

Security of Payments - September 1994

CHAIRMAN'S INTRODUCTION

This is the fifth report of the Economic Development Committee. It continues to investigate issues relating to the Committee's current reference to inquire into the Victorian building and construction industry.

The title of this Report, Security of Payments, reviews an on-going question within the building and construction industry as to the need for secure, long-term, guaranteed arrangements for payment for work performed.

Security of payment has been the subject of significant debate and research both within the Australian construction industry and overseas. It has been a subject of significant debate and research and it is clear to the Committee that there is little consensus, not only as to the scope of the problem but also the most effective solutions for overcoming it.

The Committee reviewed statistics in insolvencies and attempted to assess within the industry and compare them both within and in relation to other industry sectors. It looked at data, information and conclusions reached by CIDA, as well as various reports and studies carried out in other states. It also undertook its own survey to assess the extent of the problem in Victoria. Having done this it has been unable to confirm claims that the problem is extensive or serious, and has generally concluded there is insufficient evidence, to justify any special legislation or government intervention to address it.

The Committee notes that security of payment is a very complex and interwoven issue; and it acknowledges there have been a number of small firms and individuals who have suffered hardship as a result of the financial collapse of other players in the contractual chain. It also acknowledges however, that a significant proportion of these problems have arisen because of an unwillingness or inability on the part of the parties affected to protect their own interests.

The problem also appears to have resulted partly from informal cultural practices in the industry and partly from a lack of understanding and competence in business and financial management.

This report examines major causal factors and existing remedies to achieve security of payment and outlines additional potential remedies that could be pursued. It finds that the public sector can assist in improving security of payment problems by using appropriate contractual conditions and methods of ensuring the commitment of participants in that process. It also makes recommendations designed to encourage changes in cultural practices such as increased industry training opportunities.

Finally it seeks to provide further means of enforcing its recommendations by using purchasing power, not only to improve security of payment in public sector projects, but also as a way of achieving a flow on of reforms to contractual relationships in the private sector.

The Honourable Gerald Ashman, MLC

Chairman

Economic Development Committee

FINDINGS

- *The Committee finds that security of payment is an on-going issue within the building and construction industry and that a small number of individuals and firms, in particular subcontractors and consultants, have suffered financial hardship as a result of contractor losses further up the contractual chain. The Committee also finds however, that there is insufficient evidence and a lack of conclusive data to substantiate the problem or to justify the introduction of a substantive or costly scheme to address it. The Committee finds that its investigations on security of payment have been severely hampered by the lack of statistical data to assess and compare financial losses, insolvencies and other relevant information to quantify the extent of the problem both within the building and construction industry and on an industry wide basis.*

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- *subcontractors and consultants are the worst affected*
- *small firms are usually more affected than large ones*
- *many of these are less likely to have entered into formal or enforceable contractual arrangements*
- *those experiencing problems are often highly geared*
- *many have poor records of collecting receivables; and*
- *a substantial proportion has poor skills in cash flow management.*

The Committee finds that the issue of security payments has at its root a variety of casual factors which are interwoven and complex; and which identify problems in the areas of contract management, business and financial management, tendering procedures, risk management, and business ethics.

The Committee notes that on the available evidence:

The Committee also finds that a substantial proportion of these problems are the result of the informal culture underlying the way business is conducted and that many of them can be resolved by a change in business practices by the various parties affected. In particular it is of the opinion that subcontractors and small firms most vulnerable to the problem must take greater responsibility to protect their own interest by adopting a more business-like approach to entering into contracts; and by allocating sufficient time to improve their understanding of how to manage their finances.

The Committee finds there is a need for more financial and business management training by all participants and across all sectors of the Victorian building and construction industry as a means of changing cultural attitudes which discourage the use of more professional business practices.

The Committee further finds that industry training boards and accredited training providers have neither identified nor vigorously pursued this need, and this has contributed to an ongoing problem where many

subcontractors and small firms have insufficient knowledge and understanding of the basic financial and cash management skills needed to run a business.

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- *(i) the use of standard contracts with special provisions designed to improve security of payment such as proof of payment clauses and statutory declarations; and*
- *(ii) the use of enforceable codes of tendering and practice.*

The Committee also finds that security of payment issues can in part be addressed through the development and use of project specific and general selection criteria in the tendering selection process.

The Committee finds that the most cost effective solutions to the problems of security of payment are:

Finding 3.2

- The Committee recommends that the Victorian Government urge the Australian Bureau of Statistics to collect and publish comprehensive and meaningful data on financial losses; and the number and proportion of insolvencies and business closures for all industry groups and all sectors within the building and construction industry.

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- that industry training boards be strongly advised to include financial and business management training and ethics as a mandatory component of all courses in building and construction within Victorian TAFE and tertiary institutions;
- that other accredited training providers be strongly encouraged to follow the example in Victorian TAFE and tertiary institutions; and
- that industry associations increase their efforts to actively promote the need for training in basic cash management and accounting, business ethics, and the use and importance of contracts.

The Committee recommends that the following measures be taken to help individuals and small firms to better protect their own interests, and to influence cultural attitudes in the industry which discourage the use of more professional ways of doing business:

The Committee further recommends that the Minister for Housing review the Building Act (1993) and consider an amendment requiring mandatory training for new entrants to the industry in the aforementioned areas as a precursor to registration in any trade in the Victorian building and construction industry.

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- that project specific and general tender selection criteria be used to assess and select consultants, contractors and subcontractors;
- that the project specific criteria are used to assess financial and technical capabilities as well as quality assurance; availability of insurance; and information on company directors, management personnel and project management capabilities;
- that the general criteria are used to assess past history of performance in meeting financial obligations, project quality standards and other project specific criteria; and,

- that the Australian Standard Contract AS2124 (with appropriate special conditions of contract), be used by all government departments and agencies.
- include clauses specifying timely realistic progress payments; equitable allocation of risk and measures designed to provide optimum protection for the client from head contractor default;
- include clauses specifying that a contractor shall not subcontract or allow a subcontractor to assign or subcontract any work under that contract unless
 - (i) the value of the contract work is less than \$50,000; or
 - (ii) such subcontractors are nominated in writing by the client and subcontract documents used which incorporate AS2545 as the general conditions of contract;
- include proof of payment clauses that require the use of mandatory standardised statutory declarations; and
- not include clauses that refer to the postment of payments such as "pay if paid" and "pay when paid".

The Committee recommends:

The Committee further recommends that all government departments and agencies be required to use Australian Standard Contract AS2124 and that such contract:

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- to enforce the use of standard contracts in all contractor, sub-contractor and consultant relationships involving public building and construction works; and
- to ensure that all contractors tendering for or engaged in public works projects are complying with the proposed Victorian Code of Tendering and Practice.

The Committee recommends that government departments and agencies use their purchasing power:

The Committee recommends that all government agencies and departments engaged in building and construction be required to comply with uniform codes of tendering and practice that reflect the objectives, findings and recommendations of this and other Economic Development Committee reports.

The Committee recommends that all industry associations be encouraged to promote the use of standard documentation and the proposed Victorian Code of Tendering and Practice as a means of addressing security of payment problems.

- (i) that all government departments and agencies be required to monitor the use of statutory declarations throughout the contractual process, and to satisfy themselves as to the integrity of such declarations before any payments are made. Where any inconsistencies are detected, the reasons should be determined, and if it is believed a declaration may be false, this should be referred to the Building Industry Task Force for further investigation; and

(ii) that the Auditor General be required to monitor and conduct random audits of the use and integrity of statutory declarations made to government departments and agencies, and where any evidence of inconsistencies or false declarations is found, this be referred to the Building Industry Task Force for further investigation; and

(iii) that the Building Industry Task Force under the Attorney-General be required to investigate any matter or inconsistencies referred to it concerning the use of statutory declarations contained in contract documentation; and where appropriate, institute legal action under the Evidence Act or other relevant Acts.

The Committee recommends:

Recommendation 1.1

Recommendation 2.1

Recommendation 3.1

Recommendation 3.2

Recommendation 3.3

Recommendation 3.4

Recommendation 3.5

Finding 1.1

Finding 1.2

Finding 2.1

Finding 2.2

Finding 3.1

RECOMMENDATIONS

Last Updated on Wednesday, 07 October 2009