

## **Comments by Colin Fullerton on Draft Report (dated 30 August 2019) for the Inquiry into Government Procurement Stage 2 – Capital Works**

### **1. Purpose of the Inquiry**

The South Australian Productivity Commission invited me to provide comments on the Draft Report for Stage 2 of the Government Procurement Inquiry. Stage 2 includes the procurement for capital works projects.

Earlier, I provided comments on the Issues Paper for Stage 1, which was limited to the procurement of goods and services, excluding capital works.

In providing my comments I recognise that the Premier's terms of reference document, dated 31 January 2019, include:

- Expanding the scope of the current enquiry into the efficiency and effectiveness of the South Australian Government procurement processes and practices to include capital project procurement, and
- Implement reforms enabling South Australian businesses to better participate in government procurement, and
- Provide recommendations on action the government should take to improve the effectiveness and efficiency of State Government policies and practices for the government's procurement activities

### **2. My Background**

I am a nationally registered and chartered professional engineer and a Fellow of the Institution of Engineers Australia.

I am currently working as a private consultant practicing in the areas of procurement, contract management and dispute resolution.

I am an accredited mediator, arbitrator, adjudicator, and expert determiner. Many of my dispute resolution roles involved building and construction matters.

During my working career I have held management positions in procurement and contract/project management in a number of industries (railways, mining infrastructure, water and sewerage, transport services, electricity transmission).

This work has included managing staff involved in preparing tender documentation, evaluating tenders, forming contracts, and the administration and management of contracts during the delivery phase.

My experience included 24 years with State Government Departments (SA Water/Engineering & Water Supply, and Public Transport). This experience involved procuring goods, services and capital works, and managing contract delivery.

Since 2001, I have presented training courses in procurement and contract management as a consultant to the University of Adelaide (Professional & Continuing Education). The training has involved participants from the government and the private sector (BHP, Origin Energy, Australian Submarine Corporation, Naval Group, ElectraNet).

### **3. General Comments**

I mentioned in my previous comments on Stage 1 of the SAPC enquiry that the State Government's current policies and practices for government procurement are not dissimilar to the practices when I was working in government procurement (water & sewerage, and rail & bus services).

Previously, government departments managing government infrastructure had a high level of skills to design, build and maintain government infrastructure, eg Highways, Engineering and Water Supply (E&WS), Marine and Harbours, Housing Trust, Public Buildings and the Electricity Trust Of South Australia (ETSA).

When major government capital developments occurred (eg Adelaide's Water Filtration Programme, South Eastern Freeway, bridges on country highways, Morgan Whyalla Pipeline crossing northern Spencer Gulf) additional design and constructing resources were engaged to assist departments in developing major infrastructure.

Much of the additional design and constructing resources were South Australian based, eg Maunsells (bridge and highway design), Boulderstones (civil and building), and Mayfields (mechanical & electrical services). And local SA subcontractors were commonly used.

The situation now is very different. Government departments in SA, and other states, do not have all the resources and skills to create major public infrastructure. Governments now rely on large private companies/consortiums to create much of the road and rail infrastructure, harbours, hospitals, schools, etc.

Government may arrange for concept design to complete the approval process, but it is usually the large infrastructure companies that engage the detail designers and other consultants to work with the constructors to complete the infrastructure.

#### **The SA Water Situation**

SA Water was created from the Engineering and Water Supply Department in 1995. The organisation was subjected to less changes than other departments. Other capital works departments ceased to exist as separate sectors of government.

The metropolitan operations of E&WS were outsourced to a private company, but the private sector contracting services continued to be managed by SA Water.

It was interesting to read in the Draft Report that SA Water has a procurement system that appears to be operating satisfactorily in comparison to other sectors of the government – this may be due to less organisational disruptions, and the fact that SA Water has an on-going responsibility to ensure that the water and sewerage systems operate continuously.

#### **Some Issues**

My dispute resolution experience has shown that conflict and problems are not uncommon between designers, other consultants, and builders – and in some instances the building owners are left with problems and deficiencies.

Some builders, after contract formation, have been known to reduce the cost of construction by limiting design costs, supervision, and consulting costs, as savings created will assist the bottom line.

When contract delivery is not well managed, and builders apply the above tactics, problems will arise; including quality issues during construction, or later, after completion of the infrastructure.

In addition, delays in payments to subcontractors, at the bottom of the supply chain, is a real problem. Usually head contractors submit payment claims to principals each month, but the payments to the subcontractors, who do most of the work, may not occur until two months or more after work has been performed.

The SA Government's terms of reference for this enquiry includes:

*"6. Consider examples of contemporary procurement policies and practices from interstate overseas and the private sector and their effectiveness in:*

- a. Generating local output and employment;*
- b. Building industry capacity; and*
- c. Promoting innovation"*

I believe that this enquiry should also gather information on the failures that have occurred in the accommodation high-rise buildings in the eastern states (which I will mention later) which includes deficiencies in design, procurement processes, supervision, auditing and contract management.

The procurement and contract management processes and practices used for capital works should be designed to ensure that the finished product achieves an acceptable quality standard.

There have been examples in South Australia where system failures have occurred. Recent local major capital infrastructure projects have suffered problems. Information from these projects may provide an insight into how to avoid 'pitfalls' in the future. Improving training, skill development, procurement, contract management and auditing practices will assist in avoiding problems.

Capital projects are becoming larger and more complex, and require an approach than can best manage the risks involved. Skilled staff working in a focussed team will avoid failures and will assist in ensuring that project outcomes are achieved as planned.

A number of local builders have suffered financial problems and suppliers of goods and services have not been paid. Information gathered in relation to these matters will assist in this enquiry.

#### **4. Detailed comment**

##### **Key Messages**

4.1 I agree with the statement on page 15 of the Draft Report for Stage 2 that:

*"it is impractical to control everything from the centre of government",* and the approach stated on page 17:

**"Unlocking value: the overview".**

I agree that the 'centre of government' should be responsible for procurement policy and allocating financial delegations, but I consider, from my experience, that each 'major' capital works government sector should have the responsibility to develop procurement strategies and contracting practices, that are in accordance with government policies, but which suit their respective contracting environments.

Capital projects for roadworks, water supply & sewerage, rail and road transport and housing, will require applying procurement strategies that match the particular issues in the respective business environments.

The exceptions would be small sectors, or sectors such as Education and Health, where it is not practical for them to retain a high level of skills in procurement and contract management.

Previously, the Public Building Departments provided the necessary services to the Education and Health sectors, and it would seem appropriate that DPTI continues to service their needs.

During my time in government the various departments maintained a reasonable level of in-house technical, procurement and contract management skills. Departments regularly consulted with each other and shared information regarding procurement issues – which assisted in applying a consistent approach across government, but also recognised that each department operated in a different environment, and had different groups of suppliers and contractors.

From my experience as a procurement/contract manager and dispute resolver, I find that it is important that in-house procurement staff have an adequate level of skills and attributes to enable them to effectively and efficiently manage the procurement processes, which includes the tendering and contract formation process and, later, managing the performance of suppliers and capital works projects during the delivery phase.

Capital works projects can involve complex issues and good management can often achieve significant savings for government and suppliers. I agree with the comments stated in the Draft Report that the procurement and contract management skills required to achieve satisfactory outcomes for both contracting parties have been much undervalued, and need to be at a high level to manage the complex issues involved in capital works.

As a dispute resolver I find that a large percentage of the matters that are referred to me could have been resolved by the parties themselves - if they had applied the necessary skills.

**In Summary:** I support the views listed on page 17, which essentially is aimed at:

- Developing a highly capable procurement profession within SA Government, and
- Strengthening the capability in line agencies to undertake the procurement required by their agency

Ultimately results are achieved by people. Improving people performance eventually leads to improved results.

#### **A better System Architecture**

- 4.2 In designing system architecture it is useful to consider current practices and issues causing problems in other sections of the construction industry in Australia. The design and construction of high-rise accommodation buildings in the eastern states have not been managed well. Building defects have caused major problems for owners, tenants and authorities.

State governments are now under pressure to implement changes to improve standards within the design and construction industry. This review into capital projects should take into account the current problems in the design and construction of capital works when re-designing the procurement architecture.

The current SA Government capital projects being delivered will provide information in relation to problems being experienced. I note from the Draft Report that the SAPC will be seeking further relevant information from DPTI regarding the capital works that they are managing. The major roadworks along South Road and the Northern Connector are complex and high value requiring a high level of skills. Any feedback on how well these projects are being delivered, and issues being addressed, would be useful for this inquiry.

- 4.3 The following comments are made in reference to **the three options** proposed to develop a stronger system architecture - with the intention to increase the value generated by the capital expenditure (ref. page 20):

From my experience, I consider that the departments involved in major capital works (eg SA Water, DPTI) should have a high level of delegated responsibility, and skills to match, to manage their major procurements. These major capital spending departments need to have a high level of skills and a good understanding of the capital works they are responsible for.

If departmental staff have a high level of skills, they will be in a better position:

- to develop 'best fit' tendering processes,
- to apply high level skills to the assessment of tenders from consultants and contractors,
- to negotiate optimum solutions for government and stakeholders, and
- be capable of developing improved data collection and improved quality performance reports for government and stakeholders.

In summary, effectively managing complex issues associated with capital works requires a high level of procurement and contract management skills.

I agree with the comments in the Draft Report that the application of good procurement skills can result in substantial cost savings for both government and contractors.

I cannot comment on the level of performance being achieved by the current state government procurement system – as I operate my business outside the system. I believe others who have a better understanding of the current government procurement system are better qualified to assess the options.

I note the comments in the Draft Report that states:

***“the system is fragmented, unproductively prescriptive, cannot assess overall performance, and does not focus on developing capability in the SA government procurement professionals. The leakage value is significant: the typical 5 percent annual improvement could deliver this state \$500 million per annum.”***

It appears to me that the options being considered will involve different levels of disruption to the current system, including the effect on the current procurement workforce.

Following are some thoughts in respect to matters that may assist in selecting the most appropriate option.

- 4.4 The more routine procurements that cover general supplies to government departments (eg IT equipment, stationary, etc) could be managed by a central procurement group. All departments require office equipment etc, and if the volume of supplies required are high this should result in lower unit prices.

Page 23 of the Draft Report Stage 2 mentioned that all capital works over \$4 million must be referred to the Public works Committee.

Capital works with a value of \$4million currently represents relatively 'minor capital works' - when you consider the scope of capital works that can be purchased for \$4million.

I consider that the \$4million limit should be higher to reflect current capital costs. The referral of projects to the PWC for approval causes a delay – and the question should be – how much value is added by the referral to PWC for projects with a value of \$4million.

This inquiry should recommend a more appropriate project value that warrants assessment by the PWC.

Once projects are approved by government and budgets set, the departments involved in managing major capital projects should be given more responsibility to deliver their projects. Increasing the \$4million limit for referral to the PWC will assist in improving efficiencies in project delivery.

- 4.5 Section 9 in the report "*Other Procurement Issues*" mentions that there is a problem with "*the reporting of outcomes and collection of information by agencies*".

Question: Does this mean that the reports and information for capital works do not exist – if this is the situation, then the situation needs prompt action.

From my experience it is not difficult to implement reporting procedures for capital works. A first step is to decide what reports are regularly required and who is responsible for gathering the information and preparing the reports. Much project information is related to financial matters and measuring performance. Standard reporting proformas can assist.

Capital works contracts produce a large amount of information in respect to programming, quality outcomes, time and cost. If the information is collected as events occur this will be useful later for the preparation of reports. Moreover, good records can be very useful to resolve problems and disputes, and limit cost escalation.

Disputes that I deal with often involve claims for variations to the contract scope of work. It is important that principals and contractors correctly apply the processes set out in the contract conditions (eg approvals for variations and extensions of time). The keeping of good records, pro-active decisions, and effective risk management can limit disputation significantly – with cost savings for both contracting parties.

Expensive Legal processes for resolving disputes should be avoided. Differences should be resolved promptly by the party representatives, as they occur, and not left until later when the issues have become more complex and more difficult to resolve.

The recent "*Shergold-Weir Report*" into the building and construction industry highlighted many problems in the delivery of capital projects, which included deficiencies in design and construction practices and recording 'as-built' information. Capital works supervision and auditing was found to be very limited or did not exist - giving rise to poor performance outcomes.

The SA Government can learn from the problems experienced in the eastern states. It is important that the procurement and construction management system avoids the problems highlighted in the Shergold-Weir Report.

- 4.6 The successful implementation of capital works requires principals, consultants, suppliers, contractors and stakeholders working together to achieve optimum outcomes. Contractual responsibilities may be different, but the application of effective communications and human relation skills can avoid problems developing.

My dispute resolution experience has indicated to me that problems can arise where responsibilities and risks are not clearly allocated and managed effectively, and communications systems are insufficient in relation to what the project requires.

- 4.7 The recommendations listed on page 29 of the Draft Report Stage 2 is very high level/general in nature and subject to interpretation.

People who are responsible for procurement activities require clear guidelines, but the system should provide the flexibility to enable innovation in how capital works are planned and delivered.

Example: There are many contracting models for capital works. The model selected should match the nature of the project. The selection of the most appropriate model may involve discussion within government and with prospective contractors. The SA Government policy is to enable South Australian businesses to better participate in government procurement. This policy needs to be taken into account when selecting contracting models. Smaller work packages will enable local contractors to be more competitive.

In summary, when selecting the contracting model consider the following:

- is the model appropriate for the type of project being built;
- is the model in accordance with government policy;
- will the model deliver the required standards for quality, time, and cost; and
- will the model assist in meeting appropriate safety and environmental standards.

#### **External Stakeholder Feedback**

- 4.8 I note the feedback from external stakeholders on page 46 of the Draft Report which listed criticisms regarding the State's current procurement system, which includes such matters as;

- slow decision making
- low capabilities in government people skills
- communication problems
- inflexible in approach

This feedback indicates that the system may need a significant overhaul. Improved training in procurement matters would seem to be necessary, and the engagement of procurement 'leaders' who can elevate procurement performance to a higher level, will provide benefits and savings over the capital works program.

I note that there is a significant amount of infrastructure being planned in the future – this should give further incentive to ensure that the government has the necessary in-house skills to deliver the capital works program to the require quality standard, and provide an optimum level of work for local suppliers and contractors.

#### **Performance of Current Suppliers and Contractors**

4.9 What is missing from the Draft Report is information on the performance of current suppliers and contractors who deliver capital projects. This information would assist in developing an improved procurement system.

#### **DPTI**

4.10 I note that there is a change process underway within DPTI to improve how it operates, and I note the comments:

- there are pressures on sustaining and building internal capability to manage projects
- current contract management and procurement IT systems are inadequate, particularly given current and expected business levels.

My experience is that you need good, well trained and skilled people to manage complex capital works, and they need the IT tools necessary to record information and report on performance. Skilled resources need to be compensated accordingly. If salaries are too low government will not be able to attract the best people or retain them.

If the government wish to get better value from their \$11 billion procurement spend - they need to have the skilled people and IT tools to deliver the savings.

#### **Risk Management**

4.11 I support the views expressed in the Draft Report in relation to risk management:

Complex capital works involve many types of risks – some project specific, some site risks, and risks vary over the delivery of the project.

I strongly support the statement:

***“Effective risk allocation and management means that risks are borne by those most able to mitigate them; are efficiently priced; and are allocated in a way that shares the benefits and the cost of a materialised risk”.***

**A useful practice** is for the management teams, from the principal and contractor, to meet after the contract has been awarded and before site works have commenced, to discuss the project and how they plan to manage their respective responsibilities during the delivery of the project.

Establishing good working relationships from day one is important, and understanding the roles of other team members is essential.

Regular meetings between the parties is useful to monitor the work being performed, and to discuss the work planned for the next period.

I also support the comment on page 116 that DPTI are planning to reduce the complexity of some projects by tendering out small packages of work to address issues like service relocations, prior to tendering. This proposal is a good example of pro-active risk management.

Underground services are often a problem. On one occasion, during my time with an E&WS construction group, a trench excavator accidentally cut through a main telephone trunkline. Although the supervisor followed correct procedure by calling “Dial-before-you Dig” to



identify the location of the underground service, the “*as-constructed*” information was not accurate, and the service line was not where it should have been.

In addition, live water and sewer mains, and electrical services are best identified and plotted before work commences in the close vicinity.

I was engaged to give expert advice to lawyers involved in a building dispute on a University site. A ‘live’ underground fire main was disturbed by an excavator and the resulting flood caused damage to computers valued over a \$1million. Risk management is important.

### **Contract management**

I fully support the statement in the Draft Report on page 118:

*“Effective contract management ensures the supplier and the public authority meet their contractual commitments to time, cost, quality and other agreed matters. It requires systemic and efficient planning, execution, monitoring and evaluation to ensure that both parties fulfil their contractual obligations with the goal of achieving value for money and the intended results for the community.”*

I also support the discussion on pages 121-123 regarding using ‘standard-form’ contracts.

**Standard form contracts**, that are understood and used appropriately by principals, head contractors, and subcontractors are good for the construction industry. They assist in contract management, especially when subcontract conditions are in-line with the head contract conditions.

### **Late payments**

I support the comments by the Small Business Commissioner which highlighted the problems caused by late payment to subcontractors. The recent insolvencies in building companies and the resulting debts owed to local subcontractors is a major issue in the construction industry, and practices need to be improved.

Due diligence by government agencies can assist to ensure head contractors make prompt payments to their subcontractors.

Yours sincerely

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Accredited Mediator, arbitrator, adjudicator and expert determiner

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