Assurance Engagement Scrutiny of employment tax incentive abuse schemes

The assurance profession is founded on the trust that users of financial statements and stakeholders have in the assurance function in enhancing the credibility of financial information used in making economic decisions. The assurance function forms a significant part of the financial ecosystem that ensures stability and growth of financial markets. The task of the practitioner to enhance the credibility of financial information is made more difficult where schemes are voluntarily established or adopted by clients, with the intent to deceive or mislead.

Practitioners are alerted to the existence of potential abuse schemes and are urged to remain aware and vigilant regarding such schemes while executing an audit or review engagement. It is imperative that practitioners continue to apply appropriate levels of professional scepticism as well as professional judgement in ascertaining the facts that may be indicative of fraud and assessing the impact of these schemes on the outcome of the audit or review engagement.

On 20 August 2020, SAICA alerted members to its concerns that employers were being offered schemes by promotors that leverage the employment tax incentive (ETI). The basic principle of the scheme was laid out in that communication to guide members in identifying and analysing it while undertaking an audit or review engagement. The matter has been brought to the attention of SARS and National Treasury and following on from positive engagements with them, we expect that the necessary interventions will be implemented shortly with public communication issued in due course.

Although there are legal variations on how ETIs can be arranged, there are specific requirements that need to be complied with for employers to legally qualify for the incentive. As a point of departure, it should be noted that the ETI was meant to encourage employers to employ young people so that they gain work experience and concomitant skills. Actual employment is therefore the intention and purpose of the ETI. As noted in the 2013 Explanatory Memorandum when the ETI Act was introduced, *"the envisaged incentive reduces the cost of hiring young people to employers through a cost sharing mechanism with government, while leaving the wage the employee receives unaffected"*.

The intention of the ETI was never that employers would gain financially from the incentive or would just provide or secure education components without actual employment and related cash compensation.

The main features and risk indicators of the ETI abuse schemes that practitioners should be alert to are outlined as follows:

- An employment relationship is purported to be created in form, but in substance, no such relationship between the "scheme employee" and the participating employer exists.
- The participating employer will have a sudden material increase in staff numbers, in many instances three-to-fourfold without a corresponding business or office space increase.
- No or very little of the purported salary is paid directly to the employee as a cash component and the entire cash component or majority of the cash component is paid as a training fee to a training service provider or other party. Therefore, actual payroll cash payments will not match payroll liability data for these "scheme employees".
- The "scheme employee" is placed in a purported full-time education or training programme. This results in the "scheme employees" providing no services to the participating employer and therefore gaining no work experience or concomitant skills, as intended by the ETI.
- The net cash flow from the scheme as it relates to the employer is always positive and the positive amount is always less than the full ETI received by the employer, thereby resulting in financial gain to the participating employer.

Practitioners are encouraged to ensure that they view the possible ETI abuse schemes holistically and not as separate distinguishable components. To elaborate on this, the ETI claims, employee relationship and payments (including cession of wage arrangements) in payroll should not be separated from the training provider payments in creditors or payments/ credit notes to or from a "proxy employer". Promotors of schemes also habitually provide some sort of "legal opinion" to justify the legality of the various steps within the scheme. In this regard practitioners are reminded to apply the requirements contained in the International Standards on Auditing (ISAs) as applicable when using information involving the work of experts as audit evidence.

To illustrate the potential extent of the risk involved in a ETI abuse scheme, the following factors are assumed:

- The client has 1 000 "scheme employees" for which it claims R1 000 ETI per month per employee and pays R3 500 towards the education and training component as a "salary".

If the scheme is found to be unlawful, then:

- The ETI capital exposure could be R12 million for the year (1 000 employees at R1 000 per month, for 12 months) without taking into account any penalties and interest that the client may be liable for, which could equal this amount.
- Should SARS hold that the R3 500 "salary" was not incurred in the production of income of the client and not shown as recouped for tax purposes, the corporate tax exposure could be R11,8 million, without penalties and interest.
- The impact on Broad-Based Black Economic Empowerment and possible section 12H learnership allowances should also be considered if the scheme impacts these elements.

The potential impact of an ETI abuse scheme may be material, either individually or in aggregate and practitioners are reminded to consider the effect of all identified misstatements on the audit and the financial statements, in accordance with ISA 450, *Evaluation of Misstatements identified during the Audit*. Misstatements from such schemes may even require restatement of previous years' financial statements given the potential tax and liabilities that may arise, that the practitioner would have to respond appropriately to. The practitioner would consider any related impact on the appropriateness of management's use of the going concern basis of accounting.

The practitioner should also consider the obligations contained in Section 360 of the IRBA Code of Professional Conduct (Revised November 2018) relating to non-compliance with laws and regulations (NOCLAR), as well as Section 45 of the Auditing Profession Act and Regulation 29 of the Companies Regulations, 2011 relating to Reportable Irregularities.

In the public interest, we encourage members who perform assurance services to consider the above when executing the assurance engagements in an effort to build trust in the profession and demonstrate the critical role that the profession plays in maintaining and enhancing the financial ecosystem.

Regards

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