

## **Senate Standing Committee on Foreign Affairs, Defence and Trade**

### **Parliamentary inquiry – Inquiry into the Impact of Defence Activities and Training Areas on Rural and Regional Communities**

#### **ANSWER TO QUESTION SENT THROUGH IN ADVANCE OF PUBLIC HEARING**

##### **Department of Defence**

**Topic:** SSCFADT – Questions in advance of public hearing on impact of Defence training activities and facilities on rural and regional communities – 1.16 - The Committee

**Question reference number:** 1.16

**Date set by the committee for the return of answer:** 19 March 2018

#### **Question:**

The committee notes that in Rockhampton, Brigadier Beutel explained some protections for subcontractors under Defence's forms of contract whereby subcontractors are required to provide evidence to the managing contractor in relation to payment of its subcontracts before further payments are made.

- Can you step us through how these protections work in practice? Do they only apply to certain contracts? How effective are these current protections? It appears that the protections relate to whether payment has occurred, not the length of time before payment was made – is that correct? Is there anything further that Defence can do to assist subcontractors?
- How do you explain the evidence received about late payments?
- Noting the evidence that the Defence payment system is operating well, could contracts include a provision that subcontractors adhere to the same timing requirements as Defence?

#### **Answer:**

- The template contracts commonly used by the Department of Defence, Capital Facilities Infrastructure Branch are the Head Contract (HC 2003-1) and the Managing Contractor Contract (MCC 2003-1) which can be found at:  
<http://www.defence.gov.au/estatemanagement/Support/SuiteContracts/Default.asp>

- Each of the Head Contract and Managing Contractor contracts are structured to be consistent with both industry practice and the security of payment legislation in each State and Territory of Australia in relation to promoting the certainty and timeliness of payment to subcontractors. In particular these contracts:
  - a) require that for each payment claim submitted to Defence, the head contractor must provide:
    - i. a statutory declaration, together with supporting evidence that, except other than as disclosed, as at the date of the payment claim all subcontractors have been paid all monies due and payable to them in connection with the project; and
    - ii. documentary evidence that, except to the extent otherwise disclosed, as at the date of the payment claim all workers who have been employed by a subcontractor have been paid all moneys due and payable to them in respect of their employment in connection with the project;
  - b) entitle Defence to withhold payment to the head contractor of any amount disclosed as being unpaid by a head contractor to a subcontractor or an employee of a subcontractor;
  - c) require that payments to head contractors are made within the timeframes required by the relevant security of payment legislation. The template subcontracts developed by Defence and available for use in connection with these contracts are also structured on this basis.
- In addition, the Managing Contractor Contract, which is regularly used in connection with the construction of major Defence facilities includes added measures designed to protect the interests of subcontractors. These include:
  - a) a requirement that all amounts payable to a first tier subcontractor are paid into a trust account where the amount payable is held on trust for the subcontractor; and
  - b) transparency in respect of the terms of the subcontracts entered into by the head contractor, including the right to require amendments to the subcontracts proposed to be used.
- Defence considers that these measures materially assist in ensuring the certainty and timeliness of payments to subcontractors, particularly first tier subcontractors.
- Equally, Defence recognises the need for continuous improvement and review. Defence is also conscious that there is particular concern surrounding the timeliness of payment to lower tier subcontractors, where it is challenging for Defence to obtain visibility of the agreements made between the various parties in the subcontract chain.

- To this end, Defence is continuing to identify and implement additional measures where it is appropriate to do so. In this context it is noted:
  - a) Defence has recently amended its template Managing Contractor Contract to require that the head contractor pay its subcontractors within two working days of Defence paying the relevant amount. This initiative is expected to significantly enhance cash flow to first tier subcontractors.
  - b) Defence recognises that the interests of lower tier subcontractors should also be considered and, where feasible, better protected. In this context Defence is carefully examining options to:
    - i. introduce trust accounts at both contractor and subcontractor level for all Managing Contractor and Head Contract projects;
    - ii. mandate accelerated payment by Defence to the contractor and in turn first and lower tier subcontractors; and
    - iii. more generally, improve oversight of the risk allocation and payment terms of first and lower tier subcontracts.
- It is recognised, however, that any additional initiatives introduced by Defence will need to align with the wider state legislative and policy framework and also be workable from an industry perspective. In this context, Defence will carefully review the findings, once delivered, of the Review of Security of Payment Laws by John Murray AM (commissioned by the Government in December 2016) and as appropriate also consult with industry.
- Although there is Security of Payment legislation in place that identifies payment timeframes (with the exception of WA), parties to a contract may agree to increase this timeframe. Defence has mandated timeframes in its contracts to be consistent with the relevant state legislation, with a maximum period of 10 days for payment. The occurrences of late payments are generally with contracts further down the subcontracting levels.
- In some cases, Defence does not have visibility of the contract terms and conditions, such as in the sub-subcontract levels of a Managing Contractor Contract, or the subcontracts in a Head Contract. Defence is aware that in some cases, the parties to a contract have agreed payment terms of up to 120 days.
- It is common for there to be some dispute about the amount of work completed and payments claimed. In these cases, there may be some uncertainty about whether the money is due and payable.
- Often, these disputes are complex, and although there are legislative protections available to subcontractors (such as the Subcontractors Charges Act) these are not used. Defence understands that this may be a commercial decision that is taken to avoid being labelled as a litigious subcontractor or to preserve future business opportunities.



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##### **Department of Defence**

**Topic:** SSCFADT – Questions in advance of public hearing on impact of Defence training activities and facilities on rural and regional communities – 1.17 - The Committee

**Question reference number:** 1.17

**Date set by the committee for the return of answer:** 19 March 2018

**Question:** In Wodonga Ms Jones said: 'It is the prime's [Tier 1] responsibility to deliver the service and sub out the work as they see fit or desire'. What visibility does Defence have of the business practices/subcontracting arrangements of the primes? What are the reporting requirements of prime contractors? Do they report against KPIs? Please provide examples. What happens if they are not meeting KPIs? Do they report on the engagement of local businesses? Please provide examples.

**Answer:**

The Defence Estate Base Service Contracts (BSC) requires primes to report on their subcontracting arrangements if:

- a) the total value of all work or services performed by the subcontractor is expected to exceed 25 per cent of the fixed fee claimable over the financial year;
- b) the subcontractor will in any way be involved in:
  - design and development activities;
  - modification of systems;
  - systems installation or integration; or
  - bringing or creating IP to the proposed subcontract necessary to enable the Commonwealth to use and support the services being delivered.

As part of the recent contract extensions in 2017, Defence has now included additional reporting obligations for prime contractors in respect to the local small to medium enterprises (SMEs) that they engage. This additional reporting includes supplier details, location and size of the enterprise, Indigenous business and percentage of contract value paid to the SME. Quarterly reporting came into effect from 1 January 2018.

There are no specific Key Performance Indicators in the BSC in respect of these arrangements.



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##### **Department of Defence**

**Topic:** SSCFADT – Questions in advance of public hearing on impact of Defence training activities and facilities on rural and regional communities – 1.18 - The Committee

**Question reference number:** 1.18

**Date set by the committee for the return of answer:** 19 March 2018

**Question:** The ANAO Report Design and Implementation of Defence's Base Services Contracts, notes advice from Defence that 'in response to the internal Defence audit, the Service Delivery Division had initiated a review of its process for performance assessment, reporting and assurance'. Please provide an update for the committee about how this review is progressing? Is it anticipated that the review will result in additional reporting requirements being included in Base Services contracts?

**Answer:**

- At the time of the ANAO report, Defence had contracted the services of KPMG to review the contract performance and assessment process and has since implemented the recommendations of that review, this included some refinements to the reporting requirements.
- The subsequent contract extension process conducted in 2017 included the negotiation of a range of improvements to the contracts, including enhanced SME and Indigenous Procurement Policy reporting.
- The contracts are also subject to ongoing review of performance indicators to ensure their efficacy in measuring contractor performance.





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**Topic:** SSCFADT – Questions in advance of public hearing on impact of Defence training activities and facilities on rural and regional communities – 1.19 - The Committee

**Question reference number:** 1.19

**Date set by the committee for the return of answer:** 19 March 2018

**Question:** The ANAO Report notes:

Defence is currently two years into a minimum six-year contract, and has advised that it will begin work on its first strategic review of the contracts in late 2016. The review will inform contract extensions.

- Can you provide an update for the committee about the progress of the strategic review of the contracts? Are there any indications at this stage that systemic changes to contracts may be required? Does this provide an opportunity for some of the suggestions made as part of the committee's inquiry to be considered as part of the contract extension process? Is there any provision for amendments to be made to existing contracts?
- Is the availability of a 10 year contract (initial six years with four year extension) consistent with other industries?

**Answer:**

- Defence contracted the services of KPMG in 2016 to review the contract performance and assessment process and has since implemented the recommendations of that review including some refinements to the reporting requirements.
- The subsequent contract extension process conducted in 2017 included the negotiation of a range of improvements to the contracts, including enhanced SME and Indigenous Procurement Policy reporting.
- Due to the long term nature of these contracts, provision exists, subject to the agreement of both parties, for amendments to the contracts to be made at any time.
- A ten year contract term is consistent with other large Government service based contracts and allows adequate tenure to promote business improvement and innovation but also an appropriate tenure to maintain adequate competition in the longer term.