A low-angle, upward-looking photograph of a building's steel framework. The structure consists of numerous vertical and diagonal steel beams, creating a complex geometric pattern. The sky in the background is a mix of soft orange and pale blue, suggesting a sunset or sunrise. The building's framework is the central focus, with some sections appearing to be under construction or recently completed.

Assessing the effectiveness of Queensland's minimum financial requirements for building practitioners

Master Builders Queensland

Final report

April 2022

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Executive summary

Australia's building and construction industry has higher rates of insolvency than many other parts of the economy. Elevated rates of business failure in the industry are driven by several factors, including the fragmented structure of the industry – with major builders undertaking significant subcontracting to a large number of smaller companies – coupled with thin profit margins and relatively low barriers to entry.

Business entry and exit can be an indicator of a healthy, competitive market, driving productivity and innovation, and keeping prices low for consumers. However, financial collapse of building practitioners has significant flow-on impacts throughout the economy due to the sector's systemic importance, high levels of subcontracting, and large number of workers (there are currently around 238,000 workers in Queensland). Several large building firms in Queensland have collapsed in recent months, leaving hundreds of homes unbuilt and many subcontracting firms and other creditors unable to be paid.

Financial regulations seek to address the risks of industry insolvency

Queensland's minimum financial requirements (MFRs) are a component of Queensland's licensing regime for the building and construction industry, aiming to reduce the risk of financial failure of businesses. The MFRs cover a wide range of parties including residential and commercial builders, head contractors and subcontractors such as tilers, carpenters and painters. The regulations are administered by the state industry regulator, the Queensland Building and Construction Commission (QBCC). Businesses covered by MFRs must:

- ▶ Hold a minimum level of **net tangible assets** relative to revenue earned (different for each licence category).
- ▶ Have current assets at least equal to current liabilities (i.e. **current ratio** ≥ 1).
- ▶ **Pay debts** on or before they are due and payable.

Licensees must also provide **annual financial reports** to the industry regulator declaring or demonstrating that they meet the MFRs. While Queensland's MFR regime has been in place for over 20 years, it has been modified from time to time including most recently to strengthen its reporting obligations.

Like any regulation, the MFRs impose a range of costs on businesses, consumers, taxpayers, and other stakeholders. From a public policy perspective, regulation can be appropriate if the social benefits outweigh the costs. However, even where this is the case, it is important that regulation is efficiently designed and does not impose an undue cost burden on businesses and other stakeholders.

Other jurisdictions have varying regimes that assess the financial viability of industry practitioners, including through the private insurance sector. Overall, these regulatory alternatives are less stringent and Queensland operators tend to face a higher cost burden than their interstate counterparts.

The evidence suggests that Queensland's MFRs are no more effective than other regimes across Australia

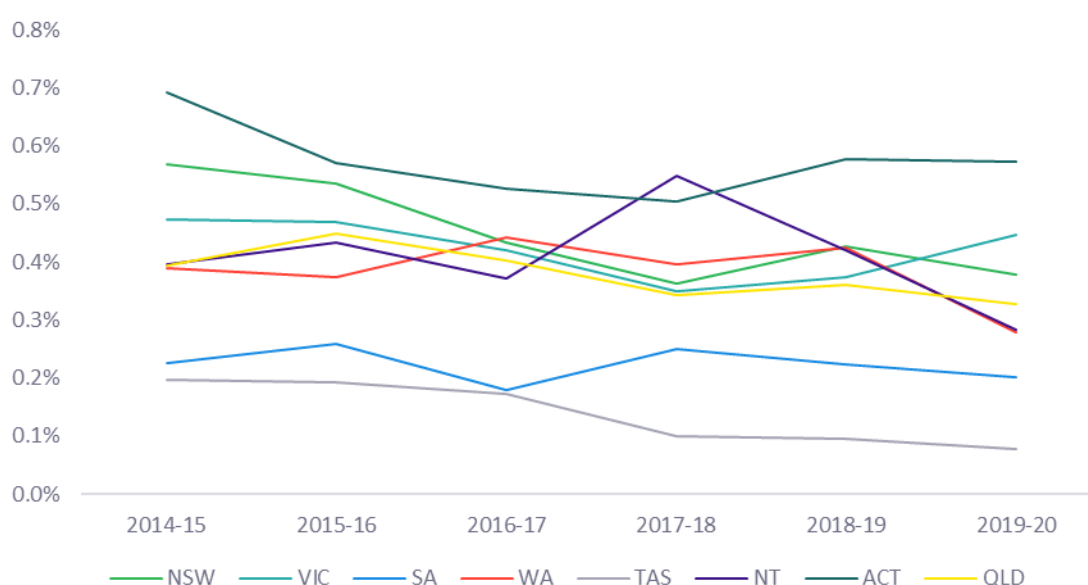
The effectiveness of Queensland's MFRs can be evaluated in terms of how they reduce financial failure in the building and construction industry in Queensland. Two indicators of effectiveness have been assessed:

- ▶ The industry insolvency rate in Queensland compared to insolvency rates in other states and territories that do not have the same MFRs.
- ▶ The insolvency rate in Queensland over time, where different versions of the regime have been in place.

From 2014-15 to 2019-20, the construction insolvency rate in Queensland has been in the middle of the pack compared to other states and territories (Figure 1). In fact, there is little change in the rankings of insolvency rates between jurisdictions over this time. On average, the insolvency rate in Queensland was 0.38% over the period, only 0.01 percentage points higher than the average for Australia and the average across the four largest states (NSW, VIC, SA and WA). While this analysis is only over a relatively short period in what tends to be a cyclical industry, any variations related to this are likely to impact all states and territories.

The average size of insolvencies in Queensland was slightly higher than the national average over 2014-15 to 2018-19.¹

Figure 1. Construction insolvency rates from 2014-15 to 2019-20, business count denominator



Sources: ASIC Table 1A.1.1, ABS cat. no. 8165.0

This analysis suggests that Queensland's MFRs are no more effective than other regimes across Australia.

The annual reporting requirement does not appear to improve effectiveness

Comparing insolvency rates across time periods when different versions of Queensland's MFRs were in place suggests the reporting requirement has a negligible impact on the effectiveness of the MFRs. In 2019 the regime was strengthened to include mandatory compliance reporting for businesses operating in the industry. The average insolvency rate in Queensland in the year after the reporting requirement was reintroduced was 0.07 percentage points below the average insolvency rate in the years without the reporting requirement in place. However, insolvency rates for the rest of Australia declined by around the same amount, on average, over those periods, suggesting the decline was not related to anything Queensland-specific. While the regulatory

¹ The data was only available up to 2018-19, with this year capturing the impact under Queensland's previous MFR regime.

change is relatively recent, being reflected in only the last year of available, relevant data, there has been no appreciable change in Queensland's insolvency performance.

The MFRs impose large costs to businesses and government, and flow-on costs to consumers

Consultations with building and construction businesses across Queensland were undertaken to understand the costs and compliance obligations of the regime.

Key costs to businesses are compliance costs such as time and resources associated with assessing and monitoring their financial position and completing and submitting forms; the costs of engaging professional services such as accountants, and the costs of holding additional capital. Under the regime, businesses are compelled to hold an asset reserve (often in the form of working capital) which imposes additional costs on them. But this falls disproportionately on smaller businesses.

The primary costs to government are the costs of administering the scheme.

In addition to these direct costs, there are also broader costs associated with reduced competition due to the MFRs creating an additional barrier to entry.

The direct costs of the current MFR regime are estimated to be least \$78 million per year (Table 1), based on a range of sources including consultations. This represents a lower bound on total cost because not all costs were quantified as part of this analysis. Costs excluded from this analysis include costs to businesses of changing company structure to comply with the MFRs (if required) and costs of changing licence categories to comply with the MFRs; as well as indirect costs to consumers associated with barriers to competition.

The costs of the previous MFRs, which did not include a requirement for businesses to report, was estimated to cost around half as much, with an estimate of at least \$43 million per year.

Table 1. Annual costs of the MFRs (\$)

| Cost category | Current MFRs | Previous MFRs (no annual reporting) |
|--|-------------------|--|
| Cost to government of administering regulatory scheme | 1,080,450 | 540,230 |
| Cost to businesses of compliance (including internal administration and third-party costs) | 67,968,200 | 33,984,100 |
| Cost to businesses of holding capital | 9,291,440 | 8,362,300 |
| Total key costs | 78,340,090 | 42,886,620 |

Note: Costs have been rounded to the nearest ten.

Source: EY estimates.

Business compliance costs are by far the largest direct cost of the scheme, representing more than 85% of total costs. Businesses need to engage external advice or allocate management time to comply with the scheme, all of which imposes costs. Indeed, the estimated costs were materially lower under the former phase of the regime which did not involve reporting requirements for businesses.

The cost burden on industry from the MFRs is also unevenly distributed, even with the MFR's tiered requirements (see Table 2). For smaller businesses, the costs of compliance are relatively higher (than for larger businesses) compared to the amount of revenue they can earn. Small companies were estimated to face an annual cost of \$689 to comply with the MFRs. In contrast, larger businesses tend to be able to manage the regime's requirements within their dedicated management structures which imposes a relatively smaller cost.

Table 2. Costs of MFRs (annual cost per business^a)

| | Cost of current MFR regime (\$) |
|---|---------------------------------|
| Cost to government of regulation | 1,080,451 |
| Cost to businesses of internal administration | |
| Small business | 559 |
| Medium business | 1,677 |
| Large business | 2,569 |
| Cost to businesses of third parties (e.g., accountants) | |
| Small business | 50 |
| Medium business | 1,500 |
| Large business | 6,000 |
| Cost to businesses of holding capital ^b | |
| Small business | 81 |
| Medium business | 239 |
| Large business | 4,839 |

Source: EY estimates

^a The cost to the Queensland Government of administering MFRs was estimated as a total annual cost.

^b These costs are adjusted to account for the number of businesses that require an increase in NTA to meet the MFRs.

When comparing to the costs of alternative regimes, Queensland's MFRs cover a broader cross-section of the building and construction industry and can apply more stringent financial adequacy and reporting requirements. As such, Queensland's regime is likely to involve higher overall costs on industry than other states and territories.

Reducing insolvencies can generate benefits across a range of stakeholders

The economic damage associated with insolvencies can be large and far-reaching. As seen in high profile collapses of building companies, there are significant spill over costs borne by subcontracting and supplier businesses, government, consumers, and the broader community. The average size (deficiency) of an insolvency in the Queensland building and construction industry in 2018-19 was approximately \$1.5 million.² This only provides a portion of the overall costs of a business failure.

Reflecting these broader impacts, minimising insolvencies through effective regulation has the potential to generate significant economic and social gains. These include:

- **Benefits to government:** include the benefits of avoided unpaid tax debts and avoided financial assistance to workers impacted by insolvencies.
- **Benefits to businesses and industry stakeholders:** include the benefits from avoided non-payment of debts such as money owed to subcontractors, and the avoided costs of insolvency practitioners.
- **Benefits to consumers and the broader community:** include the benefits to employees from avoided loss of jobs, employee entitlements, and the avoided adverse social impacts including impacts on physical and mental health; and benefits from improved industry confidence, productivity and innovation, which may flow through to consumers through avenues such as lower prices.

Importantly, any benefits of the MFRs are generated through their impact on reducing insolvencies and improving confidence in the industry. However, analysis of insolvency data did not provide

² The latest publication of the relevant ASIC data (series 3.2) was for 2018-19.

evidence that Queensland is avoiding relatively more insolvencies, so there does not appear to be related benefits.

Implications for policy

This analysis shows that insolvency rates in Queensland are broadly in line with averages of insolvency rates in other states and territories that have less onerous regimes, suggesting that Queensland's regime is no more effective. The annual reporting requirement does not appear to improve the regime's effectiveness, while adding significant costs to industry. Therefore, the benefit of the MFRs relative to other regimes could be considered negligible.

Queensland's MFRs are relatively onerous and burdensome compared to regimes in other jurisdictions across Australia, yet the insolvency rate in Queensland is largely comparable across states. This suggests there could be scope to refine the regime to reduce the regulatory burden on industry, without substantially elevating insolvency risks. The drivers of higher insolvency rates in the building and construction industry are largely structural and do not appear to be Queensland-specific.

Regulation to limit and potentially reduce the incidence and size of insolvencies in the building and construction sector can be appropriate and could generate a net benefit to society. However, due to the large costs associated with administration and compliance, it is important to ensure the regulation is targeted and efficient.

Over longer term, there may be benefits from pursuing reforms to harmonise regimes across the country, given there is not clear evidence that Queensland's MFRs are contributing toward lower rates of insolvency. National harmonisation (at the optimal level) could reduce red tape, especially for firms which operate across states and territories, providing a range of benefits such as increased efficiency.

Note: Front cover image is from Unsplash.

1. Introduction

Queensland has a set of minimum financial requirements for building and construction practitioners designed to reduce the risk of financial failure. However, like all regulation, they are not without costs.

1.1 Insolvency in the building and construction industry

The building and construction industry has one of the highest insolvency rates of all industries in Australia. A report by the Senate Economics Reference Committee (2015) found that over a 10-year period, the industry accounted for roughly 20-25% of all insolvencies in the country but only 8-10% of GDP and employment. The Senate report found that the predominant cause of the high insolvencies is the pyramid structure of the industry, whereby a small number of large firms sit at the top of the contracting chain (head contractors) and many smaller companies are lower down. The companies at the top of the chain can use their market power to allocate risk to those that are less able to bear this risk, including subcontractors, employees and suppliers. For example, head contractors can delay or reduce payments to subcontractors, which may occur more often when approaching insolvency. As such, subcontractors tend to bear the risk of head contractor insolvency. Other contributing factors to insolvency in the industry are low barriers to entry, narrow profit margins, inadequate cash flow, poor strategic management and financial control.

1.2 The case for minimum financial requirements for licensing

Regulation can be targeted to protect the interests of those lower down the contracting chain from those above that may abuse any market power they might possess. The Queensland regulator for the building and construction industry, the Queensland Building and Construction Commission (QBCC), has sought to target financial failure through introducing financial requirements in order to obtain a licence to operate. These are the minimum financial requirements (MFRs). The MFRs involve holding a minimum level of net tangible assets, meeting a minimum current ratio, and providing financial reports annually. The purpose of the MFRs is to help the QBCC identify businesses or applicants that may not be financially sustainable and reduce financial failure in the industry. The other states and territories do not have the same MFRs.

While the MFRs exist to protect industry participants against financial failure, they do not come without costs. In particular, businesses face costs to meet the MFRs, such as compliance costs and capital holding costs.

1.3 About this study

EY has been engaged by Master Builders Queensland to assess the effectiveness of Queensland's MFRs in addressing insolvency in the industry as well as the costs and benefits of the MFRs. The analysis was informed by publicly available data including insolvency data as well as consultations with a variety of industry stakeholders.

Consultations were undertaken with businesses across the building and construction industry, including:

- ▶ head contractors and subcontractors in different licence categories (see Appendix A)
- ▶ businesses operating nationally and in regional Queensland, including Mackay, Bundaberg and Cairns
- ▶ related service providers such as accounting and insolvency practitioners.

Industry discussions focused on how businesses were complying with the MFRs, their associated costs, the regime's effectiveness, and what could be done to improve the regime.

The remainder of this report is structured as follows:

Chapter 2 provides background on the building and construction industry in Queensland and information on Queensland's MFRs.

Chapter 3 describes and estimates key costs of Queensland's MFRs.

Chapter 4 includes analysis of insolvency data and describes and estimates key benefits of Queensland's MFRs.

Chapter 5 provides insights into the effectiveness, costs and benefits of Queensland's MFRs.

The **Appendices** provide additional information including calculations and assumptions underpinning the estimation, and sensitivity analysis.

2. Overview of the industry and licence requirements

2.1 The building and construction industry

The building and construction industry comprises firms that undertake construction of structures such as building, roads, railroads, transmissions lines and pipelines, as well as firms in civil engineering and irrigation. Firms also undertake alterations, installations, maintenance and repairs, and demolitions. The industry encompasses residential, commercial and civil construction. There is a vast range of professions and trades within the industry, including carpenters, construction managers, plumbers, tilers, building inspectors and engineers. The building and construction industry is characterised by several features:

- ▶ narrow margins—businesses tend to provide a similar service, so they compete on cost
- ▶ a pyramid type industry structure—there are a small number of head contractors with market power and a much larger number of subcontractors that bear a disproportionate amount of risk
- ▶ low barriers to entry
- ▶ limited innovation—the industry has one of the lowest levels of innovation.³

Australia's building and construction industry has experienced increased demand since the onset of Covid-19 as governments have invested heavily in stimulus packages for the construction of new homes and large renovations. These stimulus packages were designed to support the sector during the economic downturn associated with Covid-19, recognising the importance of the sector to overall economic activity and social wellbeing. Relatively loose macro-prudential settings and low interest rates have supported demand for new homes. Housing approvals increased by 42% in the year following the introduction of the HomeBuilder scheme (ABS, cat. no. 8731.0).⁴

Governments also invested heavily in public infrastructure to support jobs and provide economic stimulus. For example, in June 2020, the Australian Government announced a \$1.5 billion infrastructure stimulus package (Department of Infrastructure, Transport, Regional Development and Communications, 2021).

However, the supply-side has faced significant challenges. Shortages of materials and labour due to international border closures has led to significant increases in construction costs, which has greatly affected companies that have fixed contracts and are unable to pass on these cost increases.

Characteristics of the industry in Queensland

Queensland's building and construction industry contributed \$27.2 billion (8.0%) to the state's economy in 2020-21, placing it as the state's third largest industry (ABS; QGSO, 2021). Queensland's construction industry is the third largest in Australia, after New South Wales (\$47.0 billion) and Victoria (\$36.7 billion). The industry currently employs around 238,000 people in Queensland (ABS, cat. no. 6291.0), comprising around 10% of total employment in Queensland.

Important factors unique to Queensland, and relevant to the building and construction industry, are its tendency to face greater climate risk; and its decentralisation. It is home to some of the most flood prone areas in the country based on premiums at risk, including the local government areas of Brisbane and Townsville (IAG, 2020). Queensland is also the most decentralised of all the mainland

³ In 2019-20, the proportion of businesses in the Construction industry with any innovative activity was 37.4%, which was the lowest of all industries—the industry average was 51.2%. See the ABS *Characteristics of Australian Business* dataset.

⁴ The number of houses approved from July 2020 to June 2021 was compared to the number approved from July 2019 to June 2020.

states, with only 49% of residents living in the capital city, compared to 69% in other states (State Development, Infrastructure, Local Government and Planning, 2021).

Queensland is set to host the 2032 Brisbane Olympics. A substantial amount of infrastructure will be required to be constructed in the lead up to the Games, presenting opportunities for building and construction companies.

2.2 Building and construction licences and financial requirements

Building and construction licences exist to impose a barrier to entry to the industry. They can achieve certain economic and social objectives including reducing the risk of financial failure, as well as other objectives such as protecting the public from unsafe building and managing risks on site. However, while licences can achieve important objectives, they also impose costs to businesses, such as those arising from applying for approval and providing information.

Licences and permits for the building and construction industry are managed by state, territory and local governments in Australia and as such each state and territory has their own requirements for building and construction licences. However, not all industry participants require a licence, including those in the civil sector in Queensland. For those that require a licence to operate in Queensland, requirements to obtain a licence include having relevant experience, qualifications and meeting a set of minimum financial requirements (MFRs).

2.2.1 Queensland's minimum financial requirements

The MFRs help the state regulator, the Queensland Building and Construction Commission (QBCC), identify businesses or applicants that may not be financially sustainable, with the aim of reducing financial failure in the industry. The current MFRs are prescribed in the *Queensland Building and Construction Commission (Minimum Financial Requirements) Regulation 2018*.

What are the MFRs?

Queensland's current MFRs for licensing are to:

- ▶ meet a minimum level of **net tangible assets** (NTAs): businesses must meet the minimum NTA requirement for their licence category, and not exceed the maximum revenue requirement for that category (see Appendix A). NTAs are calculated by subtracting liabilities, intangible assets and disallowed assets from total assets.
- ▶ meet a minimum **current ratio** of 1:1: current assets must equal or exceed current liabilities (there must be sufficient liquidity to cover short term debts).
- ▶ **pay debts owed** to a contracted party, or a supplier of goods or services, on or before the day the debts become due and payable.

Businesses must also submit **annual financial reporting** information to the QBCC so that the QBCC can ensure compliance with these requirements.

The MFRs are tiered to minimise regulatory burden. Larger businesses (which would have a larger impact if they fail) are required to report more detail than smaller businesses.

Purpose of the MFRs

According to the QBCC, the main objectives of the financial requirements have been to “promote financially sustainable businesses and foster professional business practices in the Queensland building and construction industry. This includes ensuring that businesses have sufficient liquidity to continue trading and pay their debts”. The purpose of the annual reporting requirement, which was reintroduced in 2019, was to allow the QBCC to have greater information about licensees’ financial health and capacity to pay debt. The QBCC can take action if it suspects a licensee may not

be operating sustainably, including suspending or cancelling a licence if a licensee does not meet the minimum financial requirements, fails to pay debts or fails to comply with a financial audit.

The MFRs may reduce impacts from insolvencies to industry stakeholders, by providing information to the regulator on licensees that may not be financially sound, and ensuring licensees have minimum amounts of assets and liquidity, potentially reducing the impact of an insolvency.

Who is required to meet the MFRs?

All licensees holding a trade contractor or builder grade of licence must meet the MFRs to hold a QBCC licence. However, there are certain licensees and applicants that are exempt from meeting them.

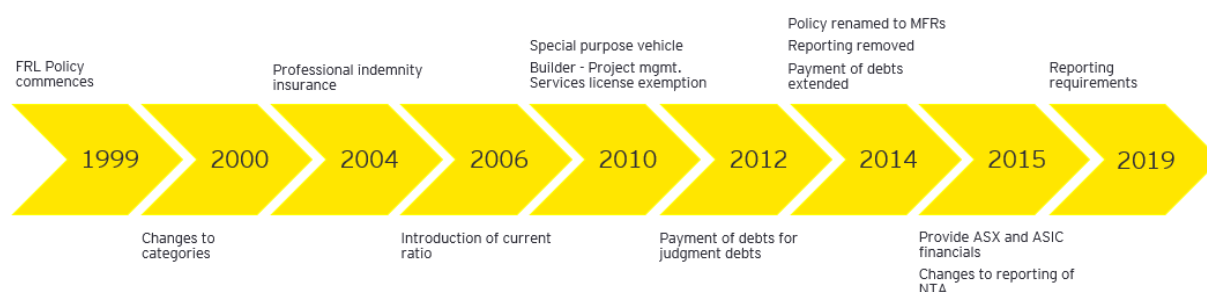
When must licensees provide an MFR report?

Aside from the annual reporting requirement, there are circumstances where licensees must provide a MFR report. These include if a builder is applying for a licence, if a licensee's NTA has decreased by certain thresholds, if a licensee is increasing its maximum revenue amount, if there is a significant change to the business, and if the QBCC requests one.

History of the MFRs

Queensland's MFRs have been in place in some form since 1999, where it was first named the *Financial requirements for licensing policy* and included a NTA test and a liquidity ratio. An overview of the changes and some highlights is presented in the Figure 2 (note this is not an exhaustive list of the changes to the MFRs over time).

Figure 2. History of the MFRs



Source: Queensland Government, 2018 (adapted)

The main policy changes considered in this report are:

- The 2014 regulatory change: the policy was renamed the *Minimum financial requirements policy*. This policy included the removal of annual reporting requirements⁵, and extended a requirement to pay all debts (that are not subject to genuine disputes) within the agreed trading terms—with consequences for non-compliance including licence suspension or cancellation. The requirement to pay debts was introduced in 2012 but was limited to judgement debts. The stated aim of the removal of the reporting requirement in 2014 was to reduce red tape and minimise reporting. Following this change, most licensees had to self-report if they did not meet the MFRs and the QBCC no longer had access to their detailed financial information, so there was potential for licensees to hide financial difficulties to keep their licence.

⁵ A financial report was only required when applying for a licence, or when changing licence categories (to upgrade a business' turnover limit).

- The 2019 regulatory change: the policy was amended and included a requirement to provide annual reports. The requirement to provide financial reports was reintroduced to provide the QBCC with greater transparency over the financial position of a licensee, enabling the QBCC to identify and take action where it had concern over a licensee's financial sustainability.

Regulatory action taken under the MFRs

The QBCC can cancel licences for a variety of reasons related to the MFRs:

- a breach of MFRs other than monies owed
- failure to pay debts (monies owed)
- failure to comply with a financial audit.

Since 2014, the QBCC has cancelled more licences due to being unable to pay debts following a monies owed complaint than for other reasons (**Table 3**).

Table 3. QBCC licence cancellations by reason

| Reason for cancellation | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| A breach of MFRs other than monies owed | 50 | 40 | 16 | 36 | 8 | 39 | 23 | 38 | 23 | 36 |
| Failure to pay debts (monies owed) | - | - | - | - | 54 | 49 | 39 | 51 | 63 | 67 |
| Failure to comply with a financial audit | 30 | 31 | 53 | 18 | 1 | 34 | 33 | 59 | 37 | 25 |

Source: QBCC annual reports

2.2.2 Other financial requirements

Financial requirements in other states and territories

Other Australian states and territories generally do not have the same level of financial requirements as Queensland and do not operate in the same way. Several jurisdictions have insurance schemes whereby financial assessments are undertaken. For example, to get a licence in Victoria, there are no explicit asset, liquidity or reporting requirements. However, building and construction practitioners must meet certain financial probity requirements and must be able to obtain insurance—and some insurance providers undertake their own financial checks. In New South Wales, a building and construction licence is only required for residential building work valued at more than \$5,000 (incl. GST) in labour and materials. For work over \$20,000, residential builders must obtain Home Building Compensation cover. In order to be eligible for the cover, certain financial checks are undertaken, and conditions can be imposed, including on capital levels, work undertaken and maximum contract prices.

National registration requirements

There does not appear to be specific financial requirements that must be met in order to register a company in Australia.

To register a company, company directors must verify their identity. Once registered, companies must complete an annual review, which includes passing a solvency resolution within two months of the review date. This is a resolution made by the directors of a company as to whether or not, in the directors' opinion, the company will be able to pay its debts when they are due. There must be reasonable basis for the opinion.

Many companies will also apply for an Australian Business Number (ABN), for which a tax file number is required. Most people with an ABN must then lodge an annual income tax return.

3. Costs of the MFRs

Regulations impose costs on businesses, taxpayers, and other stakeholders, including costs of administering the regulation and costs to those impacted of complying with the regulation. It is important that the regulation is designed to minimise the burden and ensure the costs are not borne disproportionately across the sector.

The costs associated with Queensland's current MFR regime have been assessed and, where possible, quantified. The 2020 *Regulatory Burden Measurement Framework* by the Office of Best Practice Regulation was considered in assessing costs for this analysis. Costs to the whole of Queensland were considered, including the costs incurred by businesses, government, and consumers. Annual unit cost estimates were developed (i.e., on a per business basis) as well as an estimate for the total cost of the regime.

Some of the costs varied by business size:

- ▶ Small businesses: SC1 and SC2 licence categories
- ▶ Medium businesses: category 1–3 licensees
- ▶ Large businesses: category 4–7 licensees.

Total costs were estimated based on having 53,800 small businesses, 9,600 medium businesses and 550 large businesses.⁶ Costs associated with the MFRs have been categorised as costs of administering the scheme, compliance costs and the cost of holding capital.

Further detail on the calculation of these costs and the underlying data and assumptions are provided in Appendix B.

3.1 Cost to government of administering the regulatory scheme

The MFR regime is administered by the Queensland Building and Construction Commission (QBCC), a state government body. Its role includes:

- ▶ Imposing licence conditions for failure to lodge information on time.
- ▶ Issuing show cause notices for suspected non-compliance with MFRs.
- ▶ Suspending and cancelling licences.
- ▶ Undertaking financial audits on licensees and non-payment of debts investigations.

The cost to the QBCC of administering the scheme includes employee wage and salary costs and other overhead costs, such as for leases and equipment.

The annual cost of administering the scheme was calculated by multiplying an employee cost by the number of employees dedicated to the MFRs. The employee cost was calculated by adding the employee salary and wage cost, based on a Queensland public sector wage (ABS, cat. no. 6302.0), with an overhead cost, assumed to be 10% of the employee salary and wage cost. The number of employees was calculated by multiplying the number of full-time equivalent (FTE) staff at the QBCC, from the QBCC 2020-21 annual report, by the proportion dedicated to MFRs, based on an estimate provided by Master Builders Queensland. The proportion dedicated to MFRs was assumed to be 50% less when the annual reporting requirement was not in place, as businesses only had to report if they did not meet the MFRs.

⁶ Based on estimates provided by Master Builders Queensland as at November 2021.

The annual cost of administering the scheme was estimated to be around \$1 million, with costs estimated at around half of that for the regime where there was no reporting, given the extra administration that comes with the reporting.

Table 4. Cost to government of administering regulatory scheme, annual

| | Employee salary and wage cost (\$) | Overhead cost (\$) | No. employees at the QBCC | Proportion dedicated to MFRs (%) | Annual cost (\$) |
|---|------------------------------------|--------------------|---------------------------|----------------------------------|------------------|
| Queensland's current MFRs | 98,223 | 9,822 | 523.29 | 1.91 | 1,080,451 |
| Queensland's previous MFRs without annual reporting | 98,223 | 9,822 | 523.29 | 0.96 | 540,225 |

Source: EY analysis

3.2 Business compliance costs

Businesses face the compliance costs of adhering to the scheme, which can include costs of administration, third party costs, the costs of holding additional capital and costs of restructuring.

Administrative costs

Administrative costs include the time an employee takes to assess the business's financial position and complete and submit the relevant information for the annual report; and, for some businesses, the cost of engaging and working with third parties (such as a qualified accountant). They also include monitoring costs for ensuring a business's revenue would not exceed its maximum revenue requirement for the year.⁷ There are additional costs if a business exceeds its maximum revenue by more than 10%, as it must submit an MFR report, involving administrative and third-party costs.⁸

Annual administrative costs were calculated by multiplying hours spent on MFR administration, based on consultations, with the cost per hour, based on a construction wage for small and medium businesses and a professional services wage for large businesses (ABS, Census 2016). Large businesses were assumed to have internal resources dedicated to the business's financial management. There were fewer hours spent complying with the MFRs when there was no annual reporting requirement, given businesses only had to report to the QBCC if they did not meet the MFRs—it was assumed that hours would reduce by 50%.

Larger businesses faced the greatest annual cost for administrative compliance with the MFRs in absolute terms (around \$2,500 per year). Small businesses were estimated to face an annual cost of around \$560. However, small businesses face a relatively larger burden than larger businesses, when comparing costs to the maximum revenue they can earn. The annual cost per business was 50% less under the regime where there was no annual reporting.

⁷ The licence category that a business is in stipulates the level of net tangible assets it should hold and maximum revenue it should earn (see Appendix A).

⁸ Some stakeholders said there were some instances where they turned down work in order to not exceed the maximum revenue limit. There would be a net cost to businesses in instances where the cost of submitting an MFR report exceeded the expected increase in revenue.

Table 5. Cost to businesses of compliance with MFRs

| | Hours per year spent on MFR administration | Cost per hour (\$) | Annual cost per business (\$) |
|---|--|--------------------|-------------------------------|
| Queensland's current MFRs | | | |
| Small businesses | 15 | 37.3 | 559 |
| Medium businesses | 45 | 37.3 | 1,677 |
| Large businesses | 60 | 42.8 | 2,569 |
| Queensland's previous MFRs without annual reporting | | | |
| Small businesses | 7.5 | 37.3 | 279 |
| Medium businesses | 22.5 | 37.3 | 838 |
| Large businesses | 30 | 42.8 | 1,285 |

Source: EY analysis

Note: numbers may not multiply exactly due to rounding.

Costs of third parties

Many larger companies engage accountants to assist with completing the annual report that is required to meet the MFRs. The annual costs were based on consultations, with the cost for larger businesses incorporating the finding that some businesses already report to ASIC, so face only a small incremental cost to report their financials to the QBCC to meet the MFRs. The cost for small businesses reflected an assumption that only a small proportion of businesses engage with an external accountant for assistance with annual reporting.

The costs are assumed to be 50% lower in the absence of the annual reporting requirement, as businesses only had to report to the QBCC if they did not meet the MFRs, so fewer businesses were likely to engage an accountant since the financials were not required to be provided directly to the QBCC.

Under the current MFRs, the estimated cost of third parties was \$50 per year for small businesses, \$1,500 for medium businesses and \$6,000 for large businesses.

Table 6. Cost to businesses of third parties

| | Annual cost per business (\$) |
|---|-------------------------------|
| Queensland's current MFRs | |
| Small businesses | 50 |
| Medium businesses | 1,500 |
| Large businesses | 6,000 |
| Queensland's previous MFRs without annual reporting | |
| Small businesses | 25 |
| Medium businesses | 750 |
| Large businesses | 3,000 |

Source: EY analysis

Note: These are costs per business adjusted for the likelihood they will incur the cost.

The estimated third-party costs do not include costs of changing licence category. To change licence category, an MFR report is required which requires the assistance of an accountant, which can be costly. As such, the estimated third-party costs represent a lower bound.

Costs of holding capital

Businesses are required to hold a minimum level of capital to adhere to the NTA requirement. For some businesses, this entails holding additional capital that would not otherwise be required. If this additional capital did not have to be held in the business, it could potentially generate a higher return elsewhere, such as in the stock market. There is also a loss of option value, as the funds held in the business could otherwise have been used for several different purposes. There is also a cost if the money that is tied up in the business faces greater risk within the business than it would outside of the business.

The annual cost of holding capital is calculated as the amount of NTA 'top-up' required to meet the MFRs, multiplied by the difference in return that 'top up' amount receives because it must be held in the business, as well as a cost of option value and risk.

The top-up amount was assumed to be 16.7% of the minimum NTA value required for each licence category (see Appendix A). A weighted average, based on the top-up amount and the number of businesses in each licence category (from SC1 to category 7), was calculated to obtain a NTA top-up amount for each business size (small, medium and large) (Table 7).

The difference in return that could be earned on funds was calculated as the return that could be earned outside of a business minus the return that could be earned within a business. Within a business, the NTA top-up amount was assumed (based on consultations) to be held as cash, helping to meet the current ratio requirement—which is that current assets should equal or exceed current liabilities. A savings rate was used to calculate the return on cash (1.60%). Outside of a business, 50% of the top-up amount was assumed to be held as cash, earning a savings rate (1.60%), and 50% in a stock market index, earning a stock market index return (4.97%)—so these rates were averaged to obtain a value for the return funds could earn outside of the business.⁹ This reflects the assumption that a higher return could be earned outside of the business. The cost of option value and risk was assumed to be 0.5% of the NTA top-up amount.

Based on these assumptions, the cost of holding capital to comply with the MFRs is estimated to cost between \$115 per year for small businesses and \$16,129 per year for large businesses (Table 7).

Table 7. Cost to businesses of holding capital

| | NTA top-up amount (\$) | Difference in return (\$) | Cost of option value and risk (\$) | Annual cost per business (\$) |
|-------------------|---------------------------|------------------------------|---------------------------------------|----------------------------------|
| Small businesses | 5,265 | 89 | 26 | 115 |
| Medium businesses | 21,906 | 369 | 110 | 479 |
| Large businesses | 738,182 | 12,438 | 3,691 | 16,129 |

Source: EY analysis

Evidence from consultations suggests that not all businesses need to increase their NTAs to meet the MFRs. In some cases, businesses already held the required level; and in other cases, businesses were able to make other changes to their balance sheet to meet the MFRs without changing their financial practices.

Based on this, the proportion of businesses assumed to require an increase in NTA to meet the MFRs was 70% of small businesses, 50% medium businesses and 30% of large businesses (Table 8). A greater proportion of larger businesses were assumed to hold more NTA due to their size, and fewer smaller businesses were assumed to do so due to the relative cost of holding assets.

⁹ The return on cash was estimated using a 5-year average of the pre-Covid RBA interbank overnight cash rate and the return on the market index was estimated using a 5-year average of the pre-Covid monthly ASX200 return.

Based on consultations, it was assumed that 10% fewer businesses would increase their NTA when there was no reporting requirement (Table 8). In reality, the proportion requiring an increase in the absence of the reporting requirement would not change. However, the proportion that would take action to increase their NTAs in response to the MFRs is assumed to be slightly lower when there is no requirement to report, given the lack of transparency to the regulator.

Table 8. Proportion of businesses required to increase NTA

| | Proportion (%) |
|---|----------------|
| Queensland's current MFRs | |
| Small businesses | 70 |
| Medium businesses | 50 |
| Large businesses | 30 |
| Queensland's previous MFRs without annual reporting | |
| Small businesses | 63 |
| Medium businesses | 45 |
| Large businesses | 27 |

Source: EY analysis

Table 9 presents the annual cost of holding capital per business, adjusted for the number of businesses that are estimated to actually require an increase in their NTA to meet the MFRs.

Table 9. Average cost to businesses of holding capital (adjusted for number required to increase NTA)

| | Adjusted annual cost per business (\$) |
|---|--|
| Queensland's current MFRs | |
| Small businesses | 81 |
| Medium businesses | 239 |
| Large businesses | 4,839 |
| Queensland's previous MFRs without annual reporting | |
| Small businesses | 72 |
| Medium businesses | 215 |
| Large businesses | 4,355 |

Source: EY analysis

The current ratio MFR requires that a business's current assets equal or exceed its current liabilities. Most businesses were assumed to meet this requirement as part of usual good business practice, so the cost of meeting it was not explicitly considered. However, it was indirectly considered through the cost of holding capital—the NTA top-up amount was assumed to be held as cash in order to help meet the current ratio requirement.

Restructuring costs

Some businesses need to change their company structure to comply with the MFRs. Examples of such situations were identified in consultations. One company moved from a trust to a company structure to meet the NTA requirement. This involved several costly actions, including changing their Australian Business Number (ABN) and rebuilding reputation. Another company said it had sufficient NTA to meet the requirement, but because of the treatment of related party loans it set up a special purpose vehicle and injected more capital to meet the NTA requirement. There were a

variety of costs involved in establishing the special purpose vehicle, which the company was able to meet given its size—however the stakeholder said that other companies may not be able or willing to take such actions due to the costs, potentially presenting a barrier to entry.

The cost of changing company structure would vary significantly by company and is therefore not evaluated quantitatively for this analysis.

3.3 Consumer costs

Consumers may ultimately bear the burden of the increased costs to businesses from the MFRs if they are passed through to prices. However, for the purposes of this report, only first round cost impacts have been considered (pass-through to prices has not been considered).

Consumers can also be disadvantaged if competition is diminished. The MFRs act as a barrier to entry—which is likely to reduce the number of market participants, particularly, new businesses that may struggle to meet the NTA requirement upfront. If this barrier to entry was restrictive enough to impact competitiveness, this could lead to increased market power and prices. Costs associated with decreased competition have not been included in this analysis.

3.4 Estimated total costs of the MFRs

The above estimates of costs per business can be applied to the number of licensees subject to the MFRs to obtain an estimate of the total cost of the MFR regime across the industry, presented in Table 10. Costs that could not be valued within the scope of this analysis have been discussed qualitatively and are not included in this estimate. Therefore, this total cost estimate could be considered as a lower bound.

Business compliance costs are the largest direct cost of the scheme, comprising over 85% of total costs. Businesses need to engage external advice or allocate management time to comply with the scheme, all of which impose costs. The estimated costs were materially lower under the former version of the regime which did not involve reporting requirements for businesses.

Table 10. Annual costs of the MFRs (\$)

| Cost category | Current MFRs | Previous MFRs |
|--|-------------------|-------------------|
| Cost to government of administering regulatory scheme | 1,080,451 | 540,225 |
| Cost to businesses of compliance (including internal administration and third party costs) | 67,968,200 | 33,984,100 |
| Cost to businesses of holding capital | 9,291,439 | 8,362,295 |
| Total costs (lower bound) | 78,340,090 | 42,886,621 |

Source: EY estimates

The total costs to a business of meeting the MFRs—estimated as the sum of compliance and capital holding costs, divided by the number of businesses—is greater in absolute terms for larger businesses than smaller businesses (Table 11).

Table 11. Costs of meeting the MFRs, by business size

| Business size | Total annual cost per business (\$) |
|-------------------|-------------------------------------|
| Small businesses | 689 |
| Medium businesses | 3,416 |
| Large businesses | 13,408 |

Source: EY estimates

However, when costs are compared to the revenue businesses can earn for their licence category (see Appendix A), the costs are relatively greater for smaller businesses. For example, if an estimate of the revenue a business can earn is taken to be the midpoint of the revenue range that a business can earn within its category (i.e., for small businesses, revenue can range from \$0 to \$800,000, so the midpoint is \$400,000), the cost to revenue ratio is 0.17% for small businesses, 0.02% for medium businesses and 0.01% for large businesses.¹⁰

Costs of regimes in other jurisdictions

There are a range of regimes in place in other states and territories that assess the financial viability of building and construction practitioners to varying extents. Several states have insurance markets through which providers undertake assessments of financial viability before providing insurance. In general, it is expected that these schemes would not have the same level of costs as the MFR regime in Queensland for reasons such as the wide range of practitioners that the MFRs apply to as well as the extent of what is required to meet the MFRs. For example, in New South Wales, only residential builders are required to obtain a licence, for which insurance (and therefore financial checks) is required. There would also be an absence of government administration costs where regimes are not administered by the government.

¹⁰ The actual cost to revenue ratio for large businesses may be less than 0.01%, given the calculation method. As there was no specific upper bound for revenue that category 7 companies can earn, the lower bound (\$240,000,001) for that category was applied.

4. Benefits of the MFRs

The purpose of the MFRs is to reduce insolvencies and the costs associated with them. The costs associated with insolvencies are generally large and far-reaching—borne by businesses, government, consumers, and the broader community. Avoiding insolvencies through effective regulation can therefore generate significant benefits. There are also potential indirect benefits from increased levels of business and consumer confidence, productivity and innovation. Potential benefits of MFRs include benefits to:

- ▶ **Government:** including avoided unpaid tax debts and avoided financial assistance to employees impacted by insolvencies.
- ▶ **Businesses and industry stakeholders:** including avoided non-payment of debts such as money owed to subcontractors, avoided costs of insolvency practitioners.
- ▶ **Consumers and the broader community:** including benefits to employees from avoided loss of wages and employee entitlements and the associated adverse social impacts including impacts on physical and mental health; and benefits from improved industry confidence, productivity and innovation, which may flow through to consumers through avenues such as lower prices.

4.1 Methodology and data

The MFRs could potentially reduce insolvency rates by:

- ▶ requiring businesses to hold minimum amounts of capital and liquidity and to pay debts, thereby reducing the likelihood that a business will become financially strained;
- ▶ providing the regulator with information (via annual reporting) from which it can take regulatory actions to minimise the number and impact of insolvencies; and
- ▶ increasing licensees' awareness of their financial situation and their financial control.

This section analyses insolvencies in Queensland over time and compared to other jurisdictions in Australia to consider the effectiveness of Queensland's regime at reducing insolvencies. For this analysis, Queensland was compared to two samples:

1. **Rest of Australia:** all jurisdictions except Queensland
2. **Four largest states:** NSW, VIC, SA and WA.

ASIC insolvency data for the Construction industry (ASIC series 1A) was used to compare the number of insolvencies across jurisdictions.¹¹ The dataset does not include all licensees that are subject to MFRs and also includes some companies that are not subject to MFRs. However, it is considered a reasonable proxy, and allows for comparisons across states.

To assess insolvencies in Queensland over time, 'exclusion' data from QBCC annual reports was considered. Broadly speaking, the QBCC can exclude individuals and companies if the relevant individuals have been involved in financial failure. The number of QBCC licence holders that have been excluded may be a better measure of insolvencies for the purpose of this analysis because it specifically applies to licensees that are subject to the MFRs (however, it includes some licensees that are not subject to the MFRs).¹²

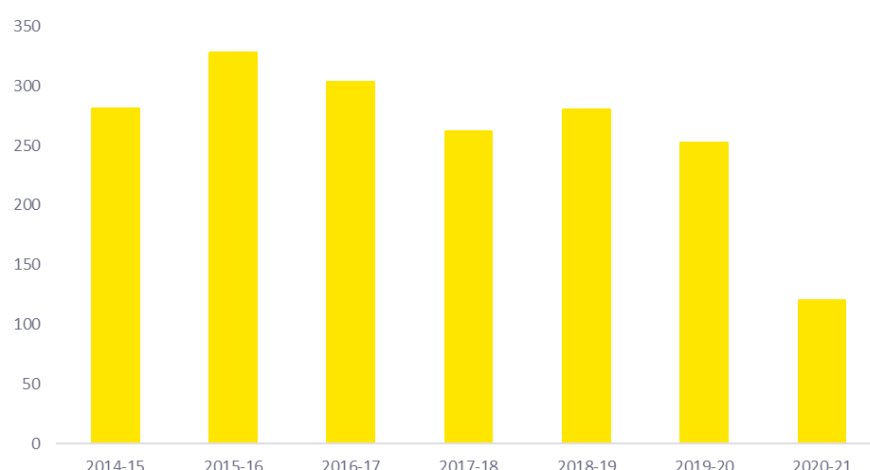
¹¹ This was the number of construction company insolvency appointments.

¹² However, individuals can also be excluded if they become bankrupt or take advantage of the laws of bankruptcy by entering into a Part IX or Part X agreement.

A key consideration for this analysis is the impact that the Covid-19 Government Economic Support Package is likely to have had on insolvency appointments. In March 2020, the Australian Government announced measures to help businesses through the Covid-19 pandemic, including temporary insolvency relief measures. A new set of insolvency reforms for small businesses was introduced on 1 January 2021. The insolvency reforms allow small businesses to quickly restructure to survive the economic impact of Covid-19, by reducing the time, complexity and costs incurred (Australian Government, 2020).

There was a large decline in the number of construction company insolvency appointments in 2020-21 (52% lower than 2019-20), which is likely to stem at least partly from the Covid-related insolvency policy measures (Figure 3). There are other factors that may also contribute to this result for the construction sector, including strong demand in the sector, aided by home building stimulus and supportive interest rate settings. In its 2020-21 annual report, the QBCC attributed the fewer insolvencies in 2020-21 to temporary changes to insolvency laws due to Covid-19, as well as the increase in activity which likely helped many contractors who were struggling financially to recover. Given the factors affecting 2020-21, insolvency data for this year has been excluded from the assessment. Data for 2019-20 has been included, as it only captures three months of Covid-related data.¹³

Figure 3. Number of construction industry insolvencies in Queensland



Source: ASIC Series 1A

Differences in insolvencies can be more meaningfully compared when they are compared against a base (i.e., an insolvency rate). The later charts in this section present the number of insolvencies as a proportion of either the number of businesses in the building and construction industry or the gross value added of the building and construction industry. ABS business count data for the building and construction industry was used as the main comparator throughout this analysis.

4.2 Effectiveness of Queensland's MFR regime compared to other jurisdictions

The rate of insolvencies can be compared across states and territories to analyse the potential effectiveness of Queensland's MFR regime relative to the regimes in other jurisdictions. Lower rates of industry insolvencies in Queensland compared to other jurisdictions could indicate that Queensland's MFRs are more effective than alternative regimes.

¹³ Note that the implementation of the regime was such that only licensees in categories 4-7 were required to report their NTA and current ratio by 31 December 2019; with all licensees required to report these metrics by 31 December 2020.

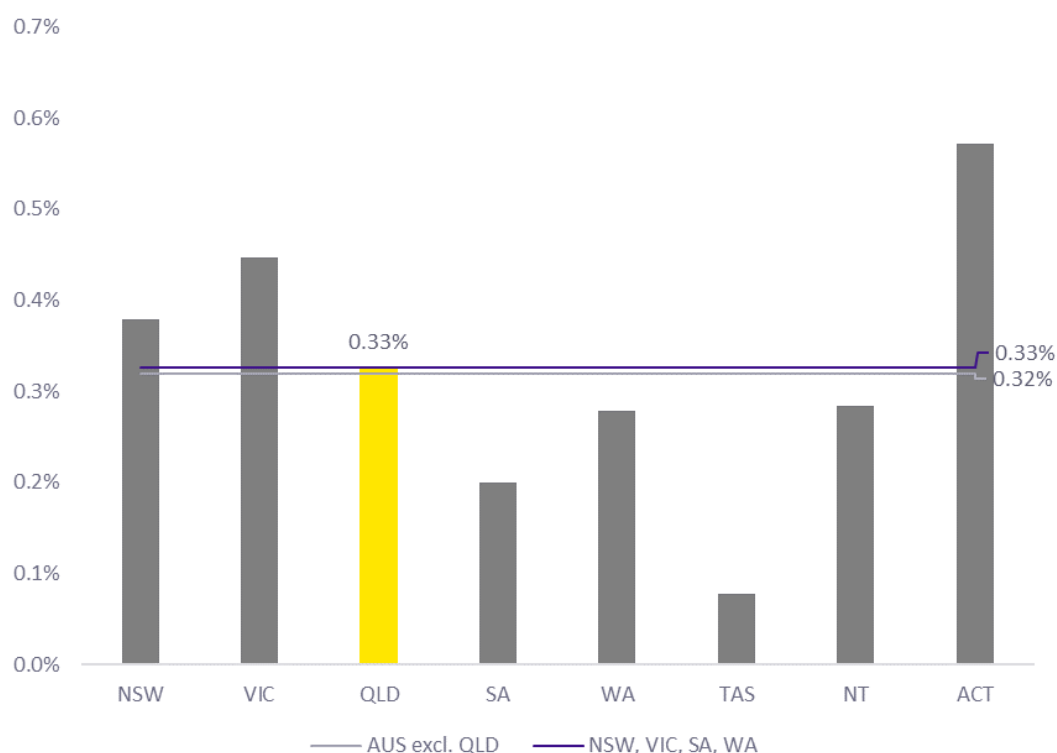
Similarly, the size of insolvencies can also be compared across jurisdictions. If insolvencies in Queensland tend to be smaller than other jurisdictions, this could indicate that the MFRs are effective at reducing the overall impact of insolvency.

4.2.1 Insolvency rate

Current MFRs

The current MFRs were introduced on 1 January 2019, so data since then can be assessed to analyse the effectiveness of the current regime.¹⁴ Figure 4 presents the insolvency rates for each jurisdiction in 2019-20, showing Queensland had the fourth-highest insolvency rate for this year, at 0.33%, following the Australian Capital Territory (0.57%), Victoria (0.45%) and New South Wales (0.38%). Tasmania had the lowest rate at 0.08%. Queensland's insolvency rate is very similar to the average rate across the rest of Australia (0.32%) and the four-state comparator group (0.33%).¹⁵

Figure 4. Construction insolvency rates in 2019-20, business count denominator



Sources: ASIC Table 1A.1.1, ABS cat. no. 8165.0

In order to have more information on the effectiveness of the current set of MFRs, more data on the current regime will be required, which will be available going forward.

Recent MFRs: A longer-term snapshot

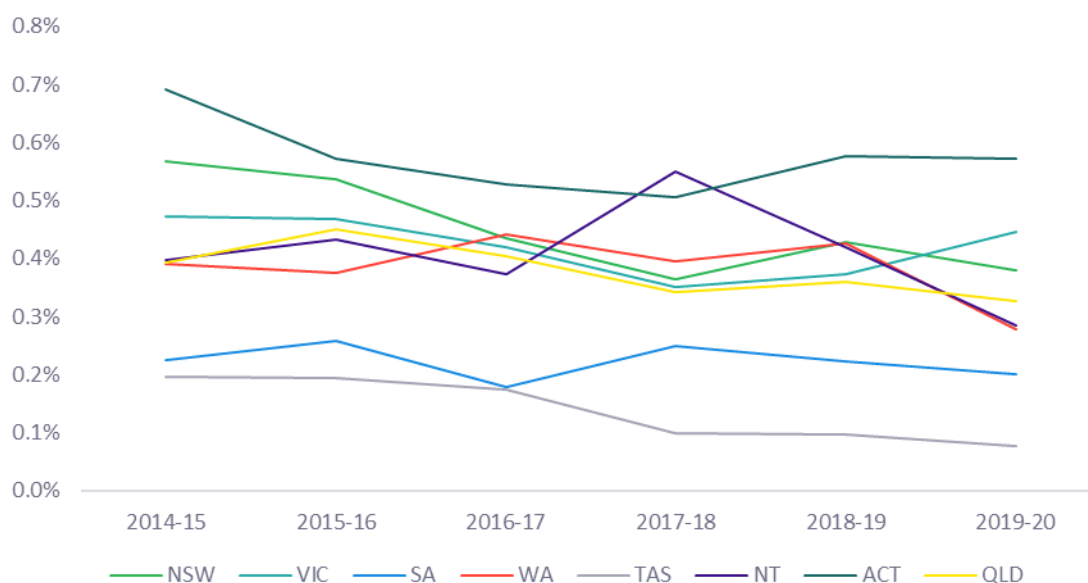
Figure 5 presents insolvency rates by number of businesses of the states and territories over a six-year period, capturing one year of Queensland's current MFR regime and five years of the previous regime (where there was no annual reporting requirement). The chart shows Queensland is around the middle of the group for most years.

¹⁴ However, note that the implementation of the regime was such that only licensees in categories 4-7 were required to report their NTA and current ratio by 31 December 2019; with all licensees required to report these metrics by 31 December 2020.

¹⁵ The insolvency rates differ beyond the second decimal place.

Over this period, the average insolvency rate in Queensland was 0.38%, the average insolvency rate for the rest of Australia was 0.37% and the average insolvency rate for the four larger states subgroup was 0.37%. Queensland's insolvency rate has been consistently below the rates in the Australian Capital Territory, New South Wales and Victoria, and consistently above those in South Australia and Tasmania. Its comparative position to Western Australia and the Northern Territory has changed over this period. While this analysis is only over a relatively short period in what tends to be a cyclical industry, any variations related to this are likely to impact all states and territories.

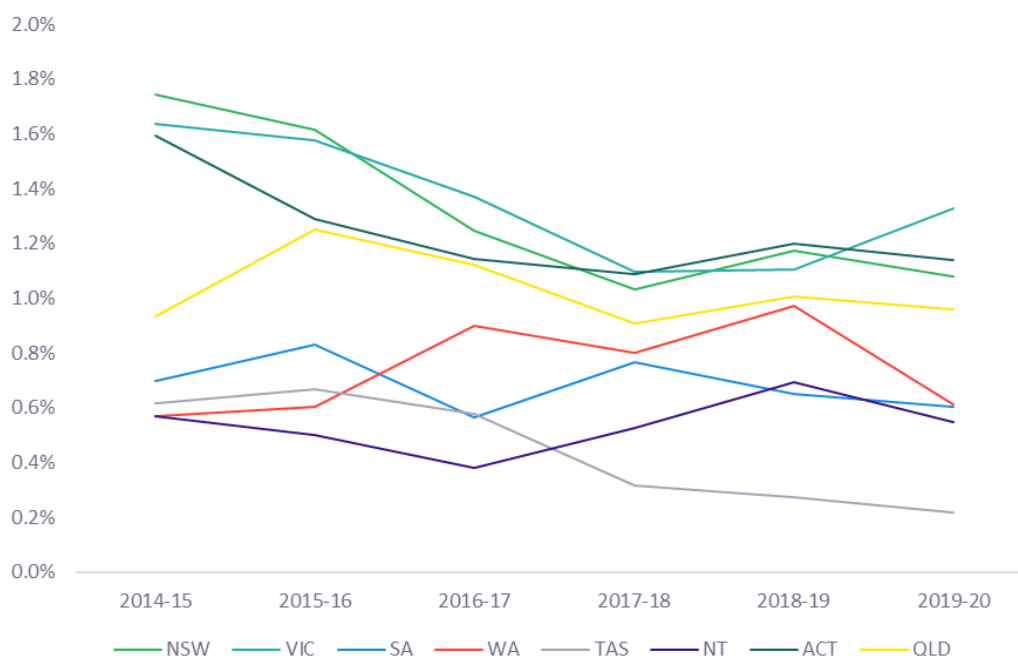
Figure 5. Construction insolvency rates from 2014-15 to 2019-20, business count denominator



Sources: ASIC Table 1A.1.1, ABS cat. no. 8165.0

The state-by-state outcomes are slightly different when gross value added is applied as a denominator, rather than business count (Figure 6), but a similar result regarding Queensland's performance is found. Queensland consistently has the fourth-highest rate of insolvencies, behind New South Wales, Victoria and the Australian Capital Territory. In 2019-20, under the current MFR regime, the insolvency rate in Queensland (0.96%) was higher than the average across the other states (0.79%) and the four-state sample (0.91%). Over the six-year period, these results were 1.03% for Queensland, 0.90% for the other states, and 1.02% for the four-state sample.

Figure 6. Construction insolvency rates from 2014-15 to 2019-20, gross value added denominator

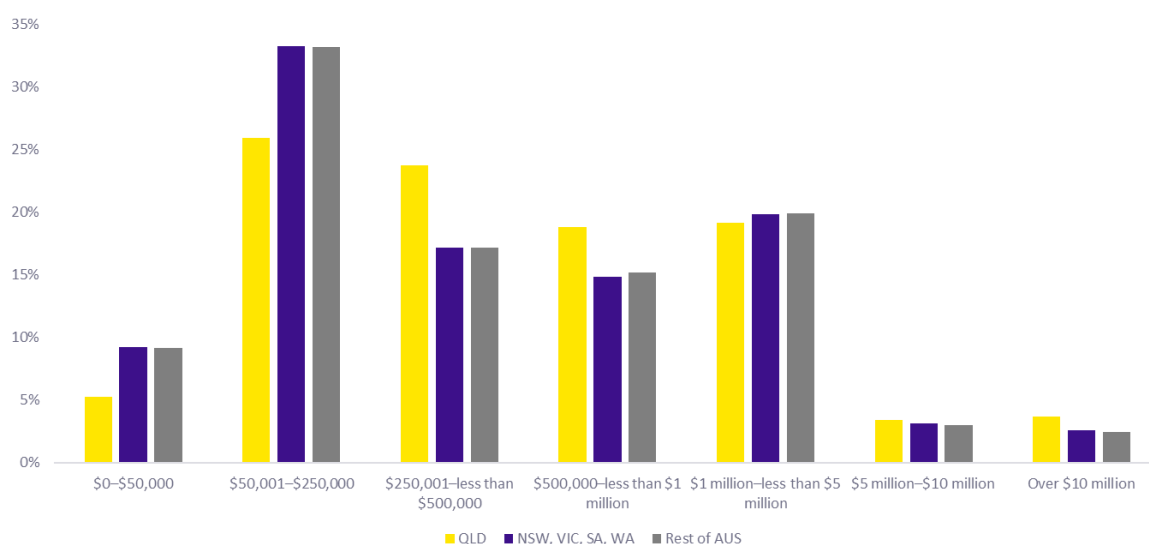


Sources: ASIC Table 1A.1.1, ABS cat. no. 5222.0

4.2.2 Size of insolvencies

Another relevant consideration is the size of the insolvencies across states, which was analysed using ASIC data on insolvency deficiency in the ANZSIC Construction industry. Deficiency is the amount by which a business' assets fall short of its liabilities. However, this data was only available up to 2018-19, so there is not information on insolvency size by jurisdiction under the current regime (which commenced 1 January 2019). Data from 2014-15 to 2018-19 was considered in this analysis. In the 2018-19, the most recent year of data, Queensland tended to have more higher value insolvencies, and fewer lower value insolvencies, than the two sample groups (Figure 7). In other words, Queensland tended to have relatively more insolvencies where there was a shortfall of assets over liabilities of more than \$250,000 compared to other jurisdictions, and relatively fewer insolvencies with a shortfall below this amount. This trend was also reflected in most years over 2014-15 to 2018-19.

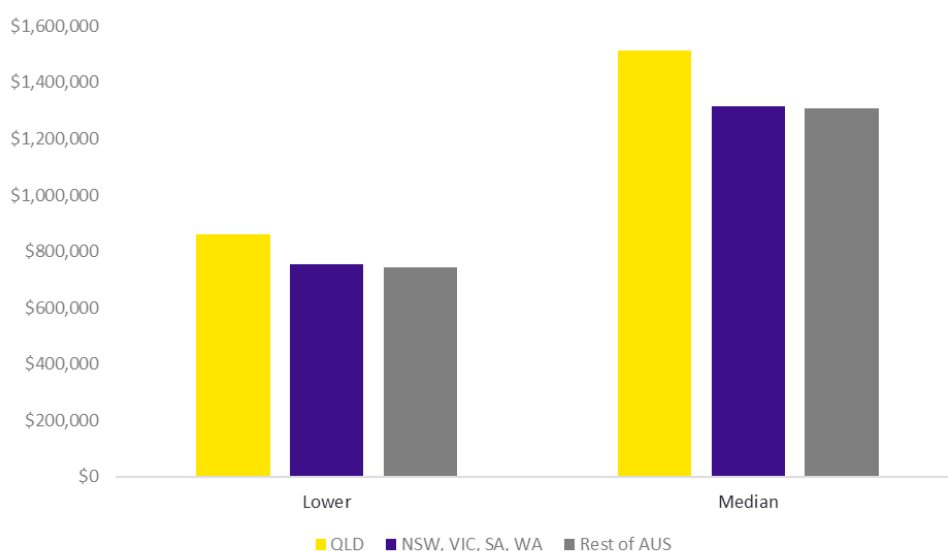
Figure 7. Proportion of insolvency reports in each deficiency category, 2018-19



Source: ASIC Series 3.2

The average deficiency over 2014-15 to 2018-19 was calculated for Queensland and each of the two samples, by multiplying the number of reports in each category by either the lower bound of the category or the median value of the category. The values were brought forward to 2021\$ using CPI (a four-quarter average). Queensland had a higher Construction industry average deficiency over this period than the two sample groups, both when applying the lower bound and the median values (Figure 8).

Figure 8. Average deficiency per insolvency over 2014-15 to 2018-19, lower and median estimates



Source: ASIC Series 3.2

The evidence suggests that Queensland's MFRs (under the regime without the reporting requirement) do not reduce the size of insolvencies in the industry relative to other jurisdictions. There may be other factors influencing the size of insolvencies across jurisdictions, and further statistical analysis could be applied.

4.3 Effectiveness of specific elements of Queensland's MFRs

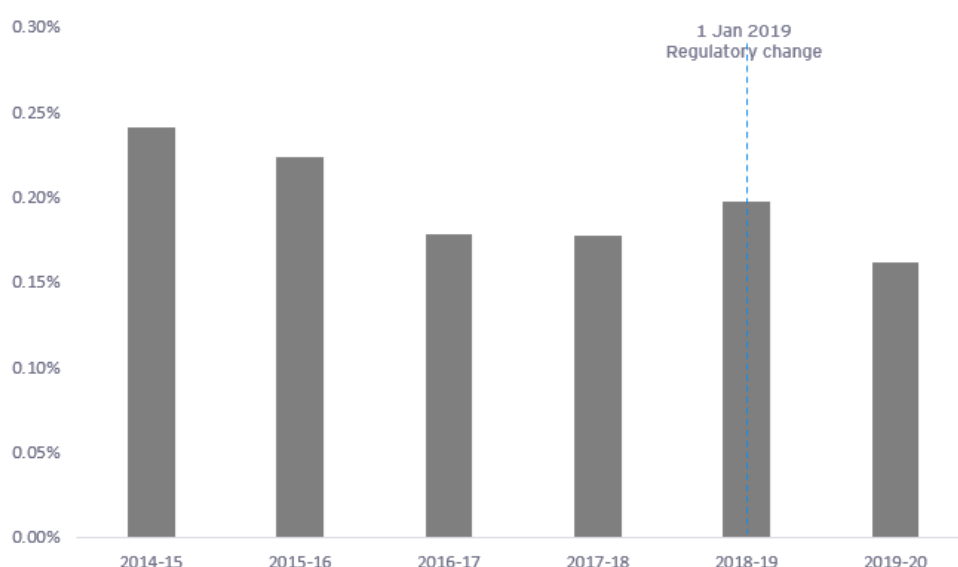
As elements of Queensland's MFRs have changed over time, the impact of these changes can be assessed by considering insolvency rates over time in Queensland and comparing to trends in other states. The two most recent changes in Queensland's MFR regime include a change from 1 October 2014 to remove the annual reporting requirement and introduce the requirement to pay debts; and a change from 1 January 2019 to introduce an annual reporting requirement.

4.3.1 2019 regulatory change

The regulatory change commencing 1 January 2019 included a requirement for licensees to provide annual reports to the regulator. The impact of the regulatory change can be assessed looking at insolvency rates before (2014-15 to 2017-18) and after (2019-20) the regulatory change.

Queensland-specific data on 'exclusions' of individuals from annual reports was used as a measure of insolvency to assess the impact of the regulatory change. The number of individuals holding QBCC licences (minus categories not subject to MFRs) was applied as a denominator to generate an exclusion rate.¹⁶ The exclusion rate in 2019-20, where the reporting requirement was in place, was lower than in the years where the reporting requirement was not in place (Figure 9).

Figure 9. Exclusion rate in Queensland from 2014-15 to 2019-20, individual licensee denominator



Source: QBCC annual reports

The lower rate of insolvencies following the change in regulation suggests the addition of the reporting requirement could be contributing to reducing insolvencies. However, there may be other external factors driving the downward trend over this period that have not been accounted for. Some of these can be controlled for by comparing Queensland's data with data in other jurisdictions, over time. However, exclusion data is not available in other jurisdictions.

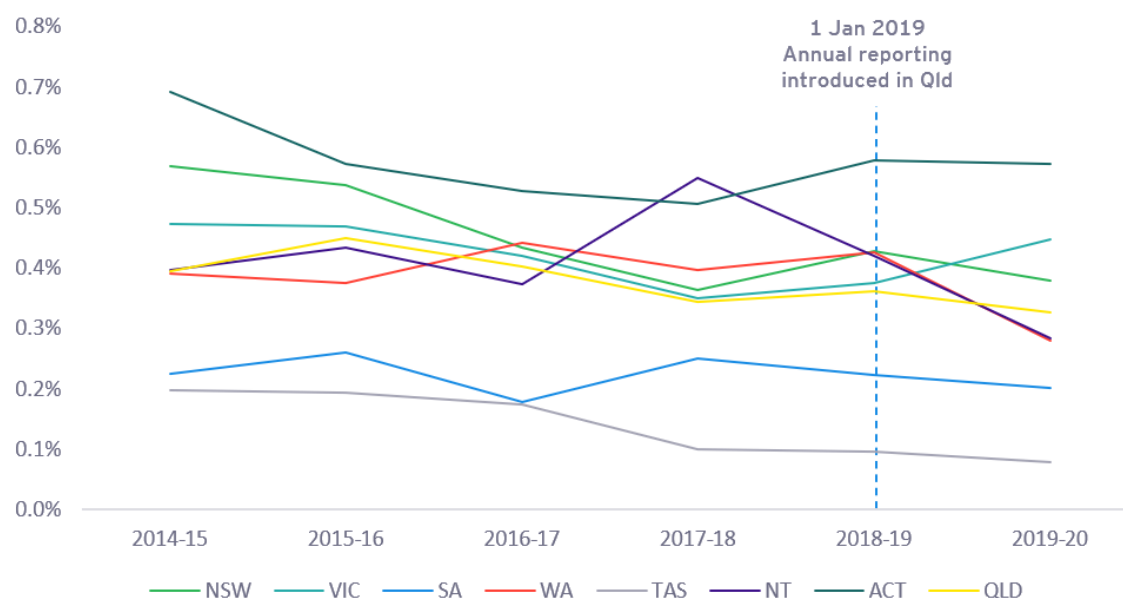
One measure available across jurisdictions is ASIC company insolvencies in the ANZSIC Construction industry. While this is overall a narrower measure of insolvencies, capturing only companies, it allows for comparison across jurisdictions. Comparing time series across jurisdictions controls for some external factors that might be contributing to the change in insolvencies in Queensland between 2014-15 to 2017-18 and 2019-20, other than the regulatory change. Figure

¹⁶ However, this sample still includes some licensees not subject to MFRs, including site and nominee supervisors.

10 presents the insolvency rates of construction companies in Australian states and territories before and after the regulatory change.

In Queensland, the company insolvency rate decreased by 0.07 percentage points across these periods—from an average of 0.40% over 2014-15 to 2017-18 to 0.33% in 2019-20. On average, the insolvency rates for the rest of Australia declined by about the same amount over the same two periods, suggesting that the reduction in Queensland construction company insolvencies might be due to broader economic factors rather than any specific element of the MFRs. The result is broadly similar when the smaller sample of four states is considered.

Figure 10. Construction insolvency rates with business count denominator, and annual reporting indicator



Sources: ASIC Table 1A.1.1, ABS cat. no. 8165.0

Table 12. Insolvency rates over different time periods

| | 2014-15 to 2017-18 | 2019-20 | Reduction | Change in QLD – Change in comparators |
|--------------------------------------|-----------------------|---------|-----------|--|
| QLD | 0.40% | 0.33% | 0.07% | N/A |
| Rest of AUS | 0.39% | 0.32% | 0.07% | 0.00% |
| 4 state sample (NSW, VIC, SA, WA) | 0.38% | 0.33% | 0.06% | 0.01% |

The impact of the annual reporting on the size of insolvencies is not able to be assessed, as the ASIC deficiency data is only available until 2018-19 (and the latest regime commenced on 1 January 2019).

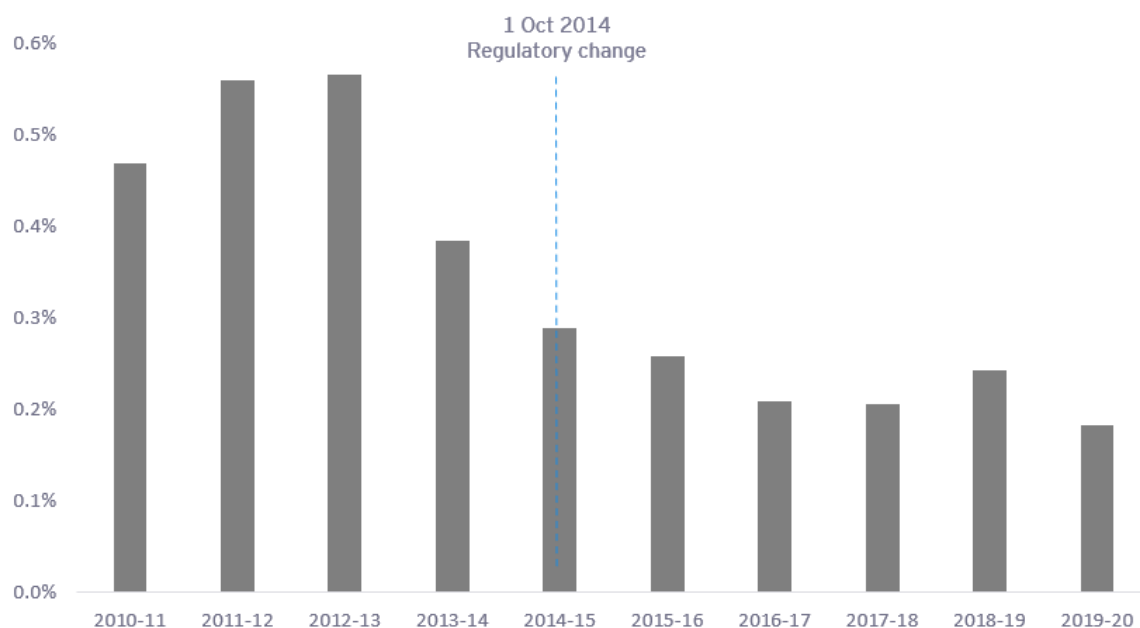
4.3.2 2014 regulatory change

The regulatory change commencing 1 October 2014 included a removal of the requirement to report, and the extension of a requirement to pay debts. Queensland-specific data on ‘exclusions’ from annual reports has been used as a measure of insolvency to assess the impact of the 2014 regulatory change. The number of construction businesses (ABS data) was applied as the denominator to generate an exclusion rate.¹⁷ The exclusion rate was much lower in the years after the regulatory change was imposed in 2014, compared to the years before (Figure 11), potentially attributable to the simultaneous removal of the reporting requirement and extension of the

¹⁷ The number of individuals holding QBCC licences could not be applied as this data was not available in earlier years.

payment of debts requirement. However, as was the case above, there may be other factors influencing this result. Other jurisdictions are unable to be compared to attempt to control for these external factors as ASIC insolvency data is not available for the earlier years.

Figure 11. Exclusion rate in Queensland from 2010-11 to 2019-20, business count denominator



Source: QBCC annual reports, ABS cat. no. 8165.0

4.4 Costs of insolvencies

The costs associated with insolvencies are generally large and far-reaching—borne by businesses, government, consumers, and the broader community. They have a substantial impact on society, given the structure of the industry and the cascading impact of insolvencies throughout the contracting chain. They can result in unpaid debts, loss of employment, adverse mental impacts and adverse impacts on productivity, among other things.

4.4.1 Costs of unpaid debts

A major direct cost of an insolvency is the amount of debt the company owes to various stakeholders, including money owed to secured creditors (e.g., banks), subcontractors and suppliers, entitlements owed to employees, and taxes owed to the Government. A measure of unpaid debts is the amount by which a business' assets fall short of its liabilities, also known as the deficiency.

The average cost of unpaid debts from an insolvency was estimated based on ASIC insolvency data for the Queensland construction industry and was calculated by summing the total deficiency for businesses in the construction industry and dividing it by the number of reports (ASIC series 3.2). The deficiencies were presented by category, for example there were 84 reports in the \$50,001–\$250,000 category. The total deficiency for each category was estimated by taking the midpoint, so \$150,001 for this category. Under this approach, the average cost of unpaid debts per insolvency was estimated to be \$1,513,381 (Table 13). If a lower bound approach is instead used, this value would be \$924,747. This method was based on the approach in the Senate Economics Reference Committee 2015 report, which reported both the lower bound and median estimates, noting the lower bound would be a conservative estimate.

Table 13. Cost of unpaid debts, per insolvency

| | Total unpaid debts (\$) | Number of reports | Average unpaid debts per insolvency 2018-19 (\$) | Average unpaid debts per insolvency (current \$) |
|---|-------------------------|-------------------|--|--|
| Avoided cost to industry stakeholders of unpaid debts | 476,150,111 | 324 | 1,469,599 | 1,513,381 |

Source: ASIC Series 3.2, EY analysis

Note: The latest publication of ASIC series 3.2 was based on 2018-19 data, so the estimates were brought forward using the Consumer Price Index (CPI).

For those debts that can be recovered, the process of recovery can be time consuming and there can be costs to businesses of recovering that money. Quantification of this cost was not within the scope of this analysis.

4.4.2 Third party costs of insolvency

Insolvency practitioners act on behalf of and provide advice to companies that are in financial difficulty. A similar approach to calculating the costs of unpaid debts was applied for calculating the costs of insolvency practitioners. The total costs of insolvency practitioners for businesses in the industry in Queensland, calculated as the sum of remuneration of voluntary administrators, deed administrators, liquidators and receivership, was divided by the number of reports (summing the reports from each of these categories) to obtain an average cost per insolvency.

The average third party costs per insolvency were estimated to be \$30,274. If a lower bound approach is instead used, this value would be \$11,204.

Table 14. Cost of insolvency practitioners, per insolvency

| | Total cost (\$) | Number of reports | Average cost per insolvency 2018-19 (\$) | Average cost per insolvency (current \$) |
|--|-----------------|-------------------|--|--|
| Avoided cost to industry stakeholders of third parties | 12,700,143 | 432 | 29,398 | 30,274 |

Source: ASIC Series 3.2, EY analysis

Note: The latest publication of ASIC series 3.2 was based on 2018-19 data, so the estimates were brought forward using the Consumer Price Index (CPI).

4.4.3 Indirect costs of assisting employees affected by insolvencies

There are indirect costs to the Australian Government of providing financial assistance to employees that have been affected by insolvency. The Government provides assistance that covers certain unpaid employee entitlements to employees whose employer has been liquidated or become bankrupt, through the Fair Entitlements Guarantee (FEG). The Government may also provide assistance to those who are unemployed as a result of an insolvency, through unemployment benefits. Quantification of this cost was not within the scope of this analysis.

4.4.4 Social costs of insolvencies

There are substantial social costs of insolvencies in the construction industry. Insolvencies can lead to personal financial distress, loss of personal property including homes and loss of reputation (to those whose business has failed for example). Such impacts can strain family relationships, as well as mental and physical health. The report by the Senate Economics Reference Committee (2015, pp. 51-54) provided some examples from stakeholders of the social impacts construction insolvencies can have, including relationship breakdowns, suicide and inability to pay for important medical expenses. It captured the significance of the social impact of insolvencies:

"The economic effect of insolvencies in the construction industry is significant. However, such insolvencies also have an equally enormous but less-easily identified non-economic impact."

Quantifying the social impacts of insolvencies was out of scope for this analysis. However, these impacts are wide-reaching and may be significant. For example, impacts on mental health alone may be substantial, including direct medical costs as well as impacts on worker productivity.

4.5 Estimated total benefits of the MFRs

4.5.1 Benefits due to avoided insolvencies

If there was found to be a reduction in insolvencies associated with the MFRs, there would be a related benefit. The associated costs of those insolvencies, primarily the unpaid debts and costs of insolvency practitioners, would be avoided. The costs of insolvencies can be substantial—so if they are avoided, the benefits would be substantial.

However, this analysis of construction insolvency data showed that Queensland has not performed better than other jurisdictions, as might be expected under the MFRs. Therefore, there does not appear to be benefits from reduced insolvencies from Queensland's MFR regime compared to the regimes in other jurisdictions.

4.5.2 Benefits due to increased confidence, productivity and innovation

The existence of a regulator and the MFR regime may lead to increased confidence in the industry, from both businesses and consumers. Some stakeholders indicated they like having regulatory oversight and some considered the MFRs are beneficial in making companies aware of their financial situation. One stakeholder said it was reassured that other companies held at least a minimum level of assets and cash.

Business confidence and consumer sentiment are important factors and contributors to economic conditions. The more confident businesses are, the more likely they are to invest, which in turn contributes to economic growth. Similarly, when consumers are confident in their own financial position and state of the economy, they are more likely to spend, which stimulates the economy and supports employment and economic growth.

Conversely, high rates of insolvency and limited regulation tend to lead to companies being less willing or able to invest in their employees or company, such as through upskilling workers or investing in new equipment or technology (Senate Economics Reference Committee 2015, pp. 54-57). The lack of innovation in the industry is demonstrated by ABS data: in 2019-20, the proportion of businesses in the Construction industry with any innovative activity was 37.4%, which was the lowest of all industries—the industry average was 51.2% (ABS, *Characteristics of Australian Business*). Improved productivity and innovation would have positive implications for consumers such as lower prices.

Given the inherent difficulty in estimating improved industry confidence, productivity and innovation, these benefits are addressed qualitatively.

5. Summary and conclusion

5.1 Summary

Overall, this analysis suggests that Queensland's MFRs are no more effective at reducing insolvencies than regimes in other jurisdictions. The average insolvency rate in Queensland was found to be similar to the average insolvency rate in the other jurisdictions, as well as a subsample of the four larger states (NSW, VIC, SA and WA), both over the six-year period as well as in 2019-20 only, which was the first complete year where Queensland's current MFRs were in place. The average size of insolvencies in Queensland was slightly higher than the national average over 2014-15 to 2018-19.¹⁸ The annual reporting requirement does not appear to increase the effectiveness of the MFRs. More data on the current MFRs, which have only been in place since 1 January 2019, would provide for a more robust analysis on the effectiveness of both the regime as a whole and the specific requirement to report.

Costs

There are costs to government, businesses and consumers of the MFRs. Key costs of the MFRs, informed largely through consultations with industry, were estimated to total at least \$78 million, with the costs of the previous regime estimated to be substantially less (\$43 million), noting that quantification of some costs were beyond the scope of the study. Small businesses were estimated to face an annual cost of \$689 to comply with the MFRs, with this value being \$3,416 for medium businesses and \$13,408 for large businesses. The costs place a relatively greater burden on smaller companies, when compared to revenue they earn; however, the burden will vary significantly by company. In general, it is expected that Queensland's MFRs would come with greater costs than regimes in other jurisdictions, due to the greater coverage and extent of requirements in Queensland's regime.

Benefits

The benefits of MFRs primarily emanate from their ability to reduce insolvencies in the industry. Fewer insolvencies mean the costs of insolvencies are avoided. Avoiding insolvencies has the potential to generate significant benefits in costs avoided, given the size of the industry and the cascading impact of insolvencies throughout the industry due to its structure. These benefits are primarily in the form of avoided non-payment of debts, although there are a range of other benefits such as social impacts on physical and mental health and increased industry confidence.

However, analysis of insolvency data has not provided evidence that Queensland has performed better in terms of construction insolvencies than other jurisdictions (in terms of number and size), as might be expected under the MFRs. Therefore, there do not appear to be associated insolvency benefits from Queensland's regime compared to regimes in other jurisdictions.

5.2 Implications for policy

Overall, Queensland's MFRs appear to be more onerous and burdensome than regimes in other jurisdictions across Australia, yet the insolvency rate in Queensland is largely comparable to the averages of rates in other states and territories. This suggests there could be scope to refine the regime to reduce the regulatory burden on industry, without materially elevating insolvency risks. The drivers of higher insolvency rates in the building and construction industry are largely structural and do not appear to be Queensland-specific. The annual reporting requirement does not appear to improve the regime's effectiveness, while adding significant costs to industry.

Regulation to limit and potentially reduce the incidence and size of insolvencies in the building and construction sector can be appropriate and could generate a net benefit to society. However, due

¹⁸ The data was only available up to 2018-19, capturing the impact under Queensland's previous MFR regime.

to the costs associated with administration and compliance, it is important to ensure the regulation is targeted and efficient.

Over longer term, there may be benefits from pursuing reforms to harmonise regimes across the country, given there is not clear evidence that Queensland's MFRs are contributing toward lower rates of insolvency. National harmonisation (at the optimal level) could reduce red tape, especially for firms which operate across states and territories, providing a range of benefits such as increased efficiency.

5.3 Stakeholder views and improvements to regulation

Stakeholders provided a range of views on the costs, benefits and effectiveness of the MFRs, with a mix of views for and against the MFRs, and several stakeholders without a strong view either way.

There may be opportunities to modify the current regulations to improve the outcomes they provide. In consultations, stakeholders raised several potential improvements to the MFRs and to regulation in the Queensland building and construction industry, including:

- ▶ Currently, the annual reporting covers the financial position of a company at a single point in time. Several stakeholders said this measure is not necessarily meaningful, as the financial position of a building and construction company can change drastically within weeks or even days. There may be benefits from capturing a more representative picture of a business' financial position over time, rather than the current point-in-time approach. Such changes would need to be weighed against the increased costs.
- ▶ While not currently part of the MFRs, a potential inclusion for licensing in the building industry is the requirement to undertake training in financial literacy. This could increase businesses' awareness of their financial position and how to operate a financially sound business, and potentially help to reduce insolvencies that occur as a result of poor financial management. This is particularly important considering the low barriers to entry to the industry. Financial or business skills training was recommended by the Senate Economics Reference Committee (2015, p. 178).
- ▶ Some stakeholders said subcontractors sometimes choose not to report non-payment of monies owed to the QBCC. A current requirement for licensing is that builders pay debts when they fall due. If this does not occur, a licensee can raise a complaint to the QBCC, who may further investigate the matter and take action against the licensee that has not paid. However, several stakeholders said subcontractors often do not report a non-paying contractor to the QBCC, as by doing so, there may be a greater risk that that contractor will have its licence suspended or cancelled, resulting in greater risk of non-payment compared to not raising a complaint (as the subcontractor may be paid eventually). There may be benefit in reviewing the monies owed complaints process.
- ▶ Some stakeholders said that meeting the MFRs is a rigid tick box exercise and there is limited scope to allow for businesses' unique situations (i.e. there may be cases where businesses may not meet an aspect of the MFRs but may be operating a financially sound business). One business said that the MFRs do not allow for businesses to have a bad year. This point is particularly relevant at present, with materials delays, labour shortages and cost increases putting significant pressure on many builders. There may be benefits from increasing flexibility; however, this would need to be weighed against the costs.

5.4 Limitations of analysis

- ▶ The analysis of the effectiveness of Queensland's MFRs are based on comparisons over time; comparing Queensland to other states as well as Queensland to itself over time. While the difference in insolvency rates over time and between jurisdictions may be influenced by the MFRs, there may also be other factors that influence this difference, which are out of scope for this analysis.

- ▶ There is only one year of insolvency data available since the current MFRs commenced in Queensland (1 January 2019), also limiting the analysis, in particular the assessment of the effectiveness of the annual reporting requirement.
- ▶ The assumptions underpinning the assessment of key costs are subject to uncertainty and varying them can impact the results. Sensitivity analysis was undertaken to demonstrate the impacts of varying these assumptions and is presented in Appendix C.
- ▶ Not all costs and benefits were quantified in this analysis, such as the costs of upgrading licence categories.

Appendix A Licence categories and requirements

Table 15. Licence categories and requirements

| Licence category | Maximum revenue | Net tangible assets |
|------------------|-------------------------------|----------------------------|
| SC1 | Up to \$200,000 | \$12,000 |
| SC2 | Up to \$800,000 | \$46,000 |
| Category 1 | \$800,001 - \$3,000,000 | \$46,001 - \$156,000 |
| Category 2 | \$3,000,001 - \$12,000,000 | \$156,001 - \$480,000 |
| Category 3 | \$12,000,001 - \$30,000,000 | \$480,001 - \$1,200,000 |
| Category 4 | \$30,000,001 - \$60,000,000 | \$1,200,001 - \$2,400,000 |
| Category 5 | \$60,000,001 - \$120,000,000 | \$2,400,001 - \$4,800,000 |
| Category 6 | \$120,000,001 - \$240,000,000 | \$4,800,001 - \$14,400,000 |
| Category 7 | > \$240,000,000 | > \$14,400,000 |

Source: QBCC.

Appendix B Calculations and assumptions

This Appendix provides detail on the calculations, underlying assumptions and data used in the assessment of key costs and benefits of the MFRs.

Cost to government of administering regulatory regime

Cost = number of FTE employees at QBCC x proportion of employees dedicated to MFRs x (public sector wage + overhead costs)

The following data sources and assumptions were applied:

- ▶ The number of full-time equivalent (FTE) staff at the QBCC was obtained from the 2020-21 QBCC annual report.
- ▶ The proportion of QBCC employees dedicated to administering the MFRs was approximately 2%, based on estimates provided by Master Builders Queensland. The proportion of employees dedicated to MFRs when there was no annual reporting requirement was assumed to be half of this amount.
- ▶ The public sector wage was obtained using ABS data (cat. no. 6302.0, Table 14C). The value for annual wage growth was calculated as the average each year from May 2011-2021.
- ▶ The overhead costs were estimated to be 10% of an employee's salary.

Cost to businesses of complying with MFRs

Cost = internal administration costs (hours x cost per hour) + third party costs

Internal administration hours

Assumptions for internal administration hours were based on consultations.

Queensland's current MFRs

- ▶ Small businesses were assumed to spend 15 hours/year (2 days) on MFR administration. This included time to assess their financial position and fill out and submit the relevant information.
- ▶ Medium businesses were assumed to spend 45 hours/year on MFR administration, based on consultations. This included time to assess their financial position (sometimes on an ongoing basis throughout the year), fill out and submit the relevant information and if relevant engage and work with an accountant.
- ▶ Large businesses were assumed to spend 60 hours/year on MFR administration, based on consultations. This included time to assess their financial position (sometimes on an ongoing basis throughout the year), fill out and submit the relevant information and engage and work with an accountant.

Queensland's previous MFRs (without annual reporting)

Businesses were assumed to spend less time on internal administration when the reporting requirement was not in place. Businesses were only required to report to the QBCC if they did not meet the MFRs, and as such on average would not spend the same time filling out the relevant information for the QBCC and may be less incentivised to assess their financials to the same extent. A 50% reduction in hours spent on administration was assumed.

Cost per hour

- ▶ Small and medium businesses: cost per hour was calculated using ABS construction wage data.
- ▶ Large businesses: cost per hour was calculated using ABS professional services data. This reflects the assumption that larger businesses have internal resources dedicated to the business' accounts and finances.

These costs were calculated from ABS Census 2016 data: Total Personal Weekly Income for Construction and Professional Services respectively. Wage growth was calculated from ABS, cat. no. 6302.0, Table 14C, using the average of growth each year from May 2011-2021 for private sector employees.

Third party costs

Assumptions for third party (typically external accounting) costs were based on consultations.

Queensland's current MFRs

- ▶ Small businesses were assumed to have an average accounting cost of \$50, which accounts for the assumption that only a small proportion of businesses engage with an external accountant for assistance with their annual reporting, given they are self-certified.
- ▶ Medium businesses were assumed to have a cost of \$1,500. Businesses reported that their accounting costs ranged from \$1,000 to \$9,000.
- ▶ Large businesses were assumed to have a cost of \$6,000. Businesses reported that their accounting costs ranged from \$10,000 to \$30,000. However, several of these businesses are already required to provide these reports to ASIC; and would therefore incur the costs even if the MFRs were not in place. For these businesses, there is no additional accounting cost for the MFRs. An accounting cost for large businesses was calculated assuming 50% of businesses in the category report to ASIC and therefore face no additional costs, and 50% do not report to ASIC and pay \$12,000 in accounting fees.

Queensland's previous MFRs (without annual reporting)

Businesses were assumed to spend 50% less on external accounting costs without the reporting requirement in place, compared to when all three MFRs were in place. They only had to report to the QBCC if they did not meet the MFRs, and as such fewer businesses may engage an accountant to do their financials, since the financials were not required to be directly provided to the QBCC.

Cost to businesses of holding capital

Cost = proportion of businesses required to increase NTA to meet MFRs x required increase in NTA x (difference in return that could be earned in absence of MFRs + cost of option value and risk)

Proportion of businesses required to increase NTA to meet the MFRs

Assumptions were informed by stakeholder consultations.

Current MFR regime

In the absence of the MFRs, it was assumed that 70% of small businesses, 50% of medium businesses and 30% of large businesses would not hold the minimum level of NTA required to meet the MFRs and would therefore require an increase in NTA to comply with the MFRs.

It was assumed that larger businesses would already tend to hold more assets due to their size, while this would be relatively more costly for smaller businesses so they would tend to hold less net tangible assets.

Previous MFR regime (without annual reporting)

Under the previous MFR regime, if these MFRs were removed, there were assumed to be 10% fewer businesses increasing their NTA to meet the MFRs, compared to what would occur when removing the current MFR regime. In other words, in the absence of this regime, 63% of small businesses, 45% of medium businesses and 27% of large businesses would not hold the same level of NTA. It is assumed that fewer businesses would take action to increase their NTAs in response to the MFRs when there is no requirement to report, given the lack of transparency to the regulator.

Required increase in NTA

It was assumed that businesses required a 16.7% NTA 'top up' to meet the requirement (for those that would not already meet the requirement). The top up amount was calculated for each licence category, based on the minimum NTA value required for that category. A weighted average was calculated to obtain a value for each licence size aggregation (small, medium and large).

Difference in return that could be earned in the absence of MFRs

The difference in the return on the NTA top up amount was based on assumptions informed by consultations. It is assumed that a greater return could be earned outside of the business, such as in a stock market index; however, this would come with higher risk compared to an alternative of holding money in a bank savings account.

- ▶ Return with MFRs: businesses were assumed to hold the NTA top up amount as cash, simultaneously helping to meet the current ratio requirement, which could earn a savings rate (as an example) (5-year average of the pre-Covid-19 RBA interbank overnight cash rate).
- ▶ Return without MFRs: Owners were assumed to hold 50% of the NTA top up amount as cash, earning a savings rate, and invest 50% in a market index to earn a higher return (5-year average of the pre-Covid-19 ASX200 return).

Cost of option value and risk

The cost of loss of option value and increased risk was assumed to be 0.5% of the NTA top up amount.

Appendix C Sensitivity analysis

Sensitivity analysis was undertaken to test the impact of key assumptions applied in estimating costs, which were largely informed through stakeholder consultations.

Many of the costs are based on assumptions derived from stakeholder consultations and are therefore subject to uncertainty. Key assumptions were adjusted, generally by +/-20%, to test their impact on the total costs of the regime. A selection of assumptions that made a large impact on the overall costs are presented in the following tables.

Current MFRs sensitivity analysis

For calculating the costs of the current MFRs, both the compliance hours and third party cost assumptions made a large difference to the overall costs (Table 16 and Table 17). If the number of compliance hours are reduced by 20%, the total cost of the scheme reduces by around \$10 million, from \$78 million to \$69 million. When increasing hours by 20%, the total cost increased by the same amount to \$88 million. When third party costs were reduced by 20%, the total cost decreased by \$4 million, resulting in a total cost of \$74 million. There was an increase of the same amount when third party costs went up by 20%, with total costs equalling \$82 million.

Table 16. Cost of current MFRs sensitivity testing: Compliance hours per year

| Variable | Fewer hours (-20%) | Central | More hours (+20%) |
|---------------------------|--------------------|------------|-------------------|
| Small businesses | 12 | 15 | 18 |
| Medium businesses | 36 | 45 | 54 |
| Large businesses | 48 | 60 | 72 |
| Impact on total cost (\$) | (9,515,640) | - | 9,515,640 |
| Revised total cost (\$) | 68,824,450 | 78,340,090 | 87,855,730 |

Table 17. Cost of current MFRs sensitivity testing: Third party costs (\$)

| Variable | Decrease in costs (-20%) | Central | Increase in costs (+20%) |
|----------------------|--------------------------|------------|--------------------------|
| Small businesses | 40 | 50 | 60 |
| Medium businesses | 1,200 | 1,500 | 1,800 |
| Large businesses | 4,800 | 6,000 | 7,200 |
| Impact on total cost | (4,078,000) | - | 4,078,000 |
| Revised total cost | 74,262,090 | 78,340,090 | 82,418,090 |

Previous MFRs sensitivity analysis

For calculating the costs of the previous MFRs, both the compliance hours and third party cost assumptions made a large difference to the overall costs (Table 18 and Table 19). If the number of compliance hours are reduced by 20%, the total cost of the scheme reduces by around \$5 million, from \$43 million to \$38 million. When increasing hours by 20%, the total cost increased by \$5 million to around \$48 million. When third party costs were reduced by 20%, the total cost decreased by \$2 million, resulting in a total cost of \$41 million. There was an increase of the same amount when third party costs went up by 20%, with total costs equalling \$45 million.

Table 18. Cost of previous MFRs sensitivity testing: Compliance hours per year

| Variable | Fewer hours (-20%) | Central | More hours (+20%) |
|---------------------------|--------------------|------------|-------------------|
| Small businesses | 6 | 8 | 9 |
| Medium businesses | 18 | 23 | 27 |
| Large businesses | 24 | 30 | 36 |
| Impact on total cost (\$) | (4,757,820) | - | 4,757,820 |
| Revised total cost (\$) | 38,128,801 | 42,886,621 | 47,644,441 |

Table 19. Cost of previous MFRs sensitivity testing: Third party costs (\$)

| Variable | Decrease in costs (-20%) | Central | Increase in costs (+20%) |
|----------------------|--------------------------|------------|--------------------------|
| Small businesses | 20 | 25 | 30 |
| Medium businesses | 600 | 750 | 900 |
| Large businesses | 2,400 | 3,000 | 3,600 |
| Impact on total cost | (2,039,000) | - | 2,039,000 |
| Revised total cost | 40,847,621 | 42,886,621 | 44,925,621 |

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