Australian Government

Australian Small Business and Family Enterprise Ombudsman

Cascading deemed statutory trusts in the construction sector

Working Paper

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Contents

Introduction

The Australian Small Business and Family Enterprise Ombudsman's (ASBFEO) inquiry into the construction industry supply chain resulted from calls from subcontractors, who lost money due to the insolvency of their contractor. Cases have also been referred by Members of Parliament representing constituents, who were paid late or not at all as a result of the insolvency of their contractor. Statutory trusts have been considered and proposed by a number of inquiries as a means of ensuring prompt progress payments to subcontractors, and ring-fencing payments in the event of insolvency of their contractor.

Mr John Murray AM commenced a Review of Security of Payments Laws on 21 December 2016. The Review was established by Senator the Hon Michaelia Cash in her then capacity as Minister for Employment. Mr Murray recommended introducing deemed statutory trusts as a way to protect payments due to subcontractors even where a contractor above them becomes insolvent.[1]

That there is a systemic issue, is supported by the increase in insolvencies in the construction sector. Disproportionally this impacts the small businesses – the subcontractors at the end of the chain. Of all insolvencies, 64 per cent of insolvencies are businesses with less than five employees.[2]

We have considered the various arguments for and against cascading deemed statutory trusts and, on balance, support their implementation in the construction sector. Our research has shown that the benefits of implementation outweigh the potential costs and impacts on working capital.

Recommendations

- Statutory trusts be implemented to protect payments to subcontractors in the event of their contractor's insolvency and to decrease payment times.
- While we support cascading deemed statutory trusts for commercial projects with a value of at least $1 million, consideration should be given to a higher project value to avoid capture of the private residential housing sector.
- Imposing statutory trusts on very small business is not warranted given their limited resources. We recommend setting a floor to exclude low value sub-contracts within a project. Consideration should be given to a floor value between $100,000–200,000 to exclude small business operators.

Research and analysis

We undertook a number of activities to understand the issues and culture of the construction industry and the impact of implementing deemed statutory trusts. These included:

- analysis of the reports of, and submissions to, the many inquiries and reviews into insolvency in the construction industry (a list of the reports is at Attachment B)
- consultation with relevant stakeholders and industry experts to understand the issues of the industry (A list of stakeholders is at Attachment C)
- examination of six case studies of small and medium-sized businesses operating in the construction industry to understand the incremental costs and benefits, if deemed statutory trusts were implemented. The case studies are based on a separate trust account being established rather than payments being comingled in the subcontractor's general bank account (a schematic of the case study contracting chain is at Attachment D).

[1] Murray J, Review of Security of Payments Laws, 22 December 2017.
[2] ASIC insolvency statistics, Table 3.2.2.1

- investigation into an insolvency practitioner's ability to access the statutory trust in the event of an insolvency.

The future of small business in the construction industry

These measures will help small business when a contractor becomes insolvent. If the contractor has received money to pay a progress claim, the trust means the money will go to the contractor.

Money will be paid faster on a day-to-day basis because it does not become part of the contractor's cash flow. Businesses will need better management to ensure they are operating on a truly profitable basis and with sufficient cash flow. Some operators will exit the industry but those remaining will operate on a more sustainable basis and contribute to growth and employment.

Statutory trusts will also reignite a culture of fair payment for work done and of protecting small players.

Small business subcontractors in the construction sector

- Small businesses with less than five employees made up 64 per cent of all construction sector insolvencies.[3]
- Subcontractors perform over 80% of all work in the Australian construction industry. They contribute resources and are promised payments later.
- Small business subcontractors have complained to our office about delayed or non-payment by mid-tier operators in the construction supply chain. They either delayed payments to their subcontractors to manage their own cash flow or they went into administration leaving the subcontractor receiving very little as an unsecured creditor.
- When a business becomes insolvent, its employees have access to the fair entitlements guarantee (FEG) to cover their losses. Suppliers have protections of the personal property securities register (PPSR) to secure payments.
- Subcontractors do not have these protections. However, they have provided labour and materials to the same project – adding to its value.
- Statutory trusts can protect these payments to subcontractors in the event of an insolvency. They also remove the temptation to use subcontractor's progress payments as their own.

Cash flow – playing by different rules

The rules are different for small businesses in the construction supply chain.

Principals and head contractors are among the ASX100 or multinationals with access to sophisticated financial advisory services and resources to manage working capital. Their business size and operations provide numerous and complex levers for profitability and financing options.

The mid-tier operators reported to our office for poor behaviours were managing cash flow by delaying payments and underquoting to win work. Some used phoenix models or used other structures to side step payments to subcontractors. These mid-tier firms were easily tipped into trouble by events such as unseasonal rain, disputes with head contractors, or delays with planning approvals.

Small business subcontractors are at the bottom of the supply chain pyramid and are squeezed on margins and payments from poor mid-tier operators higher in the supply chain. Small business is only viable with regular and certain cash flow. Close and longstanding relationships with employees and suppliers make

[3] ASIC, Insolvency Statistics, external administrators' reports (July 2016 to June 2017)Table 3.2.2.1

small business pay their bills, so cash flow is king. The need to maintain relationships for future business makes small business reluctant to raise disputes with their contractor, or to access state and territory security of payments dispute resolution.

Late payments impacts small business viability and creates social problems such as mental health and family issues.[4]

Subcontractors

The Australian construction industry has the highest involvement of subcontracting in the world, representing between 80–85 per cent of all construction work. Subcontractors contribute the materials and labour that are integrated into the value of the project. There is growing community sentiment that subcontractors have a right to be paid for work completed.[5]

The flow of payments through the supply chain is a pyramid structure with each contractor engaging one or more subcontractors. This pyramid structure has created a culture of delaying payments at each level, which disproportionally impacts the subcontractors at the bottom of the chain.

Behaviours supporting this culture include:

- lack of self-sufficient access to working capital in the industry. At each step along the chain a contractor prioritises keeping funds for working capital to enable them to tender for the next job, delaying payments to the subcontractors down the chain. These working capital reserves are seen as assets for securing finance from banks and other lenders who take priority for payment in insolvencies;
- creating disputes to delay payment through both the construction period and on completion. This can also lead to contractors holding onto retention funds and calling on bank guarantees provided by its subcontractors.

Those higher up the chain often have little regard for the impact of the pressures of the next subcontractor.[6] Those with the greatest amount of power and the deepest pockets dismiss payment disputes, challenge adjudication decisions, or take action to prevent subcontractors being able to obtain work if they take action under security of payment laws.[7]

Insolvency

The major issue in an insolvency is that, unpaid subcontractors have supplied resources that generate the assets that are seized for the benefit of secured creditors. Over 90 per cent of unsecured creditors to insolvent construction companies receive zero cents in the dollar.[8]

The disproportionate impact on small businesses is evident in the Australian Securities and Investment Commission's (ASIC) insolvency statistics for the construction industry. Medium businesses, those with 20 or more employees, represent six per cent of insolvencies and are higher in the chain. Small businesses,

[4] ASBFEO Working paper No. 3 Payment times and Practices Inquiry https://www.asbfeo.gov.au/sites/default/files/ASBFEO_WP3.pdf

[5] Senate Economics Reference Committee Executive Summary at page xxiii https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Insolvency_construction/Report

[6] Ibid Chapter 2 at page 13

[7] Ibid n2, 2.11

[8] ASIC, Insolvency Statistics, external administrators' reports (July 2016 to June 2017), Table 41.

the subcontractors, with less than five employees are at the bottom of the chain and represent 64 per cent of insolvencies.[9]

Cascading deemed statutory trusts have been proposed by a number of Inquiries into insolvency in the construction industry as a mechanism to protect payments to subcontractors. The money is deemed to be for the 'beneficial owner' so is not available to secured creditors in an insolvency. A full summation of insolvency impacts of cascading deemed statutory trusts can be found in Attachment A.

The construction industry is important to the Australian economy. It is crucial to promoting jobs and driving the nation's economic growth. Construction makes up eight per cent of industry share of output in the Australian economy[10] and has contributed five per cent of gross domestic product (GDP) growth in the last year.[11] However, the industry's insolvency rate represents nearly 21 per cent of all insolvencies in Australia.[12]

Financial pressure on subcontractors is compounded by insolvencies higher in the chain. Factors that contribute to the high rate of insolvencies are poor financial management, poor strategic management of the business, poor management of accounts receivable, and inadequate cash flow or high cash use.[13] In addition, the competition for work often results in underquoting – while this generates initial cash flow, the margins and profitability are low.

Cascading deemed statutory trusts

This is a trust imposed by law that cascades down through a string of 'deemed' trusts. The money that is payable to a business down the line is held for the benefit of that business by the business above.

The Commonwealth Review of Security of Payments Laws (the Murray Review) recommended introducing deemed statutory trusts in Recommendation 85:

> 'A deemed statutory trust model should apply to all parts of the contractual payment chain for construction projects over $1 million. The deemed statutory trust model outlined in the Collins Inquiry provides a suitable basis.'[14]

The Collins Inquiry[15] recommended the trust legislation of the US state of Maryland:[16]

> 'Any moneys paid under a contract by an owner to a contractor, or by an owner or contractor to a subcontractor for work done or materials furnished, or both, for or about a building by any subcontractor, shall be held in trust by the contractor or subcontractor, as trustee, for those subcontractors who did work or furnished materials, or both, for or about the building, for the purposes of paying those subcontractors.'

[9] ASIC insolvency statistics, Table 3.2.2.1

[10] Reserve Bank of Australia, Composition of the Australian Economy Snapshot, 3 October 2018.

[11] Australian Bureau of Statistics, 5206.0, Australian National Accounts National Income, Expenditure and Product, June 2018.

[12] ASIC, Insolvency Statistics, external administrators' reports (July 2016 to June 2017)

[13] ASIC, Insolvency Statistics, Table 3.2.2.2, Construction, 1 July 2016-30 June 2017.

[14] Murray, John AM, Review of Security of Payments Laws, 22 December 2017, Page 314.

[15] Collins, Bruce QC, NSW Government Independent Inquiry into Construction Industry Insolvency in NSW, November 2012.

[16] Ibid pp 153-154 Real Prop. Sections 9-201 et seq

Project bank accounts

Project bank accounts (PBAs) are a set of trust accounts to hold progress payments, disputed funds and retention money, until they are paid to a subcontractor. Currently, they are implemented in Western Australia on government projects of $1–100 million and have been legislated and implemented as 'Phase 1' in Queensland for state government construction projects with a value of $1–$10 million. The Queensland Government also plans to expand their use to all qualified government, commercial and private projects above $1 million in early 2019 as 'Phase 2' following a review of 'Phase 1' by a select Ministerial Reference Panel.

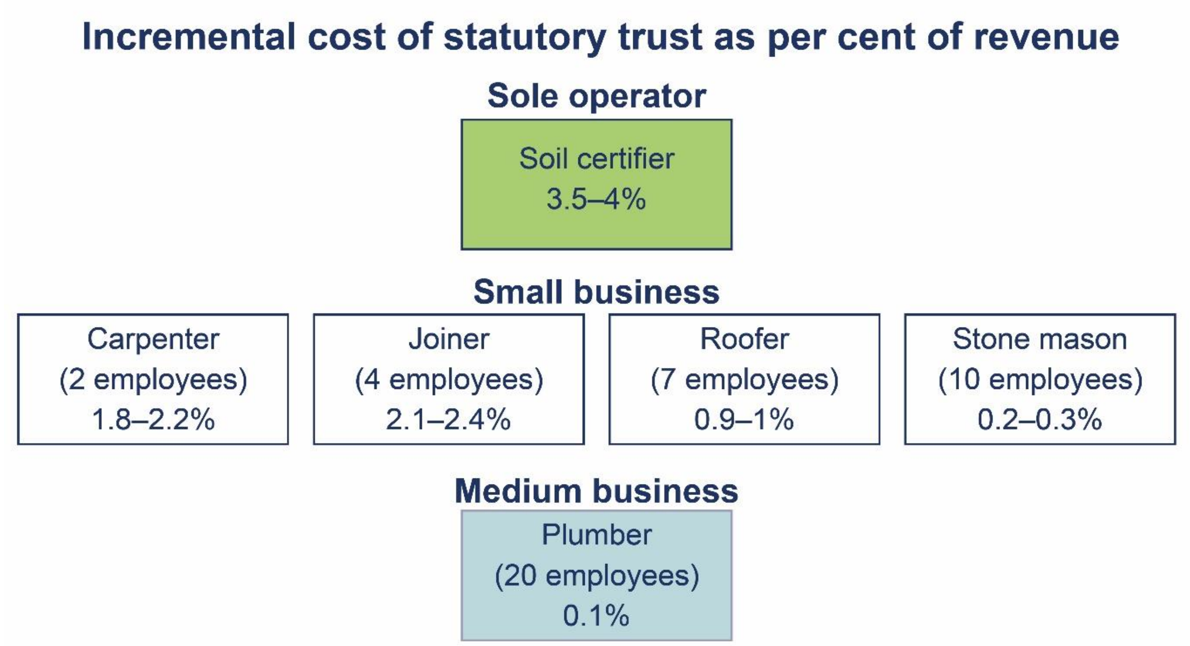
They differ to cascading deemed statutory trusts as they are set up by the head contractor for their direct subcontractors and do not cascade down the supply chain. While PBAs have elements of trust relationships, a cascading deemed trust account provides an express trustee/beneficiary relationship at all levels of the supply chain outside of other legislative or contractual requirements.

Our findings on cascading deemed statutory trusts

We had an expert in SME accounting work through some scenarios to find out the costs of running statutory trust accounts.

We found that for medium businesses (20 employees), the cost is small at 0.1% of annual revenue.

The costs are moderate for businesses with 2–10 employees at around 2%, but are higher for a sole operator at 3.5–4%.



A full copy of workings is at Attachment E.

Scenarios

We used the scenario of a new office building project to examine the implementation of deemed statutory trusts on six of the secondary subcontractors in the supply chain. The head contract was $40 million.

In the scenario, the six secondary subcontractors are:

Sole operator

- A soil certifier – an owner-operator and currently has one project in progress.

Small business

- A carpenter – 2 employees (one apprentice), 5 projects, no subcontracting out, high cost of materials.
- A joiner – 4 employees, many projects, sometimes subcontracts out.
- A roofer – 7 employees, 10 projects, mostly subcontracts out
- A stone mason – employing 10 people. It has around five projects in progress and mostly subcontracts its work

Medium business

- A plumbing business – employing 20 people. It has around 10 projects in progress and subcontracts some of its work

In order to estimate the time and dollar cost of setting up and operating a trust, we asked:

- What steps would the three companies have to take to set up a deemed statutory trust? How much time would this take? What would it cost?
- What processes would the companies put in place to operate the trust? In particular, where there is more than one project in progress at any time.
- What administrative time would be required to operate the trust in these scenarios?

We decided to apply a simple set of assumptions to initial modelling, using an experienced small business accountant. The assumptions included:

- The trust accounting reconciliations occur at least once per month, except for the sole operated business (soil certifier) which would reconcile quarterly.
- An expected revenue stream increase of $200,000 before adding an additional employee.
- The audit costs represent a 'review' by a registered audit firm, instead of a complete audit. The extent of the audit requirement will be determined by the legislation.
- The deemed statutory trusts will have its own bank account, where the transactions will be accounted for separately.

The fee ranges provided for accounting setup and ongoing bookkeeping were taken from a charge-out range from different types of accountancy firms:

- mid-tier accounting firm
- suburban accounting firm
- bookkeeping firm
- offshoring firm.

We have used the costs for services from a suburban accounting firm and a bookkeeping firm because our case study businesses are unlikely to use mid-tier firms or have limited awareness of off shoring services although this may change in coming years.

Costs

The incremental cost to the case study businesses in operating a deemed statutory trust - as a percentage of revenue. The additional administration costs for each of the small to medium businesses represent an acceptable cost of business:

- The medium-sized business would already be employing internal accounting resources and the introduction of the additional, separate account, would be minimal on top of the existing bookkeeping spend. (For example: a new bank account to reconcile, a workflow management system, a bills approvals process, a bills payment process.)

- Likewise, the small business with 10 employees would incur minimal incremental spend.
- The incremental cost for the remaining small businesses (2–7 employees) is considered acceptable taking into account the benefits of deemed statutory trusts.
- The greatest incremental increase is to the sole operator. For this reason we recommend setting a floor of $100,000 or below as contracts that are excluded from the statutory trusts regime (where project value is over $1 million). This creates a fair balance between implementation costs and benefits to small subcontractors.

Benefits

The benefits of deemed statutory trusts would include:

- Ring fencing monies owed to a subcontractor by an insolvent contractor higher up the chain to the subcontractor for work and materials supplied to the project.
- For some small businesses, moving closer to a 'business best-practice' for bookkeeping/accounting For example: timely BAS and compliance lodgements.
- Greater certainty of income (i.e. there is reduced risk of non-payment as the money is held in trust).
- Less incentive for late payments as monies held in trust cannot be used for working capital. Late payments severely impact small businesses. Survey responses from over 2,500 small businesses in the Payment Times and Practices Inquiry by ASBFEO in 2017 found real risks of insolvency for over a third of businesses and over half were faced with increased borrowing or credit card debt. Over 500 respondents were from the construction industry.[17]
- Non-financial benefits include reduction in the social and community costs of business failures such as suicide, depression, domestic violence, other family impacts and loss of productivity.

Late payments severely impact businesses and individuals

[17] See page 21 Working Paper 3 Payment Times and Practices Inquiry https://www.asbfeo.gov.au/sites/default/files/ASBFEO_WP3.pdf

- The costs for construction projects may increase from the bottom of the supply chain due to the increased cost of compliance. However, the financial quality of contractors in the supply chain will likely also increase because:
  - the practise of mistaking cash flow for profit will diminish
  - working capital will more accurately reflect the credit worthiness of the business.

We expect bookkeeping costs for micro business will decline with new and affordable software, for example, currently a cloud based account system incorporating purchase order and trust account capability is around $60 per month. In addition, there are mobile apps such as Receipt Bank that automate data entry processes. Further detail on these products is in Attachment F.

Consultation

Stakeholders' who were interviewed fell into three categories:

- those who are opposed to deemed statutory trusts being implemented in the construction sector
- those who believed deemed statutory trusts would benefit the industry. Even though they held slightly different views on how a statutory trust should work
- those who operate in environments where statutory trusts exist.

Opposed to deemed statutory trusts

The greatest objection to statutory trusts is the impact on a contractor's working capital. Statutory trusts will require that contractors and subcontractors source capital in addition to progress payments to maintain cash flow. There are views that it will be difficult for a company to judge in advance how to price projects. Both those who are opposed and in favour of the implementation of deemed statutory trusts claim that, if implemented, an appropriate transition time would be vital. Areas where clarity is required include how disputed and retention monies would be treated.

The potential adverse outcomes claimed include:

- where an error is made in tendering and a contractor makes a loss on a project. In these instances, there would be insufficient funds held in trust to pay all subcontractors
- inequity would occur where full payment is made out of the trust fund to the subcontractor earlier in the project and a shortfall is later identified. The subcontractors providing subsequent work do not receive full payment as the trust does not have sufficient funds.
- A statutory trust environment could provide an attraction to the trustee to craft their business dealings in order for their subsidiaries to seek coverage by the statutory trust regime.

It was pointed out that the residential building sector is more highly regulated than the commercial building sector and that statutory trusts should not apply to residential sector. The reasons given include:

- State jurisdictions legislate the requirements for residential builders. States require a builder to have warranty insurance for residential building work valued at over $20,000. State warranty insurances do not protect the monies owed to subcontractors and suppliers but only provide limited protection to consumers.
- Most jurisdiction's legislation imply a statutory warranty into residential building contracts covering work and materials.
- The evidence of eligibility for warranty insurance includes a financial check. While they may reduce the likelihood of failures, financial checks do not prevent the occurrence of insolvency events.

- Some state jurisdictions underwrite the insurance system. For example, in New South Wales (NSW), State Insurance Agency (SIRA) and in Queensland the Queensland Building and Construction Commission. There is no comparable review of commercial builders.
- The Housing Industry Australia (HIA) provides education to members and HIA eligibility requires member builders to abide by certain standards.

In favour of deemed statutory trusts

Those in favour were realistic about some of the consequences, such as contractors needing to reassess cash flow. However, they thought the benefits more than compensated for this. When discussing cash flow requirements to commence a project, one stakeholder commented:

> 'the smarter you are, the less money you need'.

An experienced industry stakeholder, who has advocated for statutory trusts, provided an interesting perspective when suggesting 'keep it simple' – implement the Murray/Collins model based on the Maryland US legislation and:

- implement with minimal additional bureaucracy. It is a diversion to get into expert battles about how water tight it will be in different scenarios. There will be problems with any system
- accompany implementation with extensive education
- send a message to the market by running a couple of early court cases.

Another stakeholder suggested that a statutory trust system, where a quantity surveyor signs off progress/payment claims, may be attractive to banks, if acting as the trustee, to give them another level of assurance that work has been completed to contract.

The Collins Inquiry and the Murray review have both argued strongly for implementing deemed statutory trusts in the construction industry and the reasons for doing so.

Other sectors use of trusts

Australian lawyers and real estate agents are familiar with operating trust accounts within their businesses as mandated by professional regulatory requirements. The law firm operates a trust account with an approved financial institution and maintains separate trust accounting records with ledgers for each client matter.

Different jurisdictions have variations in their rules but require annual audits and random trust account inspections. Failure to maintain proper records or to avoid misuse of trust monies can lead to disqualification from the right to practice in the profession.

In NSW, solicitors have a general trust account where they hold everyone's money. It does not earn interest as the money is held on trust for a number of different clients. Legislation demands that the account must be opened in the law company's name.

Some jurisdictions, such as NSW, have a fidelity fund to cover clients of lawyers who misuse funds. In this way the scheme self-insures for fraud. Every law firm operating a trust account is required to make an annual contribution to the fidelity fund.

Interest earned from monies held on trust can be paid to the beneficiary, shared among the parties or paid to the benefit of a regulator, e.g. NSW Real estate trust accounts share between the seller and buyer but NSW legal trust accounts remit interest to the Law Society.

The NSW Department of Fair Trading administers the NSW rental bond board. The rental bond board has a fairly stable pool of money (retail leases require bonds for three, five and even up to seven years). They invest in term deposits and the interest earned pays for overheads such as administration, education and compliance activities.

Although the fundamentals of a centralised construction trust are the same as the rental bond trust, there are differences. The issues to consider include:

- the funding model to open, manage and close trust accounts.
- the impact on project costs as the number of transactions would be much higher and require tighter timeframes
- What happens in the case of a dispute? If dispute funds are frozen, the time to resolution is important.
- a need for a system to manage the backlog.
- What entity would manage the monies? A government agency or a designated bank (project funder)?
- If the funds can be invested, which party would benefit from any gain?

Workshop

ASBFEO conducted a workshop to examine the challenges faced by subcontractors in the construction industry supply chain. A number of construction scenarios were analysed, looking to current contracting and payment practices including risk transfers.

Similar to the findings by ASIC, a key industry problem identified was poor management practices, which included:

- forecasting capability
- contract management
- financial management.

These result in a lack of self-sufficient access to working capital, unfair contract terms and an acceptance of a culture of unjust enrichment that does not meet community standards. In turn, impacting the timing, and amount of payments to subcontractors along the supply chain.

Behaviours that are widespread in the construction industry include:

- Asymmetry of power – uncertainty regarding payment for work done – underquoting to keep cash flowing – living month-to-month with debts due – unable to plan or implement resource management systems and strategies – continuous negotiation outside contract terms – 'agree to lose this time on promise you will be looked after next time'; use of disputes to hold back funds, use of power to get others to agree to discounted payments or non-refund of retention monies at end of the job.

Practical issues and the impact for statutory trusts

Anticompetitive behaviour is evident through the use of sophisticated company structures (related entities or breaks in the contractual chain) especially for mid-tier businesses, who act as raiders and participate in illegal phoenix activity.

There is a firm belief that this culture will not shift without legislation requiring change, effective enforcement and the use of well-considered definitions to minimise schemes to avoid statutory trusts.

Breaking the supply chain

Some businesses create new entities outside the contractual supply chain to carry out work for the project. The subcontractor incorrectly believes they are contracted to the project supply chain. This practice of a 'manufactured' break in the chain is a sharp practice to avoid cascading requirements imposed through the contractual chain. Queensland has proposed a broad definition of 'related entity' to avoid this behaviour.[18]

Misleading declarations

If businesses are allowed to withdraw funds from the trust after declaring all invoices are paid, there is scope for misleading declarations regarding trust payments. Technically a business that has received a payment claim for work completed by their subcontractors can declare it has paid all invoices due, although there are outstanding invoices for that work (submitted but not as yet due according to payment terms).

Aligning payments with payment Claims

There is misalignment between stage completion payments, say in head contracts from the principal and monthly work claims up to head contractor for the subcontractors

Claims made to a head contractor by subcontractors are mainly dependent on actual materials supplied and work done – so often checked off by a quantity surveyor appointed by the bank or the head contractors building manager. There may be scope to align some monthly claim payments with stage payments (authorised by quantity surveyors).

Set offs in contracts with subcontractors

Set offs are frequently used as unfair contract terms – where a payment due is decreased by matters in dispute; repair work undertaken, often with no notice. This immediately reduces the cash flow of the subcontractor.

Set offs are also applied against alleged repair work undertaken by the head contractor.

Statutory trusts have the potential to modify this behaviour as money due down the chain is quarantined removing the benefit of reducing or delaying payments to increase working capital.

Retention funds

Bank guarantees and retention money are often claimed by contractors as emergency funds by manufacturing disputes.

There is a requirement to make an automatic end to retention, e.g. refund 14 days from the end of defects liability period.

Statutory trusts have the potential to modify this behaviour as money due down the chain is quarantined removing the benefit of manufacturing disputes to increase working capital.

Legislated payment times

Mandating faster payment times in the supply chain will improve working capital for subcontractors and may reduce the risk of unpaid invoices in the case of insolvencies higher in the supply chain through minimised aged debtors.

Educating subcontractors in contract management

Many subcontractors lack time or resources to learn these skills – MBA and HIA training often does not reach beyond principal builders to subcontractors.

[18] Queensland Government, Project Bank Accounts, Summary guidelines for subcontractors.

Credit insurance

There is insurance coverage for unpaid invoices with strict debtor control requirements as part of the policy conditions. Insurance premiums may be prohibitive to small subcontractors and they may also lack sufficient management controls.

Leaking payments from the supply chain

Applying deemed trusts to projects with a value over $1 million is appropriate. A higher threshold would incentivise behaviours to avoid the trust such as fragmenting a project at owner/developer level.

Jurisdictions

The state Small Business Commissioner network (Small Business Commissioners) and the Queensland Small Business Advocate understand the issues faced by small businesses in the construction industry and recognise that the Commonwealth and State and Territory Governments have implemented a range of reforms within their jurisdictions to protect contractors and small businesses within the industry.

There are on-going reforms in state jurisdictions, which include:

- Western Australia has established an Industry Advisory Group (IAG) to review and improve security of payments for subcontractors in the construction industry. The Secretariat for the IAG is within the Department of Mines, Industry Regulation and Safety.
- New South Wales has released has released an exposure draft Bill, the *Building and Construction Industry Security of Payment Amendment Bill 2018* (the Bill) seeking to strengthen the security of payment framework while improving the operation of the Act. In conjunction with the draft bill NSW released a consultation paper on the implementation of statutory trusts.
- Queensland has conducted information sessions on the next phase of Project Bank Accounts.

The ASBFEO submission to the NSW Government consultation on statutory trusts is at Attachment G.

Attachments

Attachment A – Impacts on Insolvency practices

We looked at the Collins model and the claims that a deemed statutory trust would protect monies for beneficiaries further down the chain, in the event that a trustee higher up the chain became insolvent. The following points were made:

- A deemed trust arrangement should arise at the creation of the commercial relationship between the parties. The arrival of the trust corpus may not occur until sometime after the establishment of the relationship. However, the obligation upon the parties to act in accordance with the deemed trust should be settled upon commencement.
- Properly drafted legislation providing for the creation of a statutory trust regime within the Industry would be extremely likely to resist attempts at interference by an insolvency practitioner.
- The nature of the proposed statutory trust should not deviate from the recommendations of Collins, insofar as the control of the fund is concerned. (Note: the insolvency practitioner considered the pure Collins model, not the model put forward by Mr Murray.)
- The corpus of the Fund may comprise comingled funds without risk of infiltration by an insolvency practitioner.
- The establishment of a statutory trust regime will provide in effect for a super priority for the cascading line of subcontractor payments.
- The statutory trust regime may provide an attraction to non-subcontractors to craft their business dealings in such a manner as to seek coverage by the statutory trust regime.
- It will be important to consider the rights of subcontractors as against the existing provisions of section 556 of the Corporations Act in circumstances of insolvency of the immediately preceding contractor
- Withdrawals from the statutory trust by the ‘at level’ contractor (or trustee) should be restrained until ‘clearance’ is obtained at each ‘claims stage’ (save for funds held under dispute).
- The establishment of a deemed statutory trust may on one view be considered as providing subcontractors with a higher-priority over the rights of employee creditors – potentially to the same funds. This could produce perverse insolvency outcomes and attract other ordinary unsecured creditors to craft commercial relationships to come within the statutory trust regime and thus ‘contract out’ of the Corporations Act regime. By contrast, subcontractors must pay their own employee entitlements which should not be reduced to compensate for the contractor’s failure to fulfil their obligations thereby passing the problem down the supply chain.
- At present, unpaid employee entitlements are payable in priority in any insolvency firstly from circulating assets. A circulating asset includes a debt due to a company. Where a company retains a beneficial interest in the statutory trust, for say costs, profit or otherwise (e.g. assigned rights) and yet the statutory trust fund corpus is insufficient to discharge all claims against it, employees and in many instances Fair Entitlements Guarantee (by operation of section 560 of the Corporations Act) would be at a disadvantage.
- The Australian Taxation Office (ATO) will in some instances participate in the insolvency process on behalf of employees (in respect of unremitted compulsory superannuation contributions). The alteration of rights against circulating assets could reduce returns to superannuation.
- The requirement that GST payable in respect of downline subcontracts be paid into and retained within the fund may have a positive impact on Commonwealth revenue as, at all material times, this money should remain within the statutory trust hierarchy for payment to the ATO

- The liquidation process generally provides an environment in which rights to funds in the payment process are well known and actionable. A statutory trust regime will alter this position.
- A trustee has an equitable right of indemnity as well as exoneration for debts incurred in administering the trust. How are these costs to be accounted for both ex-ante and ex-post insolvency?
- In circumstances where a SCT fund retains insufficient funds to discharge any/all claims, how are beneficiaries to participate in the insolvency process. If their claims are the subject to the SCT regime, is the relevant company to remain contractually bound to honour any shortfall as a debt? Is this not having two bites of the cherry?

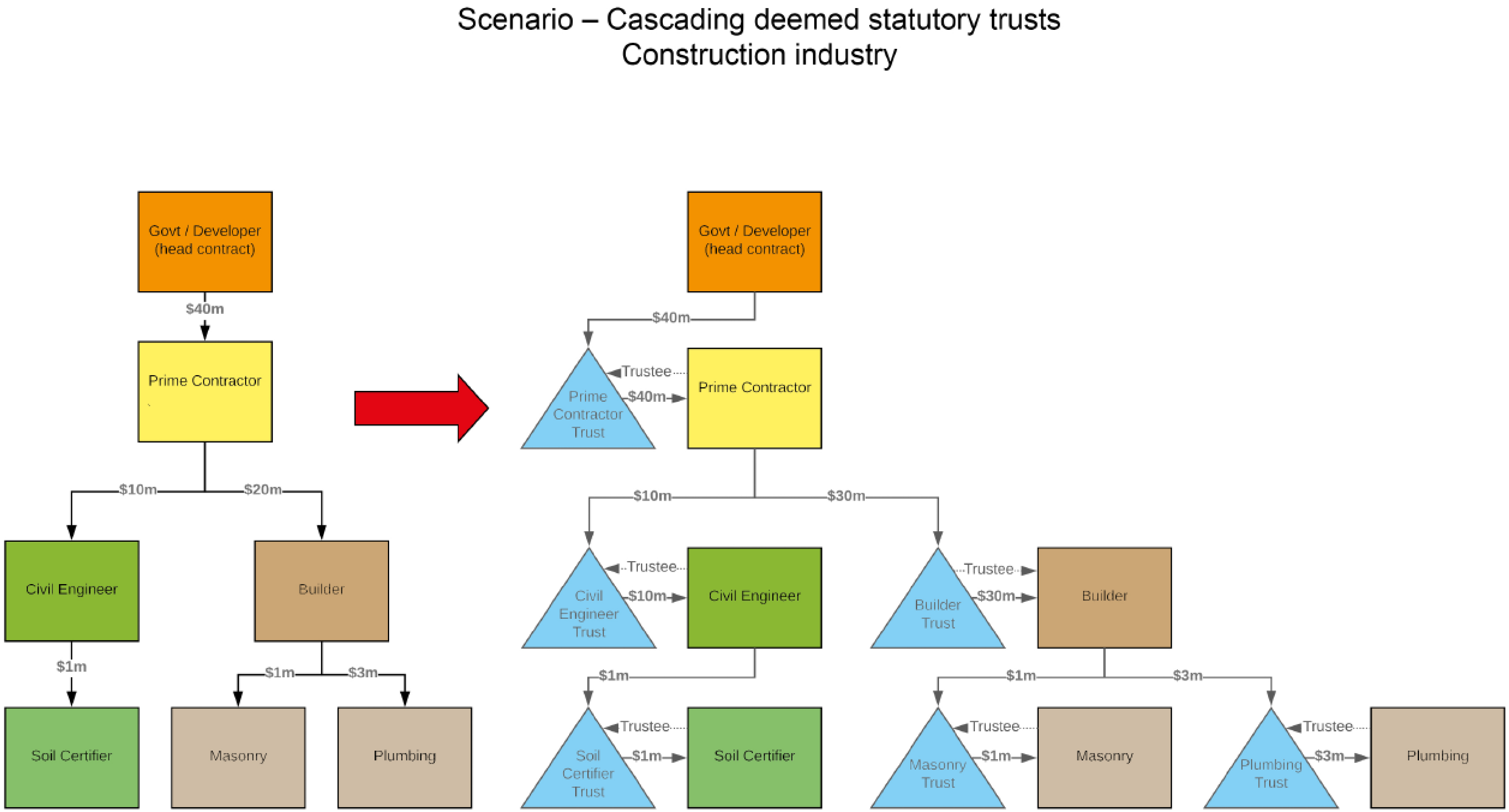
Attachment B – Reports and inquiries

- Senate Economics References Committee, Insolvency in the Australian Construction Industry.
- Bruce Collins QC, Independent Inquiry into Construction Industry Insolvency in NSW.
- Mr John Murray AM, national Review of Security of Payment Laws.
- Western Australia, Department of Mines, Industry Regulation and Safety, Discussion Paper Workshop 4, Security of Payment Reform.
- Queensland Department of Housing and Public Works, Analysis of security of payment reform for the building and construction industry, Reports 1 and 2 prepared by Deloitte.
- NSW Department of Finance, Services and Innovation, Securing Payments in the Building and Construction Industry – a Proposal for 'Deemed' Statutory Trusts.

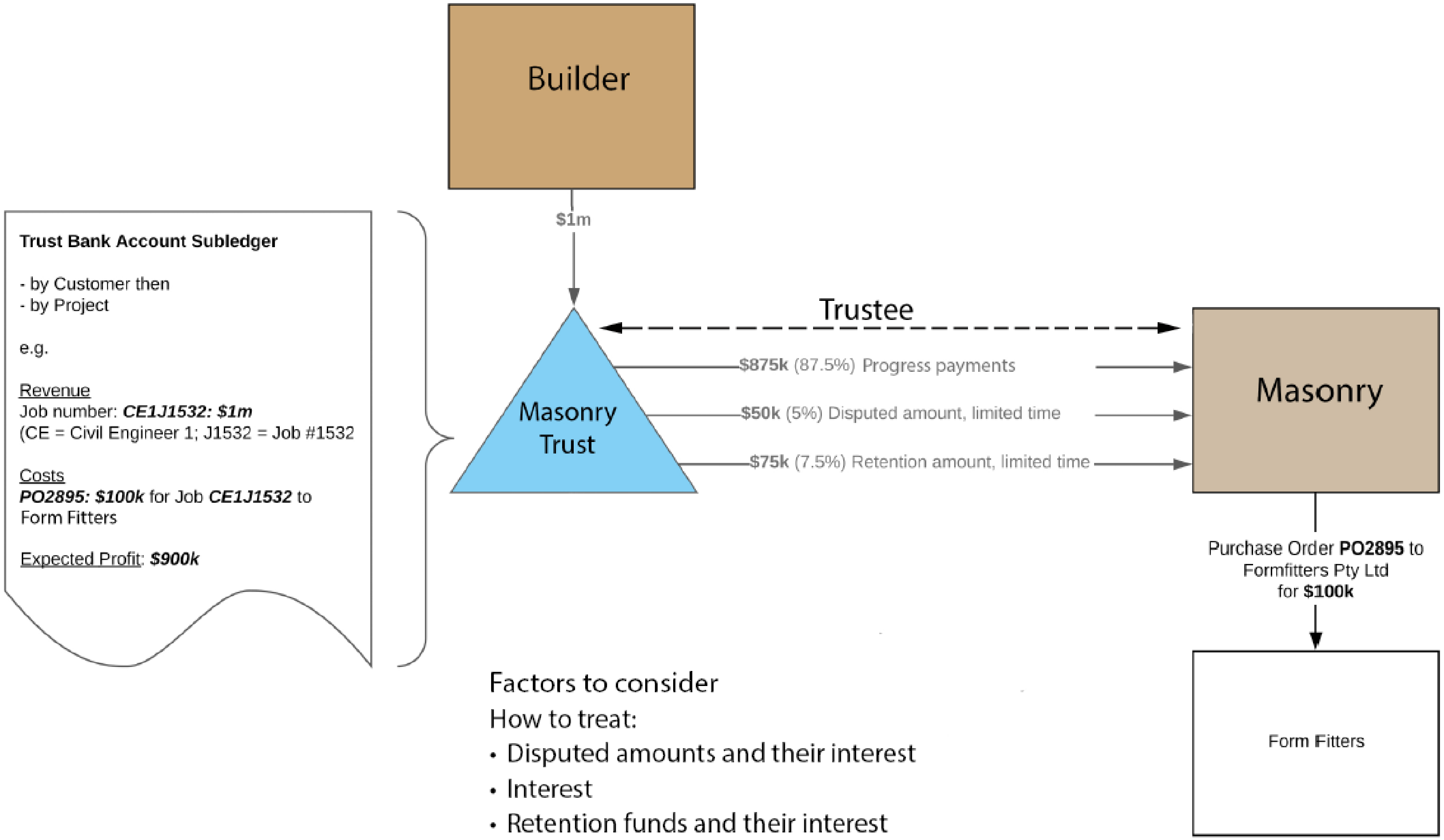
Attachment C – Consultations

- Mr John Murray AM
- Housing Industry Australia
- Mr Len Coyte, former Executive Director at Masonry Contractors Association.
- The Law Society of NSW
- Mr Phil Davenport, Solicitor, Adjudicator and Adjunct Professor UNSW
- The NSW Department of Fair Trading (administration of the NSW rental bond board).
- The NSW Department of Finance, Services and Innovation
- South Australian Small Business Commissioner
- Queensland Small Business Champion
- NSW Small Business Commissioner
- Victorian Small Business Commissioner
- Small Business Commissioner, Western Australia
- Mr Graeme Glossop, Parramatta Accountants
- The Western Australia Industry Advisory Group (IAG) Discussion Paper Workshop 4.

Attachment D – Schematic diagrams



Accounts structure



Factors to consider

How to treat:

- Disputed amounts and their interest
- Interest
- Retention funds and their interest

Attachment E – Calculations

Statutory Trust		*pre* Soil Certifier	*post* Soil Certifier	***Additional $***	***Additional %***
Entity type		Owner operator	Owner operator		
Employees		-	-		
Projects		1	1		
Revenue		$200,000	$200,000		
Trust setup		$0	$0		
Stamp Duty		$0	$0		
Accounting setup					
Mid-tier Firm (once-off)		$1,000	$1,000		
Suburban Firm (once-off)		$1,000	$1,000		
Bookkeeping Firm (once-off)		$1,000	$1,000		
Offshoring Firm (once-off)		$1,000	$1,000		
Ongoing Bookkeeping					
PO processing		-	-		
Bills processing		20	20		
Supplier payments		-	-		
Reconciliation		28	84		
Payroll		4	4		
Compliance BAS		4	4		
Compliance Trust Review		-	24		
Total Hours		56	136		
Mid-tier Firm (per month)	$150.00	$700	$1,700	*$1,000*	
Suburban Firm (per month)	$100.00	$467	$1,133	*$667*	
Bookkeeping Firm (per month)	$87.50	$408	$992	*$583*	
Offshoring Firm (per month)	$75.00	$350	$850	*$500*	
Incremental Cost %					
Incremental Cost $					
Mid-tier Firm (annualised)	$150.00	$8,400	$20,400	*$12,000*	*6.0%*
Suburban Firm (annualised)	$100.00	$5,600	$13,600	*$8,000*	*4.0%*
Bookkeeping Firm (annualised)	$87.50	$4,900	$11,900	*$7,000*	*3.5%*
Offshoring Firm (annualised)	$75.00	$4,200	$10,200	*$6,000*	*3.0%*
Incremental Cost %					
Incremental Cost $					
Mid-tier Firm (% of revenue)		4%	10%		
Suburban Firm (% of revenue)		3%	7%		
Bookkeeping Firm (% of revenue)		2%	6%		
Offshoring Firm (% of revenue)		2%	5%		
Audit Model (annual audit)		$5,000	$5,000		

Statutory Trust		*pre* Carpenter	*post* Carpenter	*Additional $*
Entity type		2 employees (one apprentice), 5 projects, no subcontracting out, high cost of materials	2 employees (one apprentice), 5 projects, no subcontracting out, high cost of materials	
Employees		2	2	
Projects		2	2	
Revenue		$400,000	$400,000	
Trust setup		$0	$0	
Stamp Duty		$0	$0	
Accounting setup				
Mid-tier Firm (once-off)		$5,000	$5,000	
Suburban Firm (once-off)		$4,000	$4,000	
Bookkeeping Firm (once-off)		$2,000	$2,000	
Offshoring Firm (once-off)		$2,000	$2,000	
Ongoing Bookkeeping		$3k - $8k pm	$3k - $8k pm	
PO processing		-	12	
Bills processing		60	62	
Supplier payments		52	52	
Reconciliation		84	126	
Payroll		26	26	
Compliance BAS		12	12	
Compliance Trust Review		-	24	
Total Hours		234	314	
Mid-tier Firm (per month)	$150.00	$2,925	$3,925	*$1,000*
Suburban Firm (per month)	$100.00	$1,950	$2,617	*$667*
Bookkeeping Firm (per month)	$87.50	$1,706	$2,290	*$583*
Offshoring Firm (per month)	$75.00	$1,463	$1,963	*$500*
Incremental Cost %		25%	25%	
Incremental Cost $		$731	$981	
Mid-tier Firm (annualised)	$150.00	$35,100	$47,100	*$12,000*
Suburban Firm (annualised)	$100.00	$23,400	$31,400	*$8,000*
Bookkeeping Firm (annualised)	$87.50	$20,475	$27,475	*$7,000*
Offshoring Firm (annualised)	$75.00	$17,550	$23,550	*$6,000*
Incremental Cost %		25%	25%	
Incremental Cost $		$8,775	$11,775	
Mid-tier Firm (% of revenue)		9%	12%	
Suburban Firm (% of revenue)		6%	8%	
Bookkeeping Firm (% of revenue)		5%	7%	
Offshoring Firm (% of revenue)		4%	6%	
Audit Model (annual audit)		$5,000	$5,000	

Statutory Trust		*pre* Joinery	*post* Joinery	*Additional $*
Entity type		4 employees, many projects, sometimes subcontracts out	4 employees, many projects, sometimes subcontracts out	
Employees		4	4	
Projects		10	10	
Revenue		$1,000,000	$1,000,000	
Trust setup		$0	$0	
Stamp Duty		$0	$0	
Accounting setup				
Mid-tier Firm (once-off)		$5,000	$5,000	
Suburban Firm (once-off)		$4,000	$4,000	
Bookkeeping Firm (once-off)		$2,000	$2,000	
Offshoring Firm (once-off)		$2,000	$2,000	
Ongoing Bookkeeping		$3k - $8k pm	$3k - $8k pm	
PO processing		-	150	
Bills processing		60	85	
Supplier payments		52	52	
Reconciliation		84	126	
Payroll		52	52	
Compliance BAS		12	12	
Compliance Trust Review		-	24	
Total Hours		260	501	
Mid-tier Firm (per month)	$150.00	$3,250	$6,263	*$3,013*
Suburban Firm (per month)	$100.00	$2,167	$4,175	*$2,008*
Bookkeeping Firm (per month)	$87.50	$1,896	$3,653	*$1,757*
Offshoring Firm (per month)	$75.00	$1,625	$3,131	*$1,506*
Incremental Cost %		25%	25%	
Incremental Cost $		$813	$1,566	
Mid-tier Firm (annualised)	$150.00	$39,000	$75,150	*$36,150*
Suburban Firm (annualised)	$100.00	$26,000	$50,100	*$24,100*
Bookkeeping Firm (annualised)	$87.50	$22,750	$43,838	*$21,088*
Offshoring Firm (annualised)	$75.00	$19,500	$37,575	*$18,075*
Incremental Cost %		25%	25%	
Incremental Cost $		$9,750	$18,788	
Mid-tier Firm (% of revenue)		4%	8%	
Suburban Firm (% of revenue)		3%	5%	
Bookkeeping Firm (% of revenue)		2%	4%	
Offshoring Firm (% of revenue)		2%	4%	
Audit Model (annual audit)		$5,000	$5,000	

Statutory Trust		*pre* Roofer	*post* Roofer	*Additional $*
Entity type		7 employees, 10 projects, mostly subcontracts out	7 employees, 10 projects, mostly subcontracts out	
Employees		7	7	
Projects		10	10	
Revenue		$4,000,000	$4,000,000	
Trust setup		$0	$0	
Stamp Duty		$0	$0	
Accounting setup				
Mid-tier Firm (once-off)		$5,000	$5,000	
Suburban Firm (once-off)		$4,000	$4,000	
Bookkeeping Firm (once-off)		$2,000	$2,000	
Offshoring Firm (once-off)		$2,000	$2,000	
Ongoing Bookkeeping		$3k - $8k pm	$3k - $8k pm	
PO processing		-	300	
Bills processing		150	200	
Supplier payments		104	104	
Reconciliation		84	126	
Payroll		91	91	
Compliance BAS		12	12	
Compliance Trust Review		-	24	
Total Hours		441	857	
Mid-tier Firm (per month)	$150.00	$5,513	$10,713	*$5,200*
Suburban Firm (per month)	$100.00	$3,675	$7,142	*$3,467*
Bookkeeping Firm (per month)	$87.50	$3,216	$6,249	*$3,033*
Offshoring Firm (per month)	$75.00	$2,756	$5,356	*$2,600*
Incremental Cost %		25%	25%	
Incremental Cost $		$1,378	$2,678	
Mid-tier Firm (annualised)	$150.00	$66,150	$128,550	*$62,400*
Suburban Firm (annualised)	$100.00	$44,100	$85,700	*$41,600*
Bookkeeping Firm (annualised)	$87.50	$38,588	$74,988	*$36,400*
Offshoring Firm (annualised)	$75.00	$33,075	$64,275	*$31,200*
Incremental Cost %		25%	25%	
Incremental Cost $		$16,538	$32,138	
Mid-tier Firm (% of revenue)		2%	3%	
Suburban Firm (% of revenue)		1%	2%	
Bookkeeping Firm (% of revenue)		1%	2%	
Offshoring Firm (% of revenue)		1%	2%	
Audit Model (annual audit)		$7,500	$7,500	

		pre	*post*	
Statutory Trust		**Masonry**	**Masonry**	***Additional $***
Entity type		10 employees, 5 projects, mostly subcontracts out	10 employees, 5 projects, mostly subcontracts out	
Employees		10	10	
Projects		5	5	
Revenue		$10,000,000	$10,000,000	
Trust setup		$0	$0	
Stamp Duty		$0	$0	
Accounting setup				
Mid-tier Firm (once-off)		$5,000	$5,000	
Suburban Firm (once-off)		$4,000	$4,000	
Bookkeeping Firm (once-off)		$2,000	$2,000	
Offshoring Firm (once-off)		$2,000	$2,000	
Ongoing Bookkeeping		$3k - $8k pm	$3k - $8k pm	
PO processing		-	150	
Bills processing		600	638	
Supplier payments		104	104	
Reconciliation		84	126	
Payroll		130	130	
Compliance BAS		12	12	
Compliance Trust Review		-	24	
Total Hours		930	1,184	
Mid-tier Firm (per month)	$150.00	$11,625	$14,794	*$3,169*
Suburban Firm (per month)	$100.00	$7,750	$9,863	*$2,113*
Bookkeeping Firm (per month)	$87.50	$6,781	$8,630	*$1,848*
Offshoring Firm (per month)	$75.00	$5,813	$7,397	*$1,584*
Incremental Cost %		25%	25%	
Incremental Cost $		$2,906	$3,698	
Mid-tier Firm (annualised)	$150.00	$139,500	$177,525	*$38,025*
Suburban Firm (annualised)	$100.00	$93,000	$118,350	*$25,350*
Bookkeeping Firm (annualised)	$87.50	$81,375	$103,556	*$22,181*
Offshoring Firm (annualised)	$75.00	$69,750	$88,763	*$19,013*
Incremental Cost %		25%	25%	
Incremental Cost $		$34,875	$44,381	
Mid-tier Firm (% of revenue)		1%	2%	
Suburban Firm (% of revenue)		1%	1%	
Bookkeeping Firm (% of revenue)		1%	1%	
Offshoring Firm (% of revenue)		1%	1%	
Audit Model (annual audit)		$10,000	$10,000	

		pre	*post*	
Statutory Trust		**Plumbing**	**Plumbing**	***Additional $***
Entity type		20 employees, 10 projects, some subcontracts out	20 employees, 10 projects, some subcontracts out	
Employees		20	20	
Projects		10	10	
Revenue		$20,000,000	$20,000,000	
Trust setup		$0	$0	
Stamp Duty		$0	$0	
Accounting setup				
Mid-tier Firm (once-off)		$10,000	$10,000	
Suburban Firm (once-off)		$7,500	$7,500	
Bookkeeping Firm (once-off)		$4,000	$4,000	
Offshoring Firm (once-off)		$4,000	$4,000	
Ongoing Bookkeeping		10k-20k pm	10k-20k pm	
PO processing		-	150	
Bills processing		600	638	
Supplier payments		104	104	
Reconciliation		168	168	
Payroll		260	260	
Compliance BAS		12	12	
Compliance Trust Review		-	24	
Total Hours		1,144	1,356	
Mid-tier Firm (per month)	$150.00	$14,300	$16,944	*$2,644*
Suburban Firm (per month)	$100.00	$9,533	$11,296	*$1,763*
Bookkeeping Firm (per month)	$87.50	$8,342	$9,884	*$1,542*
Offshoring Firm (per month)	$75.00	$7,150	$8,472	*$1,322*
Incremental Cost %		10%	10%	
Incremental Cost $		$1,430	$1,694	
Mid-tier Firm (annualised)	$150.00	$171,600	$203,325	*$31,725*
Suburban Firm (annualised)	$100.00	$114,400	$135,550	*$21,150*
Bookkeeping Firm (annualised)	$87.50	$100,100	$118,606	*$18,506*
Offshoring Firm (annualised)	$75.00	$85,800	$101,663	*$15,863*
Incremental Cost %		10%	10%	
Incremental Cost $		$17,160	$20,333	
Mid-tier Firm (% of revenue)		1%	1%	
Suburban Firm (% of revenue)		1%	1%	
Bookkeeping Firm (% of revenue)		1%	1%	
Offshoring Firm (% of revenue)		0%	1%	
Audit Model (annual audit)		$20,000	$20,000	

Deemed Statutory Trust Summary Comparison		Soil Certifier	Carpenter	PRE Joinery	Roofer	Masonry	Plumbing
Entity type		Owner operator	2 employees (one apprentice), 5 projects, no subcontracting out, high cost of materials	4 employees, many projects, sometimes subcontracts out	7 employees, 10 projects, mostly subcontracts out	10 employees, 5 projects, mostly subcontracts out	20 employees, 10 projects, some subcontracts out
Employees		-	2	4	7	10	20
Projects		1	2	10	10	5	10
Revenue		$200,000	$400,000	$1,000,000	$4,000,000	$10,000,000	$20,000,000
Trust setup		$0	$0	$0	$0	$0	$0
Stamp Duty		$0	$0	$0	$0	$0	$0
Accounting setup							
Mid-tier Firm (once-off)		$1,000	$5,000	$5,000	$5,000	$5,000	$10,000
Suburban Firm (once-off)		$1,000	$4,000	$4,000	$4,000	$4,000	$7,500
Bookkeeping Firm (once-off)		$1,000	$2,000	$2,000	$2,000	$2,000	$4,000
Offshoring Firm (once-off)		$1,000	$2,000	$2,000	$2,000	$2,000	$4,000
Ongoing Bookkeeping		$0	$3k - $8k pm	$3k - $8k pm	$3k - $8k pm	$3k - $8k pm	10k-20k pm
PO processing		-	-	-	-	-	-
Bills processing		20	60	60	150	600	600
Supplier payments		-	52	52	104	104	104
Reconciliation		28	84	84	84	84	168
Payroll		4	26	52	91	130	260
Compliance BAS		4	12	12	12	12	12
Compliance Trust Review		-	-	-	-	-	-
Total Hours		56	234	260	441	930	1,144
Mid-tier Firm (per month)	$150.00	$700	$2,925	$3,250	$5,513	$11,625	$14,300
Suburban Firm (per month)	$100.00	$467	$1,950	$2,167	$3,675	$7,750	$9,533
Bookkeeping Firm (per month)	$87.50	$408	$1,706	$1,896	$3,216	$6,781	$8,342
Offshoring Firm (per month)	$75.00	$350	$1,463	$1,625	$2,756	$5,813	$7,150
		0%	25%	25%	25%	25%	10%
		$0	$731	$813	$1,378	$2,906	$1,430
Mid-tier Firm (annualised)	$150.00	$8,400	$35,100	$39,000	$66,150	$139,500	$171,600
Suburban Firm (annualised)	$100.00	$5,600	$23,400	$26,000	$44,100	$93,000	$114,400
Bookkeeping Firm (annualised)	$87.50	$4,900	$20,475	$22,750	$38,588	$81,375	$100,100
Offshoring Firm (annualised)	$75.00	$4,200	$17,550	$19,500	$33,075	$69,750	$85,800
		0%	25%	25%	25%	25%	10%
		$0	$8,775	$9,750	$16,538	$34,875	$17,160
Mid-tier Firm (% of revenue)		4.2%	8.8%	3.9%	1.7%	1.4%	0.9%
Suburban Firm (% of revenue)		2.8%	5.9%	2.6%	1.1%	0.9%	0.6%
Bookkeeping Firm (% of revenue)		2.5%	5.1%	2.3%	1.0%	0.8%	0.5%
Offshoring Firm (% of revenue)		2.1%	4.4%	2.0%	0.8%	0.7%	0.4%
Audit Model (annual audit)		$5,000	$5,000	$5,000	$7,500	$10,000	$20,000

Deemed Statutory Trust Summary Comparison		Soil Certifier	Carpenter	Joinery	Roofer	Masonry	Plumbing
				POST			
Entity type		Owner operator	2 employees (one apprentice), 5 projects, no subcontracting out, high cost of materials	4 employees, many projects, sometimes subcontracts out	7 employees, 10 projects, mostly subcontracts out	10 employees, 5 projects, mostly subcontracts out	20 employees, 10 projects, some subcontracts out
Employees		-	2	4	7	10	20
Projects		1	2	10	10	5	10
Revenue		$200,000	$400,000	$1,000,000	$4,000,000	$10,000,000	$20,000,000
Trust setup		$0	$0	$0	$0	$0	$0
Stamp Duty		$0	$0	$0	$0	$0	$0
Accounting setup							
Mid-tier Firm (once-off)		$1,000	$5,000	$5,000	$5,000	$5,000	$10,000
Suburban Firm (once-off)		$1,000	$4,000	$4,000	$4,000	$4,000	$7,500
Bookkeeping Firm (once-off)		$1,000	$2,000	$2,000	$2,000	$2,000	$4,000
Offshoring Firm (once-off)		$1,000	$2,000	$2,000	$2,000	$2,000	$4,000
Ongoing Bookkeeping		$0	$3k - $8k pm	$3k - $8k pm	$3k - $8k pm	$3k - $8k pm	10k-20k pm
PO processing		-	12	150	300	150	150
Bills processing		20	62	85	200	638	638
Supplier payments		-	52	52	104	104	104
Reconciliation		84	126	126	126	126	168
Payroll		4	26	52	91	130	260
Compliance BAS		4	12	12	12	12	12
Compliance Trust Review		24	24	24	24	24	24
Total Hours		136	314	501	857	1,184	1,356
Mid-tier Firm (per month)	$150.00	$1,700	$3,925	$6,263	$10,713	$14,794	$16,944
Suburban Firm (per month)	$100.00	$1,133	$2,617	$4,175	$7,142	$9,863	$11,296
Bookkeeping Firm (per month)	$87.50	$992	$2,290	$3,653	$6,249	$8,630	$9,884
Offshoring Firm (per month)	$75.00	$850	$1,963	$3,131	$5,356	$7,397	$8,472
		0%	25%	25%	25%	25%	10%
		$0	$981	$1,566	$2,678	$3,698	$1,694
Mid-tier Firm (annualised)	$150.00	$20,400	$47,100	$75,150	$128,550	$177,525	$203,325
Suburban Firm (annualised)	$100.00	$13,600	$31,400	$50,100	$85,700	$118,350	$135,550
Bookkeeping Firm (annualised)	$87.50	$11,900	$27,475	$43,838	$74,988	$103,556	$118,606
Offshoring Firm (annualised)	$75.00	$10,200	$23,550	$37,575	$64,275	$88,763	$101,663
		0%	25%	25%	25%	25%	10%
		$0	$11,775	$18,788	$32,138	$44,381	$20,333
Mid-tier Firm (% of revenue)		10.2%	11.8%	7.5%	3.2%	1.8%	1.0%
Suburban Firm (% of revenue)		6.8%	7.9%	5.0%	2.1%	1.2%	0.7%
Bookkeeping Firm (% of revenue)		6.0%	6.9%	4.4%	1.9%	1.0%	0.6%
Offshoring Firm (% of revenue)		5.1%	5.9%	3.8%	1.6%	0.9%	0.5%
Audit Model (annual audit)		$5,000	$5,000	$5,000	$7,500	$10,000	$20,000

				incremental cost			
Deemed Statutory Trust Summary Comparison		**Soil Certifier**	**Carpenter**	**Joinery**	**Roofer**	**Masonry**	**Plumbing**
Entity type		Owner operator	2 employees (one apprentice), 5 projects, no subcontracting out, high cost of materials	4 employees, many projects, sometimes subcontracts out	7 employees, 10 projects, mostly subcontracts out	10 employees, 5 projects, mostly subcontracts out	20 employees, 10 projects, some subcontracts out
Employees							
Projects							
Revenue							
Accounting setup							
Mid-tier Firm (once-off)							
Suburban Firm (once-off)							
Bookkeeping Firm (once-off)							
Offshoring Firm (once-off)							
Ongoing Bookkeeping							
PO processing							
Bills processing							
Supplier payments							
Reconciliation							
Payroll							
Compliance BAS							
Compliance Trust Review							
Total Hours							
Mid-tier Firm (per month)	$150.00	$1,000	$1,000	$3,013	$5,200	$3,169	$2,644
Suburban Firm (per month)	$100.00	$667	$667	$2,008	$3,467	$2,113	$1,763
Bookkeeping Firm (per month)	$87.50	$583	$583	$1,757	$3,033	$1,848	$1,542
Offshoring Firm (per month)	$75.00	$500	$500	$1,506	$2,600	$1,584	$1,322
Mid-tier Firm (annualised)	$150.00	$12,000	$12,000	$36,150	$62,400	$38,025	$31,725
Suburban Firm (annualised)	$100.00	$8,000	$8,000	$24,100	$41,600	$25,350	$21,150
Bookkeeping Firm (annualised)	$87.50	$7,000	$7,000	$21,088	$36,400	$22,181	$18,506
Offshoring Firm (annualised)	$75.00	$6,000	$6,000	$18,075	$31,200	$19,013	$15,863
Mid-tier Firm (% of revenue)		6.0%	3.0%	3.6%	1.6%	0.4%	0.2%
Suburban Firm (% of revenue)		4.0%	2.0%	2.4%	1.0%	0.3%	0.1%
Bookkeeping Firm (% of revenue)		3.5%	1.8%	2.1%	0.9%	0.2%	0.1%
Offshoring Firm (% of revenue)		3.0%	1.5%	1.8%	0.8%	0.2%	0.1%

Attachment F – Products

ReceiptBank™

https://www.receipt-bank.com/for-business/

Attachment G – ASBFEO Submission to NSW Department of Industry

Australian Government

Australian Small Business and Family Enterprise Ombudsman

18 September 2018

Security of Payment: Consultation Paper
NSW Department of Finance, Services and Innovation
Regulatory Policy Branch
Locked Bag 2906
LISAROW NSW 2252

By email: securityofpayment2018@finance.nsw.gov.au

Dear Sir/Madam

SECURING PAYMENTS IN THE BUILDING AND CONSTRUCTION INDUSTRY- A PROPOSAL FOR 'DEEMED' STATUTORY TRUSTS

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) welcomes the NSW Government consultation on security of payments and I support 'deemed' statutory trusts in the building and construction industry subject to appropriate implementation through the supply chain. Detailed responses to questions posed in your consultation paper can be found in Annexure A to this letter.

Why small business is important to the Australian and NSW economy

Over 97 per cent of businesses in Australia are small businesses (who employ 0-19 people); 61 per cent are sole traders and 27 per cent employ 1-4 employees. In NSW approximately 96 per cent of businesses are small business.

Due to their size, resources and expertise small business have an asymmetry of power and consequently are vulnerable to poor commercial practices.

Market failure in the building and construction sector

The building and construction sector's contribution to the economy is around 9% of GDP. However the insolvency rate is high, up to 25% of all insolvencies in Australia[1]. The two major reasons for insolvency in the industry are inadequate cash flow or high cash use and poor strategic management skills.

Australia's building and construction industry has the highest involvement of subcontracting in the world. In Australia subcontractors are responsible for between 80 per cent and 85 per cent of all construction work.[2]

It is well documented that the pyramidal structure has affected the culture of the industry. Unjust enrichment can occur because the entity being paid to deliver the project receives payments mostly performed or materials supplied by someone else. The considerable pressure down the contractual chain plays out in the use of project funds for working capital, under-quoting to generate cash flow, late payment and the manufacture of disputes to keep progress payments, retention funds and to cash bank guarantees. This is only heightened when insolvency occurs. In addition, the current boom in infrastructure, especially in NSW, means that failures will continue to occur.

[1] As cited in the Senate Inquiry into Insolvency in the Building and Construction Industry p 12.
[2] Ibid.

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Australia-wide, including NSW, there have been many high profile insolvencies since 2016 where creditors included small businesses, often regional subcontractors. York Civil recently entered administration, others identified in the media include: Ostwald Brothers reportedly owing around $7.3 million to creditors[3]; Peter O'Brien Constructions owing around $5.7; Severino Homes owing more than $1 million; Edwards Constructions (NSW) Pty Ltd owing $6 million; and Bower Projects owing around $20 million[4].

Government intervention and cost of regulation

The NSW Government has previously intervened with the security of payments legislation. This regulatory approach using statutory declarations and supporting statements has been ineffective and there has been limited consequence to illegal behaviour in these areas.

The ASBFEO *Payment Times and Practices Inquiry* (2017) and the *Affordable Capital for SME Growth Inquiry* (2018) showed that adverse practices around working capital holdings where an asymmetry of power exists between businesses. Subcontractors in the construction industry work on a cultural norm of do the work first trusting you will be paid later, usually once per month in arrears. The expected reciprocal behaviour of paying on time, not unfairly disputing work to hold back working capital and not operating when insolvent has been eroded.

The ASBFEO supports low cost regulation that is affordable and effective. There are claims by some industry representatives that the regulatory cost of statutory trusts would be high. However statutory trusts are employed by other industry sectors such as the real estate agents, travel agents, the law profession and in stockbroking, to protect money belonging to other parties. These sectors also include a majority of small businesses and affordable statutory trust models have been achieved for many years. My Office has conducted some research into the book keeping costs of statutory trusts applied to the sector and our initial findings are provided in the Annexure. We will report in more detail once this research is complete.

Thank you for the opportunity to comment. If you would like to discuss this matter further, please contact Annette Conroy on 02 6121 5129 or at annette.conroy@asbfeo.gov.au.

Yours sincerely

Kate Carnell

Kate Carnell AO
Australian Small Business and Family Enterprise Ombudsman

[3] http://www.abc.net.au/news/2018-05-20/pacific-highway-subcontractors-owed-money/9780968

[4] Murray J. Review of Security of Payment Laws, p 63.

Annexure A

1. *Do you support the proposal to establish deemed statutory trusts in the Act?*
2. *What alternative reform(s) could be implemented?*
3. *Do you support the proposal to apply a cascading 'deemed' statutory trust model?*
4. *What would be an appropriate point in the contractual chain to limit the requirement for 'deemed' statutory trusts?*
5. *Do you support the proposal to apply the requirement for 'deemed' trusts to construction projects valued at $1 million or more?*
6. *What would be an appropriate alternative monetary threshold?*

We support introduction of cascading deemed statutory trusts in the building and construction supply chain for all projects with a value ***over $1million***. A higher threshold is inappropriate as it will incentivise behaviours to avoid the trust such as fragmenting a project at owner/developer level. The project value is the appropriate figure rather than the one to one contract price down the chain, to ensure the benefits flow to subcontractors who are the usual victims of insolvencies or other poor practices resulting in non-payments.

The cascading trust must also extend to situations where the project contractual chain does not exist because it is intentionally broken and a new chain is created by a related entity with regards to the principal project. For example ASBFEO assisted a business supplying air-conditioning services into a government funded nursing home. The business thought it was a subcontractor in the supply chain from the head contract. However, the business was retained by an entity separate from the supply chain, who later went into voluntary administration. This 'manufactured' break in the chain was a 'sharp' practice to avoid requirements imposed through the contractual chain. Queensland has proposed a broad definition of 'related entity' to avoid this behaviour[1].

7. *Do you support the proposal to limit the application of the requirement to parties based on the value of their individual contracts?*
8. *What would be an appropriate contract value?*

We recommend setting a floor of $100,000 or below as contracts that are excluded from the statutory trusts regime (where total project value is over $1million). This creates a fair balance between implementation costs and benefits to subcontractors.

See our further comments in regard to the cost of trust accounting set out in Question 31 where we describe results of recent modelling.

9. *Do you support the proposal that the requirement for a deemed trust should arise immediately when the contract monies are received by the trustee?*
10. *What would be an appropriate point in the contract lifecycle for the deemed statutory trust to be established?*

[1] Queensland Government, Project Bank Accounts, Summary guidelines for Subcontractors, p4.

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The deemed trust must arise at formation of the commercial relationship. This can be at the point of formation of the contract. This provides maximum protection to the beneficiary and minimises adverse results in cases of an administration of the trustee. Services and supplies provided by the beneficiary up to the point of a progress claim and in the weeks between progress claims are to the benefit of the trustee on the reciprocal expectation of payment at a delayed time. The risk associated with delayed payment has grown in recent years due to increased insolvencies in this sector allowing other secured creditors to be enriched to the detriment of the beneficiary.

11. *Do you support the proposal that responsibility for managing 'deemed' trust monies is placed on the trustee?*
12. *Do you support the proposal to allow trust monies on multiple construction projects to be held in a consolidated account?*
13. *Should there be any further obligations applied to trustees and/or beneficiaries to support the efficient flow of monies in/out of accounts (for example, a requirement for transaction certificates of some form)?*

We support your proposal for trustees to manage the trusts. While this will be new to the sector, with appropriate education and reasonable transition times, this approach maximises behavioural and management changes in the sector. The model applied to lawyers trust accounts, real estate agents and travel agents provides good examples of trust regimes where one trust account operates for each entity with separate ledgers for each beneficiary. Accounting codes allow monies to be categorised within the individual ledgers. For example retention funds, disputed monies and 'in and out' monies for payment claims. Ledgers and codes can distinguish different projects within a consolidated trust account.

This industry sector is familiar with the use of multiple entity types and complex structures with scope to add complexity especially high in the supply chain e.g. head contractors setting up additional service companies to 'leak' funds out of the cascading chain. Careful drafting to capture 'related persons' can minimise these impacts. Another example may be head contractors paying funds to related parties ahead of paying other beneficiaries. The role of the quantity surveyor may be important to overcome this behaviour.

Consideration should be given to other behaviours which may circumvent the intention of deemed statutory trusts in this industry.

14. *Do you support the proposal to not require auditing of trust records?*
15. *Do you consider that the compliance and enforcement powers proposed in the exposure draft Bill are sufficient to support the operation of 'deemed' statutory trusts?*
16. *What type of compliance and enforcement powers or framework would be preferred?*

There is a high degree of risk in the operation of statutory trusts in an industry which has been characterised by poor management practices. On the other hand, an independent audit would cost a business time and money and similarly there is a cost to the regulator to oversee the audit.

The investigation and enforcement reforms outlined in Part 3A of the draft *Building and Construction Industry Security of Payment Amendment Bill 2018* provide the Department of Fair Trading with enforcement powers they currently use in other legislation. However, there are entrenched working capital practices in the sector and regulation and unifying enforcement powers are not enough on their own. There should be an adequate transition period to implementing deemed statutory trusts, along with:

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- a budget for an on-going and sustained education campaign to help businesses who are trying to do the right thing;
- independent and transparent monitoring and reporting to provide confidence that intentional non-compliance (and hence unfair advantage) is being identified; and
- enforced penalties that act as a deterrent for businesses that are intentionally non-compliant.

We have seen through the Royal Commission into the Financial Services Sector that although agencies such as ASIC and APRA have had the means, they were reluctant to take action. The regulator needs to be tough in order to be effective. If these measures were in place, there would be less risk in not requiring independent trust account audits.

17. Do you support the proposal to allow the trustee to withdraw funds from the account before a subcontractor has been paid?

18. When should a trustee be permitted to withdraw funds?

We strongly disagree with this proposal. One of the most effective motivators to action is receiving money. Delaying this incentive until after the 'work' of paying other beneficiaries preserves the essence of a trust. Any ability for a trustee to take funds before subcontractors is open to exploitation. For example a trustee can extend payment times to subcontractors to contrive circumstances that no monies are currently due or payable so allowing all trust funds to be withdrawn into their working capital account.

The New Payment Platform infrastructure introduced in 2017 allows for instant payments by electronic funds transfer enabling the trustee to disburse all funds and pay themselves the same day.

19. Do you support the proposal to allow funds to be distributed on a pro rata basis as a proportion of their payment claims?

20. What other model of distribution would be preferred?

Pro rata distributions allow for administrative simplicity. The first preference is for sufficient funds to sit in the trust account by the contractor topping up any shortfall.

A disadvantage of pro rata distribution is that it disadvantages subcontractors who performed work earlier and rendered accounts earlier but remain unpaid. This can happen if a contractor applies differentiated rather than uniform payment times. A similar issue arises in cases of disputed monies that are held back in the trust account. A rapid and equitable payment process is required and there may be benefit in using an adjudicator such as a quantity surveyor to determine the distribution. The faster payments are made, the less this problem will occur.

> *21. Do you support the proposal relying on the existing dispute resolution mechanisms in the Act?*
>
> *22. Are any new or amended mechanisms required?*

Initial implementation should adopt practices that are familiar to participants in the industry. The proposed dispute mechanism is adequate but rapid and trustworthy processes and oversight are required to support the statutory trust system. We suggest a review of these processes two years after implementation.

A power to penalise a contractor for unfairly delayed payment to a subcontractor multiple times whether on the same or different projects would be a useful deterrent.

> *23. Do you support the proposal to allow the investment of 'deemed' statutory trust monies?*
>
> *24. Are any further provisions necessary to support the operation of this proposal?*

We do not support investment of trust monies. Deemed trusts expedite payment times and reduce disputes while protecting monies until paid to subcontractors. Retention funds may benefit from investment but this should be with approved ADIs with all interest remitted to a regulator for education and audit processes.

> *25. Do you support the proposal to allow the beneficiaries to inspect the records of 'deemed' trust accounts?*
>
> *26. Is there an alternative approach that would provide beneficiaries with a similar degree of awareness?*

We support the proposal for inspection of books by beneficiaries although this is likely to have limited use. Any inspection must be limited to the relevant ledger only. The right should also extend to an appropriate agent of the beneficiary such as an accountant or licensed bookkeeper.

> *27. Do you support the proposal to apply executive liability to directors and other relevant persons for breaches?*

Adopting provisions similar to the Corporations Act 2001 on directors and officers liability is appropriate. Liability for criminal behaviour, behaviour by shadow directors and accessorial liability are strong deterrents with well-established case law. A project value range of over $1 million dollars and an individual contract floor value of $100,000 or below will ensure the burden does not outweigh the benefits of these provisions in the context of the statutory trust.

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28. Do you consider these are the likely benefits associated with the proposal?
29. Are there any other significant benefits that are relevant?

We agree with the listed benefits however, for protections against insolvency the trust parameters must be clear. It must start when the commercial relationship is formed; the provisions must extend to cover related parties of the contractor. The right to disputed money must legally vest in the beneficiary irrespective of the contractor raising the dispute. If not, the contractor is motivated to raise disputes as a strategy to capture working capital or an insolvency practitioner will chase those funds in the trust account.

Additional benefits beyond trust remedies at law, easier fraud detection and greater efficiencies include faster payment times to smaller business and greater access to affordable capital for small business[2]. There is also greater incentive for improved financial management arising from mandatory trust accounting.

Without statutory trusts, powerful players retain the ability to influence working capital of their potential competitors. Trusts will allow businesses to grow and have mobility up the supply chain while adopting sustainable financial practices.

We agree that a segregated trust account has better protection than in a co-mingled account. However segregated funds are still open to challenge if the trustee becomes insolvent. The Collins model suggests at the very least the head contractor's trust should have the principal as trustee to avoid this issue. This is impractical and it appears many insolvencies are at a mid-level such as businesses with an annual turnover of around $10 million. Fast payment would counteract this challenge and align with the intent of a statutory trust.

There would also be the benefit of reducing the incentive to underquote to stimulate cash flow. While discounting occurs in other industries, the consequences of the endemic use of this practice include businesses not operating in a sustainable and profitable way. It also creates a culture of subcontractors being expected to give up part of their profit by accepting partial payment for work completed.

A mandatory trust scheme will require more small businesses to adopt proper record keeping processes. The burden of bookkeeping is not so hard with new and affordable technologies, for example, a cloud based account system incorporating purchase order and trust account capability is in the realm of $60 per month. In addition, there are mobile apps such as Receipt Bank that automate data entry processes.

30. Do you consider these are the likely costs associated with the proposal?
31. *Are there any other significant costs that are relevant?*

The incidence of poor management practices in the sector has created high insolvency rates where the benefits provided to the creditor pool often flow from services and supplies made by subcontractors. Secured creditors receive these benefits at the expense of subcontractors. Social expectations have changed to acknowledge the inequity of secured creditors being unjustly enriched to the detriment of the subcontractors that created the physical value to the construction through their labour and material.

[2] https://www.asbfeo.gov.au/inquiries/affordable-capital-sme-growth; https://www.asbfeo.gov.au/inquiries/payment-times-and-practices

The disadvantage is going to be felt over a transition period where businesses will need to rethink their real cash flow position.

There will be an impact on working capital. It will require businesses to take stock and assess their working capital requirements. It is essential that businesses are given a realistic time frame to transition at the very least the change will need to be incorporated into their next annual plan. The timeframe also needs to acknowledge the length of construction projects and the work in progress under existing budgets as there will be partially completed projects at the implementation of statutory trusts.

The NSW government could consider increasing the cap on up-front deposits for residential construction to alleviate working capital.

ASBFEO modelled scenarios of three companies subcontracting in the building and construction industry. A small business, a medium and a large business. The incremental cost of running a statutory trust for the medium to large business was up to 0.5 per cent of revenue and for the small business up to 3.5 per cent of revenue. The modelling did not include audit costs.

The full accounting cost for the medium to large firms modelled was 1 percent of annual revenue and for the small business the full accounting cost estimate was around 6-7 per cent of annual revenue.

The impact is greater on small businesses who do not have economy of scale. This impact on small business supports introducing a floor for a contract value of $100,000 for projects with a value over $1 million.