



INSTITUTE OF  
**PUBLIC  
ACCOUNTANTS®**

## **Tax Expenditure Statement**

**OCTOBER 2012**

## IPA - Deakin SME Research Centre

The Institute of Public Accountants (IPA) is one of the three legally recognised professional accounting bodies in Australia. The IPA has been in operation for over 90 years and has grown rapidly in recent years to represent more than 35,000 members and students in Australia and in more than 80 countries. The IPA has offices around Australia and in London, Beijing, Shanghai, Guangzhou and Kuala Lumpur. It also has a range of partnerships with other global accounting bodies. The IPA is a full member of the International Federation of Accountants and has almost 4,000 individual accounting practices in its network, generating in excess of \$2.1 billion in accounting services fees annually. The IPA's unique proposition is that it is for *small business*; providing personal, practical and valued services to its members and their clients/employers. More than 75 per cent of IPA members work directly in or with small business every day. The IPA has a proud record of innovation and was recognised in 2012 by *BRW* as one of Australia's top 20 most innovative companies.

In 2013, the IPA partnered with Deakin University to form the IPA Deakin SME Research Partnership, a first in Australia. This partnership has grown and evolved into the IPA assisting Deakin University in establishing the IPA-Deakin SME Research Centre in 2016. The goal of the Centre is to bring together practitioner insights with cutting edge SME academic research, to provide informed comment for substantive policy development.

The IPA-Deakin SME Research Centre comprises:

Chair: Professor Andrew Conway FIPA  
**(Chief Executive of the IPA and Professor of Accounting *honoris causa* Shanghai University of Finance and Economics)**

Ms Vicki Stylianou  
**(IPA Executive General Manager, Advocacy & Technical)**

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Dear Sir/Madam

### **Consultation Paper - Tax Expenditures Statement**

The IPA-Deakin SME Research Centre (IDSRC) is pleased to provide the following submission on the Federal Government's consultation paper regarding the proposed reforms to the Tax Expenditure Statement (TES). The IDSRC is a joint initiative of the Institute of Public Accountants and Deakin University. It exists to increase the awareness of government and the community more generally on issues related to small business by contributing to policy debates.

The TES is a document that has, at its core, a valid and commendable objective but we suggest that in its current form, the document appears to be flawed in execution. We argue, that it is presented in such a way that it can only be read by knowledgeable specialists and those mainly with expertise in economics or taxation. In effect, this excludes many other stakeholders, particularly individuals and groups in the broader constituency, to which any Federal Government must be accountable. In this regard, it is questionable whether the Federal Government effectively meets its accountability obligations through the publication of the current TES when it is presented in a manner that may be regarded as alienating to an intended audience.

It is of further concern that the TES publishes numbers that various experts and representative groups approach with caution given the estimates embedded in the document and the difficulty in assessing the basis of which estimates have been determined and indeed projected. We further note that the document as published, places critical information that users will require, to enable them to analyse and interpret the figures, in an appendix (Appendix B) published after the tax expenditure numbers have been presented (similar in a sense to an annual financial report with accompanying notes to the accounts).

We have no issue with this format, however, more specific material in the TES's Appendix B, contains what is effectively a disclaimer when it comes to assessing the reliability of the numbers presented to users. In our view, to allow greater readability potential, the document should be restructured so that information critical to an understanding of the figures presented be brought to the attention of readers before they attempt to read the tax expenditure numbers. This would almost be akin to a preamble accompanied by a detailed, yet simple, instructional manual or explanatory guide, as well more detailed information on the basis of which estimates have been made (see further commentary below)

We note that the issue of the reliability of estimates was a point raised by organisations that submitted to the House of Representatives Standing Committee on Tax and Revenue inquiry

on the TES held in 2015. We share the concern of some respondents that Treasury has been prepared to issue documents in the public space that Treasury itself identifies as including data that has a low level of reliability. The use of such data in general public debate on the economy and tax reform means participants are basing their discussions on information that may not only be unreliable, but also potentially, misleading. Additional criticisms of the TES made by respondents to the previous review, include but are not limited to the use of benchmarks in the TES which are claimed to be ambiguous, and accordingly can lead to a combination of different interpretations.

It is noted that the Australian National Audit Office (ANAO) stated in its submission to the parliamentary inquiry on TES held in 2015, that the implementation of suggested changes to the TES as a consequence of reviews, had been slow. A 2008 audit conducted by the ANAO found that those responsible for implementation had failed to adopt changes suggested by a series of government and parliamentary reviews of TES compilation processes. A subsequent audit by the ANAO found that the TES had implemented only two of the recommended changes recommended by the reviews. It is regrettable that a great number of suggested improvements to this accountability document have not been made despite almost a decade of reviewing the quality of TES preparation by Federal Treasury.

It is strongly hoped that changes are made to the current TES as a result of credible recommendations made from this consultation process. Change is critical in this case not just to make the document more meaningful, relevant and reliable, to various stakeholders concerned with performance and accountability matters relating to one of the largest and most important departments in government, but also to allow stakeholders to have greater confidence in the consultation processes initiated by government. It is noted with interest, that the current consultation process is taking place almost 11 months after the Federal Government responded to the report of the parliamentary committee that had reported on its work in December 2015.

We agree though, that it is insufficient for the government or the community to rely solely on these processes alone. There is a need to formalise a continuous process of review possibly via a standard setter body established to assist Treasury and other government agencies by providing ongoing opportunities for consensus on presentation, definitions and agreement on appropriate tax expenditure benchmarks inter alia. Arguably, with the establishment of a body that provides an independent review of all of the issues involved in compiling the TES, as well as producing a meaningful framework/template from which a relevant and more readily understandable document can be prepared, the community will have greater confidence in government accountability measures.

Further comments are made on issues that are of specific interest to the IPA-Deakin SME Research Centre, but questions on other areas not mentioned below are encouraged. We would be pleased to respond accordingly.

## Establishing a statutory board to set standards and oversee TES compilation

We believe that consensus within the community regarding what constitutes a relevant benchmark for tax expenditure purposes and how reliability should be determined, is critical. Submissions provided to the House of Representatives Tax and Revenue Committee provide sufficient evidence that there is dispute about the way in which Treasury has prepared the TES. Carling<sup>1</sup> noted that the statement was unreliable and has a range of problems with TES data that include:

- the ambiguities surrounding the appropriate benchmark for measurement;
- inherent imprecision in the estimates;
- the distinction between revenue foregone and revenue gain; and
- the fallacy of aggregation.

Carling further observed that the data is misused in public discussion notwithstanding that Treasury includes disclaimers about the accuracy of the information that is provided in the Appendix to TES, and accordingly, Carlin argues that practices and procedures in compiling the TES must change. We have further observed that other stakeholders and groups<sup>2</sup> have also made critical comments relating to the TES and its usefulness, as well as the problematic nature of estimates and the uncertainty of the basis of their determination<sup>2</sup>. An example of achieving a consensus on definitional matter is seen in the process for the setting of accounting standards by the Australian Accounting Standards Board<sup>34</sup>, which is monitored by Federal Treasury's Markets Group and overseen by the Financial Reporting Council. Definitions of assets, liabilities, revenue and expenses and equity must be commonly understood otherwise what results is an arbitrary application of accounting principles in the preparation and presentation of financial statements. The accounting

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<sup>1</sup> Carling, Robert (2015) Submission to the House Tax Committee Inquiry into the Tax Expenditures Statement August 2015, Centre for Independent Studies, St Leonards, NSW.

<sup>2</sup> Submissions lodged with the House of Representatives Standing Committee on Tax and Revenue during its inquiry into the TES by the Chartered Accountants Australia New Zealand, Mercer Consulting (Australia) Pty Ltd and the Australian Bureau of Statistics highlighted difficulties each organisation and its staff or members had with the manner in which the TES was compiled. The CAANZ (2015) submission also raises concerns about the lack of comprehensiveness of the TES given that it is presented as an accountability document that covers tax expenditures to the broader community

<sup>3</sup> The Australian Accounting Standards Board (AASB) ([www.aasb.gov.au](http://www.aasb.gov.au)) has a thorough due process that involves the consultation with constituents as well as board deliberations. One of the benefits of the processes used by the accounting standard setter is it provides for people to take some ownership of a regulatory outcome given that they are required to comply with the actual processes.

<sup>4</sup> The Auditing and Assurance Standards Board ([www.auasb.gov.au](http://www.auasb.gov.au)) has a similar due process and is similarly overseen by the Financial Reporting Council but audit guidance promulgated is only applicable to audit professionals. The AASB processes are deemed to be more relevant for the purposes of this submission.

standard setters both here and overseas achieve definitional consensus via the use of a conceptual framework that sets down the critical definitions on which the entire suite of accounting standards depends. Interpretational issues are also settled by having better guidance in circumstances where there is a genuine lack of clarity in the application of a particular standard.

One of the examples of a due process that was conducted by the AASB to great effect was the move to a reduced disclosure regime (RDR).<sup>5</sup> This process involved consultation over a long period with a range of constituents prior to the board eventually agreeing that numbers appearing in financial statements should be calculated in accordance with International Financial Reporting Standards. Moreover, it was also accepted that the quantum and extent of detailed disclosure published by entities could vary depending on their level of accountability.

We recommend that The Federal Government should establish an independent body that is the equivalent of an accounting standard setter for the purposes of developing a consensus on technical definitions and the presentation of tax expenditures. This will ensure that a degree of consensus is achieved as well as having the capacity for an ongoing review of the document and how it is being used. It is hoped that an ongoing process of review by a statutory board would ensure that there is a document presented to the Australian community prepared on a basis that provides stakeholders with information that enables them to make informed judgements when evaluating economic or taxation policies at the time of Federal or State elections. A constant external eye on the process of compiling, verifying and presenting the TES may also create an environment in which Federal Treasury will respond on a more timely basis to requests for change in order to make the document more useful to users.

The consultation paper asks stakeholders to consider small tax expenditures, choice of tax system benchmarks, presentation of the document, reliability and unquantifiable tax expenditures and any appendices that appear. These are matters that would be better dealt with by a body that resembles a standard setter with a deeper and lengthier due process than the one currently taking place.

### Small tax expenditures

The consultation paper proposes that small tax expenditures be reflected once every three years and then only within a range if expenditures fall beneath a particular benchmark. We argue that the arbitrary manner of dealing with expenditure data may lead users to question the relevance and reliability of the numbers reported once every three years. It may be useful for Federal Treasury to bear in mind the current generally accepted accounting

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<sup>5</sup> Porter, Brad, Ravlic, Tom & Wright, Sue 2013, 'Developing accounting regulations that reflect public viewpoints: The Australian solution to differential reporting', *Australian Accounting Review*, vol. 23, no. 1, pp. 18-28.

principles relating to ‘consistency of measurement’ and ‘representational faithfulness’. A failure to report consistently on smaller tax expenditures may lead to more requests for Treasury to further explain and ‘fill in the gaps’ from the past when expenditures may have been regarded as ‘small’ and classified differently because they have exceeded a specific benchmark.

Comparability would become an issue as well and there could accordingly, be calls to recast past TES documents to make comparability possible. Not a desirable position for Treasury to be confronted with, in our view.

A cyclical approach along with a threshold which determines the disclosure of relevant small tax expenditure as recommended in both the current consultation paper and the original report of the House of Representatives Standing Committee on Tax and Revenue on the TES, is an inherent weakness in the proposed reforms.

We suggest that it might be inappropriate for this consultation paper to be recommending a paring back of disclosures at a time when there is need to revisit the underlining definitions that ought to apply in the preparation of the TES. Agreement must be achieved on basic principles before Federal Treasury begins the process of carving disclosures out of the TES.

### **Potential of data to mislead debate**

Estimates published in the TES have the potential to mislead discussion related to debate over tax policy. This is in part because any debate drawing on data published in TES will take place on published figures and any lack of reliability or precision means the foundation of discussion is already compromised. A policy debate that follows cannot be regarded as being anything other than impaired from the start given the manner in which the data set had been calculated, compiled and then published. Carling (2015) and CAANZ (2015) have noted that the use of unreliable data in public debate cripples the ability of Australians to have a properly informed debate on tax policy. The only manner in which to improve the quality of the data is to establish a process that results in a consensus that is agreed about the appropriate format and the manner of calculating the numbers presented in the TES annually.

### **Use of online technologies to make the TES more interactive**

Some of the comments to the previous TES review argue that one of the main problems with the TES, is how the Federal Government presents the information. The document formats are only presented in a manner that suggests the document is prepared solely for the purposes of compliance. Little creativity is used in presentation. There are no graphs or pie charts to illustrate the information in some more presentable form. The document appears busy and somewhat dense with detail as well as lacking in colour, ie essentially black and white throughout, hardly inviting for the readership.

The current format of TES will most likely be used as supplied, ie as presented and unaltered, by economists, academics, political analysts, technical tax experts and journalists because it is the only way in which this report is available. These stakeholders have no control over content and in this sense, are obliged to use the document in its current form – they have little choice. As previously suggested, it is questionable whether the current format of the TES is the best possible manner that will engage other taxpayers given that the Government is accountable to all taxpayers and not just the narrow group that must refer to it as a consequence of their profession.

The Government should also consider the use of online methods of presenting the information contained in the TES to a broader range of users. Listed companies are using different methods to highlight key financial data online and the Federal Government can use similar web-based methods. Major financial institutions have developed a method of ‘breaking down’ the information for interested parties, ie allowing those parties wanting only highlights to see only highlights and for those parties seeking more detail (such as a comprehensive set of financial statements), to have options to do so. It would be useful for the current presentation of the TES online to have a snapshot of what the report means in terms of the overall cost of tax expenditures.

We would be pleased to respond to any additional questions or queries you may have on any of the remarks made above.

Yours Sincerely  
Tony Greco



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