

The Auditor-General
Audit Report No.13 2004–05
Business Support Process Audit

Superannuation Payments for Independent Contractors working for the Australian Government

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of Australia 2004

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Canberra ACT
28 October 2004

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a business support process audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Superannuation Payments for Independent Contractors working for the Australian Government*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett', is positioned above the printed name.

P. J. Barrett
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

ABS	Australian Bureau of Statistics
AGS	Australian Government Solicitor
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
BSP Audit	Business Support Process Audit
CSS	Commonwealth Superannuation Scheme
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
GaPS	Gazette Publishing System
GST	Goods and Services Tax
PB Act	<i>Superannuation (Productivity Benefit) Act 1988</i>
PSS	Public Sector Superannuation Scheme
PS Act	<i>Public Service Act 1999</i>
SG Act	<i>Superannuation Guarantee (Administration) Act 1992</i>
SIS Regulations	<i>Superannuation Industry (Supervision) Regulations 1992</i>

Glossary

Administer	For the purposes of this audit, this term is used in the context of Administrative Arrangement Orders rather than the usage commonly applied in a superannuation context of the payment of superannuation contributions and benefits in respect of individual employees.
Continuing contribution	Term used within the <i>Superannuation (Productivity Benefit) Act 1988</i> to specify superannuation amounts to be paid on a qualified employee's behalf for work being currently performed.
Contract	Regulation 3 of the <i>Financial Management and Accountability Regulations 1997</i> defines a Commonwealth contract as "an agreement for the procurement of goods and services under which the Commonwealth is obliged, or may become obliged, to make a payment of public money.
Independent Contractor	For the purposes of this audit, this term is defined as an individual that operates a business as an individual or sole trader but is not considered to be a common-law employee.
Individual	A person who operates a business under the structure of an individual or a sole trader, as opposed to a company, trust, partnership etc.
Interim benefit	Term used within the <i>Superannuation (Productivity Benefit) Act 1988</i> to specify amounts to be paid on a qualified employee's behalf for work previously performed. Includes an interest component.
Qualified employee	A range of people who are entitled to have superannuation benefits paid on their behalf under the <i>Superannuation (Productivity Benefit) Act 1988</i> .
Salary sacrificing	An arrangement between an employer and an employee whereby certain expenses, for example motor vehicles and personal superannuation contributions, are paid from an employee's gross pay, with personal income tax being calculated after these amounts are deducted.

Superannuation Guarantee Charge	Penalty for non-payment of superannuation contributions in accordance with the <i>Superannuation Guarantee (Administration) Act 1992</i> . Includes the amount of the superannuation shortfall, plus a nominal interest component and an administration fee.
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Summary and Recommendations

Summary

Background

1. Successive Australian Governments have sought to improve self-provision in retirement and reduce reliance on the age pension. This has been done by requiring compulsory saving through mandatory superannuation contributions by employers on behalf of their employees. As a result of this policy, a number of superannuation arrangements exist covering both the private and public sectors.

2. The employer is legally responsible for making superannuation contributions for the benefit of the employee. If superannuation is not contributed in accordance with this, the employer is considered to be at fault and reparation will be required.

3. Contractors who operate under the business structure of an individual or sole trader fall outside the traditional definition of 'employee' and, therefore, are not covered by the traditional mandatory superannuation regimes¹. Instead, these individuals have superannuation contributions paid on their behalf where the contracts they work under are considered to be for their labour.

4. The two pieces of relevant legislation that create a statutory obligation for the Commonwealth to provide superannuation contributions for certain contractors and consultants who are employed by the Commonwealth are as follows:

- *Superannuation (Productivity Benefit) Act 1988* (PB Act), which establishes superannuation arrangements for employees of the Commonwealth and 'approved authorities' who are not covered by the Commonwealth Superannuation Scheme or the Public Sector Superannuation Scheme. The PB Act was expanded to cover labour contracts in July 1992, by reference to subsection 12(3) of the *Superannuation Guarantee (Administration) Act 1992*, which states:

if a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract.

- *Superannuation Guarantee (Administration) Act 1992* (SG Act), which establishes a minimum level of superannuation contribution for the community. The SG Act applies to Commonwealth organisations

¹ For example, the Public Sector Superannuation Scheme (PSS), available to workers employed under the *Public Service Act 1999*, and other Australian Government employees.

where there has been a shortfall in the superannuation contributions paid under the PB Act.

The audit

Audit objectives

5. The objectives of the audit were to:
- examine a number of contracts to determine whether the obligations under the *Superannuation (Productivity Benefit) Act 1988* had been met; and
 - identify the level and appropriateness of advice given and received by Commonwealth organisations on the application of the *Superannuation (Productivity Benefit) Act 1988*.

Audit methodology

6. The audit methodology included testing a sample of contracts from the 2002–2003 financial year recorded in the Gazette Publishing System (GaPS) where the supplier was operating under the business structure of an individual. The sample, selected by the Australian Bureau of Statistics (ABS), was statistically based, and as a result, conclusions from the findings can be used to make valid inferences about the audit population².

7. The audit also examined the roles of the Department of Finance and Administration (Finance) and the Australian Taxation Office (ATO) as administrators³ of the PB Act and SG Acts, respectively, and the level and appropriateness of advice that they had provided to Commonwealth organisations on the application of the Acts.

Audit conclusion

8. The ANAO concluded that, of the contracts tested in the audit sample, superannuation obligations had been met in 25 instances. This was out of a total of 78 contracts where it was considered that the contract was *wholly or principally for labour* and where it was unclear⁴ as to whether the contract were *wholly or principally for labour*.

² The 34 organisations included in the audit are listed in Appendix 1.

³ The term administrator is used in the context of Administrative Arrangement Orders rather than the usage commonly applied in a superannuation context of the payment of superannuation contributions and benefits in respect of individual employees.

⁴ An unclear assessment was made of a contract where the legal advice sought by the ANAO from two legal advisors concluded differently as to whether the contract was *wholly or principally for labour*.

9. The ANAO concluded that, generally, there was a lack of awareness of the requirements of the PB Act within Commonwealth organisations, even though some had sought legal advice and developed policies, procedures and standard contract clauses that incorporated superannuation requirements for independent contractors.

10. Finance and the ATO had provided appropriate advice on the application of the PB and SG Acts, in various forms, over a number of years. However, the ANAO concluded that clarification of a number of issues was still required. The most significant of these issues were:

- the interaction and boundaries between the PB and SG Acts;
- whether there is a continuing role for the PB Act, and if so, how to make the PB Act less complex in achieving that role; and
- mechanisms for monitoring Commonwealth organisations' compliance with the PB Act.

Recommendations

Recommendation No.1 is directed at the Department of Finance and Administration and the Australian Taxation Office. Recommendation No.2 is based on the findings from the Commonwealth organisations reviewed but is likely to have relevance to other Commonwealth organisations.

Recommendation No.1 The ANAO recommends that, in conjunction, Finance and the ATO clarify:

Para 4.47

- the interaction and boundaries between the PB and SG Acts;
- whether there is a continuing role for the PB Act, and if so, how to make the PB Act less complex in achieving that role; and
- mechanisms for monitoring Commonwealth organisations' compliance with the PB Act.

Recommendation No.2 The ANAO recommends that Commonwealth organisations:

Para 5.20

- determine whether existing administrative processes adequately control the risks of contracting with individuals where contracts are *wholly or principally for labour*;
- establish appropriate controls and processes where it is found that existing processes do not adequately control the risks of contracting with individuals; and
- address the risk that statutory superannuation obligations in past and current contracts have not been met.

Organisations' responses to the recommendations

11. Finance and the ATO agreed with Recommendation No.1 and all organisations generally agreed with Recommendation No.2.

12. Organisations' full responses to Recommendation No.2 and general comments are in Appendix 7.

Audit Findings and Conclusions

1. Introduction

Background to superannuation

1.1 Successive Australian Governments have sought to improve self-provision in retirement and reduce reliance on the age pension by requiring compulsory saving through mandatory superannuation contributions by employers on behalf of their employees. As a result of this policy, a number of superannuation arrangements are available covering both the private and public sectors.

1.2 The employer is legally responsible for making superannuation contributions for the benefit of the employee. If superannuation is not contributed in accordance with this obligation, the employer is considered to be at fault and reparation will be required.

1.3 Contractors who operate under the business structure of an individual, or sole trader, fall outside the traditional definition of 'employee' and, therefore, are not covered by the traditional mandatory superannuation arrangements⁵. Instead, these individuals have superannuation contributions paid on their behalf where the contracts they work under are considered to be for their labour.

1.4 The two pieces of relevant legislation that create a statutory obligation for the Commonwealth to provide superannuation contributions for certain contractors and consultants who are employed by the Commonwealth are as follows:

- *Superannuation (Productivity Benefit) Act 1988* (PB Act), which establishes superannuation arrangements for employees of the Commonwealth and 'approved authorities' who are not covered by the Commonwealth Superannuation Scheme or the Public Sector Superannuation Scheme. The PB Act was expanded to cover labour contracts in July 1992, by reference to subsection 12(3) of the *Superannuation Guarantee (Administration) Act 1992*, which states:

if a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract.
- *Superannuation Guarantee (Administration) Act 1992* (SG Act), which establishes a minimum level of superannuation contribution for the community. The SG Act applies to Commonwealth organisations

⁵ For example, the Public Sector Superannuation Scheme (PSS), available to workers employed under the *Public Service Act 1999*, and other Australian Government employees.

where there has been a shortfall in the superannuation contributions paid under the PB Act.

Senate Committee Request

1.5 In June 2002, the Senate Select Committee on Superannuation was advised that, between 1998 and May 2002, the Australian Quarantine Inspection Service (AQIS) had failed to make superannuation contributions on behalf of engaged independent contractors. The Senate was also advised that:

AQIS had now obtained legal advice that under the *Superannuation Guarantee (Administration) Act 1992* (SG Act), independent contractors should be deemed employees for the purposes of the Act. As a result, AQIS should have made superannuation payments for the independent contractors in accordance with the rates outlined in the *Superannuation (Productivity Benefit) Act 1988*.⁶

1.6 In August 2002, the Senate requested that the ANAO conduct an audit on:

- the extent to which Commonwealth government departments are using, or have used, contracting-out arrangements and, as a result, have avoided the payments of the Superannuation Guarantee; and
- the involvement of the Department of Finance and Administration (Finance), the Australian Taxation Office (ATO) or any other organisation in the establishment of contracting-out arrangements which resulted in the non-payment of the Superannuation Guarantee in AQIS and/or any other Commonwealth government department⁷.

Audit objectives, methodology and approach

Audit objectives

1.7 The objectives of the audit were to:

- examine a number of contracts to determine whether the obligations under the *Superannuation (Productivity Benefit) Act 1988* were met; and
- identify the level and appropriateness of advice given and received by Commonwealth organisations on the application of the *Superannuation (Productivity Benefit) Act 1988*.

⁶ Senate Select Committee on Superannuation letter, 22 August 2002.

⁷ *ibid.*

Audit methodology

1.8 The audit methodology included testing a sample of contracts, from the 2002–2003 financial year, recorded in the Gazette Publishing System (GaPS) where the supplier was operating under the business structure of an individual. The sample, selected by the Australian Bureau of Statistics (ABS), totalled 170 entries across 34 Commonwealth organisations⁸. The sample was selected using accepted statistical methodology, and as a result, conclusions from the findings can be used to make valid inferences about the audit population.

1.9 The ANAO examined each contract, in conjunction with legal advice where necessary, to determine whether superannuation contributions should have been made. If superannuation contributions should have been made, the ANAO examined whether they were paid, and if so, whether they had been calculated correctly.

1.10 The audit also examined the roles of Finance and the ATO as administrators⁹ of the PB Act and SG Acts, respectively, and the level and appropriateness of advice that they had provided to Commonwealth organisations on the application of the Acts.

Audit approach

1.11 The audit approach involved interviews with selected officers, testing a sample of contracts, examination of documents and records supporting the GaPS entries, and general observation.

1.12 The ANAO provided each organisation reviewed with a management report on the audit. The management report included results of the review of the organisation's contracts and legal advice received.

1.13 The audit was undertaken in accordance with ANAO Auditing Standards during the period May 2003 to September 2004, at an approximate cost of \$341 000.

⁸ The 34 organisations included in the audit are listed in Appendix 1.

⁹ The term administrator is used in the context of Administrative Arrangement Orders rather than the usage commonly applied in a superannuation context of the payment of superannuation contributions and benefits in respect of individual employees.

Audit report structure

1.14 The legislative framework surrounding the provision of superannuation for contractors is outlined in Chapter 2. Chapter 3 details the methodology used and the results of the audit sample testing and Chapter 4 provides an outline of the roles and activities of Finance and the ATO. Chapter 5 details matters for Commonwealth organisations to consider so that they can comply with the PB Act.

2. Legislative Framework

Superannuation legislation covering contractors

2.1 As discussed briefly in Chapter 1, the two pieces of relevant legislation for superannuation contributions by Commonwealth organisations¹⁰ for contractors are the PB and SG Acts.

The PB Act

2.2 The PB Act was enacted in 1988 to provide a three percent productivity benefit to public sector employees, after a decision by the Conciliation and Arbitration Commission in 1986 provided for employers and unions to negotiate new and/or additional superannuation agreements costing up to three percent¹¹. It was intended to be an interim arrangement due to ‘time constraints ...precluding finalisation of the longer-term form of the benefits’¹², and one that ‘could be administered without a central administrator’^{13,14}.

2.3 The PB Act originally provided for a ‘productivity benefit’ to those employees who had no other employer-sponsored superannuation, as well as an additional benefit to public sector employees who already had benefits under the *Superannuation Act 1976*.

2.4 The PB Act in its current form, by virtue of amendments made in 1990¹⁵, now requires superannuation contributions to be provided only to public sector employees with no other employer-sponsored superannuation. The obligation to make productivity superannuation contributions for relevant members of the Commonwealth Superannuation Scheme (CSS) and Public Sector Superannuation Scheme (PSS) was transferred on 1 July 1990 to the *Superannuation Act 1976* and the *Superannuation Act 1990* respectively. In that same amendment, the section providing for ‘continuing contributions’ and

¹⁰ The PB Act applies to ‘approved authorities’. An approved authority for the purposes of the PB Act is a body that is an approved authority for the purposes of the *Superannuation Act 1976* or the *Superannuation Act 1990*.

¹¹ The PB Act came into being under a different name, the *Superannuation Benefit (Interim Arrangement) Act 1988*, to serve the purpose of providing that benefit. This benefit (known as the ‘interim benefit’) was originally unfunded and payable into an approved fund, or in cash if less than \$500, only when employees retired or left their public sector employment.

¹² Explanatory Memorandum, *Superannuation Benefit (Interim Arrangement) Bill 1988*, p. 1.

¹³ *ibid.*

¹⁴ The Department of Finance and Administration is responsible for advising the Minister for Finance and Administration on policy issues concerning the PB Act. Compliance with the PB Act is the responsibility of individual Commonwealth organisations.

¹⁵ *Superannuation Legislation Amendment Bill 1990*, No.40 of 1990.

their method of calculation was included, along with the power for the Minister for Finance to make declarations under the PB Act.

2.5 Further significant amendments were enacted by way of a Ministerial Declaration, which took effect from 1 July 1992. The definition of ‘qualified employee’ was expanded by reference to subsection 12(3) of the SG Act to cover contracts that are *wholly or principally for labour*. Such people can include certain contractors, consultants, and board members, amongst others.

Superannuation benefits made under the PB Act

2.6 The PB Act provides for two types of benefits as follows:

- **Continuing contributions.** These contributions are payable for current labour provided by persons with no other employer-sponsored superannuation cover in respect of their Commonwealth or ACT sector employment or appointment.
- **Interim benefits.** These benefits are payable for past employment where the employer has failed to make contributions, regardless of whether that contractor has ceased employment or the employment is still continuing. Contractors, whose employment is still continuing, will be entitled to receive continuing contributions for the remainder of the employment period in addition to the ‘catch-up’ interim benefit paid.

The SG Act

2.7 The SG Act applies to employers generally. The SG Act requires all employers to provide a prescribed minimum level of superannuation support in each financial year for each of their employees, subject to limited exemptions. Employers who fail to provide the prescribed minimum level of support are liable to the Superannuation Guarantee Charge, equivalent to the amount of the shortfall plus a nominal interest component and an administration fee¹⁶.

2.8 The SG Act generally does not, in practical terms, have an impact on Commonwealth organisations because superannuation contributions made in accordance with the PB Act reduce, by virtue of section 23 of the SG Act, any superannuation liability under the SG Act to zero. However, if the PB Act does not apply and no other superannuation contributions are made, Commonwealth organisations will still incur a liability to pay the superannuation guarantee charge. The charge which is paid, and which is equal to the shortfall amount plus interest, is distributed in the form of superannuation contributions for the benefit of relevant employees.

¹⁶ <<http://www.ato.gov.au/super/content.asp?doc=/content/19165.htm>>.

Superannuation contribution rates

2.9 The minimum rates of superannuation provided under both Acts are broadly comparable. The contribution rate was nine percent for 2002–2003, which has increased from the original three percent for 1990–1991.

Responsibilities for administering the Acts

2.10 As the employer, an individual Commonwealth organisation is responsible for complying with the PB Act, including making superannuation contributions for contractors working under contracts that are *wholly or principally for labour*.

2.11 Finance is responsible for administering¹⁷ the PB Act. The ATO is responsible for administering the SG Act and for providing advice to Commonwealth organisations on the definition of *wholly or principally for labour*.

Role of Finance

2.12 Finance supports the Minister for Finance and Administration with his responsibilities for superannuation for Commonwealth employees and parliamentarians by:

- providing policy advice to the Minister for Finance and Administration on superannuation issues, including those arising under the PB Act;
- providing general advice to Commonwealth employers on the PB Act arrangements; and
- distributing information to Commonwealth employers when new contribution figures or interest factors are declared, when new funds are approved and in response to substantial changes in the way the arrangements are to be administered.

Role of ATO

2.13 As the administrator of the SG Act, the ATO's role is to provide advice and assistance to Commonwealth employers on subsection 12(3) of the SG Act, that is, on contracts *wholly or principally for labour*. The ATO's role also includes:

- assisting Commonwealth employers to understand and meet the ancillary obligations that apply to Commonwealth employers under the

¹⁷ The term administrator is used in the context of Administrative Arrangement Orders rather than the usage commonly applied in a superannuation context of the payment of superannuation contributions and benefits in respect of individual employees.

SG Act, such as the recently introduced requirement to report contributions to employees; and

- ensuring that Commonwealth employers and employees receive correct advice regarding superannuation obligations, including where necessary referral of employers to Finance for advice in relation to the PB Act.

3. Audit Testing Results

Introduction

3.1 The audit methodology included selecting an audit population of contracts from the 2002–2003 GaPS database, where the supplier was operating under the business structure of an individual. This population totalled 8252 contracts, of which, a sample of 170 contracts was randomly selected.

3.2 Of the 170 contracts in the sample, 20 were found to be outside of the scope of the audit. These 20 contracts were removed from the sample, and the total audit population of contracts was reduced proportionately.¹⁸

Testing methodology

3.3 Each contract in the sample was tested to determine whether, under the PB Act, a statutory superannuation obligation existed. The ANAO developed, in conjunction with legal advisors and technical consideration by Finance and the ATO, a two-step process to review each contract, as follows.

3.4 The first step was to consider whether the individual could be considered a common-law employee. The distinction between a common-law employee and an independent contractor was necessary because common-law employees are automatically captured under the PB Act regardless of whether the contract is *wholly or principally for labour*¹⁹.

3.5 The second step assessed any contract where the individual was not considered to be a common-law employee. The ANAO classified these contracts as those with an ‘independent contractor’ and then assessed whether the contract was *wholly or principally for labour*. If the relationship with an ‘independent contractor’ was found to be *wholly or principally for labour*, a statutory superannuation obligation existed under the PB Act.

3.6 Where a superannuation obligation was identified, the ANAO assessed whether superannuation contributions had been made and had been calculated correctly.

¹⁸ The original audit population of 8252 contracts was adjusted proportionately for the 20 contracts in the sample found to be out-of-scope. The size of the resulting ‘in-scope’ audit population was estimated to be 7260 contracts. The estimates of proportions of the audit testing results were calculated using the ‘in-scope’ audit population.

¹⁹ Classification as a common-law employee has other implications, which are discussed in Appendix 3 of this report.

Step 1: Common-law employee

3.7 The ANAO used a number of indicators to determine whether a common-law employee relationship existed. The traditional test of an employment relationship is the ‘control test’²⁰, that is, does the employer have the right to control how and what the contractor does. The ANAO was advised, however, that the Courts now tend to regard it only as one of the indicators, even though it is still an important one. The other indicators include the mode of remuneration, the obligation to work, the hours worked, and the power to delegate performance of work²¹. The final decision is generally a fine balance of all the indicators rather than one overriding test. Table 3.1 provides a description of these indicators.

Table 3.1

Common law employee relationship indicators

Indicators	Description
Right to control work	This test involves who has the right to control how, when and where the work is done. The control does not have to be exercised—just the right to it is sufficient to imply an employer-employee relationship.
Supervision, remuneration and finances including the provision and maintenance of equipment	Employers generally supervise the conduct and work of their employees, as well as remunerating them based on time. Additionally, they invest in their staff by way of training and providing equipment for them to work. The High Court postulated in <i>Federal Commissioner of Taxation v Vabu Pty Ltd</i> : It is significant to note that one of the considerations mentioned by Meagher JA in the Taxation decision [the SGA Act] as indicating that the couriers were independent contractors was that they bore the ‘very considerable’ expense of providing, maintaining and insuring their own vehicles.
Obligation to work	Employees generally are obliged to work certain days or hours to continue in their employment
Hours of work and place of work	Employers have the right to dictate the hours and place of work of their employees.
Provision of holidays, deduction of income tax and payment of superannuation	An employer-employee relationship could be implied if a contractor is provided with paid leave entitlements such as holidays. Additionally, an employer-employee relationship could also be implied where payments to the contractor have income tax deducted from the gross amount.

²⁰ *Queensland Stations Pty Ltd v Federal Commission of Taxation* (1945) 70CLR 539 at 545.

²¹ *Stevens v Brodribb Saw Milling Company Pty Ltd* (1986) 160CLR 16.

Indicators	Description
Right to delegate to someone else	Legal precedent has shown that a contract is a contract for a person's labour if only that person is able to perform the tasks required under that contract. If the contract leaves it to the discretion of the contractor as to who performs the work, then the contract is not a contract for the labour of a particular person. ²²
Exclusive right to the services of the particular worker	Employers generally have the right to the exclusive services of their employees. If a contractor works only for one organisation, an implication could be made that an employment relationship exists.
Right to suspend or dismiss the person engaged	Employers generally have the right to suspend or dismiss an employee when their performance does not meet the required standard. A dispute involving a contractor will generally involve alternate remedial action such as mediation or non-payment until the service standard is remedied.
Whether the worker is an emanation of the employer and works as part of the employer's business or pursues the worker's own business – the business integration test	The integration test examines whether the individual's services are an integral part of the employer's business or merely ancillary to it. The ATO, in <i>Draft Superannuation Guarantee Ruling SGR 2004/D1</i> , also considered it necessary to keep in mind the distinction between a worker operating on his or her own account and a worker operating in the business of the payer ²³ .
Providing skilled labour or labour which requires special qualifications, whether able to make an independent career	The use of professional or skilled labour implies that the contractor can make an independent career. A contractor with an independent career can imply that the contractor could be conducting his/her own business using those skills. This generally suggests that a contractual relationship exists rather than an employer-employee relationship. However, professionals can be engaged to provide services under a contract that is an employer-employee relationship.
The way the parties themselves have characterised their relationship	Contracts often include a specification that the worker is not to be treated as an employee and therefore, the contract is not <i>wholly or principally for labour</i> . This specification cannot stand against the true nature of the relationship if it is to a contrary effect. However, it was treated as decisive in <i>Building Workers Industrial Union of Australia and Ors v Odco Pty Ltd</i> ²⁴ where matters of fine judgment were involved.

Source: ANAO, based on legal advice, Department of Finance and Administration Superannuation Circular Number 43 and ATO's *Superannuation Guarantee Ruling 93/1* (Note – Superannuation Guarantee Ruling 93/1 was superseded by *Draft Superannuation Guarantee Ruling 2004/D1* in August 2004).

²² *World Book (Australia) Pty Ltd v Commissioner of Taxation* 92 ATC 4327; (1992) 23 ATR 412.

²³ Australian Taxation Office, *Draft Superannuation Guarantee Ruling 2004/D1 Superannuation guarantee: who is an employee?*, August 2004, para. 38.

²⁴ *Building Workers Industrial Union of Australia and Ors v Odco Pty Ltd* (1991) 99 ALR 735.

3.8 These indicators are not always straightforward as there may be some indicators within a contract suggesting an employment relationship, and others suggesting an independent contractual relationship. Each individual indicator has to be balanced against the others to determine the overall nature of the relationship.

Step 2: Engagement—*Wholly or principally for labour*

3.9 Where a contract has been deemed to be one with an ‘independent contractor’ rather than a common-law employee relationship, it was then necessary to determine whether it is *wholly or principally for labour*. If it is, the PB Act applies. Table 3.2 below describes the indicators used to determine whether the contract is *wholly or principally for labour*. Again, these indicators are not always straightforward, and a balanced judgement has to be made.

Table 3.2

Criteria for determining whether a contract is *wholly or principally for labour*

Indicators	Description
Contract principally for labour	A contract is principally for labour if the contract is ‘chiefly’ or ‘mainly’ for labour ²⁵ . Labour includes mental and artistic effort as well as physical work ²⁶ . This is opposed to a contract that is to produce a given result. For example, the production of an advertisement.
Contract for particular person – ie. No right to delegate	The contract is for the labour of the person who works under the contract, that is, the contractor has no right to delegate work to another party.
Contract is with a natural person	A contract for labour inherently requires a contract with an individual as opposed to a contract with a company etc.
Payment for time rather than outcome/results	Payment for outcome/results implies that: <ul style="list-style-type: none"> the contract is for a particular result; the contractor is free to choose the manner in which the result was produced; duties being performed by the contractor are discrete and separate from the business of the organisation; the contractor is paid a set fee; and the fee or final instalment is payable upon completion of the task

²⁵ Australian Taxation Office, op. cit., para. 61.

²⁶ *ibid.*, para. 13.

Indicators	Description
The way the parties themselves have characterised the relationship	Contracts often include a specification that the worker is not to be treated as an employee and therefore, the contract is not <i>wholly or principally for labour</i> . This specification cannot stand against the true nature of the relationship if it is to a contrary effect. However, it was treated as decisive in <i>Building Workers Industrial Union of Australia and Ors v Odco Pty Ltd</i> ²⁷ where matters of fine judgment were involved.

Source: Based on legal advice, Department of Finance and Administration Superannuation Circular Number 43 and ATO's *Superannuation Guarantee Ruling 93/1* (Note – Superannuation Guarantee Ruling 93/1 was superseded by *Draft Superannuation Guarantee Ruling 2004/D1* in August 2004).

3.10 If a contract is found to be *wholly or principally for labour*, the Commonwealth employer is obligated, in accordance with the PB Act, to make superannuation contributions for the benefit of the contractor.

Interpretation of the indicators

3.11 The indicators used to determine whether a common-law employment relationship exists or a contract is *wholly or principally for labour*, have to be balanced against each other.

3.12 The courts, over time, have placed differing levels of emphasis on the various indicators in different cases. Because each contract has its own particular characteristics, it is difficult to assess how a court would interpret particular facts in each situation, and, what emphasis would be placed on the different indicators. This means that, when contracts are being interpreted, conflicting, yet legitimate, viewpoints can be established on the facts of the same contract.

3.13 These conflicting viewpoints were evidenced in the legal advice provided to the ANAO as part of the audit. The ANAO obtained legal advice from two legal advisors, about 85 contracts. Both legal advisors acknowledged that the characterisation of the contractual relationship involves questions of judgement in assessing the various indicators. The legal advisors' assessment differed in their interpretation of whether a contract was *wholly or principally for labour* in 45 instances. The approaches taken by both legal advisors are summarised below.

3.14 Legal Advisor 1 considered all indicators (noted in Tables 3.1 and 3.2 above) when analysing a contract, and suggested that the power to delegate should be considered as an important criterion for identifying a contract to produce results, as distinguished from a contract wholly or principally for the

²⁷ *Building Workers Industrial Union of Australia and Ors v Odco Pty Ltd* (1991) 99 ALR 735.

labour of a person. Legal Advisor 1 considered other factors were also relevant noting that a question of judgement was involved in each case. In relation to the power to delegate, Legal Advisor 1 referred to the *World Book* case²⁸:

However, in the present case, when the essence of the contract was to achieve a result and not to do work, and where under the contract the payee was not obliged to do any work at all (although in fact he apparently did a great deal), in my view the payment was not made under a contract of the kind to which the statutory definitions refer.

3.15 Legal Advisor 2 agreed that a contract in which the contractor can delegate is not a contract for labour, but is for a result achieved. However, Legal Advisor 2 did not believe that the obverse was true, noting that the absence of a power to delegate did not necessarily mean that the contract was one *wholly or principally for labour*. Legal Advisor 2 considered it to be appropriate to consider whether: the contractor was paid a set fee; there was an upper limit to the fee payable; payment was contingent upon completion of a task or certain milestones; and the duties, being performed by the contractor, were discrete, and separate from the main business of the Commonwealth organisation.

Analysis of audit testing results

Audit objective	Examine a number of contracts to determine whether the obligations under the <i>Superannuation (Productivity Benefit) Act 1988</i> were met.
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Statutory obligation compliance

3.16 The ANAO reviewed each contract in the audit sample against the indicators shown in Tables 3.1 and 3.2. The sample was tested to determine whether the contract could be assessed as *wholly or principally for labour* and whether the resulting superannuation obligation had been met. The ANAO sought two legal opinions on any contract where it was not clear whether it was *wholly or principally for labour*. A contract was assessed as unclear where the two legal advisors had differing viewpoints (see Table 3.3).

²⁸ *World Book (Australia) Pty Ltd v Federal Commissioner of Taxation* (1992) 108 ALR 510.

Table 3.3**Overall sample results**

Total number of contracts reviewed	Contracts <i>wholly or principally for labour</i>	Contracts where it is unclear whether it is <i>wholly or principally for labour</i>	Contracts not <i>wholly or principally for labour</i>
150	33	45	72

Source: ANAO fieldwork results

3.17 Table 3.4 shows the number of contracts in the audit population²⁹ that could be considered as being *wholly or principally for labour* ranged from 1186 to 2501. The number of contracts where it is unclear whether the contract is *wholly or principally for labour* ranged from 1085 to 2124.

Table 3.4**Statistical analysis of contracts**

Contract assessment category	No. of contracts	95% Confidence Interval for the estimate of no. of contracts in pop.		95% Confidence Interval for the estimate of no. of contracts as % of total in-scope pop.	
		Lower bound	Upper bound	Lower bound	Upper bound
Contracts <i>wholly or principally for labour</i>	33	1186	2501	16.5	34.3
Contracts unclear as to whether they are <i>wholly or principally for labour</i>	45	1085	2124	15.1	29.1

Source: ANAO fieldwork results

Contracts where superannuation had been paid

3.18 The ANAO found that superannuation contributions had been made in relation to 25 of the 78 contracts, which had been categorised as *wholly or principally for labour* or unclear as to whether they were *wholly or principally for labour* (See Table 3.5).

3.19 The estimate of the number of contracts where superannuation had been paid ranged from 823 to 2022. Table 3.5 also presents this estimate as a percentage of the estimated number of contracts that had been categorised as *wholly or principally for labour* or unclear as to whether they were *wholly or principally for labour*.

²⁹ Estimates have been calculated by weighting the sample data to represent all the contracts in the population. A confidence interval has been presented with each estimate to give a measure of its accuracy.

Table 3.5**Extrapolation of contracts where superannuation contributions were made**

No. of contracts incl.	Contracts where super. was paid	95% Confidence Interval for the estimate of no. of contracts where superannuation was paid in the population		95% Confidence Interval estimate of contracts where super. was paid as % of contracts either wholly or principally for labour or unclear	
		Lower bound	Upper bound	Lower bound	Upper bound
78	25	823	2022	26.3	56.2

Source: ANAO fieldwork results

Calculation of superannuation contributions

3.20 Of the 25 contracts where superannuation contributions had been made, only 10 superannuation contributions had been correctly calculated (see Table 3.6).

Table 3.6**Analysis of contracts where superannuation contributions were made**

No. of contracts incl.	Contracts where super. was paid correctly	95% Confidence Interval for the estimate of no. of contracts where superannuation was paid correctly		95% Confidence Interval estimate of contracts where super. was paid correctly as % of contracts either wholly or principally for labour or unclear	
		Lower bound	Upper bound	Lower bound	Upper bound
78	10	196	784	6.3	22.2

Source: ANAO fieldwork results

3.21 Finance's *Superannuation Circular 43*³⁰ details how to calculate superannuation contributions. Firstly, a notional full-time rate of salary is to be calculated where a contractor is working part-time. Secondly, superannuation contributions are calculated at a flat rate of nine percent unless they are below or above certain thresholds, at which point the contribution is a specified set amount.

3.22 In the other 15 instances, the calculation method detailed in *Superannuation Circular 43*, had not been applied and overpayments of superannuation contributions had been made. The overpayment of superannuation contributions did not create a breach of the PB Act. However,

³⁰ Department of Finance and Administration, *Superannuation Circular 43*, June 2003.

the relevant Commonwealth organisations had paid more superannuation than they were statutorily obliged to pay.

Contracts not considered to be wholly or principally for labour

3.23 The ANAO concluded that a statutory superannuation obligation did not exist under the PB Act for 72 contracts for the following reasons:

- 41 contracts were with independent contractors, for results-based performance rather than *wholly or principally for labour*;
- 29 contracts were for the provision of materials, where the materials were the main item of the contract value³¹; and
- two contracts were with non-residents³².

3.24 The ANAO did not examine why superannuation contributions had not been made in relation to these 72 contracts and, therefore, was unable to conclude whether this situation was the result of an internal assessment of the contractual and corresponding statutory obligations or not.

Actions taken by Commonwealth Organisations to comply with the PB Act

3.25 A number of organisations had included references and guidelines on their obligations under the PB Act within Chief Executive Instructions and standard contract clauses. However, despite this, the ANAO found that, generally, there was a lack of awareness amongst staff, of the audited organisations, about superannuation obligations.

3.26 The ANAO also found that, prior to the audit commencing, 12 organisations had sought legal advice about their statutory superannuation obligations. This legal advice was used to assist the organisations in understanding superannuation requirements for contractors, including how to determine if contracts were *wholly or principally for labour*.

3.27 The ANAO also found that a number of Commonwealth organisations had implemented various standard contract clauses about statutory superannuation obligations. These clauses assist organisations in meeting statutory superannuation obligations. However, the ANAO was advised that where the true nature of the contractual relationship is *wholly or principally for labour*, standard contract clauses will not make it otherwise.

³¹ Australian Taxation Office, op. cit., para. 61.

³² Superannuation is not payable for work performed by a non-resident outside of Australia, and both of these cases were for work performed outside Australia.

Other issues

3.28 The ANAO identified a number of other issues, including recordkeeping and GST administration, as a part of the audit. These are discussed at Appendix 2.

Conclusion

3.29 The ANAO concluded that 33 of the 150 contracts reviewed in the audit sample could be assessed as being *wholly or principally for labour*, and as such superannuation obligations may exist under the PB Act. It was unclear in 45 other contracts as to whether they were *wholly or principally for labour*. Of the 25 contracts for which superannuation contributions had been made, 10 had been calculated correctly.

3.30 The ANAO considers that Commonwealth organisations need to address the results of audit testing in terms of the level of risk of non-compliance with the PB Act, currently and in the past, that the organisation faces. Chapter 5 of the report details issues that Commonwealth organisations may need to consider in addressing compliance with the PB Act.

4. Agencies' Roles in Administering the PB Act

Introduction

4.1 As discussed previously, an individual Commonwealth organisation is responsible for complying with the PB Act, including making superannuation contributions for contractors working under contracts that are *wholly or principally for labour*. Finance is responsible for administering³³ the PB Act, while the ATO is responsible for administering the SG Act and for providing advice to Commonwealth organisations regarding the definition of *wholly or principally for labour*.

Audit objective

Identify the level and appropriateness of advice given by the Department of Finance and Administration and the Australian Taxation Office on the application of the *Superannuation (Productivity Benefit) Act 1988*.

Role and activities of Finance

4.2 Finance provides the majority of its advice on the PB Act through the following means:

- The publication of the *Superannuation Circular*, which is discussed in detail later in this chapter.
- The operation of the *Superannuation Inquiry Hotline*. Finance staff members operate the hotline, answering questions on the PB Act. Any questions on the interpretation and application of subsection 12(3) of the SG Act, that is, whether contracts that are *wholly or principally for labour*, are referred to the ATO. 99 calls were received by the hotline from 1 July 2003 to 30 June 2004.
- A letter to Portfolio Secretaries in April 2003 reminding them of the requirement to provide superannuation for certain contractors and advising them of the information and assistance available to Departments and agencies from Finance in relation to the matter.
- A joint presentation by Finance and ATO at one of Finance's 2003 CFO forums to advise agencies of their obligations under the PB Act and how to make determinations as to whether a contract is *wholly or principally for labour*. Both Finance and the ATO advised that they had

³³ The term administering is used in the context of Administrative Arrangement Orders rather than the usage commonly applied in a superannuation context of the payment of superannuation contributions and benefits in respect of individual employees.

received increased levels of queries from agencies subsequent to the presentation at these forums, indicating that such a forum had raised awareness of the issues surrounding superannuation for contractors.

- The publication of a joint circular with the ATO. This included a circular titled *Superannuation entitlements for contractors/consultants and temporary employees engaged through independent agencies*³⁴, issued in March 2004.
- The participation in joint seminars with the ATO. These seminars, titled *Superannuation for contractors engaged by the Australian Government*, were held in Sydney, Canberra and Melbourne in June 2004.

Finance's Superannuation Circular

4.3 The primary method Finance uses to provide advice on the application of the PB Act is the *Superannuation Circular*, which is issued once a year. Additional circulars are issued as required. The circulars cover the following areas:

- overview of the PB Act;
- who is covered by the PB Act;
- superannuation funds accepting PB Act contributions;
- calculation of continuing contributions;
- reporting requirements;
- calculation of interim benefits; and
- short-term and highly casual arrangements.

4.4 The ANAO considered that there were a number of technical issues in the *Superannuation Circular 43*, current at the time of the audit, which required clarification and correction. These issues are detailed below.

Qualifying period

4.5 Section 5 of the PB Act states that:

an interim benefit is not payable in respect of a qualified employee unless, at the time when that benefit would be payable in respect of the employee, the employee has completed at least three months continuous service³⁵.

³⁴ <<http://www.ato.gov.au/super/content.asp?doc=/content/43970.htm>>, 19 June 2004.

³⁵ *Superannuation (Productivity Benefit) Act 1998*, subsection 5(1).

4.6 However, Finance's *Superannuation Circular 43* did not mention this section when providing advice on calculating interim benefits. Finance advised that this was because:

A strict application of the qualifying provisions would create an anomalous situation, in that where an employer fails to make continuing contributions on behalf of an employee and the safety net (interim benefit) arrangements in the PB Act apply, the employee would then have to meet the three month continuous service (or part-time equivalent) qualifying period in order to become entitled to an interim benefit. As [the ANAO] will note from the Circular, the interim benefit, includes a component for the contributions which should have been made, together with an interest component which ensures that the employee is not disadvantaged because those contributions were not paid to a fund when they were due to be paid.

The existence of a qualifying period for the payment of SG type benefits is not consistent with the current SG legislation, which contains no minimum qualifying period of employment before benefits are payable. [Finance's] examination of the Department's files on the PB Act has not located any discussion of the reasons for the retention of the qualifying period after the commencement of the SG arrangements.³⁶

4.7 The ANAO sought legal advice from the AGS to determine whether section 5 of the PB Act should be applied as it stands. The AGS agreed that where an employer fails to make statutory superannuation contributions for an employee from the start of their employment, an anomalous situation would exist because the employee would not be entitled to an interim benefit if the employment ceases before meeting the qualifying period. However, the AGS considered that, although the contrary argument is open, it was not open to agencies to ignore section 5 of the PB Act.

4.8 The AGS also considered that where the qualifying service requirement was not met, generally, the SG Act will apply.

4.9 During the course of the audit, Finance advised the ANAO that legislative amendments are currently under consideration to repeal section 5 of the PB Act.

Cashing restrictions

4.10 Section 6(3)(b) of the PB Act provides that an interim benefit of less than \$500 may be paid to the person when they cease employment, rather than being paid into a superannuation fund. Part 7 of Finance's *Superannuation Circular 43* stated, however, that the benefit could be taken in cash where it is less than \$200.

³⁶ Finance letter to the ANAO, 15 December 2003.

4.11 Finance's advice in the *Superannuation Circular 43* was based on the *Superannuation Industry (Supervision) Regulations 1992* (SIS Regulations)³⁷, which, amongst other things, govern payments of benefits under the SG Act. The SIS Regulations Schedule 1 Item 104 allows that a cash benefit can only be paid where the member's preserved benefits in the fund at the time of termination are less than \$200. Finance advised the ANAO that this approach was taken to provide a consistent and practical approach to administering the legislation.

4.12 The ANAO sought legal advice from the AGS, to clarify which authority prevails.

In our [AGS] view, strictly, an interim benefit under the PB Act is payable where the benefit is less than \$500. The \$200 SIS Regulations limit does not apply to interim benefits under the PB Act.

...there is nothing in the PB Act, or SIS legislation, that means the SIS cashing restriction prevails over the provisions of the PB Act itself in relation to interim benefits.

4.13 Finance issued *Superannuation Circular 43.1* in April 2004. The Circular advised Commonwealth organisations that the cashing restriction limit was \$500 rather than \$200, as previously advised.

Contributions for contractors aged 70 years and over

4.14 The PB Act does not state an age limit for the payment of superannuation contributions. Paragraph 2.5 of Finance's *Superannuation Circular 43* states that contributions should continue to be paid irrespective of the age of a person, and

if the employee's superannuation fund will not accept the contributions, the payments should be made directly to the employee.

4.15 However, sub-regulations 7.04(1C) and (1D) of the SIS Regulations only provide for employer contributions to be accepted by a regulated superannuation fund in respect of members who have reached the age of 70 and over, where the contributions are mandated employer contributions³⁸. The PB Act does not specify an age limit for the payment of superannuation contributions. However, contributions for employees aged 70 years and over would not usually be considered as 'mandated employer contributions' for the

³⁷ SIS Regulations are issued under the *Superannuation Industry Supervision Act 1992*, and govern the operation of superannuation funds, including the cashing limit of amounts once they have been paid into a fund.

³⁸ Mandated employer contributions are defined under SIS Regulation 5.01 as generally relating to superannuation guarantee (SG) contributions, SG shortfall components and award-related contributions (that is employer contributions payable under an award of agreement of an industrial authority).

purposes of the SIS Regulations, which means that a regulated superannuation fund cannot accept them.

4.16 The ANAO obtained legal advice from the AGS. The AGS considered that although the view adopted by Finance is arguable, and a possible resolution of the discrepancy, there may be another position to consider. The AGS advised that payments are not required in respect of persons aged over 70 years captured under the PB Act, for the following reasons.

The SIS Regulations operate to support the view that superannuation is not payable in respect of a person who is 70 years or over. Further, payments made directly to individuals are not in the nature of superannuation payments but rather are wages or salary.

We [the AGS] accordingly prefer the view that superannuation contributions are not payable in respect of a person who is 70 years or over. We consider, however, that the view taken by Finance is arguable and that it is reasonable for the Commonwealth to act on Finance's view in the short to medium term until the legislative position is clarified.

4.17 The ANAO advised Finance of the AGS view. Finance indicated that legislative amendments were currently under consideration to state explicitly that contributions could be paid directly to contractors who are aged 70 years and over.

Salary sacrificing

4.18 Finance's *Superannuation Circular* 43 states:

Salary sacrifice arrangements can be made for employees covered by the PB Act where a certified agreement or Australian Workplace Agreement made under the *Workplace Relations Act 1996* incorporates flexible remuneration arrangements that include salary sacrifice. In working out contributions and benefits under the PB Act, 'salary' means the salary that would be payable if there were no arrangements for salary sacrifice deductions.

4.19 The ANAO identified two Commonwealth organisations that, at the request of the contractor, paid the contract fee into the contractor's superannuation fund account.

4.20 The ANAO consulted with the ATO on what constitutes a salary sacrifice arrangement. The ATO considered that such arrangements, by their very nature, were not appropriate for contracting arrangements even if the contract was *wholly or principally for labour*. The ATO further noted that any fee amounts in excess of statutory superannuation obligations paid to a contractor's superannuation fund would be treated as income in the hands of the individual. If the individual in question did not declare that income to the ATO, the Commonwealth organisation could be seen as aiding and abetting the redirection of income, even if it was done so unknowingly.

4.21 Finance has included a statement in *Superannuation Circular 44* highlighting that salary sacrifice arrangements do not apply to contractors. The Circular was issued in June 2004.

Common-law employment relationship

4.22 Section 2.2 of the *Superannuation Circular 43* specifies that employers have a statutory obligation under the PB Act to make superannuation contributions on behalf of contractors considered to be common-law employees.

4.23 The ANAO received legal advice that considered that it may be more appropriate for superannuation contributions for common-law employees to be made in accordance with employment under the *Public Service Act 1999*. The ANAO considered that this advice should be included in superannuation circulars. Additionally, the superannuation circulars could provide advice on other consequences of a common-law employment relationship, such as the requisite provision of other entitlements³⁹.

4.24 Finance advised the ANAO, that Superannuation Circulars cover a broader range of individuals than just those covered by the *Public Service Act*. Finance also advised that particular issues concerning employment under the *Public Service Act*, and the consequences of a common-law employment relationship, are the responsibility of individual agencies.

4.25 During the course of the audit, Finance included a link in *Superannuation Circular 44* to a joint ATO/Finance publication on the ATO website⁴⁰, which provides more detail about common-law employment relationships.

Legislative issues

4.26 The ANAO identified the following issues with the PB Act.

Definitions of a qualified employee

4.27 The ANAO found that the definition used to determine whether a Commonwealth organisation is obligated under the PB Act to make superannuation contributions on behalf of a particular individual, was complex. In determining whether the PB Act applies a number of definitions must be considered. Firstly, it must be determined if the individual is a 'qualified employee', then a 'remainder employee', and then a 'class employee', 'fund employee' or 'interim arrangement employee', while ensuring that they are not a 'scheme employee'. The definitions of these

³⁹ The consequences of a common-law employment relationship are detailed in Appendix 3 of this report.

⁴⁰ <<http://www.ato.gov.au/super/content.asp?doc=/content/43970.htm>>, 19 June 2004.

employees are included at Appendix 4 of this report. The ANAO considers that in any review of the PB Act, Finance should review the complexity of the definitions used.

Two classes of superannuation payable

4.28 The two types of superannuation payable under the PB Act are referred to as interim benefits and continuing contributions. Interim benefits are payable for past labour for which superannuation, including an interest component, has not been paid. Continuing contributions are payable for current labour. Although the types of benefits are different, there is no clear reason for the different terminology. The ANAO considers that the situations under which a contribution is payable could be outlined in the legislation without separate definitions. The ANAO also considers that in any review of the PB Act, Finance should review the complexity of the classes of superannuation payable.

Significant number of amendments to the legislation, by way of Ministerial Declarations.

4.29 The ANAO considers that amendments to the PB Act, by way of Ministerial Declarations, have added to its complexity. The ANAO recognises that this approach allows for detailed matters about the legislation to be implemented in a timely manner without the need for amending legislation.

4.30 These amendments have included significant changes to the PB Act, such as capturing workers engaged under contracts *wholly or principally for labour* within the definition of 'qualified employee'. These amendments are not incorporated within the PB Act itself and must be referred to separately to understand the PB Act and its application.

4.31 Finance's *Superannuation Circular 43* has incorporated the intent and application of the amendments, without specifically referring to them. *Superannuation Circular 43* also states that Commonwealth organisations need to refer to the Act, associated Regulations and Statutory Rules, as they are the final authority. However, there is currently no complete listing of all Statutory Rules and Ministerial Declarations that apply. This creates a risk that Commonwealth organisations may not be aware of all the relevant requirements of the PB Act.

4.32 During the course of the audit, Finance advised the ANAO that links to the relevant instruments made under the PB Act had been added to the superannuation pages of the Department's website.

Advice on assessing and calculating past liabilities

4.33 In discussing the audit's findings with the ANAO, the audited organisations, identified a number of issues with assessing and calculating past liabilities under the PB Act, as follows.

- The PB Act was extended to cover contracts *wholly or principally for labour* in 1992. Commonwealth organisations recognised that they may have performed authorised disposals of records that relate to this period. The organisations requested that Finance clarify what was expected of them in identifying contracts *wholly or principally for labour* where records no longer exist.
- Commonwealth organisations also requested advice from Finance on what funding arrangements would be for periods both pre and post accrual budgeting. Questions were also raised as to whether there would be special funding arrangements for the actual project to identify contracts with individuals that were wholly or principally for the contractor's labour.
- The need to review past contracts extends across the Commonwealth and in some cases the same contractor will have been employed in a number of different Commonwealth organisations. Commonwealth organisations asked whether whole-of-government approaches could be taken to dealing with some or any contractors.
- One organisation raised a concern that as the determination of whether a contract is *wholly or principally for labour* is extremely complex, a degree of uncertainty could always exist as to whether a superannuation obligation actually existed or not. The organisation was concerned that they may be seen to be breaching the *Financial Management and Accountability Act 1997* if they paid public monies for liabilities where there was no certainty of an actual liability.

4.34 Finance advised that it would provide general advice to organisations about meeting their past liabilities under the PB Act but noted that a number of the matters mentioned above are matters for decision by organisations rather than whole of Government issues. Finance also noted that there are established processes and procedures in relation to any agency proposal for additional resourcing.

Advice provided by the ATO

4.35 The ATO monitors the compliance of the private sector with the SG Act. Where private sector employers do not pay the required superannuation contributions for their employees, the ATO can impose the

Superannuation Guarantee Charge. The interest and administrative components of the Superannuation Guarantee Charge impose a significantly more onerous penalty on the private sector organisation than the interest imposed on the Commonwealth organisation that does not comply with the PB Act. A full description of the penalties for both Acts is included at Appendix 5 of this report.

4.36 The role of the ATO in relation to the PB Act is more limited than that of Finance. The ANAO was advised by ATO of its responsibilities in relation to superannuation for Commonwealth organisations, as follows:

The [Tax] Commissioner has the general administration of the SG Act. Government agencies that are part of the Commonwealth are not liable to pay superannuation guarantee charge but the SG Act applies in all other respects as though they were liable to pay the charge (section 5). So the Commissioner must administer the Act in relation to Commonwealth agencies as though they could be liable to pay the charge.

The ATO issues rulings and gives advice to employers generally about the definition of employee in the SG Act, including the operation of subsection 12(3). In so far as the same issues arise under the PB Act, in [ATO Tax Counsel] view it is appropriate and sensible for the ATO to advise other Commonwealth agencies about these issues in helping to fulfil their PB Act obligations.⁴¹

4.37 The ATO has provided Commonwealth organisations with advice on whether they consider contracts to be *wholly or principally for labour*. The advice reviewed by the ANAO took into account current legal precedent as to whether the contract was *wholly or principally for labour*. The ANAO also noted that, more often than not, the advice concluded that superannuation was payable in respect of arrangements entered into with individual contractors, but depended entirely on the individual facts of the case. The ATO attended one of Finance's CFO Forums and provided advice on what they considered to be the indicators of a contract that was *wholly or principally for labour*.

4.38 The ATO undertook a survey during 2004 to assist in determining Commonwealth organisation's compliance with the PB and SG Acts. The ATO considered that the survey would enable the ATO and Finance to identify Commonwealth organisations that were having difficulty complying with the PB and SG Acts. The ATO planned to inform Finance of the results of the survey and to encourage Commonwealth organisation to meet their PB Act obligations.

⁴¹ ATO Tax Counsel Network letter, 15 September 2003.

4.39 The ATO advised the ANAO that other outcomes of the survey would be to:

- offer assistance to those employers who require it;
- conduct seminars in June 2004 where site visits will also be offered;
- review education and assistance products, by reference to feedback from seminars; and
- develop and decide on further strategies to assist Commonwealth employers and to expand to other Government sectors.

4.40 The ATO is also developing a procedure for dealing with Commonwealth employees' complaints about superannuation received through the ATO call centre.

Alternate view

4.41 The ATO's role in the application of the SG and PB Acts, as described above, has been determined based on the advice given by the ATO Tax Counsel Network.

...in practice it would be very unusual for an agency to refuse to accept the ATO's view that it has PB Act obligations towards a person. If this did happen, the ATO could not legally force the agency to comply. The ATO could instead seek to pursue the matter at Ministerial level. It is also possible that the aggrieved individual could take private legal action against the agency in an effort to compel the agency to comply with the PB Act.⁴²

4.42 The opinion concluded that:

There is no provision for [a Commonwealth] agency to be required to pay superannuation guarantee charge. Nor is there any provision for agencies to make 'notional' payments of charge to the ATO (by contrast with the FBT law and the GST law). It follows that the Commissioner could not be required to pay the employee concerned any payment under Part 8 of the SG Act, as that Part only operates if there has been an actual payment of charge to the Commissioner.⁴³

4.43 The AGS disagreed with this view. In its view:

The Commonwealth, although not legally able to impose superannuation guarantee charge on itself, is to act as though it is obliged to make that payment. It is notionally liable. The payment of superannuation guarantee charge is deemed to have been made on the relevant dates set out in subsection 5(3). Contrary to the view expressed by the ATO, the point of

⁴² op. cit., ATO Tax Counsel Network.

⁴³ *ibid.*

subsection 5(3) is to activate the Commissioner's obligation to make a distribution for the benefit of a benefiting employee.

4.44 The AGS was also of the opinion that other employee definitions included in the SG Act, for example that of an artiste, apply to Commonwealth organisations as well, even though Ministerial Declarations have not been made to specifically include as qualified employees in the PB Act. In other words, Commonwealth organisations may have obligations under the SG Act in relation to some classes of persons who are not covered by the PB Act.

4.45 Given the alternate view of the AGS, the ANAO considers that Finance and the ATO should review, amongst other things, the application of the PB Act in relation to the SG Act.

Other issues

4.46 The ANAO identified some additional issues, which if addressed could improve the administration of the PB Act.

- Finance and the ATO have defined their roles in the administering of the PB and SG Acts. However, there was no formal agreement as to the working arrangements between the two organisations. The ANAO is aware that Finance and the ATO have begun a process to clarify the roles and formalise the working arrangements.
- Additionally, although the ATO has conducted a survey of compliance by Commonwealth organisations with the PB and SG Acts, neither Finance nor the ATO have the specific responsibility, and even the requirement, for monitoring compliance with the PB Act. The ATO survey and the ANAO's audit are the first examination of the Commonwealth's compliance with these pieces of legislation. The ANAO notes that monitoring of compliance under the SG Act of private sector organisations is more rigorous than that under the PB Act.

Recommendation No.1

4.47 The ANAO recommends that, in conjunction, Finance and the ATO clarify:

- the interaction and boundaries between the PB and SG Acts;
- whether there is a continuing role for the PB Act, and if so, how to make the PB Act less complex in achieving that role; and
- mechanisms for monitoring Commonwealth organisations' compliance with the PB Act.

Finance and ATO's responses

4.48 Both the ATO and Finance agreed with the recommendation. The ATO provided the following comment:

- The Australian Taxation Office has no concerns with Recommendation No. 1. We will progress this matter further with the Department of Finance and Administration in an effort to clarify:
 - the interaction and boundaries between the *Superannuation (Productivity Benefit) Act 1988* (PB Act) and *Superannuation Guarantee (Administration) Act 1992* (SG Act);
 - the continuing role of the PB Act; and
 - mechanisms for monitoring Commonwealth organisations' compliance with the PB Act.

Conclusion

4.49 Over the last few years, Finance has regularly provided advice to Commonwealth organisations, through the issue of an annual *Superannuation Circular* and other mechanisms, about the application of the PB Act. The ATO has also provided advice to Commonwealth organisations on the interpretation of the definition of *wholly or principally for labour*.

4.50 The ANAO found that, generally, the information provided by both Finance and the ATO was appropriate. However, the ANAO identified some issues with *Superannuation Circular 43*, the majority of which were dealt with by Finance during the course of the audit.

4.51 The ANAO also considered that the interpretation of the SG Act's application to Commonwealth organisations, and the roles of Finance and ATO, including the responsibilities for monitoring compliance with the PB Act, should be clarified.

5. Considerations for Commonwealth Organisations

Introduction

5.1 As discussed previously, Commonwealth organisations are responsible for complying with the PB Act. Chief Executives are responsible for establishing appropriate controls and processes to mitigate associated risks of contracting with individuals, particularly where the contract is *wholly or principally for labour*.

5.2 The ANAO considers that Commonwealth organisations should address the issue of superannuation contributions for contractors by:

- developing an approach for identifying and treating current and future contracts that impose a statutory superannuation obligation; and
- identifying those contracts with individuals, which are no longer current and were *wholly or principally for labour*, and assess whether a superannuation liability exists and if so, calculate the amount.

Identifying and treatment of current and future liabilities

5.3 The ANAO identified a number of key elements, which as a minimum, each organisation should consider in developing its approach to contracting with individuals. These elements are discussed below.

Policy for contracting with individuals

5.4 Commonwealth organisations should provide staff with clear policy guidance on contracting with individuals. The consequences of dealing with individuals may not be limited to superannuation obligations, as common-law employment arrangements, which result in the organisation facing additional costs such as leave and other employment entitlements, may be entered into unknowingly. These consequences are discussed further in Appendix 3 of this report.

5.5 The ANAO noted that a number of Commonwealth organisations have a preferred position of not dealing with individuals or requiring individuals to be placed on non-ongoing employee contracts. However, this position will not always be practical or result in the best outcome for the Commonwealth, as particular individuals may offer the best value for money, or may be the only viable supplier in certain circumstances. Even if organisations prefer not to deal with individuals, policies should be in place to enable staff to deal with situations where an individual has to be engaged.

Procedures for contracting with individuals

5.6 The procedures for contracting with individuals should incorporate, as a minimum:

- how to identify, and confirm, the business structure the contractor is operating under;
- clarification of what an ABN is and means in practice;
- an explanation of how to identify a contract that is *wholly or principally for labour* and the steps to take; for example seeking advice from Finance, ATO and legal advisers, where the situation is not clear;
- sufficient guidance on what standard contract clauses mean in practice and the potential implications including the financial impacts of those clauses;
- guidance on negotiation in relation to whether the superannuation obligation should be calculated in addition to, or as part of, the contract rate;
- procedures for identifying the relevant superannuation fund and the minimum contractor's details required to enable contributions to be accepted by that fund;
- how to notify internal accounts and finance sections of the superannuation obligation; and
- processes for monitoring and reviewing that legal obligations, including superannuation, are being met.

Training and awareness raising

5.7 Policies and procedures will only be beneficial where relevant staff members are aware of them, and are adequately trained in the requirements. The ANAO found that staff members of many Commonwealth organisations were not aware of potential legal implications and obligations of entering into contractual arrangements with individuals, including the existence of the PB Act and its requirements.

5.8 As purchasing and contracting functions may have been devolved to individual branches and organisational units, staff in these areas may need to be trained so that legal obligations, including superannuation, are identified and dealt with in the contractual process, as early as possible.

5.9 In addition, Commonwealth organisations will need to take into account staff turnover in training activities. Even the lowest staff turnover could result in a loss of knowledge in what is a complex area of law.

Accounting processes

5.10 Organisations are required, under the PB Act, to report, every quarter, to contractors how much superannuation has been paid on their behalf. The ANAO did not examine whether organisations had met their reporting responsibilities to contractors.

5.11 However, the ANAO found that a number of the audited organisations had difficulty in retrieving and collating the relevant information. One of the difficulties faced by organisations was that their Financial Management Information Systems (FMIS) did not link payments for contractors to payments to the contractor's superannuation fund.

5.12 The ANAO identified better practice in the Department of Defence (Defence) where the functionality within its FMIS was used to nominate an alternate payee within a supplier account. The alternate payee was the superannuation fund. Defence also used spreadsheets to calculate superannuation for individual contractors from invoices. These spreadsheets totalled the superannuation paid, and Defence advised that these also assisted in meeting superannuation reporting requirements to the contractor.

Assessment of past liabilities

5.13 The identification and calculation of past superannuation liabilities by Commonwealth organisations may be a significant task for some organisations, and one which needs to be planned thoroughly before any action is taken.

Identifying relevant contracts and contractors

5.14 The ANAO considers that Commonwealth organisations should use a risk management approach to identify the level of risk faced by each organisation. In order to do this, Commonwealth organisations may need to assess:

- **The number of contractors who conduct business as an individual.** The ANAO identified individuals by comparing ABNs reported by organisations in GaPS with the registration on the Australian Business Register. Commonwealth organisations may not wish, at this stage, to look at specific contracts to perform this assessment. The ANAO found that a majority of Commonwealth organisations entered into contracts with individuals without identifying the business structure of the contractor. The ANAO considers that Commonwealth organisations should use tools such as the Australian Business Register to assure themselves of the business structures of their contractors.

- **Whether the contracts used by the organisation appear to be *wholly or principally for labour*.** The ANAO's checklist, at Tables 3.1 and 3.2, may be useful to ascertain whether individual contracts are *wholly or principally for labour*. Alternatively, Commonwealth organisations may choose to do an overall assessment of the types of contractors used and contract arrangements entered into with individuals.

Calculations of superannuation contributions

5.15 From the results of the assessment above, organisations should determine the approach they wish to take, to calculate superannuation liabilities. The approach taken by each Commonwealth organisation will depend on the level and nature of risk, accounting processes and various other constraints. The ANAO identified two main approaches, that organisations could take, as follows:

- **Detailed calculations.** This approach would be possible when a small number of contracts are identified and sufficiently detailed records are available for them.
- **Individual calculations with assumptions.** This approach may be necessary where a significant number of contracts are identified and sufficiently detailed records are not available for the entire period of the contract.

5.16 Commonwealth organisations should document the reasons for the approach taken, including any constraints that may impact on the performance of the calculations. Commonwealth organisations are most likely to face the following constraints.

- **Recordkeeping.** The extended definition of 'qualified employee' has been in place since 1992. However, since then, many organisations will have conducted authorised disposals of relevant records, so that contracts and other supporting documentation may not be available to provide sufficient information to determine whether superannuation obligation exists and to calculate any subsequent liability.
- **Corporate knowledge.** Corporate knowledge may not exist in relation to some contracts due to staff turnover or the length of time since the contract was entered into.
- **Finding contractors.** A superannuation liability can exist even where the contractor is no longer used by the organisation. However, finding the contractor to make the payment to their fund may be difficult. Finance's *Superannuation Circular 44*, details the information AGEST, as a default fund, requires about contractors, to accept the contributions.

Employment agencies

5.17 One of the issues identified as part of the audit was the contracting of individuals through intermediary agencies, such as employment agencies.⁴⁴

5.18 The ATO advised the ANAO that, for the type of labour hire, or ‘temp’ arrangements most commonly used by Commonwealth organisations, where intermediary agencies make superannuation contributions on behalf of the contractors performing the service, no additional liability under the PB Act would arise for the engaging Commonwealth organisation.

5.19 However, where the Commonwealth was responsible for paying contractors their ‘salary’ directly, and the intermediary was not providing for the individual’s superannuation, then, applying the usual common law employment or contract *wholly or principally for labour* tests, a superannuation obligation would exist for the Commonwealth.

Recommendation No.2

5.20 The ANAO recommends that Commonwealth organisations:

- determine whether existing administrative processes adequately control the risks of contracting with individuals where contracts are *wholly or principally for labour*;
- establish appropriate controls and processes where it is found that existing processes do not adequately control the risks of contracting with individuals; and
- address the risk that statutory superannuation obligations in past and current contracts have not been met.

Organisations’ responses

5.21 All but two organisations agreed with the recommendation. The Department of Defence, while agreeing with the first two parts of the recommendation, considered that, in addressing the risk of statutory superannuation obligations not being met in past and current contracts, there were important issues that needed to be addressed at the whole of government level.

5.22 The Australian Industrial Registry stated that anything that could assist agencies implement their legal obligations was of value and should be supported. However, it also considered that other issues needed to be considered.

⁴⁴ Australian Taxation Office, *Superannuation Guarantee Ruling 93/2 Independent agencies: service firms, labour hire firms and employment agencies*, April 1993.

5.23 Specific comments provided by organisations are included at Appendix 7.

Canberra ACT
28 October 2004



P. J. Barrett
Auditor-General

Appendices

Appendix 1: Audited organisations

The 34 organisations included in the audit were:

- Aboriginal and Torres Strait Islander Services;
- Attorney-General's Department;
- Australian Agency for International Development;
- Australian Bureau of Statistics;
- Australian Federal Police;
- Australian Government Information Management Office (formerly National Office for the Information Economy);
- Australian Industrial Registry;
- Australian Public Service Commission;
- Australian Radiation Protection and Nuclear Safety Agency;
- Australian Taxation Office;
- Bureau of Meteorology;
- Centrelink;
- CRS Australia;
- Department of Agriculture, Fisheries and Forestry;
- Department of Communications, Information Technology and the Arts;
- Department of Defence;
- Department of Education, Science and Training;
- Department of Employment and Workplace Relations;
- Department of Family and Community Services;
- Department of Finance and Administration;
- Department of Foreign Affairs and Trade;
- Department of Health and Ageing;
- Department of Immigration and Multicultural and Indigenous Affairs;
- Department of the Environment and Heritage;
- Department of the Prime Minister and Cabinet;

- Department of the Treasury;
- Department of Transport and Regional Services;
- Department of Veterans' Affairs;
- Equal Opportunity for Women in the Workplace Agency;
- Family Court of Australia;
- Insolvency and Trustee Service, Australia;
- National Oceans Office;
- National Occupational Health and Safety Commission; and
- Office of the Employment Advocate.

Appendix 2: Other issues noted by ANAO during sample testing

The ANAO identified the following issues that Commonwealth organisations faced when identifying contracts *wholly or principally for labour*.

Awareness

Staff members of many Commonwealth organisations were not aware of the existence of the PB Act or the obligations that it places on them in their engagement of contractors. In discussions with these staff members, the ANAO identified a general lack of awareness of other potential legal obligations resulting from entering into contractual arrangements with individuals.

The most significant potential legal obligation arising from contracting with individuals is that the arrangement could be deemed to be one of common law employment. A common law employment relationship requires the employer to treat the contractor as it would any other employee, that is provide all other employment benefits⁴⁵.

There was also a number of misconceptions raised by agency staff with the ANAO or identified by the ANAO during audit testing.

- **An ABN means the contractor is a company.** Holding an ABN does not indicate any particular business structure.
- **Use of a business name means that the contractor is a company.** Any business structure, including individuals operating as sole traders, can use and register a business name. In addition, the ANAO noted one case where a business name used by an individual supplier contained the words 'Pty Limited' even though the business was not an incorporated entity.
- **A contract is only a contract if it is writing.** A contract can be written or oral and statutory superannuation obligations may exist for either type.
- **The wording in the contract alone determines the true nature of the relationship.** The contract forms only *part* of the contractual relationship. If the true nature of the relationship is *wholly or principally for labour*, a contract cannot be written in such a way to override that fact.

⁴⁵ If employees are engaged under contract outside of the *Public Service Act 1999* regime, that is, not as an 'ongoing' or non-ongoing' worker, then Commonwealth organisations must provide that *all* employment benefits are provided for such workers, as outlined in Appendix 3.

- **Clauses of contracts can be written to remove statutory superannuation obligations.** Any entity, including a Commonwealth organisation, is not able to contract out of any statutory obligations, including superannuation or other statutory entitlements.
- **Superannuation contributions can be refused or non-payment negotiated by the parties.** Where Commonwealth organisations have a statutory obligation to make superannuation contributions, refusal by the contractor, or mutual agreement by the parties not to pay, will not remove the liability.

A consequence of such misconceptions is that Commonwealth organisations were not aware of the true nature of the contracts that had been entered into. The result of this is that Commonwealth organisations are unable to confirm whether statutory superannuation obligations under the PB Act have been met.

Other issues noted from sample testing

The ANAO also noted a number of peripheral issues that may assist in agencies further identifying and understanding potential areas of error in complying with the PB Act and other legislative requirements.

Recordkeeping

During the audit, the ANAO noted instances of inadequate recordkeeping practices. Commonwealth organisations could not provide the ANAO with the following:

- Commonwealth organisations could not provide a signed copy of the contract to the ANAO in 41 instances;
- in 38 instances organisations did not have formal contracts in place to document arrangements with their contractors; and
- in 42 instances sufficient supporting documentation was not held by organisations to clarify the true nature of the relationship in the absence of corporate knowledge;

Inadequate recordkeeping increases the risk that agencies cannot make appropriately informed decisions about superannuation statutory obligations, amongst others.

Goods and Services Tax

The ANAO identified the following issues with administration of the Goods and Services Tax and ABNs by the audited organisations.

- **GST charged when not registered.** The ANAO noted 12 cases where a supplier's invoice contained a charge for GST, where the supplier was not registered for GST⁴⁶. This may have resulted from a misunderstanding, by either party, of the Goods and Services Tax legislation, which requires an additional registration by the holder of the ABN to be entitled to charge GST. If the supplier is not registered for GST, the ABN merely means that payers do not need to withhold tax, but does not allow/require charging of GST. The ANAO considers it better practice for Commonwealth organisations to conduct a reasonableness check on the Australian Business Register of the ABNs provided by suppliers. This check reduces the risk of fraud against the Commonwealth.
- **Agencies did not withhold tax when no ABN quoted.** The ANAO noted one case where a supplier did not provide an ABN yet the Commonwealth organisation did not withhold tax⁴⁷ from payments where it should have.
- **ABNs not included in GaPS or old/incorrect ABN had not been updated in the FMIS even where new ABN provided by supplier.** The ANAO noted that in 14 cases an ABN was not quoted in GaPS by the Commonwealth organisation. In addition, the ANAO identified three instances where the incorrect/previous ABN of the supplier had been included in GaPS as the FMIS had not been updated to reflect the new ABN.
- **ABN did not match business name provided.** The ANAO noted four cases where the ABN did not match the ABN of the business name provided on the invoice.
- **GaPS entry for a Commonwealth organisation was incorrectly entered under the portfolio agency's name.** The ANAO noted 11 cases where the portfolio agency had listed the contracts in GaPS under their name rather than that of the line agency that entered into the arrangements.

⁴⁶ Information as to whether a supplier was registered for GST was gathered from the Australian Business Register, at <www.abr.gov.au>.

⁴⁷ Tax should be withheld where an ABN is not provided in the supply of goods or services, in accordance with section 12-190 of Part 2-5 (the PAYG provisions) of Schedule 1 to the *Taxation Administration Act* 1953. See advice provided in the ATO's Taxation Ruling TR2001/9 and at:

<http://www.ato.gov.au/businesses/content.asp?doc=/content/38509.htm&pc=001/003/021/001/009&mn_u=610&mfp=001/003&st=&cy=1>

Appendix 3: Common-law employees

The AGS provided the following general outline of the implications, other than superannuation, of a person being engaged as a common law employee. The following is an outline only and is, necessarily, general.

The relevant Commonwealth agency and employee will be bound by the Pay As You Go (PAYG) withholding provisions, contained in Part 2-5 of Schedule 1 to the *Tax Administration Act 1953*. An employer, for example, is required, among other things, to withhold an amount from the salary or bonuses or allowances paid to the employee and pay that amount to the Commissioner of Taxation (ss.12-35 and 16-70 of the *Tax Administration Act*).

A reversal of any GST payment made by the employer to the employee may be required.

The *Public Service Act 1999* (PS Act) and the regulations made thereunder will only apply to a (common law) qualified employee under the PB Act where he or she has been engaged under the PS Act procedures (see the decision of the Full Bench of the Australian Industrial Relations Commission in *Arends v. Department of Defence* (2002) PR935265. The case is to go before the Federal Court).

The PS Act does not necessarily provide for the terms of employment of people who are (common law) qualified employees under the PB Act engaged by an authority of the Commonwealth. An authority of the Commonwealth will have obligations under the PB Act if it is an approved authority within the meaning of that Act (s.3(c) of the PB Act). That authority may or may not be an Agency within the meaning of the PS Act. The terms of the legislation by which the authority is established will determine whether it has obligations under the PS Act. If it engages people otherwise than under the PS Act the effect of a determination that a person has in fact been engaged as a common law employee will need to be considered in light of the specific legislation governing the authority.

A 'Commonwealth public sector employee' may, pursuant to s.170CB(1) of the *Workplace Relations Act 1996*, apply to the Australian Industrial Relations Commission for relief in relation to termination of employment on the ground that that termination was harsh, unjust or unreasonable. 'Commonwealth public sector employee' means 'a person in employment under the *Public Service Act 1999* or the *Parliamentary Service Act 1999*; by or in the service of a Commonwealth authority; or by authority of a law of the Commonwealth.' In *Arends*, the Australian Industrial Relations Commission assumed jurisdiction over a radiographer engaged by the Department of Defence by 6 different written contracts over a period of 8 years. This was on the basis that the radiographer was a person in employment by authority of the *Defence Act*

1910–2002 and/or the *Financial Management and Accountability Act 1997* (at [157]).

After 10 years service, a person employed by the Commonwealth will be entitled to long service leave entitlements pursuant to the *Long Service Leave (Commonwealth Employees) Act 1976*.

A female employee may be entitled to maternity leave (s.5 Maternity Leave (*Commonwealth Employees) Act 1973*).

The *Safety Rehabilitation and Compensation Act 1988* makes provision for compensation payable in respect of injuries incurred by a person employed by the Commonwealth or a Commonwealth authority and arising out of that employment as well as rehabilitation for that employee. The *Occupational Health and Safety (Commonwealth Employment) Act 1991* imposes obligations on the controller of a workplace, most of which will apply regardless as to whether a person is an employee or independent contractor.

Appendix 4: PB Act definitions

Definitions used in the PB Act, in determining whether someone is captured by the PB Act, are included in section 3 of the PB Act.

qualified employee means:

- (a) a person employed by the Commonwealth; or
- (b) a person who is the holder of an office established by an Act, by regulations under an Act or by an Ordinance of the Australian Capital Territory;
- (c) a person who is employed by a body that is an approved authority, being a body that does not provide superannuation benefits (other than superannuation benefits approved under the *Superannuation Benefits (Supervisory Mechanisms) Act 1990*) to any of its employees otherwise than under the Superannuation Act or the new Superannuation Act;
- (d) a person who is an eligible employees for the purposes of the Superannuation Act and is employed by a body that is an approved authority, being a body that provides superannuation benefits to some of its employees otherwise than under that Act;
- (e) a person to whom superannuation 4(5A) or (6) of the Superannuation Act applies; or
- (f) a person who, under the regulations or a declaration under subsection 3F(1), is a qualified employee;

but, subject to regulations and declarations made for the purposes of paragraph (g), does not include:

- (g) a person who is an employee of the Northern Territory or of an authority of the Northern Territory;
- (j) a person who is not an eligible employee for the purposes of the Superannuation Act but is a member of a superannuation scheme or has superannuation benefits funded by the person's employer or partly by the person's employer or partly by the person's employer and partly by contributions from the person and other employees;
- (k) a person who is a member of the Defence Force;
- (l) a person who is engaged or appointed for employment outside Australia only;
- (m) a member of the Parliament;

- (n) a person who is a judge for the purposes of the Judges' Pensions Act 1968; or
- (o) a person who, under the regulations or a declaration under subsection 3F(2), is not a qualified employee.

remainder employee means a qualified employee who is neither:

- (a) a scheme employee; nor
- (b) a class employee.

class employee means a qualified employee in a class in respect of which a declaration is in force under section 4A.

fund employee means a remainder employee who is a member of a declared fund.

interim arrangement employee means a remainder employee who is not a fund employee.

scheme employee means:

- (a) a qualified employee who is an eligible employee within the meaning of the Superannuation Act; or
- (b) a qualified employee who is a member of the superannuation scheme within the meaning of the new Superannuation Act.

Appendix 5: Penalties for non-compliance with the PB and SG Acts

PB Act

Interest is calculated on superannuation contributions not paid. The rate for 2002–2003 was 6.1%.

A penalty interest factor is also applied if an individual has nominated a fund, or the Commonwealth organisation identifies an obligation, no payment is made. The penalty interest rate for 2002–2003 was 8.1%.

SG Act

Reporting

For not following quarterly reporting requirements from 1 July 2003, 30 penalty units per employee can be charged, at \$110 per penalty unit.

False or misleading reports can result in 12 months imprisonment.

Tax short-fall amount

If the amount of superannuation guarantee charge paid is less than it should have been, then a 'tax shortfall amount' arises. If the tax shortfall is a result of making a false and misleading statement, then the base penalty amount that can be imposed is 75% of the tax shortfall.

Failing to keep records

The maximum penalty that may be imposed for failure to keep adequate records is \$2200.

Not providing a statement when required

A late lodgement penalty of up to 200% of the amount of the charge payable may be charged.

Entering into avoidance arrangements

If arrangements to reduce or avoid the liability for the superannuation guarantee charge are entered into, a penalty of up to 50% of the charge avoided may be payable.

Tax deductibility

The Superannuation Guarantee Charge (ie. Contributions), administration component, interest and General Interest Charge for non-payment are non-deductible.

Commonwealth organisations

Under the SG Act, interest at the rate of 10% is imposed on the shortfall amount from the beginning of the contribution period to the date of required lodgement of a SG Statement for the applicable contribution period.

Appendix 6: ABS Statistical Testing

The ANAO consulted the Statistical Consultancy Unit (SCU) of the Australian Bureau of Statistics (ABS) on the audit sampling approach to statistical sampling. The ABS SCU confirmed that:

- a sample size of 170 contracts from the audit population allowed the audit to support conclusions about estimates of the population; and
- stratified random sampling was a preferred methodology in the circumstances as it provided a random sample with reasonable coverage of different types of transactions and allowed the audit to make valid inferences about the population. Different proportions of contracts were selected from the different strata, and so stratum-level weights were used to calculate estimates for the total population.

A 95% confidence interval was calculated for each estimate of interest, to give a measure of the accuracy. Roughly speaking, a 95% confidence interval means that there is a 95% chance that the true population value lies within that interval.

Appendix 7: Organisations' comments on Recommendation No.2

This appendix provides the audited organisations' comments on the report generally and Recommendation No. 2 specifically.

Aboriginal and Torres Strait Islander Services (ATSIS)

ATSIS has no detailed comments to make on the report and generally supports Recommendation No. 2.

Attorney General's Department

The Department supports Recommendation No. 2, and has put in place strategies to address this recommendation as well as the other issues highlighted in the report relating to low-value, low-risk procurements.

Australian Agency for International Development (AusAID)

Audit Recommendation No. 2, which is directed at the AusAID (and other Commonwealth organisations) reflects the results of earlier discussions with the ANAO and is accepted by AusAID.

Australian Bureau of Statistics (ABS)

The ABS notes the recommendations. As outlined in the report, and highlighted by the conflicting legal advice that the ANAO received in relation to particular transactions that were audited, there are some ambiguities in the way the relevant legislation has been applied to the operational circumstances of independent contractors. This has resulted in the adoption of different practices across and within agencies. Consistent with the recommendations the ABS will review its practices to ensure that the arrangements for the payment of the compulsory employer contribution for superannuation are consistent for all such contractors.

Australian Federal Police (AFP)

The AFP agrees with Recommendation No. 2 and has already acted to implement these treatments. The AFP is of the view that advice from the Department of Finance and Administration as described in paragraph 4.34 would be of assistance in finalising this action.

Australian Government Information Management Office (AGIMO)

AGIMO agrees with the findings and supports the recommendations arising from the audit. AGIMO will review its contracting procedures to ensure that

appropriate controls are in place to identify instances where there is a superannuation liability for contractors.

Australian Industrial Registry

As an overarching comment, anything, which can assist agencies implement their legal obligations is of value and should be supported.

The audit report identifies that superannuation obligations had been met in only a minority of contracts examined and makes a recommendation which at face value would remedy the situation – namely that agencies should examine their existing processes for controlling the risks of contracting with individuals where contracts are *wholly or principally for labour*; establish remedial processes and controls; and address the risk within contracts already entered into.

With respect, this recommendation, and the audit methodology which led to its making, overlook the possibility that these risk assessment and control processes may already have been undertaken by line agencies about that the audit outcome might actually be a product of the inability of the two legal experts who assessed the contracts to agree in the face of the legislation and associated common law. Your legal experts appear to have taken different views about whether the same individual is, or is not, engaged *wholly or principally for labour*. The audit report's recommendations does not appear to take into account the strong possibility that, irrespective of the rigour of an agency's risk assessment and control process, future contracts could be similarly critiqued by legal experts differentially applying the same legislation and common law. Clearly this, possibility is undesirable and could lead to agencies deciding that the only way to definitively manage the superannuation risks associated with contractors is not to engage individuals as contractors. That too, is undesirable and probably not particularly practical.

These problems could be overcome by the ANAO considering amending the recommendations to suggest that Parliament reconsider the underlying legislation to provide better guidance on when superannuation payments should be made, and when they need not be made.

ANAO's comment

The audit did take into account the risk assessments and work previously completed on this topic matter by the audited organisations. The result of this work is shown at paragraphs 3.25 to 3.27. These results were discussed with all of the organisations included in this audit.

We appreciate that the legal interpretation required to determine whether a contract is *wholly or principally for labour* is complex. However, the ANAO clearly states at paragraph 5.5 that not contracting with individuals is not a particularly practical method of addressing the issue. Chapter 5 offers advice

to Commonwealth organisations on how to address this matter in a practical way.

Recommendation 1 of this report to Parliament reflects the need to review the current legislation. However, it is not the ANAO's practice to comment on government policy.

Australian Public Service Commission

The Commissioner supports Recommendation 2 of the proposed ANAO report on *Superannuation Payments for Independent Contractors working for the Australian Government*.

Australian Radiation Protection and Nuclear Safety Agency (ARPANSA)

ARPANSA is in general agreement with the report and Recommendation No.2.

ARPANSA will fully take the report into account when reviewing its existing administrative arrangements, to ensure appropriate controls and processes are in place to manage the risks of contracting with individuals where contracts are *wholly or principally for labour*.

Australian Taxation Office (ATO)

The ATO has no concerns with Recommendation 2. The current processes have been reviewed to ensure they provide adequate controls and the office is presently reviewing previous arrangements to ensure compliance with statutory obligations. The risk that statutory obligations have not been met is being addressed as part of this process.

Bureau of Meteorology

The Bureau of Meteorology confirms that the report properly reflects audit findings and our earlier input. Implementation of the recommendations will assist the refinement of our contract management processes.

Centrelink

Centrelink makes the following comments in respect of Recommendation 2.

- Centrelink devotes considerable resources to comply with its superannuation obligations and currently makes contributions for around 1000 contractors per month.

- Centrelink has conducted retrospective reviews of past contracts to confirm it has no outstanding superannuation liabilities for these contracts.
- Centrelink has previously sought professional advice from both legal and taxation professionals in relation to a number of classes of contractors and has received conflicting advice regarding obligations to pay superannuation. Centrelink notes that the ANAO sought legal advice from two independent legal advisors in relation to 85 contracts reviewed in this audit and received conflicting advice in respect to more than 50% of the contracts examined. Centrelink considers that the existing level of uncertainty about the application of the current laws, evidenced by the conflicting legal advice, is unacceptable as it significantly frustrates attempts by employers to confidently comply with the rules. Centrelink would welcome the introduction of measures aimed at simplifying the arrangements and clarifying exactly when superannuation obligations arise in respect of contracts with individuals.

CRS Australia

We [CRS Australia] have taken a number of steps including:

- taking advice from the Australian Government Solicitor; and
- taking advice from the Australian Taxation Office,

to fully inform ourselves about the implications of this complex area of legislation and believe that we have processes and standard contractual documentation in place to ensure our compliance.

Department of Agriculture, Fisheries and Forestry (DAFF)

DAFF notes the findings and agrees with Recommendation No.2 of the draft report.

Department of Communications, Information Technology and the Arts (DCITA)

DCITA is strengthening existing procedures to improve controls over the risk that contracts with individuals do not meet statutory obligations. However, the Department notes that some uncertainties will remain as there are differing legal interpretations of the relevant laws (as described in the report). The Department will give further consideration to the extent to which it is practicable to review past contracts.

Department of Defence

Defence agrees with the first two parts of Recommendation 2 but in relation to the third part believes that there are important issues, which need to be addressed at the whole of government level.

Defence's view is that attempts to implement the third part of recommendation 2 are likely to be futile given the complex nature of superannuation and the legal uncertainty surrounding its application. In several cases cited in the management letter to Defence of 23 June 2004, it is clear that different lawyers have reached opposite conclusions based on the same evidence. There is little prospect of simple administrators doing any better and the employment of a third set of lawyers will be undoubtedly increase costs but not guarantee final resolution. What this does suggest is the need for legislative clarification perhaps, but the draft report is silent in this regard, although you indicated in an e-mail to me dated 13 September that the final report would address the need for legislative and procedural clarity.

The Department of Defence responded to each individual dot point in the recommendation, as follows:

- Agree.
- Agree.
- There are important issues, which need to be addressed at the whole of government level.

Department of Education, Science and Training (DEST)

DEST welcomes the audit report and agrees with the report's recommendation relating to Commonwealth organisations. The audit has provided valuable information and assistance in clarifying a complex and multifaceted issue for Australian Government agencies.

DEST is addressing the issues raised in the audit report. In particular, we have been reviewing and, where appropriate, improving our administrative and related processes regarding arrangements for contracting individuals where contracts are *wholly or principally for labour*. For example, we will further strengthen our Chief Executive Instructions and contract management systems, and ensure that these issues are covered in Departmental contract management training. We have also commenced reviewing and assessing DEST's potential liabilities to determine the best way to proceed.

Department of Employment and Workplace Relations (DEWR)

DEWR notes the recommendation contained in the report. DEWR has already addressed the issue and implemented a number of strategies where the

contract is *wholly or principally for labour* to ensure that appropriate controls are in place to mitigate associated risks as suggested in the recommendation.

Department of Family and Community Services (FaCS)

FaCS welcomes the audit and its recommendations and will work to deliver improvements in processes.

Department of Finance and Administration (Finance)

Agree. The report provides a useful analysis of issues relating to the implementation of the *Superannuation (Productivity Benefit) Act 1988* and makes constructive recommendations to further improve administration by Australian Government agencies.

Department of Foreign Affairs and Trade (DFAT)

We [DFAT] have no difficulties with the ANAO's proposed recommendations in relation to Commonwealth agencies. As has been acknowledged by the ANAO, DFAT has made significant improvements to its management of labour contracts. The Contractor Management Unit (CMU) in the Department's Corporate Management Division has introduced centralised procedures requiring all contract managers to seek prior approval from the CMU before engaging a contractor. We are currently preparing contractor management guidelines as an adjunct to advice and training provided to line areas. We also propose to review our contracts for potential superannuation liabilities under the *Superannuation (Productivity Benefit) Act 1988*.

Department of Health and Ageing

The Department of Health and Ageing (the Department) responded to each individual dot point in the recommendation as follows:

- The Department's Chief Executive Instructions and related Procedural Rules provide support and guidance to officials undertaking tendering and contracting activity. In particular, *Procedural Rule 5.6 – Consultants and Contractors* requires consideration of superannuation and further requires that any liability be determined before a contract is signed.
 - The Department notes the ANAO considers the general advice contained in the Chief Executive Instructions is appropriate while not over-complicating the issue for staff involved in engaging contractors.
- The Department notes the ANAO considers there are appropriate controls in place and the general advice contained in the Chief Executive Instructions (relating to consultants and contractors) is sufficient. The Department will update its procurement training

material to include information on superannuation entitlements for consultants and contractors.

- The Department notes the Department of Finance and Administration will be providing advice to agencies on how to approach the issue of potential superannuation obligations relating to the engagement of contractors in the past. The Department will await Finance's advice as a definitive guide on this matter.
 - In the meantime, as part of addressing this risk the Department will continue to review its contracting processes and procedures as appropriate to address the incidence of future superannuation obligations.

Department of Immigration and Multicultural and Indigenous Affairs (DIMIA)

DIMIA agrees with the recommendation of the ANAO report on Superannuation Payments for Independent Contractors.

DIMIA has conducted an analysis of potential past superannuation liabilities and is confident that it is meeting its obligations under the *Superannuation (Productivity Benefit) Act 1988* to those contractors who satisfy the definition of having been engaged *wholly or principally for labour*.

A number of enhancements to procurement practices have been instituted to ensure future superannuation obligations are managed appropriately.

Department of the Environment and Heritage (DoEH)

The Department accepts the overall audit conclusions and findings as they relate to the operation of this agency.

The Department noted that Recommendation No. 1 is directed to the Department of Finance and Administration and the Australian Taxation Office and understand the recommendations are to seek clarification of the boundaries of the *Superannuation (Productivity Benefit) Act 1988* and the *Superannuation Guarantee (Administration) 1992* and to get clarification on these agency's roles in monitoring compliance with the legislation. DoEH supports this approach, as clarity in these areas will further assist us to meet our responsibilities.

The audit revealed that, across Government, there was a high percentage of the cases examined where it was uncertain as to whether the contract was wholly or principally for labour and in some cases, despite several legal opinions there was still some differences of interpretation on the classification of these contracts. Clear policy guidance to agencies to assist in the identification of

contracts, which are wholly or principally for labour would be a valuable tool in reducing ongoing interpretation issues of this type.

We believe DoEH has adequate controls and systems in place to meet our requirements under the *Superannuation (Productivity Benefit) Act 1988* and the *Superannuation Guarantee (Administration) Act 1992*.

Our risk of non-compliance is low. We recognise that there is always room for improvement in practices and procedures, so in line with the audit recommendations, and as outlined in our management response to the draft report, we will strengthen our current processes by modifying our procedures and incorporating the approaches, outlined in the draft report, for identifying superannuation obligations and treating future liabilities into the Department's procurement and legal procedures.

In addition, in light of the findings across government that there may be a potential liabilities risk with past contracts, DoEH will engage our internal auditors to examine a cross section of contracts across the Department going back a number of years to ascertain if the ANAO audit results are representative. Following that examination DoEH will, if necessary, take further action in regard to liabilities under past contracts.

Department of the Prime Minister and Cabinet (PM&C)

PM&C agreed to Recommendation No.2.

Department of the Treasury (Treasury)

As one of the agencies covered by the audit, Treasury has indicated its agreement with the recommendation and has commenced action to ensure internal processes satisfy the requirements for adequate controls. Further, Treasury will investigate past contracts to determine the extent of any necessary corrective action.

Department of Transport and Regional Services (DOTARS)

DOTARS remains of the view that the treatment of the contracts reviewed by the ANAO was correct.

Nonetheless, the Department recognises that the distinction between contracts for services and consultancies is complex, and therefore acknowledges the need for ongoing awareness training, and the implementation of appropriate risk mitigation strategies.

Department of Veterans' Affairs (DVA)

DVA agrees with the recommendation.

DVA has been working for some time with other government agencies in seeking clarification of its liabilities for making superannuation contributions for the benefit of contractors and is now well advanced in the development of controls and processes envisaged in the Recommendation.

Equal Opportunity for Women in the Workplace Agency (EOWA)

EOWA has read the report and will ensure that the recommendations are adhered to with existing engagements and in any further engagements with contractors. In particular, EOWA will develop a policy around contracting with individuals where contracts are *wholly or principally for labour*, and establish appropriate controls and processes to mitigate associated risks. These controls will include raising awareness of managers and HR personnel about how to approach and deal with contractors. We will also organise a training session with relevant personnel. We will ensure accounting processes include informing contractors quarterly of the amount of superannuation they are receiving.

EOWA has also assessed past and current contractors and established whether there were any existing liabilities from past and current contracts captured by the PB Act.

Family Court of Australia (The Court)

The Court believes that the recommendation and findings contained within the report are fair and reasonable. The Court will continue to review and monitor its obligations under contractual arrangements where superannuation legislation, either *Superannuation (Productivity Benefit) Act 1988* and/or the *Superannuation Guarantee (Administration) Act 1992*, may apply.

Insolvency and Trustee Service, Australia (ITSA)

ITS agrees with Recommendation 2 that Commonwealth agencies should review the adequacy of their existing arrangements for compliance with the *Superannuation (Productivity Benefit) Act 1988* (the PB Act).

ITSA notes the advice by the Australian Taxation Office to the Australian National Audit Office that, for the type of labour hire, or 'temp' arrangements most commonly used by Commonwealth organisations, where intermediary agencies make superannuation contributions on behalf of the contractors providing the service, no additional liability under the PB Act would arise for the engaging Commonwealth organisation (see para 5.18 of the audit report).

ITSA further notes that an initial review of relevant contracts since ITSA became an executive agency suggests that, on a case-by-case basis, none of those contracts would give rise to an existing liability arising under the PB Act.

National Oceans Office

The National Oceans Office notes that the ANAO received differing legal advice on whether contracts were wholly or principally for labour. We consider that we have complied with the requirements of the *Superannuation (Productivity Benefit) Act 1988*.

This is an extremely complex area of taxation law and following a review of our internal practices we have posted the ATO/DoFA document *Superannuation entitlements for contractors/consultants and temporary employees engaged through independent agencies* on our intranet site. Every contract will be subjected to the tests contained in these guidelines and staff working in the corporate services area have been given hard copies of the guidelines.

National Occupational Health and Safety Commission (NOHSC)

The NOSHC supports this recommendation. NOHSC will take steps to ensure that it complies with this recommendation, including examining statutory superannuation obligations for current and recent past contracts as part of an internal audit of contract management planned for this financial year.

Office of the Employment Advocate (OEA)

The OEA wishes to advise that, having considered the proposed extracts of the audit report provided, it has no further comment to make beyond those already provided in its management response.

As detailed in the management response, the OEA is actively reviewing its contracting policies and procedures, concerning the engagement of individuals, to ensure that existing and future contracts comply with the requirements of the *Superannuation (Productivity Benefit) Act 1988* and the *Superannuation Guarantee (Administration) Act 1992*.

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