

The Auditor-General  
Audit Report No.48 2006-07  
Performance Audit

**Superannuation Payments for Contractors  
Working for the Australian Government:  
Follow-up Audit**

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of Australia 2007

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Canberra ACT  
22 June 2007

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance 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 Contractors Working for the Australian Government: Follow-up Audit*.

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 'Ian McPhee'.

Ian McPhee  
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

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AQIS	Australian Quarantine Inspection Service
ATO	Australian Taxation Office
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
PB Act	<i>Superannuation (Productivity Benefit) Act 1988</i>
PSS	Public Sector Superannuation scheme
PSSAP	Public Sector Superannuation Accumulation Plan
SG Act	<i>Superannuation Guarantee (Administration) Act 1992</i>
SGR	Superannuation Guarantee Ruling

# Glossary

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Common law employee	A judicial definition of 'employee' established by the courts through case law precedents. As such, some contractors are employees, depending on the interpretation of a number of factors including: whether they are working under the direction and control of staff at an agency; being paid on an hourly rate rather than on a results basis; and/or able to delegate work to agency staff.
Commonwealth 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 a common law employee or in a contract wholly or principally for labour.
Individual	A person who operates a business as an individual or a sole trader, as opposed to working for a company, trust, partnership or other business structure.
Interim benefit	Term used within the <i>Superannuation (Productivity Benefit) Act 1988</i> to specify amounts to be paid on an employee's behalf for work previously performed. It includes an interest component.
Contracts wholly or principally for labour	Contracts that are mainly for a person's labour, including mental and artistic effort. As such, the labour component of the contract would be over 50 per cent of the total value.





# Summary



# Summary

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## Background

1. Compulsory saving for retirement through mandatory superannuation contributions by employers has been a policy of successive Australian governments. Some contractors who operate as individuals/sole traders are also considered to be employees and are therefore entitled to have superannuation contributions paid on their behalf by the entity that contracts them. The key issues are whether: there is an employer-employee relationship at common law in the contract the organisation has entered into with the contractor; or the contract is wholly or principally for labour. In such cases, employers, including Australian Government organisations, are responsible for making these superannuation contributions.

2. The legal framework concerning employers' obligations for contractors can be technical and complex. The framework is established through a mix of legislation and common law. The two main Acts are:

- the *Superannuation (Productivity Benefit) Act 1988* (PB Act); and
- the *Superannuation Guarantee (Administration) Act 1992* (SG Act).

3. The Department of Finance and Administration (Finance) is responsible for administering the PB Act. The Australian Taxation Office (ATO) is responsible for administering the SG Act. Finance provides guidance and advice to Australian Government organisations about PB Act arrangements. The ATO's main role is to provide guidance and advice to employers to help them comply with their superannuation guarantee obligations. One aspect of the role includes assisting Australian Government organisations understand who is an employee for superannuation purposes according to section 12 of the SG Act.

4. To establish whether contractors are employees, courts typically consider a number of indicators. These indicators include whether the employer has the right to control how and what the contractor does, and whether the worker is paid for hours worked and has the right to delegate.

5. Where a contract has been assessed as not creating a common law employee relationship, it is then necessary to determine whether it is wholly or principally for labour according to s.12(3) of the SG Act. The main considerations in this regard are whether: the contract is mainly for the

person's labour, including mental and artistic effort; the worker is being paid for hours worked; and the worker has the right to delegate. Again, the decision is often a fine balance of many indicators rather than one overriding test.<sup>1</sup>

6. The incidence of Australian Government contracts with individuals is small when compared to other contracting arrangements, and has been declining. Of the 4 546 contracts entered into by seven agencies examined in this audit,<sup>2</sup> only around two per cent were with contractors who were individuals and therefore could possibly have been entitled to superannuation contributions.

### **Previous audit coverage**

7. In October 2004, the Australian National Audit Office (ANAO) tabled in Parliament Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government* (the previous audit). That audit examined a number of contracts to determine: whether superannuation obligations had been met; and the level and appropriateness of advice given and received by Australian Government organisations.

8. The previous audit report acknowledged the difficulties agencies face in establishing whether they have an obligation to provide superannuation for contractors, due to the complexity of the legal issues involved. It concluded that agencies generally lacked awareness of such requirements. The report made two recommendations:

- Recommendation No.1 was directed at Finance and the ATO, and proposed those two agencies clarify: the interaction between the PB and SG Acts; whether there was a continuing role for the PB Act; and mechanisms for monitoring Australian Government organisations' compliance with the PB Act; and
- Recommendation No.2 was directed at Australian Government organisations generally, and proposed they: establish processes that controlled the risks of contracting with individuals; and address the risk that statutory superannuation obligations in past and current contracts have not been met.

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<sup>1</sup> In addition, certain workers may be entitled to superannuation benefits under other provisions of s. 12 of the SG Act, even if they are not contracted wholly or principally for labour.

<sup>2</sup> These contracts were reported on the Department of Finance and Administration, *AusTender–Contracts Reported* system for 2005. They represent all contracts entered into by the seven agencies that have a total contract value of \$10 000 or more. As such, they cover contracts for goods as well as services.

9. Finance and the ATO agreed with Recommendation No.1, and all agencies generally agreed with Recommendation No. 2.

## Audit approach

10. The objective of this audit was to determine: the extent to which selected agencies have implemented the two recommendations of the previous audit; and the appropriateness of advice provided by Finance and the ATO. To address this audit objective, the audit assessed:

- the roles of Finance and the ATO in clarifying: the interaction of the PB and SG Act; the ongoing role of the PB Act; and mechanisms to monitor Australian Government organisations' compliance with the PB Act;
- the extent to which Finance and the ATO have provided guidance and other support to assist Australian Government organisations manage and meet statutory superannuation obligations for eligible contractors; and
- whether Australian Government organisations have managed and met statutory superannuation obligations for contractors in past and current contracts.

11. The methodology for the audit involved an assessment of Finance's and the ATO's activities in administering relevant superannuation legislation, and providing relevant guidance to Australian Government organisations. In addition, the ANAO analysed agency contracts commencing in 2005 to ascertain the likely magnitude of obligations to pay superannuation, and if so, whether payments were made correctly. The audit also assessed agencies' administrative processes for managing superannuation obligations for people contracting as individuals.

12. The audit included the following agencies: Finance; the ATO; the Australian Bureau of Statistics; CRS Australia; the Department of Foreign Affairs and Trade; the Department of Veterans' Affairs; Geoscience Australia; and Insolvency and Trustee Service Australia.

## Audit conclusion

13. Overall, the ANAO concluded that agencies had largely implemented the recommendations from the previous report.

14. Finance and the ATO worked together to clarify the ongoing role of the PB Act within the context of broader reform to the superannuation framework for Australian Government organisations. This was reflected in changes to superannuation legislation, including the closure of the PB Act to new employees (including certain contractors) and office holders from 1 July 2006. As the number of contractors covered by the PB Act was expected to decline rapidly, Australian Government organisations will now rarely need to consider both the PB Act and SG Act when assessing whether contractors who are individuals are entitled to superannuation benefits.<sup>3</sup>

15. The ANAO concluded that Finance and the ATO have generally provided appropriate advice to Australian Government organisations on changes to the legislative framework and superannuation issues more broadly, including the PB Act, within a challenging environment of major changes to superannuation. The audit has highlighted that, in addition to Finance providing guidance about these issues to human resource staff at Australian Government organisations, it would be worthwhile for procurement staff to also be made aware of these issues, given the central role of procurement in the acquisition of services. In this light, it would be beneficial if the guidance provided by Finance in connection with the Commonwealth Procurement Guidelines could make brief reference to these issues.

16. The audit has also highlighted that agencies appreciated the assistance of the ATO, but were not always aware of the range of support services it provided. To increase the awareness of its capabilities in this regard, there would be benefit in the ATO more actively promoting the superannuation telephone help line and Provision of Written Advice service<sup>4</sup>, and the Government superannuation section of its website.

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<sup>3</sup> Australian Government organisations would have to consider both the PB and SG Acts only for contractors who are individuals and who had been working continuously for that organisation, on the same contract, since before 1 July 2006. However, as some people covered by the PB Act are office holders who have been appointed for relatively long terms such as five years, it may be some years before the PB Act is completely phased out.

<sup>4</sup> The ATO has a superannuation telephone help line and a Provision of Written Advice service accessible to all employers to provide assistance relating to superannuation issues. Through these services, the ATO answers questions regarding employer obligations under the SG Act, and assesses whether a contractor is an employee for superannuation purposes.

17. The audited agencies have adopted common approaches to control the risk of having unmet superannuation obligations to contractors. These approaches have mainly involved minimising the incidence of contracting with individuals, and implementing processes and practices to assess whether contractors who are individuals are entitled to superannuation benefits. The audit identified scope for agencies to further refine these approaches in some instances, by: developing contract templates that reduce the risk of unintentionally creating an employment relationship; seeking advice from the ATO about a contractor's entitlement to superannuation benefits; and recording the basis on which staff have assessed contracts with individuals for superannuation entitlements.

18. Despite the closure of the PB Act, the legal framework for superannuation can impose high costs on employers when assessing entitlements to superannuation benefits for a contractor who is an individual. As discussed above, to minimise costs, many of the audited agencies have reduced the incidence of contracting with individuals. The ANAO notes that avoiding contracts with individuals may not always result in the best outcome for the Australian Government or the community, as contracting with individuals may represent the best value for money in some circumstances.

## Key findings

### Finance and the ATO's Roles in Administering the PB and SG Acts (Chapter 3)

#### *Clarifying the role of the PB Act*

19. With the enactment of legislation that closed the PB Act to new employees and contractors from 1 July 2006, the PB Act's overlap with the SG Act has declined. This addressed the complexity of the interaction of the PB Act with the SG Act and Finance's role in administering the PB Act.

### *Adequacy of guidance provided by Finance*

20. Finance is responsible for policy development, implementation and advice on Australian Government civilian and parliamentary superannuation arrangements and management of the financial aspects of those superannuation arrangements. Finance is also responsible for administering the PB Act. In this role it provides general advice to Australian Government organisations on PB Act arrangements.

21. Since the previous audit, Finance has: disseminated a number of circulars about changes to the superannuation statutory framework, including the closure of the PB Act and issues associated with individuals contracting with the Australian Government; provided information on its superannuation website; and conducted a comprehensive program of seminars on superannuation.

22. The ANAO considered the activities Finance had undertaken to inform Australian Government organisations of changes to the PB Act were appropriate. As noted in paragraph 15, it would be beneficial if Finance could extend the targeted dissemination of its guidance material beyond human resource and finance staff to include procurement staff. The audit also found that Australian Government organisations would benefit from Finance preparing a checklist, in consultation with the ATO, which highlights some of the considerations in establishing and managing contracts. Adding a requirement to determine whether an employment relationship exists would reduce the risk that employers do not identify superannuation liabilities.

### *Adequacy of guidance provided by the ATO*

23. As the administrator of the SG Act, the ATO's main role is to provide guidance and advice to employers to help them comply with their superannuation guarantee obligations. One aspect of the role includes assisting Australian Government organisations understand who is an employee for superannuation purposes according to section 12 of SG Act.

24. The ANAO found that relevant staff in all of the audited agencies were aware of the SG Act and the PB Act. This knowledge arose both from existing policy and guidance in their own agency, past efforts to consider superannuation obligations for contractors, guidance provided by Finance, and guidance and advice provided by the ATO.



25. The ATO's two Superannuation Guarantee Rulings<sup>5</sup> provide advice to employers about how to assess whether a contractor who is an individual is entitled to superannuation benefits. While these documents comprehensively address a difficult topic, supplementing them with decision-making tools to simplify the process of identifying contractors eligible for superannuation would assist employers, including Commonwealth employers, in meeting their SG Act obligations. The ANAO noted that the ATO was developing such aids at the time of the audit. The ATO, together with Finance, could also supplement advice to Australian Government employers by drawing their attention to other classes of workers who are employees for superannuation purposes under s. 12 of the SG Act.

26. As noted in paragraph 15, while the ATO has developed a considerable amount of material about how to identify superannuation obligations for contractors, some agencies were not aware of its full range of support services. These include the ATO's superannuation telephone help line, Provision of Written Advice service, and the Government superannuation section of the ATO's website.

27. The ATO provides guidance to agencies about calculating superannuation payments for eligible contractors in a number of documents, via its website (<[www.ato.gov.au](http://www.ato.gov.au)>), and in response to requests to the superannuation telephone information line. Overall, the ANAO found ATO guidance was adequate for the calculation of superannuation entitlements. The ANAO supports the ATO's proposals to improve guidance surrounding the calculation of the Superannuation Guarantee Charge (paragraph 35 discusses this issue).

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<sup>5</sup> ATO, *Superannuation Guarantee Ruling (SGR 2005/01)* and *Superannuation Guarantee Ruling (SGR 2005/02)*. SGR 2005/1 explains when an individual is considered to be an 'employee' under section 12 of the SG Act. SGR 2005/2 explains how the definitions of 'employer' and 'employee' in the SG Act apply to contractual arrangements involving three or more parties, such as through a labour hire company.

## Individual Agencies' Management of Superannuation Obligations to Certain Contractors (Chapter 4)

28. The ANAO found that 94, or around two per cent, of the 4 546 contracts of the audited agencies in 2005 were with individuals.<sup>6</sup> As indicated in paragraphs 17 and 18, a primary approach taken by many of the audited agencies to control the risk of not meeting superannuation obligations to contractors has been to enter into relatively few contracts with individuals. To implement this strategy, some agencies had contracting policies which stated a preferred position of not contracting with individuals, or allowed results-based contracts only. Such contracts largely avoid the need to pay superannuation, as contractors are not employees if they are paid for achieving results rather than for hours worked.

29. Further, a comparison of the results of ANAO analysis for the current audit with those from the previous audit indicated a substantial decline in the proportion of contracts with individuals. The previous audit indicated that around 3.4 per cent of contracts entered into by Australian Government organisations in 2002–03 were with individuals, while only 2.1 per cent of the contracts entered into by the seven agencies in this audit were with individuals.<sup>7</sup>

### *Contractors with superannuation obligations*

30. The ANAO assessed 36 of the audited agencies' 94 contracts with individuals, and identified seven contractors who could be considered employees for superannuation purposes.<sup>8</sup> The selected agencies had identified and paid superannuation for two of these seven contractors.

31. While these numbers are small, it is possible that agencies may be continuing to under-identify contractors with superannuation entitlements, and consequently not to be meeting all such financial obligations. However, the number of contracts the ANAO considered to have an unmet

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<sup>6</sup> This refers to the number of contracts listed on Finance's *AusTender—Contracts Reported* (AusTender) system for the seven audited agencies for the 2005 calendar year. The ANAO also examined records of 2 425 contracts on these agencies' Contract Registers and 1 293 purchase orders. As the extent of overlap between these entries and those on AusTender was not clear, the ANAO primarily reports the analysis of AusTender data.

<sup>7</sup> The comparisons between these findings from the current and previous audits are indicative only. The previous audit conducted a random sample across many Australian Government organisations. The current audit was selective rather than random, and covered only the seven audited agencies.

<sup>8</sup> These findings suggest that considerably less than one per cent of contracts examined were with individuals with superannuation entitlements.

superannuation obligation did not exceed two<sup>9</sup> for any of the seven audited agencies. Further, the circumstances in some cases were unique. The nature of the contracts and the surrounding circumstances were as follows:

- one contract was for a musical performance. The ANAO found the contract was not for employment at common law or wholly or principally for labour, but separate provisions in the SG Act created an entitlement to superannuation;
- one contract involved a specialist IT project manager. The person was a non-resident for immigration purposes and had been engaged as a contractor because it was thought that they could not be engaged as an employee under the *Public Service Act 1999*. The person was considered an employee for superannuation purposes;
- two contracts involved the same specialist IT trainer. The agency had sought general legal advice about the two contracts with the individual and had been advised there were ‘no legal issues’ with the contract. The ANAO examined the legal advice, which did not indicate whether superannuation had been considered;
- one contract was for a public service finance manager. The individual was a semi-retired public servant working on a casual, as needs, basis. The contract was executed shortly before the agency implemented more stringent contract clearance processes; and
- the other two contracts were both with semi-retired people working on a casual basis. One contractor was an analyst and the other was a historian. The agency had paid superannuation in both cases.

32. For the five contracts above where superannuation had not been paid, the four contracting agencies agreed to seek advice from the ATO or a legal opinion about their superannuation liabilities. These agencies also agreed to calculate and meet any superannuation obligation, based on this advice.

33. The current audit identified an unmet superannuation obligation for 5.3 per cent of the contracts with individuals (representing five contracts) from the seven audited organisations. This compares to 35.3 per cent of contracts with

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<sup>9</sup> The ANAO identified only one agency that had two such contracts. These two contracts were with one person working continuously for the agency.

individuals in the previous audit.<sup>10</sup> The ANAO found that for the seven agencies reviewed, the reduction in unmet superannuation obligations to contractors was largely attributable to a preference to: contract with companies, trusts and partnerships; enter into 'results-based' contracts with individuals; or engage individuals as part-time and/or non-ongoing Australian Public Service employees.<sup>11</sup>

### *Calculating superannuation benefits*

**34.** Only one of the audited agencies had paid superannuation for contractors the ANAO considered eligible, and had done so for two separate contracts. As the benefit for one of the contractors was paid late, the agency was required to pay interest. The payment met the minimum requirements for an interim benefit under the PB Act.

**35.** The ANAO notes that, with the closure of the PB Act to people engaged from 1 July 2006, the SG Act now requires Australian Government employers to calculate any interest amounts paid after the quarterly Superannuation Guarantee Charge<sup>12</sup> (SGC) cut-off date using interest calculated so that it compounds daily. Although departments and untaxable authorities are not liable for the SGC, the SG Act applies to them in all other respects. Administratively, this means that for any SG shortfall amounts, Australian Government employers are required to pay to the individual's superannuation account an amount equal to the sum of the shortfalls with interest calculated according to the SG Act. As a consequence, interest amounts payable under the SG Act are now greater than those previously required under the PB Act.<sup>13</sup>

### *Determining whether contractors are entitled to superannuation contributions*

**36.** There are two main parts to determining whether contractors are entitled to superannuation contributions. The first is to establish whether the

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<sup>10</sup> As explained in footnote 7, the comparisons between these findings from the current and previous audits are indicative only. The previous audit conducted a random sample across many Australian Government organisations. The current audit was selective rather than random, and covered only the seven audited agencies.

<sup>11</sup> A number of the audited agencies explained that they had engaged individuals as part-time and/or non-ongoing Australian Public Service employees to avoid potential uncertainties surrounding the use of contractors, including the need to determine superannuation obligations. Individuals engaged as part-time and/or non-ongoing Australian Public Service employees are entitled to superannuation benefits.

<sup>12</sup> The Superannuation Guarantee Charge is the penalty that employers pay to the ATO for non-payment or late payment of superannuation contributions in accordance with the SG Act. The calculation is based on the SG shortfall plus a nominal interest component and an administration fee for the ATO's costs.

<sup>13</sup> The ATO advised the ANAO that it is currently developing an on-line Superannuation Guarantee Calculator, which will assist employers in calculating SGC amounts.

contractor is an individual, and the second is to establish whether he or she is an employee under common law, or in a contract wholly or principally for labour.<sup>14</sup>

37. The ANAO found that agencies had informal approaches to identifying whether a contractor was an individual. Conversely, where agencies had considered a contractor to be an individual, they generally had detailed processes to assess whether he or she was an employee under common law, or in a contract wholly or principally for labour. Nevertheless, given the final decision as to whether a contractor is entitled to superannuation benefits is sometimes a fine balance of many factors, if uncertain, agencies should be mindful of the opportunity to seek advice from the ATO about a contractor's entitlement to superannuation benefits.

38. The ANAO emphasises the importance of agencies documenting their key considerations in making assessments as to whether a contractor is entitled to superannuation. Having such documentation is likely to reduce the risk that superannuation obligations are not identified and provide evidence that superannuation was properly considered before a contract was signed.

#### *Policies and processes*

39. All seven agencies audited had developed and promulgated a range of policy and guidance material on superannuation obligations to contractors. However, the audit found that guidance material was not current for a number of agencies. The ANAO considers that agencies should review and update guidance material at appropriate intervals to keep it current in light of agencies' ongoing experiences and broader developments.

40. The ANAO assessed each of the seven agencies as generally having adequate administrative processes in place, given their respective levels of exposure to potential superannuation obligations. Five of the seven agencies audited had established a centralised contracts unit, with specialist contract staff. In the other two agencies, individual business units were responsible for identifying contracts with individuals that may pose a superannuation risk. These business units were supported with checklists to support the assessment of individual contractors.

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<sup>14</sup> It is also necessary to establish whether a contractor is eligible for superannuation under other provisions of the SG Act.

41. The ANAO identified a better practice whereby some agencies had standard clauses within contracts that reduced the risk of unintentionally creating an employment relationship, for example, by specifying results-based contracts where this was appropriate. The ANAO suggests that Australian Government organisations consider including such clauses in standard contract templates.

#### *Unmet superannuation liabilities associated with past contracts*

42. The previous audit considered that Australian Government organisations should use a risk-based approach to identify and provide for unmet superannuation liabilities associated with past contracts with individuals.

43. The current audit found that three of the seven agencies had conducted systematic reviews of past contracts to identify the level of potential superannuation obligations to individual contractors. The remaining agencies indicated the risk of having unmet superannuation obligations was addressed informally and considered to be low. None of these agencies documented the basis for reaching this conclusion.

44. The ANAO considers that conducting a systematic, risk-based review of past contracts to identify the level of potential superannuation obligations to individual contractors is better practice. Such an exercise may include: focusing on the main contract types or business areas that are likely to involve contracting with individuals; checking whether contractors are individuals by referring to the Australian Business Register; and utilising a checklist containing indicators such as those in Tables 2.1 and 2.2 in considering higher-risk individuals. Agencies should record the basis of their considerations of unmet superannuation liabilities associated with past contracts with individuals.

### **Better practices**

45. Amongst the audited agencies, the ANAO identified a number of administrative arrangements that it considered to be good examples of managing superannuation obligations to certain contractors. Table 1 lists these practices.

**Table 1****Better practices to manage superannuation obligations to contractors**

Component of superannuation administration	Better practice
Maintaining awareness of superannuation obligations regarding contractors	<ul style="list-style-type: none"> <li>• A number of agencies included advice on potential superannuation implications when contracting with individuals in standard contract templates.</li> <li>• One agency included a clause which specified payment on completion of a specific result for a fixed contract price inclusive of all costs.</li> <li>• Five agencies used specialist contract staff to review and clear contracts with individuals before they were entered into.</li> <li>• One agency included superannuation obligations for contractors in its checklist of key finance and human resource requirements, and sent quarterly reminders to its branch and administrative units.</li> <li>• The establishment of a contract manager network and associated newsletter to provide contract managers with updates of current issues.</li> </ul>
Identifying eligible contractors	<ul style="list-style-type: none"> <li>• One agency provided guidance, within their standard contract templates, on how to check a contractor's business structure or legal identity through the Australian Securities and Investment Commission (ASIC) National Names Index or the Australian Business Register &lt;<a href="http://www.abr.business.gov.au">www.abr.business.gov.au</a>&gt;.</li> <li>• Two agencies used checklists (based on ATO guidance) to help identify and assess individuals considered to be employees.</li> </ul>

Source: ANAO.

**Agencies' responses to the audit**

46. Each of the eight audited agencies agreed with the audit report's conclusions and findings. Appendix 1 reports each of their responses.





# **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter provides background information about the audit, including an overview of Australian Government superannuation obligations to contractors, and describes the audit approach.*

## Superannuation obligations to contractors

**1.1** Compulsory saving for retirement through mandatory superannuation contributions by employers has been a policy of successive Australian governments. The Superannuation Guarantee, which came into effect on 1 July 1992, was introduced to promote national savings and reduce reliance on the Age Pension by individuals.

**1.2** Since 1 July 2002, the Superannuation Guarantee has required employers to contribute nine per cent of employees' earnings to a complying superannuation fund or retirement savings account. The Superannuation Guarantee covers both public sector and private sector employees and extends the definition of employee to a range of people who are not ordinarily thought of as being employees.

**1.3** The legal framework concerning employers' obligations for contractors can be technical and complex. The framework is established through a mix of legislation and common law. The two main Acts are: the *Superannuation (Productivity Benefit) Act 1988* (PB Act); and the *Superannuation Guarantee (Administration) Act 1992* (SG Act).

**1.4** Chapter 2 describes in detail the legal framework for determining superannuation obligations to contractors. In brief, Australian Government organisations are liable to pay superannuation for contractors that are considered employees for superannuation purposes, or where contracts are mainly for their labour. Such contractors are individuals who are sole traders, and likely to be: working under the direction and control of staff at an agency; being paid on an hourly rate rather than on a results basis; and/or able to delegate work to agency staff.

**1.5** Australian Government organisations are not liable to pay superannuation for contractors: working for, or part of, companies, trusts or partnerships; or who provide goods rather than services.

**1.6** Most contractors work for companies, trusts or partnerships and a substantial number provide goods rather than labour. As a consequence,

Australian Government agencies are not obliged to pay superannuation for most contractors. Of the 4 546 contracts of seven agencies examined in this audit, only around two per cent were with contractors who were individuals/sole traders and therefore could possibly be entitled to superannuation.<sup>15</sup>

1.7 The Department of Finance and Administration (Finance) is responsible for administering the PB Act. The Australian Taxation Office (ATO) is responsible for administering the SG Act. Finance provides guidance and advice to Australian Government organisations about PB Act arrangements. The ATO provides guidance and advice to employers about SG Act arrangements, and also about the definition of employees and contracts wholly or principally for labour.

## Previous audit coverage

### ANAO Audit Report No.13 2004–05

1.8 In October 2004, the ANAO tabled Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government* (the previous audit). This audit was undertaken after the Senate Select Committee on Superannuation requested an audit when it received reports that an Australian Government agency had not paid superannuation contributions over a four-year period for contractors who were entitled to them.<sup>16</sup>

1.9 The objectives of the previous audit were to determine: whether the superannuation obligations under the PB Act had been met; and the level and appropriateness of advice given and received by Australian Government organisations on the application of PB Act and SG Act.

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<sup>15</sup> These contracts were reported on the Department of Finance and Administration, *AusTender–Contracts Reported* system for 2005. They represent all contracts entered into by the seven agencies that have a total contract value of \$10 000 or more. As such, they cover contracts for goods and services.

<sup>16</sup> 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 advised that AQIS had obtained legal advice that under the SG Act certain contractors should be deemed employees for the purposes of the Act. As a result, AQIS should have made superannuation payments for these contractors in accordance with the rates outlined in the PB Act.

In August 2002, the Senate requested that the ANAO conduct an audit on: the extent to which Commonwealth government departments were using, or had used, contracting-out arrangements and, as a result, had avoided Superannuation Guarantee payments; and Finance, ATO or any other organisation's involvement in establishing contracting-out arrangements resulting in non-payment of the Superannuation Guarantee in AQIS and/or any other Commonwealth government department.

**1.10** The previous audit found that, of contracts tested in the audit sample, superannuation obligations had been met in 25 instances. This was out of a total of 78 contracts for which a superannuation obligation was identified or it was unclear and an obligation might therefore exist. The audit concluded that agencies were generally not aware of superannuation requirements for contractors, even though some had sought legal advice and developed policies, procedures and standard clauses incorporating superannuation requirements into contracts.

**1.11** The previous audit also concluded that while the ATO and Finance had provided appropriate advice on the application of the Acts, there was scope to clarify a number of issues relating to the legislative framework and mechanisms for monitoring agency compliance with the PB Act. The audit report contained two recommendations (see Figure 1.1).

**Figure 1.1**

### **Recommendations from the previous audit**

#### **Recommendation No. 1 from the previous audit**

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.

#### **Recommendation No. 2 from the previous audit**

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 if 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.

Source: ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, p. 14.

**1.12** Finance and the ATO agreed with Recommendation No. 1 and all agencies generally agreed with Recommendation No. 2.

## The current audit

### Audit objective

**1.13** The objective of this audit was to determine: the extent to which selected agencies have implemented the two recommendations of the previous audit; and the appropriateness of advice provided by Finance and the ATO. To address this audit objective, the audit assessed:

- the roles of Finance and the ATO in clarifying: the interaction of the PB and SG Act; the ongoing role of the PB Act; and mechanisms to monitor Australian Government organisations' compliance with the PB Act;
- the extent to which Finance and the ATO have provided guidance and other support to assist Australian Government organisations manage and meet statutory superannuation obligations for eligible contractors; and
- whether Australian Government organisations have managed and met statutory superannuation obligations for contractors in past and current contracts.

### Audit scope and focus

**1.14** The audit examined changes to the legal and administrative framework since the previous audit, the roles of Finance and the ATO as administrators of the PB Act and SG Act, respectively, and the advice they have provided to Australian Government organisations on applying the Acts in practice. Detailed testing of agency contracts was undertaken in seven agencies.<sup>17</sup> The previous audit examined all but one of these agencies, namely Geoscience Australia. The agencies included in the current audit were:

- Finance;
- the ATO;
- the Australian Bureau of Statistics;
- CRS Australia;
- the Department of Foreign Affairs;
- the Department of Veterans' Affairs;

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<sup>17</sup> Detailed audit testing of agency contracts was undertaken in all agencies listed in paragraph 1.14, except the ATO.

- Geoscience Australia; and
- Insolvency and Trustee Service Australia.

## Audit criteria

**1.15** In forming an opinion against the audit objectives, the ANAO assessed, where relevant, whether each selected agency satisfied the key audit criteria outlined in Table 1.1. Where appropriate, the report includes references to better practices.

**Table 1.1**

### Key audit criteria

Criteria	Description
<b>Contract testing</b>	The agency is meeting its obligations under the PB Act and SG Act to identify superannuation liabilities associated with independent contractors, and correctly pays superannuation on their behalf.
<b>Past superannuation obligations</b>	The agency has addressed the risk that statutory superannuation obligations in past and current contracts have not been met.
<b>Policies</b>	The agency provides clear, accessible and comprehensive policy and procedural guidance on contracting with individuals/sole traders.
<b>Process Controls</b>	The agency has administrative processes that adequately control the risks of contracting with individuals who are employees under common law or in contracts wholly or principally for labour.
<b>Training and awareness raising activities</b>	The agency has adequate training and awareness activities in place to ensure that agency staff are aware of the existence of the PB Act and the SG Act, their obligations under the Acts and other potential legal obligations of entering into contracts with individuals.

Source: ANAO.

**1.16** As mentioned in paragraph 1.13, the ANAO also examined: Finance and the ATO's role in simplifying and clarifying the relevant superannuation legislation; and the extent to which Finance and the ATO have provided guidance and other material to assist Australian Government organisations manage and meet statutory superannuation obligations for eligible contractors during the period of legislative change.

## Audit methodology

**1.17** The audit methodology involved interviews with selected officers, and the examination of the selected agencies' policies, procedures, and practices against audit objectives and criteria.

**1.18** For the seven agencies where the ANAO undertook detailed testing of agency contracts, the ANAO obtained a complete list of contracts from Finance's *AusTender–Contracts Reported* system for the 2005 calendar year. The ANAO then checked these contracts against the *Australian Business Register*<sup>18</sup> to identify suppliers operating under the business structure of a sole trader/individual. The audit then typically examined a sample of five contracts with individuals from each of the seven agencies to determine whether there was a superannuation obligation, and if so whether payments had been made correctly.

**1.19** As noted in Chapter 2, from 1 July 2006 the PB Act was closed to new contractors, amongst others, which reduced the complexity of legal arrangements concerning Australian Government contractors. As audit fieldwork covered contracts from the 2005 calendar year, prior to these changes to the PB Act, the PB Act contracts were assessed against the requirements of the PB Act and the SG Act. The ANAO also examined agencies' policy and procedural guidance to ensure that it reflected the changes to the PB Act applying from 1 July 2006.

**1.20** The ANAO provided each agency with a management report on the audit findings, some of which included recommendations specific to the particular agency.

## Assistance to the audit

**1.21** The ANAO engaged Courage Partners Pty Ltd to support the audit by analysing audit evidence collected by the ANAO, and drafting management letters and sections of the parliamentary report. The ANAO engaged Allanson Consulting Pty Ltd to undertake statistical analysis of the contracts covered in the audit. The audit was conducted in accordance with the ANAO Auditing Standards, at a cost to the ANAO of approximately \$320 000.

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<sup>18</sup> The database can be accessed via the Internet at <[www.abr.business.gov.au](http://www.abr.business.gov.au)>.



## Audit reporting and structure

**1.22** This audit is part of a programme of cross-agency performance audits that examine business processes which support the delivery of services provided by Australian Government organisations. These audits are normally conducted at a selection of organisations, under the provisions of section 18 of the *Auditor-General Act 1997*, which provides for the examination of a particular aspect of the operations of the whole or part of the Australian Government sector. As any audit recommendations are framed to have general application, audit findings are reported to Parliament in generic terms, without being attributed to particular organisations.

**1.23** Chapter 2 provides an overview of the legal framework for superannuation for contractors, including statutory changes since the last audit.

**1.24** The results of the audit, together with suggestions for improving the management of superannuation obligations for contractors, are set out in Chapters 3 and 4. Chapter 3 examines the roles of Finance and the ATO in clarifying the interaction of the PB and SG Act; the ongoing role of the PB Act; and mechanisms to monitor Australian Government organisations compliance with the PB Act. As such, it assesses the extent to which Finance and the ATO have implemented Recommendation No. 1 from the previous audit. The chapter also examines the roles of Finance and the ATO as administrators of the PB Act and SG Act, respectively, and the advice they have provided to Australian Government organisations to comply with the Acts.

**1.25** Chapter 4 assesses the extent to which the audited agencies have met their statutory superannuation obligations to contractors in current and past contracts, and have adequate controls and processes to manage the risks of not meeting these obligations. As such, it assesses the extent to which these agencies have implemented Recommendation No. 2 from the previous audit.

## 2. Legal Framework for Contractors' Superannuation Entitlements

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*This chapter provides an overview of the legal framework for superannuation entitlements for certain contractors.*

**2.1** Australian Government organisations are responsible for meeting superannuation obligations to certain contractors. The key issues are whether there is an employer-employee relationship at common law in the contract the organisation has entered into with the contractor; or the contract is wholly or principally for labour.

**2.2** The legal framework concerning employers' obligations for contractors can be technical and complex. The framework is established through a mix of legislation and common law. The two main Acts are:

- the *Superannuation (Productivity Benefit) Act 1988* (PB Act); and
- the *Superannuation Guarantee (Administration) Act 1992* (SG Act).

**2.3** The PB Act does not define 'employee' and sub-section 12(1) of the SG Act, subject to other provisions in section 12, provides that 'employee' has its ordinary meaning. Both Acts therefore rely on a judicial notion of 'employee' established by the courts through case law precedents to provide the meaning of the term.

**2.4** Two Superannuation Guarantee Rulings, re-issued by the ATO in 2005, identify the various indicators established by the courts to determine whether a person is an employee and arrangements or relationships that do not give rise to an employer/employee relationship:

- SGR 2005/1 *Superannuation guarantee: who is an employee?*<sup>19</sup> and
- SGR 2005/2 *Superannuation guarantee: work arranged by intermediaries.*<sup>20</sup>

**2.5** These rulings also provide further guidance (which does not have the force of law) about individuals considered to be an 'employee' under section 12 of the SG Act, contractual and working arrangements.

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<sup>19</sup> <<http://law.ato.gov.au/atolaw/view.htm?locid='SGR/SGR20051/NAT/ATO'&PiT=99991231235958>>, accessed 1 May 2007.

<sup>20</sup> <<http://law.ato.gov.au/atolaw/view.htm?locid='SGR/SGR20052/NAT/ATO'&PiT=99991231235958>>, accessed 1 May 2007.

## **PB Act**

2.6 The PB Act was enacted in 1988 and now applies only to public sector employees who were engaged prior to 1 July 2006. The PB Act originally provided superannuation for most temporary employees, statutory office holders and certain other persons who were not covered by an Australian Government superannuation scheme.

2.7 From 1 July 2006 the PB Act was closed to new employees, office holders, contractors and consultants. Closing the PB Act to new employees has reduced the complexity of legal arrangements concerning Australian Government contractors, as it has decreased the incidence of overlap with the SG Act.

2.8 Finance is responsible for administering the PB Act, and provides advice to Australian Government organisations about their obligations under this Act.

## **SG Act**

2.9 The SG Act applies to employers generally, including Australian Government organisations, and provides a minimum level of superannuation for a range of individuals including:

- employees within the ordinary, or common law, meaning of the term—s. 12(1) of the Act;
- members of the executive body (including the board of directors) of an incorporated body—s. 12(2);
- people working under a contract wholly or principally for their labour—s. 12(3);
- people paid to participate in performing or presenting any music, play, dance, entertainment, sport, display or promotional activity; or any similar activity involving intellectual, artistic, musical, physical or other personal skills; or to provide services in connection with such activities—s. 12(8)(a) and (b);
- people paid to perform services in, or in connection with, making any film, tape or disc or of any television or radio broadcast—s. 12(8)(c); and
- people holding an appointment, office or position under the Constitution or a Commonwealth law, or people otherwise in the

service of the Commonwealth (including the Defence Force or a police force)—s. 12(9).

The SG Act also considers certain workers not to be employees.<sup>21</sup>

**2.10** The ATO is responsible for administering the SG Act. This includes providing advice to Australian Government organisations on the definition of employee contained in the Act and non-binding advice as to whether a person is engaged through a contract that is wholly or principally for their labour.

### **Contracts with companies, trusts and partnerships**

**2.11** Where an individual performs work for another party under a contract with a company, trust or partnership, there is no employer-employee relationship for the purposes of the SG Act. However, they may be an employee of the company, trust or partnership. A person who holds an ABN may still be an employee.<sup>22</sup>

### **Contractual clauses denying an employment relationship**

**2.12** A contractual term denying the creation of an employment relationship is not valid at law if the effect of the agreement as a whole contradicts the term.<sup>23</sup> The parties to an agreement cannot alter the true substance of the relationship by simply giving it a different label.<sup>24</sup> All SG Act s. 12 provisions and common law employment indicators must therefore be considered when determining whether there is an employment relationship with a contractor.

### **Interaction of the PB Act with the SG Act**

**2.13** An individual's entitlement to superannuation must be assessed where applicable, against the requirements of both the PB Act and the SG Act, even if a benefit has been paid under the PB Act.<sup>25</sup>

**2.14** Although the PB Act and the SG Act provide coverage to similar categories of people and comparable levels of benefit, the two Acts' provisions

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<sup>21</sup> The main exceptions are in sections 27 to 29 of the SG Act, employees: who are paid less than \$450 in any month; aged 70 years or over; under 18 years of age and working for not more than 30 hours a week; or performing work of a private or domestic nature for not more than 30 hours a week for a non-business employer. The PB Act did not exclude such workers.

<sup>22</sup> SGR 2005/1 paragraphs 13–16.

<sup>23</sup> *Australian Mutual Provident Society v. Chaplin and Anor* (1978) 18 ALR 385 at 389 cited in SGR 2005/1, paragraph 28.

<sup>24</sup> *Massey v. Crown Life Insurance Co* [1978] 1 WLR 676; [1978] 2 All ER 576 cited in SGR 2005/1, paragraph 28.

<sup>25</sup> This only applies to individuals employed continuously since before 1 July 2006.

are not identical. There are some differences in their coverage of people and the methodology for calculating superannuation payments.<sup>26</sup>

**2.15** A benefit paid under the PB Act exceeding the minimum requirements of the SG Act will, under section 23 of the Act, reduce any SG superannuation liability to zero.<sup>27</sup> However, a PB Act benefit falling short of minimum SG Act requirements will incur a superannuation guarantee shortfall.<sup>28</sup> A shortfall will also occur for people who were entitled to superannuation under the SG Act but did not receive it. Where a shortfall is identified, Australian Government employers are liable to pay these superannuation contributions, plus any associated interest, equivalent to the Superannuation Guarantee Charge.<sup>29</sup>

## Determining whether a contractor is entitled to superannuation benefits

**2.16** There are two main considerations when determining whether an Australian Government organisation is obliged to contribute superannuation benefits for a contractor. These are whether:

- there is an employment relationship at common law; or
- the contract is wholly or principally for the labour of the person.

### Determining an employment relationship at common law

**2.17** The traditional test of an employment relationship is the 'control test' — the right of the employer to control how and what the contractor does. The courts now tend to regard it as only one of several indicators, though it is still important. The totality of the relationship between the parties must be considered to determine whether, on balance, the worker is an employee or independent contractor. The final decision is generally a fine balance of all the indicators rather than one overriding test.

**2.18** Table 2.1 lists these indicators. The ANAO used these indicators to assess whether an individual was an employee for superannuation purposes.

<sup>26</sup> See Department of Finance and Administration, *Superannuation Circular 2006/8: Consolidated advice on the Superannuation (Productivity Benefit) Act 1988 arrangements and Superannuation Guarantee Ruling SGR 2005/1*.

<sup>27</sup> ANAO Audit Report No.13, 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, p. 22.

<sup>28</sup> Department of Finance and Administration, *op. cit.*, p. 3. Some people, too, might not be entitled to any PB Act benefit but still have an entitlement under the SG Act.

<sup>29</sup> The Superannuation Guarantee Charge is the penalty that employers pay to the ATO for non-payment or late payment of superannuation contributions in accordance with the SG Act.

**Table 2.1**

**Indicators of an employment relationship at common law**

Key Indicators	Authority
<b>Control:</b> Does the employer have the right to direct what work is to be done, and how and where it is to be done—rather than expressing their directions in the terms of the contract?	<i>Stevens v. Brodribb</i> (1986) 160 CLR 16 at 24, per Mason J and CLR 36, per Wilson and Dawson JJ. (SGR 2005/1 paragraphs 33–38)
<b>Integration test:</b> Does the worker operate in the business of the employer—rather than on his or her own account?	<i>Hollis v. Vabu</i> (2001) 207 CLR 21 (SGR 2005/1 paragraphs 39–41)
<b>'Results' contract:</b> Is the contractor remunerated for hours worked—rather than for achieving a specified result?	<i>World Book (Australia) Pty Ltd v. FC of T</i> 92 ATC 4327; (1992) 23 ATR 412 <i>Queensland Stations Pty Ltd v. FC of T</i> (1945) 70 CLR 539; (1945) 19 ALJ 253; (1945) 8 ATD 30. (SGR 2005/1 paragraphs 42–47)
<b>Right to delegate or subcontract:</b> Does the worker have the right to delegate—rather than having to perform the work personally?	<i>Stevens v. Brodribb</i> (1986) 160 CLR 16 at 26, per Mason J (SGR 2005/1 paragraphs 48–50)
<b>Risk:</b> Does the employer bear the risk of costs arising out of injury or defect in the contractor's work—rather than the worker?	<i>Hollis v. Vabu</i> (2001) 207 CLR 21 (SGR 2005/1 paragraph 51)
<b>Provision of tools and equipment and payment of business expenses:</b> Does the employer bear the costs of tools, equipment, direct costs and overheads—rather than the worker?	<i>Stevens v. Brodribb</i> (1986) 160 CLR 16; <i>Vabu Pty Ltd v. FC T</i> 96 ATC 4898; (SGR 2005/1 paragraphs 52–57)
<b>Other Indicators:</b> <ul style="list-style-type: none"> <li>• right to suspend or dismiss the person;</li> <li>• right to the exclusive services of the person;</li> <li>• provision of benefits such as annual, sick and long service leave.</li> </ul>	<i>Stevens v. Brodribb</i> (1986) 160 CLR 16 (SGR 2005/1 paragraphs 58–60)

Sources: Based on ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, and ATO *Superannuation Guarantee Ruling SGR 2005/1*.

## Contracts wholly or principally for the labour of the person

**2.19** Where a contract has been assessed as being with an independent contractor rather than creating a common law employee relationship, or satisfying any of the other conditions of s. 12 of the SG Act, it is then necessary to determine whether it is wholly or principally for labour according to s. 12(3) of that Act.

**2.20** If a contractor is entitled to superannuation under s. 12 of the SG Act, then the PB Act applies to people whose contract commenced before 1 July 2006, and the SG Act applies to people whose contract commenced after 1 July 2006.

**2.21** Table 2.2 below lists and describes the indicators used to determine whether a contract is wholly or principally for labour. Again these indicators are not always straightforward, and a balanced judgement needs to be made.

**Table 2.2**

### Indicators of a contract wholly or principally for labour

Indicator	Authority
<p><b>'Principally' for the labour of the person:</b> Is the contract mainly for the person's labour, including mental and artistic effort—rather than for something else? (for example, the supply of goods, materials or hire of plant)? As such, is the labour component of the contract over 50 per cent of the total value?</p>	<p>SGR 2005/1 para 66—'principally' assumes its commonly understood meaning: 'chiefly' or 'mainly'. <i>Deputy Commissioner of Taxation v. Bolwell</i> (1967) 1 ATR 862 at 873 (SG Ruling 2005/1 paragraphs 65–66)</p>
<p><b>Right to delegate or subcontract:</b> Does the worker have the right to delegate—rather than having to perform the work personally?</p>	<p><i>Neale (Deputy Commissioner of Taxation) v. Atlas Products (Vic) Pty Ltd</i> (1955) 94 CLR 419  <i>World Book (Australia) Pty Ltd v. FC of T</i> 92 ATC 4327; (SG Ruling 2005/1 paragraphs 70–73)</p>
<p><b>'Results' contract</b>—Is the contractor remunerated for hours worked—rather than for achieving a specified result?</p>	<p><i>World Book (Australia) Pty Ltd v. FC of T</i> 92 ATC 4327. (SGR 2005/1 paragraphs 74–78)</p>

Sources: Based on ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, and ATO, *Superannuation Guarantee Ruling 2005/1*.

## 3. Finance and the ATO's Roles in Administering the PB and SG Acts

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*This chapter examines the roles of Finance and the ATO in implementing Recommendation No. 1 from the previous audit. It also examines the roles of Finance and the ATO in administering the PB Act and SG Act, respectively, and advice they provided to Australian Government organisations on applying the Acts in practice.*

### Introduction

#### Role and activities of Finance

**3.1** Finance is responsible for policy development, implementation and advice on Australian Government civilian and parliamentary superannuation arrangements and management of the financial aspects of those superannuation arrangements. Finance is also responsible for administering the PB Act. Finance supports the Minister for Finance and Administration with his responsibilities for superannuation for Australian Government employees and parliamentarians by:

- providing policy advice to the Minister on superannuation issues, including those arising under the PB Act;
- implementing changes to the superannuation framework for the Australian Government sector;
- providing general advice to Australian Government employers on the Government's superannuation schemes, including PB Act arrangements; and
- distributing updated information to assist Australian Government employers in determining superannuation benefits, employer contributions to superannuation schemes and other administrative arrangements.



## Role and activities of the ATO

**3.2** As the administrator of the SG Act, the ATO's main role is to provide guidance and advice to employers to help them comply with their superannuation guarantee obligations. One aspect of the role includes assisting Australian Government agencies understand who is an employee for superannuation purposes according to section 12 of SG Act.<sup>30</sup>

## Previous audit findings

**3.3** The previous audit found that the legal framework and administrative arrangements for identifying contractors who are employees for superannuation purposes and for paying superannuation under the PB Act were complex. The ANAO found that Finance and the ATO had generally provided appropriate advice to agencies on the PB and SG Acts.

**3.4** Despite these efforts, however, and initiatives within individual agencies to address the complexity and the risks, the ANAO concluded that Australian Government organisations were not sufficiently aware of the PB Act and superannuation requirements for contractors. The previous audit considered that a number of issues needed to be clarified including the PB Act's role, its interaction with the SG Act, and Australian Government organisations' compliance with the PB Act. Accordingly, the ANAO made Recommendation No. 1 in the previous audit (see Figure 3.1). Both Finance and the ATO agreed with the recommendation.

### Figure 3.1

#### Recommendation No. 1 from previous audit

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.

Source: ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, p. 14.

<sup>30</sup> The definitions of a common law employee or a contractor engaged wholly or principally for their labour apply to both the SG Act and the PB Act.

## Implementation of Recommendation No. 1 from the previous audit

3.5 Finance and the ATO worked together since the previous audit to clarify the ongoing role of the PB Act within the context of broader reform to the superannuation framework for Australian Government organisations.

3.6 Major changes to the superannuation framework for Australian Government employees and to superannuation arrangements more broadly over the past two to three years have included:

- closure of the Public Sector Superannuation (PSS) scheme to new employees and its replacement with the Public Sector Superannuation Accumulation Plan (PSSAP);
- choice of superannuation fund for new employees and eligible contractors; and
- closure of the PB Act to new employees (including certain contractors) and office holders from 1 July 2006.<sup>31</sup>

3.7 With the closure of the PB Act, superannuation arrangements for individuals who are common law employees or engaged since 1 July 2006 on contracts wholly or principally for their labour have been exclusively within the domain of the SG Act.

3.8 As the number of contractors covered by the PB Act was expected to decline rapidly from 1 July 2006, Australian Government organisations will now rarely need to consider both the PB Act and SG Act when assessing whether contractors who are individuals are entitled to superannuation benefits.

### **Mechanisms for monitoring Commonwealth organisations' compliance**

3.9 The ATO, in conjunction with Finance, has clarified or developed a number of mechanisms for monitoring Australian Government organisations' compliance with their superannuation obligations. The key mechanisms have been:

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<sup>31</sup> Legislation was introduced into Parliament and passed in June 2005 to give effect to these changes and to clarify a number of technical issues. As part of these changes, the *Superannuation (Consequential Amendments) Act 2005* amended various Acts. These amendments included closure of the PB Act to new employees (including contractors) and office holders from 1 July 2006.

- amendments to the SG Act to clarify the Act's enforcement provisions with respect to Australian Government organisations;
- clarifying the ATO's role and developing an agreed process with Finance for dealing with enquiries from Australian Government employees, including complaints about superannuation not being paid;
- developing a risk-based approach to ensuring compliance with SG obligations that includes the risk that Australian Government organisations do not correctly provide superannuation support to eligible contract workers; and
- including Commonwealth superannuation guarantee obligations in the ATO's annual compliance program for government organisations.

**3.10** The ATO's annual compliance approach is based on ensuring that Australian Government organisations have sufficient information and support to meet their superannuation payment obligations. This includes providing advice on request, and visits to government organisations to enhance their awareness of superannuation obligations for certain contractors. The ATO also undertakes to follow up all employee claims that their employers have not offered them choice of fund or made superannuation payments on their behalf.

### **Status of implementation of Recommendation No. 1 from the previous audit**

**3.11** The ANAO considers the developments described above have effectively addressed the role and complexity of the PB Act and its interaction with the SG Act, including Australian Government organisations' compliance with superannuation obligations. The ANAO concludes therefore that Recommendation No. 1 from the previous audit has been fully implemented.

### **Finance's guidance and support to agencies**

**3.12** Finance provided a range of activities to advise Australian Government organisations about changes to the superannuation framework, and their implications. The activities broadly encompassed:

- publication of updates to advice for employers and employees posted on Finance's superannuation website;
- dissemination through Finance's distribution list of a series of *Superannuation Circulars*;

- a *PB Act Hotline* (or *Inquiry Hotline*) staffed by Finance's Superannuation Policy Branch staff, and an electronic mailbox address to address specific enquiries;
- a separate *Choice Inquiry Hotline* and an electronic mailbox; and
- a comprehensive program of seminars developed as part of an overall strategy with other agencies to inform Australian Government employers of changes to the superannuation statutory framework, including the PB Act's closure and issues associated with individuals contracting with the Australian Government.

**3.13** Finance advised the ANAO that closure of the PB Act to new employees (including certain contractors) and office holders from 1 July 2006 was expected to result in a rapid decline in its coverage. Finance noted, however, that, as some office holders are appointed for relatively long terms such as five years, it may be some years before the PB Act is completely phased out. As a consequence, therefore, some maintenance of the PB Act's arrangements will be needed. Until there is a reasonable degree of certainty that no employees or office holders are no longer covered by PB Act arrangements, Finance advised that the department will need to prepare annual determinations of interest rate factors and benefit levels, and an updated Superannuation Circular.

### **Finance's guidance to agencies for managing their superannuation obligations**

**3.14** The ANAO concluded that Finance has generally provided appropriate advice to Australian Government organisations on changes to the legislative framework and superannuation issues more broadly, including the PB Act, within a challenging environment of major changes to superannuation.

**3.15** The audit has highlighted that, in addition to Finance providing guidance about these issues to human resource staff at Australian Government organisations, it would be worthwhile for procurement staff to also be made aware of these issues, given the central role of procurement in the acquisition of services. In this light, it would be beneficial if the guidance provided by Finance in connection with the Commonwealth Procurement Guidelines could make brief reference to these issues.

**3.16** The audit also found that Australian Government organisations would benefit from Finance preparing a checklist, in consultation with the ATO, which highlights some of the considerations in establishing and managing

contracts. Adding a requirement to determine whether an employment relationship exists would reduce the risk that employers do not identify superannuation liabilities.

## The ATO's guidance and support to agencies

**3.17** With the closure of the PB Act resulting in a diminishing role for Finance with respect to contractors, the ATO has primary responsibility for assisting Australian Government employers in meeting their superannuation obligations to contractors. These responsibilities involve:

- keeping Government employers aware of their obligations;
- providing guidance and direct advice to enable them to identify contractors eligible for superannuation payments; and
- providing guidance and direct advice about the calculation of superannuation benefits.

**3.18** The ATO undertook a range of activities for employers generally, including some activities or information products specifically targeted at Australian Government employers. These broadly encompassed:

- the revision and reissue of the ATO's two Superannuation Guarantee Rulings *SGR 2005/1 Superannuation guarantee: who is an employee?*, and *SGR 2005/2 Superannuation guarantee: work arranged by intermediaries*;
- *Superannuation Guarantee—a guide for employers*: a guide that assists employers generally to meet their SG obligations;
- *Choice of superannuation fund—guide for employers*: a publication that explains what employers need to do to meet their choice of superannuation fund obligations, including to contractors;
- *Superannuation Guarantee for contractors*: a fact sheet which explains that an employee for SG purposes includes a person engaged under a contract that is wholly or principally for the person's labour;
- *Superannuation obligations for Australian government employers under the Productivity Benefit Act and the Superannuation Guarantee Administration Act*: a publication that assists Government agencies in determining which contractors/consultants and temporary employees should receive support under the PB Act or the SG Act;

- the ATO *Superannuation Telephone Help Line*: a service to provide assistance relating to superannuation issues to all employers;
- a Provision of Written Advice (POWA) service: which can provide non-binding advice as to whether a contractor is an employee for superannuation purposes; and
- a Government home page on the ATO website: which was first released in December 2005 and includes a section on superannuation.

**3.19** The ATO also undertook joint seminars with Finance in 2004 to assist Australian Government agencies in various States and Territories to understand and meet their superannuation obligations. The Tax Education and Seminars Section of the ATO also provides seminars to Australian Government organisations on request.

### **Adequacy of the ATO's guidance to assist Australian Government organisations to manage their superannuation obligations**

#### *Adequacy of the ATO's guidance to raise awareness of Australian Government organisations' obligations to pay superannuation for certain contractors*

**3.20** The ANAO found that the Australian Government organisations subject to audit were aware typically of their obligations to pay superannuation for certain contractors. Relevant staff in all of the audited agencies were aware of the SG Act and the PB Act, although a significant number were not aware that the PB Act had been closed to new employees and contractors from 1 July 2006. Relevant staff in the audited agencies knew of the SG and PB Acts from: existing policy and guidance in their own agency; past efforts to consider superannuation obligations for contractors; guidance provided by Finance; and material from the ATO, especially the two superannuation Rulings, and the contents of the ATO website.

#### *Adequacy of the ATO's guidance to assist Australian Government organisations to identify contractors entitled to superannuation payments*

**3.21** The ATO's two Superannuation Guarantee Rulings provide detailed advice to employers about how to assess whether a contractor who is an individual is entitled to superannuation benefits. The ANAO considers that these documents deal comprehensively with this difficult topic.

**3.22** Relevant staff in the audited organisations commented that they found some of the material developed by the ATO, such as the two SG Rulings, difficult to use because of its complexity. The ATO advised the ANAO that it

was developing a decision-making tool to simplify the process of identifying people not ordinarily considered to be employees who are eligible for superannuation. The ANAO examined an on-line tool developed by the ATO for the building and construction industry, and considered that it significantly simplifies the decision-making process. The ANAO considers its extension to other industry sectors should considerably benefit other employers and promote better record-keeping as it provides a printable record of the decision.

**3.23** The ANAO notes that Australian Government organisations' compliance with the SG Act could be improved if their attention was drawn to other classes of workers who are employees for superannuation purposes under s. 12 of the SG Act, notably:

- people paid to perform or connected with performing intellectual, artistic, sporting, entertainment or media activities (s. 12(8)); and
- people holding an appointment or position under a Commonwealth law (s. 12(9)).

**3.24** As s. 12(9) is broader than the definition of public office holder under the PB Act, it would also be prudent if the ATO and Finance could clarify its application to Australian Government organisations.

**3.25** While the ATO has developed a considerable amount of material about how to identify superannuation obligations for contractors, some of the audited agencies were not aware of its full range of support services. This particularly related to the superannuation telephone help line, Provision of Written Advice service, and the Government superannuation website.

**3.26** The ATO has a superannuation telephone information line accessible to all employers to provide assistance relating to superannuation issues. Through this service, the ATO answers questions regarding employer obligations under the SG Act, and assists employers to assess whether a contractor is an employee for superannuation purposes. The ANAO found that many of the relevant staff from the audited agencies were not aware of this service.

**3.27** The ANAO would expect staff from Australian Government organisations to access the ATO's website when seeking information about obligations to pay superannuation on behalf of contractors. However, the site contains extensive information, and it is not immediately evident where to look on the site for more detailed guidance about this issue. In this regard, the ANAO notes that the two Superannuation Guarantee Rulings were difficult to

find in on the website.<sup>32</sup> Given their importance, the ANAO suggests that the ATO displays these two documents more prominently on the site.

### *Adequacy of the ATO's guidance and advice to assist agencies calculate superannuation payments*

**3.28** The ATO provides guidance to employers about calculating superannuation payments for eligible contractors in its publication *Superannuation Guarantee—a guide for employers*. The ANAO noted, though, that as Australian Government organisations are not liable for the Superannuation Guarantee Charge under the SG Act, this guide does not meet their needs in this respect. Australian Government employers have an administrative obligation to pay any superannuation guarantee shortfall amounts with interest directly to the person's superannuation fund rather than to the ATO. This requirement was not reflected in the publication *Superannuation Guarantee—a guide for employers* or other guidance to Australian Government employers.

**3.29** One of the audited agencies had sought to calculate the correct amount of interest on a late superannuation payment for a contractor using the *Superannuation Guarantee—a guide for employers*.<sup>33</sup> While the agency had met its obligations to the contractor through the operation of the PB Act in that instance, the interest calculation was not consistent with SG Act requirements.

**3.30** The ANAO agreed with the agency that calculating the correct amount of interest can be difficult, particularly where payments are made after the quarterly Superannuation Guarantee Charge cut-off date and should include an interest component based on interest compounding daily. The ATO advised it was developing an on-line Superannuation Guarantee Calculator to assist employers. The project is being developed in stages and an initial version was planned for release in May 2007. The ANAO considers this tool should be of considerable benefit to Australian Government organisations.

**3.31** The ATO also advised the ANAO that it will assist Australian Government employers to calculate superannuation liabilities, if they ask for assistance through the superannuation telephone information line. As noted

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<sup>32</sup> Information about superannuation obligations for contractors to Australian Government organisations is concentrated in the superannuation section of the Government home page on the ATO website <[www.ato.gov.au](http://www.ato.gov.au)>. The two Superannuation Guarantee Rulings were not separately available in this section, rather they could be accessed through an on-line search in the Legal database section, but not by direct link from the superannuation section of the Government home page.

<sup>33</sup> This is discussed in more detail at paragraphs 4.15–4.15.



above, however, the ANAO found that relevant staff in the audited agencies were not aware of this service.

### **Future responsibility for superannuation advice to Australian Government employers**

**3.32** Finance advised the ANAO that it will continue to advise Australian Government employers about superannuation requirements. The ANAO notes that there is broad agreement between Finance and the ATO regarding their respective roles and responsibilities. This includes:

- ATO responsibility for compliance with superannuation obligations, assisting employers in identifying contractors who are employees for superannuation purposes and communicating advice about the new choice arrangements to employers;
- shared ATO-Finance responsibility initially for advising Australian Government employers about superannuation choice of fund arrangements, although Finance expects a reduced involvement over time in respect of Australian Government employers; and
- Finance considers that it, rather than the ATO, will continue to communicate issues concerning superannuation that are unique to Australian Government employers.

**3.33** Given the recent closure of the PB Act to new workers and office holders, the ANAO considers that it would be an opportune time for Finance and the ATO to review their respective strategies and activities in promoting awareness of superannuation requirements for contractors. Where a future realignment of activities between Finance and the ATO is anticipated, there would be merit in establishing which activities would be the responsibility of each agency and communicating to Australian Government organisations the timelines for implementing any changes.

### **Cost of compliance**

**3.34** The ANAO notes that despite the closure of the PB Act, the legal framework for superannuation can impose high costs on employers when assessing entitlements to superannuation benefits for a contractor who is an individual. These costs arise from:

- the relatively high level of agency resources required to identify and calculate complex superannuation entitlements for contractors;<sup>34</sup>
- the need, at times, to seek legal advice, typically at a cost of \$1 000 to \$1 200 per contract, to determine whether a contractor is an employee for superannuation purposes;
- legal advice to develop terms in contracts in those instances where employers do not wish to enter inadvertently into an employer-employee relationship with a contractor;
- maintaining policies and procedures to identify superannuation obligations for the small number of contractors who are individuals; and
- the ATO responding to employer requests for assistance.

**3.35** No agency had quantified the costs to Australian Government organisations or other employers of complying with requirements to manage superannuation obligations to certain contractors.

**3.36** To minimise compliance costs, many of the audited agencies had reduced the incidence of contracting with individuals. This is discussed further at paragraphs 4.33 to 4.35.

**3.37** The ANAO considers that increased promotion of the ATO's superannuation advisory services should mitigate the costs to employers of complying with the legislation. The costs of compliance for employers should also be mitigated through the ATO's development of its on-line tools to assist employers in identifying contractors eligible for superannuation, and in calculating superannuation entitlements for contractors.

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<sup>34</sup> The ANAO found that entitlements need to be calculated manually as contractors are paid on invoice for 'ordinary time earnings' rather than salary. The small number of transactions would not justify the cost of systems to automate calculations.

## 4. Individual Agencies' Management of Superannuation Obligations to Certain Contractors

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*This chapter assesses the extent to which the audited agencies have met their statutory superannuation obligations to certain contractors in current and past contracts, and have adequate controls and processes to manage the risks of meeting these obligations. As such, it assesses the extent to which these agencies have implemented Recommendation No. 2 from the previous audit.*

### Introduction

**4.1** The previous audit examined a number of contracts to determine whether selected organisations were meeting their statutory superannuation obligations. The audit found that, of the organisations tested in the audit sample, superannuation obligations had been met in 25 instances. This was out of a total of 78 contracts where a superannuation obligation was identified or it was unclear whether an obligation existed.

**4.2** The previous audit identified that staff members of many Australian Government 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. Accordingly, it made Recommendation No. 2 (see Figure 4.1).

### Figure 4.1

#### Recommendation No. 2 from the previous audit

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 if 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.

Source: ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, p. 14.

**4.3** Based on the implementation of Recommendation No. 2 from the previous audit, the current audit examined:

- the extent to which selected agencies had met their statutory superannuation obligations to contractors for current and past contracts; and
- the adequacy of the agencies' administrative processes and practices to manage superannuation obligations to contractors.

## Agencies' performance in meeting superannuation obligations to contractors

### Current contracts

**4.4** The ANAO expects Australian Government organisations to have arrangements in place to determine whether the contracts they entered into are likely to incur obligations, and how to meet those obligations.

**4.5** Table 4.1 outlines the results of the ANAO's analysis of agencies' contracts commencing in 2005, and the extent to which agencies' may have incurred and met superannuation obligations for contractors in 2005. It shows that in the 2005 calendar year, the seven agencies entered into 4 546 contracts valued \$10 000 or more, with a total value of \$1.3 billion.<sup>35</sup> The ANAO checked the business structure of these 4 546 contractors against the Australian Business Register database and found that in 4 452 cases no employment relationship existed as the contractors were with companies, partnerships, trusts or other business structures. As such, the agencies had no obligation to pay superannuation on their behalf.

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<sup>35</sup> All contract value figures are GST-inclusive if the contract was for a taxable supply.

**Table 4.1****Extent to which agencies incurred and met superannuation obligations for contractors in 2005**

Contracts	Number	Value <sup>A</sup> (\$'000)
Total service provider contracts <sup>B</sup>	4 546	\$1 329 416
Total contracts with individuals	94	\$2 333
The ANAO sampled 36 contracts that it identified as being with individuals and found: <sup>C</sup>		
• those where individual was an employee for superannuation purposes	7	\$234
• those where employee was paid superannuation	2	\$14

Notes: (A) GST-inclusive, where applicable.

(B) This is the number of contracts listed on AusTender for the seven audited agencies for the 2005 calendar year. The ANAO also examined records of 2 425 contracts on agencies' Contract Registers and 1 293 purchase orders. As the extent of overlap between these entries and those on AusTender was unclear, they are not included in this table.

(C) Of the 36 contracts with individuals that the ANAO examined in detail, 29 were identified from AusTender data, while the remaining seven contracts were identified from agencies' Contract Registers and/or purchase order transactions on agencies' Financial Management Information Systems.

Sources: Department of Finance and Administration, *AusTender—Contracts Reported* system for 2005, and ANAO audit sampling.

**4.6** The ANAO considered that 94 of the contracts examined were with individuals. The total value of the contracts with individuals was \$2.3 million, which was less than two per cent of the value of all contracts. The ANAO assessed 36 of these 94 contracts against the employment relationship indicators detailed in Tables 2.1 and 2.2 to assess whether those contractors could be considered common law employees or engaged wholly or principally for labour. The ANAO also considered the other criteria under section 12 of the SG Act, to establish whether agencies had a statutory superannuation obligation to those contractors under the PB Act and SG Act.

**4.7** In 29 cases, the ANAO considered the contractors were paid for completing a defined service or providing goods, and therefore, were not employees under section 12 of the SG Act. These findings were consistent with agencies' decisions that they had no obligations to pay superannuation for these contractors. However, given the degree of judgement involved in weighing up the available facts against a range of indicators, the ANAO acknowledges that the ATO may reach a different conclusion.

**4.8** The ANAO identified seven contracts with individual contractors who could be considered employees for superannuation purposes. In only two cases was superannuation paid for these contractors. There was no evidence that the four relevant agencies had assessed whether there was a potential superannuation liability regarding the other five contractors who the ANAO considered to be employees for superannuation purposes, although one agency had sought legal advice broadly on the contract.

**4.9** While these numbers are small, it is possible that agencies may be continuing to under-identify contractors with superannuation entitlements, and consequently not to be meeting all such financial obligations. However, it should also be noted that the number of contracts that the ANAO considered to have incurred an unmet superannuation obligation did not exceed two<sup>36</sup> for any of the seven audited agencies. Further, the circumstances in some cases were unique. The nature of the contracts and the surrounding circumstances were as follows:

- one contract was for a musical performance. The ANAO found that the contract was not for employment at common law or wholly or principally for labour, but separate provisions in the SG Act created an entitlement to superannuation;
- one contract involved a specialist IT project manager. The person was a non-resident for immigration purposes and had been engaged as a contractor because it was thought that they could not be engaged as an employee under the *Public Service Act 1999*. The person was considered an employee for superannuation purposes;
- two contracts involved the same specialist IT trainer. The agency had sought general legal advice about the two contracts with the individual and had been advised that there were ‘no problems’ with the contract. The ANAO examined the legal advice, which did not indicate whether superannuation had been considered;
- one contract for a public service finance manager. The individual was a semi-retired public servant working on a casual, as needs, basis. The contract was executed shortly before the agency implemented more stringent contract clearance processes; and

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<sup>36</sup> The ANAO identified only one agency that had two such contracts. These two contracts were with one person working continuously for the agency.

- the other two contracts were both with semi-retired people working on a casual basis. One contractor was an analyst and the other was a historian. The agency paid superannuation in both cases.

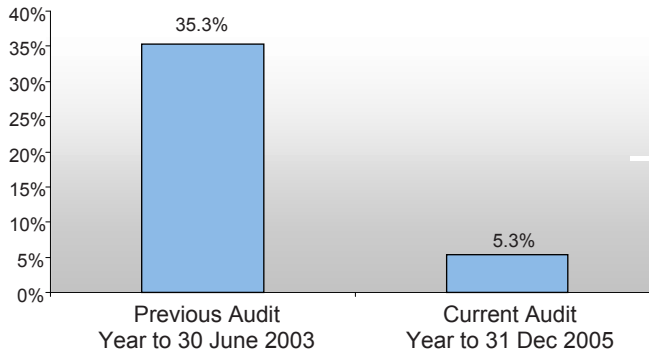
4.10 For the five contracts above where superannuation had not been paid, the four contracting agencies agreed to seek advice from the ATO or a legal opinion about their superannuation liabilities. These agencies also agreed to calculate and meet any superannuation obligation, based on this advice.

*Reduction in non-compliance*

4.11 The current audit identified an unmet superannuation obligation for 5.3 per cent of the contracts with individuals (representing five contracts) from the seven audited organisations. This compares to 35.3 per cent of contracts with individuals in the previous audit (see Figure 4.2).<sup>37</sup>

**Figure 4.2**

**Reduction in non-compliance: unmet superannuation obligations as a proportion of contracts with individuals**



Sources: ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, and ANAO audit sampling.

4.12 The contracts with unmet superannuation obligations in the previous audit included those the ANAO had assessed as unclear as to whether the individual was an employee for superannuation purposes. In extrapolating its findings across all Australian Government organisations, the 2004–05 audit estimated that superannuation had only been paid for 26.3 per cent to 56.2 per

<sup>37</sup> The comparisons between these findings from the current and previous audits are indicative only. The previous audit conducted a random sample across many Australian Government organisations. The current audit was selective rather than random, and covered only the seven audited agencies.

cent of contractors engaged wholly or principally for their labour, or it was unclear whether that was the case.

**4.13** The ANAO found that for the seven agencies it reviewed,<sup>38</sup> the reduction in unmet superannuation obligations to contractors was largely attributable to a preference to: contract with companies, trusts and partnerships; enter into 'results-based' contracts with individuals; or engage individuals as part-time and/or non-ongoing Australian Public Service employees.<sup>39</sup>

#### *Calculating superannuation contributions*

**4.14** The ANAO expects Australian Government organisations to have procedures to assist their staff to calculate superannuation entitlements consistent with statutory requirements. As only one agency had paid superannuation (for two contractors), the ANAO was only able to review the calculations made by this agency.

**4.15** The agency had correctly calculated the base amounts of superannuation in accordance with the minimum requirements of the SG Act. As the benefit for one of the contractors was paid late, the agency was required to pay interest, and did so consistent with the minimum requirements for an interim benefit under the PB Act.

**4.16** The ANAO notes that, with the closure of the PB Act to people engaged from 1 July 2006, the SG Act now requires Australian Government agencies to calculate any interest amounts paid after the quarterly Superannuation Guarantee Charge (SGC) cut-off date using interest calculated so that it compounds daily. Although departments and untaxed authorities are not liable for the SGC, the SG Act applies to them in all other respects. Administratively, this means that for any SG shortfall amounts, Australian Government agencies are required to pay to the individual's superannuation account an amount equal to the sum of the shortfalls with interest calculated according to the SG Act. As a consequence, interest amounts payable under the SG Act are now greater than those previously required under the PB Act.<sup>40</sup>

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<sup>38</sup> These findings cannot be extrapolated across all Australian Government organisations as selection of the contract sample was not statistically based.

<sup>39</sup> A number of the audited agencies explained that they had engaged individuals as part-time and/or non-ongoing Australian Public Service employees to avoid potential uncertainties surrounding the use of contractors, including the need to determine superannuation obligations. Individuals engaged as part-time and/or non-ongoing Australian Public Service employees are entitled to superannuation benefits.

<sup>40</sup> As indicated previously, the ATO advised the ANAO that it is currently developing an on-line Superannuation Guarantee Calculator, which will assist employers in calculating SGC amounts.



## Past superannuation obligations

**4.17** The previous audit considered that Australian Government organisations should use a risk-based approach to identify and provide for unmet superannuation liabilities associated with past contracts with individuals. The current audit examined the extent to which audited agencies had addressed the risk of past superannuation liabilities to contractors.

**4.18** The ANAO found that three of the agencies audited had conducted systematic reviews of past contracts to identify the level of potential superannuation obligations to individual contractors, as follows:

- the review in one of these agencies was comprehensive and resulted in over \$3 million in past obligations being identified and subsequently paid to 241 individual contractors. Legal advice was obtained for a significant number of contracts to clarify whether an employment relationship existed; and
- the reviews taken by the other two agencies took a more risk-based approach:
  - one of these, a medium-size agency, focused on identifying potential superannuation liabilities for past contractors from two of the agency's common contract types. The review identified 34 past contractors with potential superannuation liabilities from these contracts; and
  - the other (large) agency assessed a sample of 470 past contracts and found less than two percent of these contracts had a potential superannuation liability.

**4.19** The latter two agencies considered the cost of obtaining legal advice to clarify if an employment relationship existed outweighed the perceived benefits. Instead, these agencies implemented a number of risk mitigation strategies including: implementing a policy preference for staff to enter into contracts with companies rather than individuals; and establishing a dedicated contracts unit to review all contracts before they were executed.

**4.20** The remainder of the agencies indicated the risk of having unmet superannuation obligations was addressed informally and considered to be low. There was no documented approach as to how these two agencies reached this conclusion.

**4.21** The ANAO considers that conducting a systematic, risk-based review of past contracts to identify the level of potential superannuation obligations to individual contractors is better practice. As outlined in the previous audit, agencies should take a risk-based approach to this exercise. Such an exercise may involve:

- focusing on the main contract types, or business areas, that are likely to involve contracting with individuals;
- checking whether contractors are individuals by referring to the Australian Business Register; and
- utilising a checklist, containing indicators such as those in Tables 2.1 and 2.2 of this report in considering higher-risk individuals.

**4.22** Agencies should record the basis for their consideration of unmet superannuation liabilities associated with past contracts with individuals.

## Processes and practices to manage superannuation obligations to contractors

### Identifying and assessing contractors who may have superannuation entitlements

**4.23** There are two main parts to determining whether contractors are entitled to superannuation contributions. The first is to establish whether the contractor is an individual, and the second is to establish whether he or she is an employee under common law, or in a contract wholly or principally for labour.<sup>41</sup>

**4.24** There are a range of approaches to identify contractors who may have superannuation entitlements. These different approaches have widely varying resource costs. In undertaking this audit, the ANAO adopted a comprehensive approach that comprised: checking the business structure of each contractor against the Australian Business Register to determine whether he or she was an individual; applying a test of relevant statutory and case law indicators to determine whether the contractor was an employee for the purposes of superannuation;<sup>42</sup> and receiving legal advice.<sup>43</sup>

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<sup>41</sup> It is also necessary to establish whether a contractor who is eligible for superannuation under other provisions of the SG Act.

<sup>42</sup> As per Table 2.1 and Table 2.2 in Chapter 2.

<sup>43</sup> The ANAO considered legal advice provided as part of the previous audit.

**4.25** The ANAO sought information from agencies about their approaches to identifying contractors who are individuals, and assessing whether they were employees under common law, or in a contract wholly or principally for labour. To do so, the ANAO interviewed relevant staff, examined documentation relating to the contracts examined in the audit, and reviewed policies and procedural guidance.

**4.26** The ANAO found that agencies had various approaches to identifying whether contractors were individuals. However, where they had considered a contractor to be an individual, these agencies generally had adequate processes to assess whether they were employees at common law, or in a contract wholly or principally for labour.

*Identifying whether a contractor is an individual*

**4.27** Most of the audited agencies did not have documented guidance about how to determine whether a contractor was an individual. Further, for the contracts examined in the audit, none of the agencies had recorded the actions they had taken to identify contractors as individuals. Without such records, these agencies could not demonstrate to the ANAO that assessments were actually being conducted to identify such contractors.

**4.28** The ANAO notes that some agencies had a centralised contracts unit, which identifies and assesses contracts with individuals and potential superannuation obligations (see paragraph 4.42). It is likely that specialist staff within these units are able to readily identify which contracts are with individuals. Where this is not the case, the following two approaches may assist agencies to identify contracts with individuals:

- including a requirement in the contract that the contractor nominate whether they are an individual or contracting under another business structure;<sup>44</sup> or
- checking the business structure of contractors against the Australian Business Register to determine whether they are an individual.

**4.29** The ANAO emphasises the importance of agencies documenting their key considerations in making assessments as to whether a contractor is entitled to superannuation contributions. Having such documentation is likely to reduce the risk that superannuation obligations are not identified and will also

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<sup>44</sup> If the contractor is a company, trust or partnership, the agency would not be incurring a superannuation liability. If the contractor did nominate that they are an individual, then the agency should consider further options to determine their eligibility.

provide evidence that superannuation was considered before a contract was signed.

*Assessing whether a contractor is an employee under common law or in a contract wholly or principally for labour*

**4.30** The ANAO found that agencies had detailed approaches to assessing whether contractors who are individuals were employees under common law or in a contract wholly or principally for labour. These approaches broadly encompassed developing, and promulgating to relevant staff:

- procedures and controls which required staff to have contracts reviewed and cleared by specialist contract staff (this was common to five of the seven agencies audited); and
- employment indicator checklists to assist staff assess whether an individual contractor was an employee under common law or in a contract wholly or principally for labour. One agency had a checklist summarising and explaining a range of indicators for assessing both a common law employment relationship and contracts wholly or principally for labour. Another agency had summarised only the common law indicators into a quick reference guide. The two agencies that did not have a dedicated contracts unit had these checklists.

**4.31** The ANAO considered these approaches were adequate to enable agencies to assess whether contractors who are individuals, were employees at common law, or in a contract wholly or principally for labour.

**4.32** However, given the final decision as to whether a contractor is entitled to superannuation benefits is sometimes a fine balance of many factors, if uncertain, agencies should be mindful of the opportunity to seek advice from the ATO about a contractor's entitlement to superannuation benefits.

*Reducing the incidence of contracts with individuals*

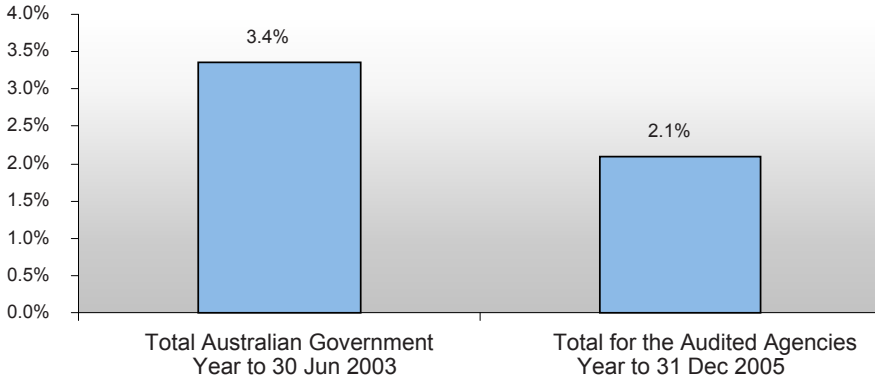
**4.33** Each of agencies audited had actively sought to manage the risks of incurring superannuation obligations by reducing the number of contracts entered into with individuals. The audit found that a number of agencies had contracting policies which stated a preferred position of not contracting with individuals or allowing results-based contracts only. This largely avoids the need to pay superannuation, as contractors are not employees if they are paid for achieving results rather than for hours worked. These policies indicated that services for individuals should be obtained through intermediary business

entities such as trusts, companies and partnerships (including labour hire firms).

**4.34** The audited agencies typically advised the ANAO that they had substantially reduced the number and proportion of contracts with individuals since the last audit. Further, a comparison of the results of ANAO analysis for the current audit with those from the previous audit indicated a substantial decline in the proportion of contracts with individuals. The previous audit indicated that around 3.4 per cent of contracts entered into by Australian Government organisations in 2002–03 were with individuals, while only 2.1 per cent of the contracts entered into by the seven agencies in this audit were with individuals (see Figure 4.3).<sup>45</sup>

**Figure 4.3**

**Contracts with individuals as a proportion of all contracts, 2002–03 and 2005**



Sources: ANAO Audit Report No.13 2004–05, *Superannuation Payments for Independent Contractors working for the Australian Government*, ANAO audit sampling, and <[www.finance.gov.au/procurement/contract\\_statistics](http://www.finance.gov.au/procurement/contract_statistics)>, accessed on 1 May 2007.

**4.35** The ANAO notes that avoiding contracts with individuals may not result in the best outcome for Australian Government agencies or the community, as contracting with individuals may represent the best value for

<sup>45</sup> As explained in footnote 37, the comparisons between these findings from the current and previous audits are indicative only. The previous audit conducted a random sample across many Australian Government organisations. The current audit was selective rather than random, and covered only the seven audited agencies.

money in some circumstances. Guidance should always be in place to enable staff to deal with situations where an individual should be engaged.

## **Policy and procedural guidance**

**4.36** All seven agencies audited had developed and promulgated a range of policy and guidance material on superannuation obligations to contractors. These policies and procedures were easily accessible via agency intranets or internal databases. The majority of these policies and procedures reflected ATO and Finance guidance on superannuation obligations and requirements and/or contained references and provided hyperlinks to Finance and ATO on-line guidance on superannuation obligations to contractors.

**4.37** The audit found that guidance material was not current for a number of agencies. In particular, at the time of audit fieldwork, references in agency guidance to relevant legislation, Finance Superannuation Circulars and ATO Superannuation Guarantee Rulings had not been updated for changes made in 2005 and 2006. For example, some agencies' policy and guidance did not reflect the phasing out of the PB Act from 1 July 2006 and the withdrawal of the ATO's Superannuation Guarantee Ruling SGR 93/1 on 25 August 2004 and its replacement with ATO Superannuation Guarantee Ruling SGR 2005/1.<sup>46</sup>

**4.38** In addition, guidance did not always refer to provisions under section 12 of the SG Act which may be relevant. For example, sub-sections 12 (8) and 12 (9) of the Act extend the definition of employee to work performed by sports or creative people and holders of public office. The audit found one of the contracts examined by the ANAO to be non-compliant with these provisions, but that Finance and ATO guidance had not brought them to agencies' attention.

**4.39** The ANAO considers that agencies should be aware of these provisions, and review and update guidance material at appropriate intervals so that it remains current and informative in light of agencies' ongoing experiences and any broader developments.

### *Process controls*

**4.40** The ANAO considers that Australian Government organisations should have administrative processes that adequately control the risks of not meeting superannuation obligations when contracting with individuals.

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<sup>46</sup> One agency had continued to base its guidance on SGR 93/1 as they considered it easier to understand than SGR 2005/1.

**4.41** The ANAO assessed each of the seven agencies as having adequate administrative processes in place, given their respective levels of exposure to potential superannuation obligations.

**4.42** As indicated in paragraph 4.30, five of the seven agencies audited had established a centralised contracts unit, with specialist contract staff. Procedures in these agencies required the contract units to review and clear all contracts prior to their commencement. In some agencies, the contracts unit also was responsible for identifying and assessing contracts with individuals and potential superannuation obligations. One of the agencies had employed a Senior Legal Advisor to provide advice on contract-related matters, including superannuation issues.

**4.43** In the other two agencies, individual business units were responsible for managing contracts, including those with individuals that may pose a superannuation risk. These business units had detailed checklists to support their staff to identify and assess individual contractors.<sup>47</sup>

**4.44** Additional agency activities to control the risk of contracting with individuals included:

- alerts and embedded advice to staff in standard contract templates on how to complete the contract, including advice on the implications of potential superannuation requirements;
- standard clauses within contracts to reduce the risk of unintentionally creating an employment relationship. For example, one of the agencies included a clause in one of its standard contract templates which specified payment on completion of a specific result for a fixed contract price inclusive of all costs; and
- guidance, within standard contract templates, on how to check a contractor's business structure or legal identity through the Australian Securities and Investment Commission (ASIC) National Names Index or the Australian Business Register.

**4.45** The ANAO notes that one agency had no requirement for the contract unit to review or clear individual contractors engaged via a purchase order. As a result, potential superannuation obligations for contractors engaged via this method were not subject to checking or review by the agency's contract unit.

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<sup>47</sup> As mentioned in paragraph 4.23 the check list for one agency included the indicators for assessing both a common law employment relationship and contracts wholly or principally for labour. The other agency's checklist covered only the indicators for assessing a common law employment relationship.

The ANAO considers that, while it did not identify any unmet superannuation obligations in that agency, this reduced the effectiveness of the agency's controls.

## **Training and awareness raising activities**

**4.46** The ANAO considers that Australian Government organisations should have adequate training and awareness activities in place to inform relevant staff of: the existence of the PB Act and the SG Act; their obligations under the Acts; and other potential legal obligations of entering into contracts with individuals.

**4.47** Unlike the previous audit, the ANAO found that relevant staff from each of the audited agencies were aware of the risks of contracting with individuals/sole traders, and the existence of the PB and SG Acts. However, staff from a number of the agencies were not aware of changes to the PB Act or the current Superannuation Guarantee Rulings issued by the ATO.

**4.48** Training and awareness raising activities within agencies included:

- internal distribution, to relevant staff, of Finance Superannuation Circulars;
- alerts and information related to superannuation issues placed on internal procurement intranets;
- internal procedures, although in the majority of agencies these did not provide detailed information regarding superannuation obligations;
- individual access to information via the ATO and Finance websites;
- annual agency procurement discussion forums and conferences, which included discussion of superannuation requirements and issues; and
- establishment of a contract manager network with an associated newsletter to provide contract managers with updates of current issues.

**4.49** The audit found that while relevant agency staff were aware of issues raised via Finance Superannuation Circulars, agency staff were generally less familiar with guidance issued by the ATO, and in particular, the current ATO Superannuation Guarantee Rulings.



## Conclusion

**4.50** Overall, the ANAO concluded that audited agencies have adopted common approaches to control the risk of having unmet superannuation obligations to contractors. These approaches have mainly involved minimising the incidence of contracting with individuals, and implementing processes and practices to assess whether contractors who are individuals are entitled to superannuation benefits. The ANAO therefore concluded that Recommendation No.2 has been substantially met.

**4.51** The ANAO also identified opportunities for many agencies to further refine approaches to controlling the risk of not meeting superannuation obligations to certain contractors in some instances. These opportunities included: developing contract templates that reduce the risk of unintentionally creating an employment relationship; seeking advice from the ATO about a contractor's entitlement to superannuation benefits; and recording the basis on which staff have assessed contracts with individuals for superannuation entitlements.

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Ian McPhee  
Auditor-General

Canberra ACT  
22 June 2007



# Appendix



## Appendix 1: Appendix 1: Agencies' Responses to the Proposed Audit Report

Each of the agencies selected for audit and the ATO were provided with the opportunity to comment on the proposed audit report (or extracts of the proposed report, where applicable) in accordance with the provisions of section 19 of the *Auditor General Act 1997*.

Agencies' responses are produced below.

### Australian Taxation Office

The Australian Taxation Office advised as follows:

The Tax Office is pleased that you found we have fully implemented the recommendation from the previous audit.

I note the suggestions for further improvement you have made in the report and can advise that the Tax Office will examine these matters and give them due consideration. We will also continue to work with the Department of Finance and Administration, as we have previously, to ensure every assistance is given to Australian Government employers in meeting their superannuation obligations.

As you may be aware, the Tax Office has worked with Australian Government employers in the past to help them with their superannuation guarantee and choice of superannuation fund issues. We encourage these agencies to continue to contact us for the help that we can provide, such as correctly calculating employee superannuation guarantee entitlements.

### Australian Bureau of Statistics

The Australian Bureau of Statistics advised as follows:

The Australian Bureau of Statistics agrees with the conclusion and has no further comments.

## **CRS Australia**

CRS Australia advised as follows:

CRS Australia welcomed this audit given the historical lack of clarity on superannuation obligations. CRS Australia has adopted a general policy position of preferring not to contract with individuals so as to avoid any uncertainty.

While the specific report on CRS Australia produced during this audit finds that our policies and procedures are appropriate risk mitigation measures, this position may not always be sustainable for us given the limited availability of certain skills across our dispersed geographic network of offices.

I therefore agree with the findings and support the suggestion that the Department of Finance and Administration and the Australian Taxation Office continuously improve the guidance they provide in this area and the dissemination and accessibility of this guidance.

## **Department of Finance and Administration**

The Department of Finance and Administration advised as follows:

As you are aware, the follow-up audit included the conclusions that Recommendation 1 from the previous audit has been fully implemented and that Recommendation 2 from the previous audit has been substantially met. I agree with these conclusions.

The follow-up audit also contains suggestions for enhancing the guidance provided to agencies. Consistent with the report, my Department continues to work with the Australian Taxation Office in relation to ensuring agencies are provided with appropriate information concerning their superannuation requirements.

## **Department of Foreign Affairs and Trade**

The Department of Foreign Affairs and Trade advised as follows:

The department agrees with the report findings and notes methods for better practice.

## **Department of Veterans Affairs**

The Department of Veterans Affairs advised as follows:

It is noted that the ANAO report did not make any specific recommendations but identified a number of best practices for agencies to consider. This Department has noted the suggested best practices and ANAO conclusions. As the ANAO found, the Department has satisfied its unmet superannuation contribution liabilities and has robust procedures in place to ensure the Department has a low risk of not satisfying any emerging superannuation contribution liabilities.

## **Geoscience Australia**

Geoscience Australia advised as follows:

Geoscience Australia agrees with the findings of the audit and has no further comment on the report.

## **Insolvency and Trustee Service Australia**

The Insolvency Trustee Service Australia advised as follows:

ITSA agrees with the [suggestions] made in this report. Also, I note that although ITSA's exposure to superannuation liabilities for contractors is low, ITSA has met the statutory obligation for contractors and has adequate controls and processes in place to manage these obligations when they might arise.

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