million, and introduced a Code of Conduct for contractors on State contracts worth more than $10 million. The Code aims to stamp out inappropriate behaviour on construction sites and will apply from 1 January 2017.

Dispute resolution processes are more robust

- Government has historically not accepted that it has a payment obligation to a subcontractor in the event of non-payment by a contractor. However, it has recognised the need to facilitate dispute resolution procedures. More recently, each agency has required contractors to keep them informed of payment disputes between a contractor and its subcontractors.
- All agencies have an adequate system and process in place to manage subcontractor claims of non-payment. BMW and Housing provide this information on their websites. The number of concerns raised at the agencies varies from 102 at BMW to 2 each at Treasury and Housing, although Treasury's information only includes complaints since March 2016. The complaints we reviewed were assessed within the prescribed time and against each agency's policy and closed.
- In November 2016, Parliament passed legislative changes that strengthened dispute resolution processes. These changes arose from the SBDC recommendation that the Building Commission review the CCA. A key finding of the review was that subcontractors were not given sufficient time to lodge payment dispute claims. The legislative changes

increased the time to lodge from 28 elapsed days to 90 working days and excluded the period between 24 December and 7 January from the calculation of working days.

- The Building Commission plans to push for a second set of legislative amendments in 2017 that will include continuing professional development for adjudicators of payment disputes, penalties for failure to comply with the CCA, and reducing overlap in the CCA.

Three recommendations were not assigned to a specific agency

- Work had commenced on 14 of the 17 recommendations, but the progress varied across recommendations and agencies. We found 3 of the recommendations had not been assigned to a specific agency. However, the Building Commission is progressing one of the three unassigned recommendations, a review of the *Inquiry into Construction Industry Insolvency in NSW* (Collins report).
- The other 2 unassigned recommendations relate to a study of commercial best practice for assessing risk and awarding contracts, and a role for BMW to positively lead standards and behaviours in the WA construction industry. However, given the range of reforms in the last few years, clear direction from government is required on whether it wishes to implement these recommendations.

Building and Construction Training Levy payment gap

- There is a real risk that the levy payable by contractors on government projects is not paid or not paid in full. The BCITF relies on BMW, Housing and Treasury to provide information to it on government construction contracts but it has not established arrangements with all agencies to access this information directly. There is also a need to determine more closely the nature of Government contracts and if the contract as issued includes elements and services to which the BCITF levy would not apply. Testing of 41 BMW, Housing and Treasury construction contracts to the BCITF system showed a potential net underpayment for 13 contracts or variations, but these were not material.

Recommendations

By 30 June 2017:

a. Housing, BMW and Treasury should ensure full information on strategies for protection of payments to subcontractors is made publicly available to inform contractors looking for work of government requirements

b. Treasury and Housing should set clear standards for financial information, weighting of financial capacity, currency of business risk assessments and recording of risk strategies, to inform decisions on awarding contracts

c. Treasury should develop a facility for subcontractors to submit complaints online, and improve its systems for subcontractor complaints about non-payment to track and manage complaints

d. BCITF should formalise communication protocols with BMW, Treasury and Housing for sharing of information about government construction projects to monitor payment of the BCITF levy

e. the Building Commission and the Department of Finance should liaise with their respective Ministers to determine whether the 2 unassigned SBDC recommendations are to be addressed.

Agency responses

Building Management and Works

The Department is pleased that the Office of the Auditor General has recognised efforts the Department has made since the release of the Small Business Commissioner's Construction Subcontractor Investigation report to improve security of payment in relation to its contracts. These efforts included significant business process re-engineering, the trial of project bank accounts, the introduction of new approaches such as the undertaking of spot checks of subcontract payments and the expansion of support provided to industry in terms of education and awareness.

The Department accepts the recommendations directed to it, namely that it implement measures to enhance the information on security of payment that is publicly available, and liaises with the Minister for Finance on unassigned report recommendations. The Department will implement these measures by 30 June 2017.

Department of Treasury

Overall, Treasury supports the recommendations insofar as they are relevant to the agency, and will implement improvement measures accordingly.

In this regard, it is important to note that the recommendations of the Small Business Development Corporation (SBDC) that are the key focus of the performance audit were directed at building contracts managed by the Department of Finance's Building Management and Works (BMW) business. As acknowledged in the report, these contracts and their administration and management differ materially in many respects from the high value, complex building contracts managed by Treasury's Strategic Projects and Asset Sales (SP&AS) business. Therefore, the measures implemented by BMW and Treasury in managing subcontractor payment and related matters security are necessarily different in a number of respects.

Treasury's response to the individual recommendations has been included in Appendix 2.

Housing Authority

Thank you for the audit undertaken which assessed the Housing Authority's progress on improving the security of payments made to subcontractors by contractors on government construction projects.

The Housing Authority accepts all the pertinent report recommendations and has started to address the matters raised by the audit.

Building Commission

The Department of Commerce accepts in full the finding in the report and the recommendation. The Department of Commerce, Building Commission Division will, by 30 June 2017, liaise with the Department of Finance and the Minister for Commerce to determine if the two unassigned recommendations from the Small Business Development Corporation's 2013 report should be implemented, and if so, assign responsibility.

Further consideration of the recommendations in the 2013 *Inquiry into Construction Industry Insolvency in NSW* (the Collins report) will be undertaken as part of the development of the second package of reforms to the *Construction Contracts Act 2004*.

Small Business Development Corporation

Thank you for the opportunity to comment on the Audit. I read it with interest and believe the findings presented will further contribute to reforms by government agencies playing significant roles as major procurers of building and construction works for the State or as regulators of the construction industry.

I am of the view that this audit, along with the three significant initiatives have recently been implemented in Western Australia (i.e. the adoption of projects bank accounts, improvements to the principal security of payment legislation and the development of a code of conduct for state-procured construction projects) will lead to improved behaviour in the construction industry in the State.

Construction Training Fund

The Construction Training Fund acknowledges the finding contained within the report. Previously, it has been difficult for the Fund to access information from other government agencies when they have awarded building and construction contracts for works where the BCITF levy would apply. The OAG audit has identified a control weakness in this practice and established there is a need for all government agencies to agree on a consistent and systematic process that will provide the Fund with all the relevant information it needs to undertake its statutory obligation.

Consequently, as a matter of urgency, the Fund will convene a meeting with all relevant government agencies to agree on a consistent method for exchanging information so the Fund can ensure the BCITF levy is paid on all building and construction contract works that are managed by government agencies.

The Fund would like to thank the OAG staff for their assistance and support during this audit.

Audit focus and scope

The objective of the audit was to assess progress to improve the security of payments made to subcontractors by contractors on WA State government construction projects and compliance with the *Building and Construction Industry Training Fund and Levy Collection Act 1990*.

We based our audit on the following lines of inquiry:

1. Have the recommendations of the Small Business Development Corporation's (2013) Final Report: Construction Subcontractor Investigation been implemented?
2. Have Treasury and Housing reviewed their policies, processes and practices for management of their contractors against the recommendations of the SBDC report?
3. Have agencies implemented policies and procedures to monitor contractor compliance with legislation, specifically the *Building and Construction Industry Training Fund and Levy Collection Act 1990*?

We focused on the activities of BMW, Housing, Treasury, the Building Commission and BCITF from July 2013 to November 2016.

The audit was not intended to address the issue of insolvency of contractors on government building projects, although we did focus on financial sustainability checks done by agencies. Information related to the effectiveness of initiatives underway, such as project bank accounts (PBAs), was only gathered as available.

In conducting this audit we:

- assessed the policies, processes, strategies and guidelines for BMW, Housing and Treasury for management of their contractors
- reviewed pre-tender and prequalification documents, panel reports and documented outcomes of panel meetings, where available, for BMW, Housing and Treasury
- tested the administrative processes for a sample of 5 construction projects at each agency (15 in total)
- reviewed Building Commission documents to determine the extent it had undertaken work to address the SBDC report recommendations. We also considered the statutory review of the CCA and the CCA amendment bill based on the review's recommendations
- reviewed the policies and procedures of BMW, Housing and Treasury for collection of the BCITF levy and tested a sample of 41 government construction projects to the BCITF database
- met with members of the Master Builders Association
- attended a seminar run by BMW to provide information about the prequalification process for contractors looking for work.

This was a narrow scope performance audit, conducted under section 18 of the *Auditor General Act 2006* and in accordance with the Australian Auditing and Assurance Standards. Narrow scope performance audits have a tight focus and generally target agency compliance with legislation, public sector policies and accepted good practice. The approximate cost of tabling the audit is $265,000.

Audit findings

Our findings follow the same sequence as the recommendations of the SBDC report: prequalification, risk assessment and tender award, administration of payments, management of complaints and Part 2, Operations regarding the Construction Industry. We also looked at how BMW, Housing and Treasury had monitored compliance with the *Building and Construction Training Fund and Levy Collection Act 1990*.

Initial assessments of contractor capacity have improved

SBDC's recommendations on the prequalification of contractors:	
a.	There be a more robust approach in the requirement for provision of prequalification documentation
b.	A system assigning relevant weight to information provided by applicants for prequalification be established, with greater weight being assigned to financial capacity, performance history and technical expertise
c.	Consideration be given to methods of obtaining better 'real-time' financial assessment
d.	Cost benefit of ascertaining the total financial exposure of a head contractor at prequalification be considered

BMW uses a robust approach to prequalify firms for construction work. It requires contractors to provide current and reliable financial information and consistently applied this requirement across the contracts we tested. It also communicates these requirements in its prequalification documents so that contractors are aware of and comply with the requirements. BMW require:

- 3 years of financial reports prepared by a qualified accountant and audited by a registered auditor or 3 years of financial reports prepared by a qualified accountant
- 3 years of financial reports for any corporate entity required to provide a deed of guarantee
- management accounts not more than 3 months old, signed by a director
- a letter from a bank confirming availability and extent of finance (preferably dated within 3 months)
- current references from at least 3 trade creditors, confirming credit limit, monthly average spend and payment terms.

Both Treasury and Housing have contractor appointment processes that differ from the model used by BMW. We adapted our testing to take account of each agency's processes.

Treasury and Housing were not expecting tendering contractors to consistently provide financial information of a similar nature and currency. Both used old or unreliable information in their financial capacity assessments. In one case, the most recent financial information used in an assessment was more than 18 months old. However, both agencies have since agreed that standardising information requirements is necessary.

We also saw an example where the only information provided by a tendering firm was a set of half-yearly unaudited management accounts, yet another tenderer for the same contract provided 3 years of audited financial statements.

Agencies need to set and maintain a high standard for the financial information expected from tendering contractors, otherwise the robustness of financial capacity assessments will vary and cannot be relied on equally.

We consider the risk for Treasury projects to be low because the financial capacity of preferred contractors is assessed again at the Request for Proposal stage. Though this assessment may be based on the same financial information supplied at the Expression of Interest Stage.

We found all agencies use a weighted system to evaluate tender submissions. Weighting is assigned to different assessment criteria such as technical expertise, performance history and financial information.

BMW prioritises financial information in its weighting and respondents will not be prequalified if their business risk assessment shows high risk. Treasury and Housing generally apply a pass/fail status to financial assessments. A key objective of the weighted evaluation process is to achieve consistency, fairness and transparency of the tendering and selection processes.

BMW and Housing have processes to monitor real time financial capacity of contractors though Treasury do not. BMW undertakes updated business risk assessments at least every year, once contractors have prequalified and before awarding contract work. It also requires contractors to requalify every 3 years. Housing review financial ratios that indicate a contractors' capacity when awarding work to them.

In addition, all 3 agencies used professional advisers or market information or both to ascertain total financial exposure of contractors. Only Housing was able to show they had undertaken work to determine the most cost-effective way to do this.

However, it is important to recognise that while financial capacity assessments help provide assurance, they are not a guaranteed predictor as evidenced in May 2016, when one of BMW's contractors went into 'Administration'. A financial capacity assessment undertaken by BMW of this contractor just 14 months earlier had not predicted the potential insolvency of the contractor (Figure 1).

The company met BMW's prequalification requirements for the project. BMW's initial business risk assessment, completed on 16 September 2014, found the financial capacity of the company was 'low risk'. A second assessment on 3 March 2015 confirmed the risk level.

BMW had 2 panels review the tender due to the large difference between the tender offer ($1,705,856) and the pre-tender estimate ($2,852,500). Members of review teams included senior project managers from BMW, staff from the agency for which the project was undertaken, and advisors from contracted professional firms including a quantity surveyor and an architect. Both review teams recommended BMW accept the tender as it represented value for money to the state. The contract was awarded in April 2015.

As per BMW policy, the construction company submitted statutory declarations each month from June 2015 to March 2016 confirming all subcontractors had been paid. Further, BMW conducted spot checks in June 2015 and March 2016 to ensure subcontractors had been paid.

BMW did not receive any complaints regarding the company's non-payment of subcontractors until just days before it went into administration.

Figure 1: Financial capacity assessments are a guide not a guarantee

Business risk conditions are better accounted for

SBDC's recommendations on risk assessments and awarding of tenders:	
a.	Review the level of expertise and experience of persons engaged in project manager roles
b.	Develop practices and procedures to ensure that business risk assessment conditions are communicated to relevant decision-makers and stakeholders and included in business risk documentation, and that there is accountability for their implementation

Understanding and managing key business risks is a fundamental requirement for agencies dealing with complex, large value construction projects. Project managers in particular need to understand the project business risks including those risks associated with the contractor. Also the project managers need to be up-to-date with changes in business risk conditions and with the implementation of risk mitigation strategies.

We found that all 3 agencies have processes in place to ensure project managers have the skills to manage projects and monitor business risks. The job description for project managers at all agencies include good project management skills. Treasury employs its project managers for particular construction projects as part of a multi-disciplinary team, and look to see they are suited to the complex strategic projects when recruited.

BMW and Housing have courses in place to update the skills and knowledge of project managers. BMW has also undertaken an audit of its education and continuing professional development framework for project managers to identify knowledge they need for their work. It has used the findings to develop a continuing education and development plan for its project managers.

Although all agencies have processes to ensure the business risks of contractors are assessed and managed, Treasury and Housing require further improvement.

We found that all 3 agencies had established panels to consider the business risk assessment of respondents applying for work. Though only BMW was able to show it had addressed risk mitigation recommendations in their decision-making about projects we tested, or that they implemented the decisions. Treasury and Housing were not able to show, in their documents for the projects we tested, decisions made about identified business risks or how they implemented those decisions.

During our testing, we noted variable consistency in how well Treasury and Housing implemented their risk mitigation strategies. For example, Housing did not always obtain security undertakings from the directors of construction companies.

Treasury did not document its decisions regarding financial risks identified for the successful respondent for a service contract to one of its projects. However, in this instance the project was a public-private partnership. We acknowledge that for projects delivered through public-private partnerships, the private party bears significant financial risk and management responsibility.

Administration of payments at all agencies has improved

SBDC's recommendations on the administration of payments:	
a.	Monitor and conduct random audits of the use and veracity of statutory declarations made by contractors and contractors be made aware that this will be undertaken as standard practice by including details in prequalification package and tender documentation
b.	Consideration be given to referring all suspicious statutory declarations to a person assigned the task of monitoring payment performance and that person refer non-compliant statutory declarations to the Police for investigation, and liaise with the Police in respect of investigation and prosecution
c.	Consider adopting, as a matter of policy and practice, a more robust use of AS2124-1992 clause 43 provisions to withhold payments, and to obtain its own legal advice in respect of: • whether payments withheld under clause 43 may be held as funds of a stakeholder or as an equitable set-off • options available at law to protect payments to subcontractors from being treated as preferential payments by liquidators
d.	A communication strategy to all industry stakeholders raising awareness and understanding of policy, practices and processes in relation to monitoring of payment performance, auditing of statutory declarations and the withholding provisions of AS2124-1992 clause 43

Although Government does not accept that it has a legal obligation to compensate subcontractors on government projects who are not paid by a contractor, it is committed to helping ensure security of payment.

We found that all 3 agencies are conscious of the need to help protect subcontractors on government construction projects from non-payment and have developed strategies for communicating their intent to stakeholders. However, we have identified some areas for improvement.

All agencies have strengthened the conditions for their contracts they use with their contractors to help protect payments to subcontractors. They have also made it known to contractors that they have clear expectations about security of payments to subcontractors and will monitor payments.

BMW sought to strengthen its contract clauses even further but was concerned that it could alter the State's responsibilities in regard to subcontractors. In June 2013, BMW was directed by Government to trial the use of Project Bank Accounts (PBAs). The use of a PBA is an alternative to strengthening the contract clauses (Figure 2).

Project bank accounts trial

PBAs use a dedicated trust account to allow payments to be made directly from the State through to the contractor and subcontractors involved in a project. They are intended to improve transparency and accountability.

The key findings of the trial were that PBAs:

- can be successfully used on BMW construction projects
- improve the transparency of the payment process
- may improve the speed of payment for subcontractors
- cost about $80,000 per project to implement
- are challenging to establish due to the administrative effort required
- require demanding administration of the monthly payment process.

However, the trial was unable to establish if PBAs mitigate the impact of an insolvent contractor as none of the contractors in the trial entered into administration.

Further work is required to determine the extent to which PBAs apply to projects of varying size, complexity or location. On 12 August 2016, the government updated the trial mandating PBAs on all BMW construction projects valued between $1.5 million and $100 million.

Figure 2: Trial of project bank accounts

All agencies have processes to ensure they are adequately informed of the status of payments to subcontractors. These include:

- the requirement for contractors to supply statutory declarations confirming they have paid all subcontractors money due and payable to them
- random audits of statutory declarations may include spot checks of subcontractors and reviews of creditor lists
- spot checks of randomly selected subcontractor payments
- the requirement for contractors to disclose any payment disputes with subcontractors and the status including any applications made under the CCA
- processes for liaising with Police to investigate statutory declarations found to contain false information. Only BMW has had instances where this action was required (Figure 3)
- BMW and Treasury have had independent reviews done of their strategies for security of payment of subcontractors. Housing has committed to do this.

Subsequent to the release of the SBDC report, BMW reported 10 contractors to the Police for providing false documentation about payments to subcontractors. One contractor was found guilty on 2 counts of forgery and sentenced to 2 terms of 18 months imprisonment for each offence to be served concurrently.

Figure 3: Prosecution of contractors supplying false information about subcontractor payments

Although all 3 agencies included the above processes in their contracts, none were publicly promoting and explaining awareness of the processes as recommended by the SBDC. BMW includes the information in its prequalification scheme document, which is on its website, but finding this information is not simple.

Generally adequate processes for complaints management

SBDC's recommendations on the management of subcontractor complaints:	
a.	Consider establishing a central register of subcontractor complaints
b.	Consider establishing a process to investigate claims of non-payment made by subcontractors

All agencies have processes for managing complaints by subcontractors about non-payment though Treasury require minor improvement. We found all agencies have a central register they use for capturing subcontractor complaints and have processes for investigating the claims.

In the period from 2013 to July in 2016, BMW received 102 complaints of non-payment while Housing received 2 complaints. Treasury established a new complaints procedure in March

2016. At June 2016, it had received 2 complaints under its new procedure. Prior to this, Treasury recorded complaints individually and in different databases.

BMW was not clear on the reason for the higher number of complaints it received. Though it considers this reflects the work undertaken to make their complaints process visible to subcontractors and encouraging feedback. A number of complaints result from administrative errors and are easily resolved. Also, we saw complaints from subcontractors on projects managed by other state agencies and on private construction work.

Treasury's website does not contain information about making a complaint or the ability to lodge a complaint online.

We also found that BMW and Housing kept information about the investigation of complaints. A review of the complaints for projects in our sample showed the complaints had been investigated. This level of detail was not present in the complaints register used by Treasury.

When complaints are made, a reliable record of the investigation needs to be kept for future reference, or in case a further dispute or issue results from the matter. Tracking and managing project complaints helps to ensure agencies address issues.

Legislative change has occurred and more is planned

SBDC's recommendations regarding legislation and construction industry insolvency:	
a.	The Building Commissioner review the suite of dispute resolution legislation and services for which he has oversight, to ascertain what amendments or enhancements are required, and what funding is necessary, to improve the accessibility of dispute resolution processes in the construction industry for small business operators
b.	The findings and recommendations of the NSW inquiry: • that a 'reference group' be established to review the material and recommendations of the *Inquiry into Construction Industry Insolvency in NSW*[6] (Collins report) • the review should consider the findings and recommendations and their application to the Western Australia construction environment. This review should not necessarily be limited to government construction but may encompass the whole construction industry

The Building Commission has done a range of work to address the SBDC's recommendation that it review the suite of dispute resolution legislation and services for which it has oversight. Principally, it supported an independent review[7] of the *Construction Contracts Act 2004* (CCA).

In its support of the review, the Building Commission provided staff and other administrative services, including the management of reference groups. It has also worked with Parliamentary Counsel to draft amendments to the CCA based on the recommendations of the review. Parliament passed the first of 2 proposed sets of legislative amendment in November 2016.

The amendments passed in November 2016 mostly address increased time for subcontractors to lodge payment dispute claims. The second proposed set of amendments would address issues such as professional development of adjudicators of payment disputes, penalties for failure to comply with the CCA, and reducing overlap in the CCA.

The Building Commission has told us that in December 2016 it received Government approval to fund 2 positions to deliver process improvements to support the recent amendments and the proposed second set of amendments.

6 Collins, B QC 2012, Final Report Independent *Inquiry into Construction Industry Insolvency in NSW*, New South Wales Government.

7 Professor Philip Evans, Report on the Operation and Effectiveness of the *Construction Contract Act 2004* (WA), August 2015.

In regard to Part b of this suite of SBDC recommendations, the Commission advised that it has reviewed the Collins report as part of previous research it undertook about statutory trusts for construction contracts. Further, it intends to establish a reference group so that it can advise Government on matters concerning construction industry insolvency.

Responsibility for 2 of the SBDC recommendations were not assigned

SBDC's recommendations regarding the awarding of contracts and the role of BMW:	
a.	A review of commercial best practice in relation to assessing risk and awarding contracts in the construction industry should be conducted, including what represents 'value for money'
b.	Consideration be given to the public policy question of the role of BMW within the construction industry in Western Australia and the positive influence it could exert on standards and behaviours without imposing unnecessary additional regulatory burden on the industry

We found that Parts c and d of this suite of the SBDC's recommendations were not assigned to a specific agency and that no agency has stepped forward to take responsibility for them. We also found no agency is currently intending to take responsibility for these recommendations.

In our view, BMW and the Building Commission need to clarify with Government whether it wishes to implement these recommendations.

Building and Construction Industry Training Fund Levy is not always paid

As mentioned earlier, the *Building and Construction Industry Training Fund and Levy Collection Act 1990* (the Act) established a fund to contribute to the training of workers for WA's construction industry. Funding is by way of a 0.2% levy on construction work over $20,000 and on variations over $25,000. The Act requires a project owner to pay the levy. For most government projects, this will be the contractor.

We tested selected construction projects at BMW, Treasury and Housing to establish whether each agency has adequate processes to monitor contractor compliance with the Act. The audit identified a real risk of non-payment or payment not made in full.

We found that the 3 agencies rely on the issuing of a building permit as proof that the levy was paid. However, this self-regulating system fails when a building permit is not needed, such as for many types of refurbishment. It is also not a reliable method of ensuring the levy is paid on contract variations.

To test the robustness of agencies' processes to ensure the levy was paid for contracts requiring a building permit, and on contract variations, we selected 41 contracts from lists provided by BMW, Treasury and Housing. We then matched these records to the Building and Construction Industry Trust Fund (BCITF) database. This testing showed:

- there had been no apparent record of payment on 12 contracts with a combined value of around $604 million. Subsequent to our testing, BCITF has been working with agencies to follow-up on and trace the records. BCITF advises that of the $604 million worth of work, only $506 million was applicable to pay the BCITF levy and to date all applicable levy payments have been received
- 5 contracts that had significantly lower contract values than the agency data. The difference totalled $3.6 million, with a levy value of $7,200. We also found 3 contracts where the reported contract value was larger than the agency data. These totalled over $8.4 million and represented a potential levy overpayment of around $16,800

- contract variations for 5 contracts were different to the agency data. The difference totalled about $1.4 million, with a potential levy value of around $2,800.

The BCITF relies on BMW, Housing and Treasury to provide information to it on government construction contracts but it has not established arrangements with all agencies to access this information directly. We have recommended to the BCITF that it give priority to establishing such arrangements so that it can obtain assurance that correct payments are made according to the nature of the contract and the elements of construction to which the levy may apply. As well, it follows up the potential underpayment referred to above.

Appendix 1: Progress against SBDC recommendations

Part 1 recommendations of the SBDC report	BMW	Treasury	Housing
Prequalification (Tendering)			
1. There be a more robust approach in the requirement for provision of prequalification documentation		*	*
2. A system assigning relevant weight to information provided by applicants for prequalification be established		*	*
3. Consideration be given to methods of obtaining better 'real-time' financial assessment		*	*
4. Cost benefit of ascertaining the total financial exposure of a head contractor at prequalification be considered		*	*
Risk assessment and tender award			
5. Review the level of expertise and experience of persons engaged in project manager roles			
6. Develop practices and procedures to ensure that business risk assessment conditions are communicated to relevant decision makers and stakeholders and included in business risk documentation, and that there is accountability for their implementation			
Administration of payment recommendations			
7. Monitor and conduct random audits of the use and veracity of statutory declarations and details included in prequalification and tender documentation			
8. Consideration be given to referring all suspicious statutory declarations to a person assigned the task and statutory declarations referred to the Police for investigation where appropriate			
9. BMW consider adopting a more robust use of AS2124-1992 clause 43 provisions to withhold payments, and to obtain its own legal advice		The recommendation does not fully apply though we have looked at the processes Treasury and Housing adopt to protect payments to subcontractors and found them to be adequate.	
10. A communication strategy to all industry stakeholders raising awareness and understanding of policy, practices and processes in relation to monitoring of payment performance, auditing of statutory declarations and the withholding provisions of AS2124-1992 clause 43			
Management of Complaints Findings			
11. Consider establishing a central register of subcontractor complaints			
12. Consider establishing a process to investigate claims of non-payment made by subcontractors			

Part 2 recommendations of the SBDC report	Department of Finance	Building Commissioner
13. The Building Commission review the suite of dispute resolution legislation and services for which he has oversight.	N/A	
14. A 'Reference Group' be established to review the *Inquiry into Construction Industry Insolvency in NSW*	N/A	
15. Consideration given to the public policy question of the role of BMW within the Construction Industry in Western Australia		
16. A review of commercial best practice in relation to assessing risk and awarding contracts, including what represents 'value for money'		

Key:

Moderate issues	Complied or only minor issues	Recommendation not assigned in SBDC

* testing adapted to take account of agency processes

Appendix 2: Treasury's response to recommendations

Recommendation (a): Housing, BMW and Treasury to ensure full information on strategies to protect payments to subcontractors is publicly available

Treasury is of the view that adequate information regarding measures implemented by the State Government to address subcontractor payment security is already publicly available, particularly following recent activity in this area including the review of the *Construction Contracts Act 2004* and introduction of the *Western Australian Building and Construction Industry Code of Conduct*. The Department of Commerce (Building Commission), Department of Finance (BMW) and SBDC collectively provide substantial information. Treasury (SP&AS) has updated its internal contract management processes to include strengthened measures directed at subcontractor payment security and will include relevant advice within future pre-construction and procurement documents.

Recommendation (b): Treasury and Housing should set clear standards of financial assessment

Assessments of historical financial data are only one of a number of financial risk management strategies implemented by Treasury for its building projects. Treasury also uses forward-looking risk management tools (for example, performance bonds, equity support arrangements, parent company guarantees and an active risk management strategy). These are – in each case – specifically tailored to the needs of the project in question. Standardising these processes would compromise risk management because of the unique risks that Treasury manages in its portfolio of complex, high-value projects. However, to provide greater clarity to both internal and external stakeholders, Treasury will investigate the development of an assessment tool to guide project teams in establishing the right mix of financial risk management strategies. Treasury will also ensure that the particulars of, and reasons for, these risk management strategies are clearly documented for future reference. This will include guidance on relevant information required for financial assessments.

Recommendation (c): Treasury to develop a webpage for subcontractor complaints

Whilst Treasury notes that SP&AS has a designated 'enquiries' email address that is used by external parties to raise issues, the intent of this recommendation is supported. However, rather than adopt an agency or project-specific webpage for subcontractor complaints, Treasury believes there is merit in adopting a whole-of-government approach with a single webpage for subcontractor complaints, preferably also providing relevant information and guidance, including in respect of the Government's subcontractor payment security initiatives. Treasury will discuss this proposal with other agencies, notably the Department of Commerce which, through the Building Commission, could provide a logical host site.

Recommendation (d): Building and Construction Industry Training Fund (BCITF) should formalise communication protocols with BMW, Treasury and Housing

Treasury supports the recommendation for improved and more efficient access to and sharing of information and will await BCITF's proposals in this regard.

Auditor General's Reports

Report number	Reports	Date tabled
30	Measuring Tax Collection Performance	22 December 2016
29	Improving Immunisation Rates of Children in WA	21 December 2016
28	Malware in the WA State Government	7 December 2016
27	Opinions on Ministerial Notifications	7 December 2016
26	Opinion on Ministerial Notification	23 November 2016
25	Opinion on Ministerial Notification	9 November 2016
24	Audit Results Report – Annual 2015-16 Financial Audits	9 November 2016
23	Western Australian Waste Strategy: Rethinking Waste	19 October 2016
22	Opinion on Ministerial Notification	13 October 2016
21	Opinion on Ministerial Notification	6 October 2016
20	Ord-East Kimberley Development	7 September 2016
19	Information and Communication Technology (ICT) in Education	17 August 2016
18	Opinions on Ministerial Notifications	11 August 2016
17	Financial and Performance Information in Annual Reports	21 July 2016
16	Grant Administration	7 July 2016
15	Management of Feedback from Public Trustee Represented Persons	30 June 2016
14	Management of Marine Parks and Reserves	30 June 2016
13	Maintaining the State Road Network – Follow-on Audit	29 June 2016
12	Regulation of Builders and Building Surveyors	22 June 2016
11	Information Systems Audit Report	22 June 2016
10	Opinions on Ministerial Notification	8 June 2016
9	Payment of Construction Subcontractors – Perth Children's Hospital	8 June 2016
8	Delivering Services Online	25 May 2016
7	Fitting and Maintaining Safety Devices in Public Housing – Follow-up	11 May 2016
6	Audit of Payroll and other Expenditure using Data Analytic Procedures	10 May 2016
5	Audit Results Report – Annual 2015 Financial Audits – Universities and state training providers – Other audits completed since 1 November 2015; and Opinion on Ministerial Notification	10 May 2016
4	Land Asset Sales Program	6 April 2016
3	Management of Government Concessions	16 March 2016
2	Consumable Stock Management in Hospitals	24 February 2016
1	Supplementary report Health Department's Procurement and Management of its Centralised Computing Services Contract	8 June 2016 17 February 2016

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