INTRODUCTION

A recent webinar on Client Verification and Engagement provided guidance on:

- members’ obligations under the Code of Professional Conduct with regards to taking reasonable care
- the importance of client verification
- the requirement to use engagement documents, particularly with tax engagements.

Below are the questions and answers from that webinar.

The presenters were:

- Ian Taylor, Chair of the Tax Practitioners Board
- Mark Morris CPA, Professor of Practice at La Trobe University
- Gavan Ord, Manager of Business and Investment Policy at CPA Australia
- Josephine Haste, Manager of Quality Review Education at CPA Australia

QUESTIONS AND ANSWERS

Is a client engagement letter required for each activity or can you use an open engagement letter which is not so specific given we cover a lot of areas as general practitioners e.g. GST, Tax, FBT, CGT?

APES 305: Terms of Engagement requires that the terms and scope of any engagement are to be documented and communicated for every client. This mandatory requirement of the Standard applies to every CPA Australia member in public practice in Australia. For members outside of Australia, the scope of APES 305 must be followed to the extent local laws and regulations are not contravened.

The Tax Practitioners Board (TPB) does not require the use of engagements letters (specific or open), however, it strongly recommends that there be a written agreement between you and your client setting out the terms and conditions of the arrangement.

A letter of engagement helps both parties know and understand the expectations they are agreeing to in their contract. It will define the rights and obligations of both parties, and set out in writing the agreed terms and conditions for the work to be done.

The TPB encourage agents to use letters of engagement as one means of ensuring they provide professional service to their clients. This will also help to avoid uncertainty and misunderstandings.

A letter of engagement usually covers:
• the work to be done
• who will do it
• how it will be done
• when it is to be done
• how much the work will cost.

A common understanding clarifies the responsibilities of the agent and the client and how the work is to be completed and paid for. It can assist in avoiding disputes over fees and the scope of work.

More information is available on the [TPB website](http://tpb.gov.au) and on the [CPA Australia website](https://www.cpaaustralia.com.au).

**With regard to the registration renewal case study, 11 clients do not seem a lot, were the claims significant?**

Each TPB decision is based on the specific facts of the matter. In making its decision in this matter, the Board had particular regard to the circumstances in which certain deductions were claimed. Due to the disclosure provisions under the *Tax Agent Services Act 2009*, the TPB is not in a position to provide further information on the specific circumstances of the matter.

**Where can I find guidelines regarding sighting documentation to substantiate deductions? In an earlier slide, it was stated that we don’t have to audit the information provided by the client, so does everything need to be substantiated or just some things?**

You must take reasonable care to ascertain a client’s state of affairs. If information supplied by a client does not seem credible or appears to be inconsistent with a previous pattern of claim or statement, further enquiries are necessary. Some other circumstances which may require you to make further enquiries include:

- new or substantial changes in the law
- an inexperienced client
- a new client
- unusual transactions in the context of the business of a regular client.

In most cases, this will require that you ask the client appropriate questions. It’s particularly important when taking on new clients where there’s no pre-existing relationship.

**Where do you draw the line between auditing the client and sighting documentation? How many claims are you meant to sight to determine if its correct? Where are the guidelines on this?**

Paragraph 3.11 of [APES 220: Taxation Services](https://www.cpaaustralia.com.au/publications-guidance/standards/standard-220-taxation-services/) requires you to exercise professional competence and take due care when providing taxation services. When preparing a client’s income tax return, it is therefore necessary to ensure that there is sufficient information available so that a client’s income tax return can be prepared with due care. Accordingly, practitioners are expected to use their professional judgement in preparing such returns including the current regulatory environment in which deductions are claimed by individual clients for work-related expenses.

As the Australian Taxation Office (ATO) has recently announced that it will more closely scrutinise amounts claimed as work-related deductions it is very important that a practitioner demonstrates that all reasonable steps have been taken to ensure that the client has actually spent the money they are claiming, and that such expenditure was directly related to earning their income. This is especially important if the tax return is being prepared for a new client with whom you are not familiar.
A practitioner can demonstrate that they have taken due care by accurately completing tax return checklists as well as sighting invoices particularly for material amounts claimed. Copies of standard tax return checklists prepared by CPA Australia for members can be downloaded from the CPA Australia website.

In addition, where there is a highly unusual issue or a claim which requires you to analyse the deductibility of amount in detail it would be highly advisable to document your discussions with the client in a file note.

For certain clients with large claims or more complex affairs it may be prudent to do all of these steps.

Hence, whilst you are not required to audit every item of every client’s affairs to verify their accuracy it is highly recommended that some detailed check of the client information be undertaken so that you can form an opinion on whether claims are allowable. Further analysis may be required if you have any concerns about the accuracy of any representations made by the client. This is especially important in relation to deductions claimed for work-related expenses as the ATO has flagged that it will directly contact tax agents to ensure that deductions have been correctly claimed in certain circumstances.

Are you able to elaborate on the traditional $150 laundry and maintenance claim and where to from here?

Essentially, the ATO has two major concerns regarding claims made for laundry expenses of up to $150.

Firstly, laundry expenses are only allowable to the extent to which the cost of the clothing being cleaned is itself deductible. Accordingly, if the cost of purchasing conventional clothing is non-deductible any related laundry costs will likewise be non-allowable.

Secondly, the Commissioner of Taxation has expressed concerns that deductions for laundry costs of up to $150 may be regarded by some tax agents as being a ‘standard’ deduction which can be claimed without the agent making further enquiries as to its deductibility. Once again, the ATO has flagged that it will be more vigilant in auditing such claims going forward.

Accordingly, in making claims for laundry costs it is very important that the agent clarify that the client is in fact entitled to such a deduction, and that the taxpayer keeps the required details of the cleaning costs as set out in Item D3 of the Individual Tax Return instructions.

In relation to the polling question, do we need to sight the invoices?

As discussed, you are expected to demonstrate that you have applied professional competence and due care in the provision of taxation services including the preparation of individual tax returns.

As part of that process you need to be assured that the client has kept the records necessary to substantiate a claim and that the claim is allowable because the individual has incurred that expense in the course of deriving their assessable income.

Given that the ATO has stressed that this is an area of audit activity it is highly advisable that you can prove that you have checked the accuracy of the client information including sighting invoices especially for any material deductions claimed. Whilst it is the responsibility of the client to keep full and proper records you are expected to demonstrate that you have taken reasonable steps to ensure that your client is aware that their claims must be proven and allowable under the income tax law.

Why do taxpayers who lodge their own tax returns online appear to be given so much latitude?

The ATO has expressed concerns for claims made by all taxpayers in relation to the deductibility of work-related expenses which topped $21.8 billion as reported in the ATO’s Taxation Statistics for the 2014-15 year.
These concerns extend to both returns prepared by self-preparers as was those prepared by tax agents, and all such claims will be subject to diagnostic checks by the ATO whose use of artificial intelligence and data analytics is becoming increasingly sophisticated in identifying possible excessive claims.

However, as around 73 per cent of individual taxpayers engage a registered tax agent to prepare their income tax return the ATO is concerned that there may be a risk that particular agents are not paying sufficient attention to ensuring that claims for work-related expense deductions are correctly claimed. For example, it currently appears that one in every two working Australian individuals is claiming a deduction of some sort for clothing expenses, and that around three quarters of taxpayers seek advice from a registered tax agent. Intuitively, therefore, it would appear that some claims for clothing expenses made by some tax agents in respect to some of their individual clients may be incorrect given the limited circumstances in which individuals can claim a deduction for clothing expenses.

Thus, the ATO has been very vocal that it will ramp up its compliance activities to reduce the over claiming of such work-related expenses including those made by tax agents who are expected to have a better understanding of when such claims are allowable than ordinary taxpayers.

If a client has provided a spreadsheet of receipts, then do we need to see actual receipts? Are we required to sight and copy all invoices for every claim? Some clients prepare a summary showing the total amount to be claimed for each expense type.

As discussed, a practitioner must demonstrate professional competence and due care in preparing income tax returns under paragraph 3.11 of APES 220.

Accordingly, you have to exercise professional judgement in each case as to when a deduction can be claimed for work-related expenses and other deductions. For example, you would not merely accept a client’s representations that an amount was allowable without doing further checking particularly for a new client with whom you are not familiar. Similarly, if a client wishes to claim an amount which is disproportionately high compared to the usual pattern of claims made by someone in the same job or business it would be expected that you would make further enquiries in relation to such claims. Therefore, it would be appropriate in these circumstances to sight some invoices to make sure that you are reasonably comfortable that the claims can be substantiated and are allowable.

From a client relationship point of view, you are also required under APES 220 to ensure that the client has kept full and proper records, and that the return was being prepared on the basis. It would therefore be prudent to stress to your clients that they must be able to produce their invoices and receipts especially for large claims using tools such as the myDeductions app, which would also allow you to quickly check or sample the client’s records to ensure that they have retained any required documentation.

Thus, while you are not required to sight an invoice for each and every claim you must nonetheless take reasonable stops to check that the client has the required documentation and that the return has been prepared with reasonable care especially as the ATO has confirmed that it will actively check the deductibility of some work-related expense claims.

Is the ethical clearance required for all individual clients or just business clients?

Paragraphs 210.9 to 210.15 of APES 110: Code of Ethics for Professional Accountants require you to determine whether there are any circumstances that could threaten your independence in accepting any non-audit engagement.
To ensure that there are no such threats it is highly advisable that a practitioner contact the former accountant to determine whether there are any professional or ethical reasons why the engagement should not be accepted. The most efficient way to determine whether there are any reasons preventing the acceptance of a new client is to issue an ethical clearance letter to the former accountant.

Accordingly, whilst it is not mandatory to issue ethical clearance letters for non-audit clients it is highly advisable and prudent to do so regardless of the size of the client. The time spent in issuing such correspondence may in the long term be a lot less the cost of taking on a client who later threatens your integrity because they are dishonest or unreliable.

Therefore, embedding a process of issuing ethical clearance letters in respect of all new clients is good practice from a quality control perspective and should be consistently applied as part of your acceptance of new client engagements.

What is involved in an identity check? Do we need to sight a client’s driver’s licence to match their photo with the client sitting in front of you? It is difficult to match photos if the client is an online client and everything is electronic.

Paragraph 38(c) of APES 320: Quality Control for Firms requires a firm to establish policies and procedures concerning the acceptance of new client engagements including a review of the integrity of any proposed client.

As part of that process you may wish to do an identity check as part of your procedures in determining whether you should accept a new client. Whilst APES 320 does not mandate what criteria you should apply in such an identity check it is good practice in my view to ask to see a copy of the proposed client’s driver’s license as part of the client screening procedures. This is often a common requirement in doing an identity check for other purposes.

I often explain to clients that this is being undertaken to confirm their identity, and that I am, therefore, being vigilant in trying to ensure that I do not inadvertently provide any public accounting services to anyone other than the client. This is an important practice given the increasing incidence of identity theft particularly where identities are stolen on-line because of cyber-attacks.

Furthermore, where a client refuses to provide their driver’s licence on the client interview a red flag should drop that this particular individual may have things that they wish to hide and may lack the required integrity to be part of your client base.

What should we do if the existing accountant does not provide the information we requested in the Ethical Clearance letter (e.g. copy of prior years’ tax return, financial statements etc.)?

Where a former accountant does not provide requested information as set out in your letter of ethical clearance on a non-audit engagement it would be good practice for you to personally contact the accountant to understand why they have not provided the required financial statements or tax returns. Where such a predecessor accountant is either non-contactable or not co-operative it would be appropriate to contact the client to see if they could provide the required returns and financial statements and/or obtain third-party data such as ATO pre-filling reports.

However, where you do not get a response in relation to an ethical clearance letter from a former accountant it is also important that you make further enquiries of the client before you accept any appointment as their tax agent to ensure that you are comfortable with their integrity before you are engaged to provide a service. In some cases, a non-response from a predecessor accountant may be a red flag that you need to make further enquiries before you accept the client.
There is a lot of software providers providing digital signing facilities (e.g. Adobe E-sign). Is digital signing accepted by the ATO in respect of signing tax returns, minutes & financial statements?

The ATO has long accepted the documents and forms an agent lodges on behalf of a client can be forwarded by way of an electronic signature as illustrated in Practice Statement PSLA 2005/20.

Moreover, a taxpayer or their agent can choose to provide a taxpayer’s declaration electronically to their tax agent in accordance with section 9 of the Electronic Transactions Act 1999.

However, the ATO neither discourage or mandate the use of specific digital certificates or electronic signatures (i.e. Adobe e-sign) in what is a rapidly evolving area.

Instead the ATO’s principal concern is that the declaration from a client to an agent must state that the agent is authorised to Lodge a document and that information contained in the document is true and correct.

Further details on client declarations and on-line lodgment is available on the ATO website.

Is the response to ethical clearance compulsory?

As discussed, it is very good practice for a tax practitioner to issue an ethical clearance letter as part of their client engagement processes even though it is not mandatory to do so. Likewise, it is also good practice to respond to an enquiry made an ethical clearance letter to the practitioner who has taken over your client even though it is not compulsory to do so. Such professional behavior will assist the new accountant in determining whether they should accept the engagement and is what you would professionally expect should you have been the firm which has issued the ethical clearance letter. Moreover, in the great bulk of cases this is not a particularly difficult or time-consuming process as there will seldom be an ethical reason why the new accountant should not accept the engagement.

I assume you need to use discretion in terms of ID check - e.g. if it is an employee of a client, or a referral from an existing client, it is probably not a fake identity - yes?

As discussed, paragraph 38(c) of APES 320 requires you to establish policies and procedures concerning the engagement of new clients including procedures to check their integrity which includes taking steps to verify the identity of a proposed client. Clearly you will have greater comfort taking on a new client who is referred directly to you by an existing client who can confirm the identity of the new client if they are well known to them.

However, I nonetheless believe that it would be prudent to have some standard verification check process in place for all new clients to ensure consistency of treatment across the practice in relation to the engagement of new clients. This is especially the case as identity theft is emerging as a more serious threat to practitioners, and it is hard to restore a person’s identity once it has been stolen. Although there are no prescriptive rules as to the terms of any ID check it is recommended that you asked for a copy of their driver’s licence to verify their identity being a commonly accepted verification process.

Regarding the ‘What can go wrong’ slide, doesn’t the ELD and substantiation declarations help cover us and keep the taxpayer liable? We can’t know if the clients story changes; they don’t tell us everything.

The Electronic Lodgment Declaration (ELD) and substantiation declaration are important as it is necessary that the client acknowledge that they are responsible for the accuracy and completeness of the return.

However, under paragraph 3.15 of APES 220 it is also necessary that any engagement letter or brochure concerning the provision of tax return preparation services expressly state that it is the client who is responsible for the accuracy and completeness of information relied upon in the preparation of the return, and that the client
is responsible under self-assessment for keeping full and proper records in order to facilitate the correct preparation of a tax return.

Finally, a practitioner must also take due care under paragraph 3.11 of APES 220 in the preparation of any income tax return. Therefore, more care will be required to be taken in relation to any client whose story changes over time as you will be expected to make additional enquiries to understand the client’s actual state of affairs in providing them with any taxation services.

**What if you have identified an expense to be not deductible and notified the client but they insist you claim it anyway?**

Essentially, paragraph 7.6 of APES 220 requires a practitioner to consider whether they should withdraw from an existing client engagement where the client insists on lodging a return with the ATO which has an understated tax liability as would be the case where a deduction is claimed which is not allowable. In these circumstances, it is incumbent on the practitioner to try and convince the client not to claim the non-allowable deduction prior to lodgment of the return. However, the agent may have no choice but to withdraw from the engagement if the client insists on lodging such a return after such consultation has occurred.

**From an employer’s perspective, are client’s employment and industrial relations conditions part of NOCLAR reporting?**

Section 225 of APES 110 sets out when a public practitioner needs to consider whether a client has not complied with laws and regulations which has either resulted in materially incorrect disclosures in the client’s financial statements or has fundamentally affected the operations of a business.

Thus, it applies to accountants providing public accounting services as opposed to a regulatory regime imposed on employers in respect of their employees.

To recap, paragraph 225.2 of APES 110: Non-Compliance with Laws and Regulations (NOCLAR) comprises acts of omission or commission, intentional or unintentional, committed by a client of those charged with governance, by management or by individuals working for under the direction of a client which is contrary to the prevailing laws and regulations.

NOCLAR should only be considered by a public practitioner when non-compliance with laws and regulations has a direct material effect on the disclosures in the client’s financial statements or has fundamentally affected the operating aspects of the client’s business. That is, non-compliance with laws and regulations must have wide public interest implications such as the potential to cause substantial harm to investors, creditors, employees or the general public.

**Who do you refer clients to who don’t want to take your advice/aren’t doing the right thing? I don’t want to pass them onto fellow accountants – the client is just going to keep going around annoying everyone until they get what they want.**

As discussed, paragraph 7.6 of APES 220 requires you to withdraw from an engagement where the client insists on lodging a return which has an understated tax liability.

Reference should be made to paragraphs 44 and 45 of APES 320 on the process that should be applied in withdrawing from an engagement.

However, there is no obligation for you to also refer that client to any other accountant. Where the former client seeks to engage another firm that practitioner should issue you a letter seeking ethical clearance at which time
you need to notify that accountant of any ethical concerns you may have regarding your former engagement with the client. Once this is done you have complied with your ethical obligations.

**Can an engagement letter be in the form of an email?**

Yes, APES 305 paragraph 3.4 states that, ‘A member in Public Practice shall document the terms of engagement in the engagement document’. Engagement document means the document in which the terms of engagement are specified in a written form. So as long as it is in a written form, such as brochure, leaflet, or electronic communication, it is acceptable.

**So if the client doesn’t sign the engagement letter isn’t it worthless? Isn’t it like a pro-forma contract, worthless if unsigned?**

From the perspective of APES 305, members in Public Practice should ensure that the terms of engagement are documented and communicated to the client. There is no specific requirement to get the engagement letter signed. Having said that, some other Professional Standards require the engagement letter to be acknowledged by clients, and the most common acknowledgement that could be obtained from clients are by having their signature on the document. While have a signed engagement document may not be a requirement for non-audit engagements, we suggest that best practice is that the you have evidence of the client’s acknowledgement, this may be via a return email acknowledging the terms of the engagement.

**Is an engagement letter/document required each year for tax return clients?**

There is no requirement in APES 220 for engagement letters to be reissued every year. Having said that, we would suggest that you include the period of the engagement as part of the engagement letter.

APES 220 paragraph 5 provides some guidance in relation to recurring engagements and the conditions when members should consider the need to reissue or amend an engagement document.

**I enquired of CPA Australia this year to review my engagement letter to ensure the compliance of the document as I wanted a verification. I was told CPA Australia do not provide this service but it will be checked when we have our quality review. Can this not be a service CPA can provide to ensure and provide support to its members? We need support in the current regulatory environment. If CPA cannot assist us then who do we seek advice from to ensure we are doing the right thing?**

CPA Australia assists members by way of providing examples and template engagement documents in the Public Practice toolkit available on the CPA Australia’s website. This is a free resource for members. It is imperative that our services are available to all members – as such, that is the purpose of the quality review process. We encourage members to make contact with us regarding questions they have about the standards and their documentation, however, we are not able to review individual documents. We suggest that where members have already produced documentation, that they compare these documents to those available on our website in the first instance. If members still have questions about elements of their documentation, then we are willing to assist.

**Does CPA provide a shorter engagement letter template for tax returns?**

On CPA Australia’s website, in the Client Engagement toolkit, we provide examples of engagement documents in the form of a letter and a brochure template. The engagement brochure is the shorter format.

**Does the sample engagement letter now include NOCLAR?**

Yes. The example of an engagement document that CPA Australia provides on its website has been updated to include NOCLAR.
Will we need to reissue engagement letters to reflect NOCLAR? Would NOCLAR need to be considered for BAS/tax returns?

Yes, members are expected to reissue the engagement letters to reflect NOCLAR. Yes, NOCLAR should be considered when providing any type of public accounting service.

If you are specifying entities then it can’t be a generic engagement letter then?

Correct. When specifying different services to different type of entities, members should consider issuing an engagement letter which specifically describes the terms of engagement and the services offered to the various entities.

FURTHER RESOURCES

- Client engagement documentation
- Year-end tax checklists
- NOCLAR guidance
- APES 305 Terms of Engagement guidance
- APES 320 Quality Control for Firms guidance
- APES 325 Risk Management for Firms guidance
- APESB standards
- CPA Australia’s Quality Review Program
- Most common non-audit breaches
- Live chat Q&A transcripts