United States Senate
COMMITTEE ON THE BUDGET
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September 15, 2016

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G St, NW, Suite 6814
Mail Stop 6H19
Washington, D.C. 20548

Dear Ms. Payne:

As the Chairman of the Senate Committee on the Budget, I am committed to accurate public information on our country's financial position. The Federal Accounting Standards Advisory Board (FASAB) serves the public interest by publishing financial statements, but I have concerns that the Exposure Draft on *Tax Expenditures: Management's Discussion and Analysis and Disclosure Requirements* does not include a full picture of the government's revenues.

As the goal of the proposal is to disclose the impact on and treatment of tax expenditures within the federal budget process, it is relevant to Congress's annual budget that the information be complete and considered in the correct context.

FASAB does not plan to produce independent information on tax expenditures, but instead to include Treasury data for informational purposes in their financial reports. It is important that any limitations to this information are also included for users. FASAB's financial statements are currently prepared in conformity with generally accepted accounting principles. Tax expenditure information, which is admittedly not auditable, appears to be an expansion of scope that is not justified in the Exposure Draft, except to be informational.

Appendix B contains background information on the Exposure Draft that should be integrated into the illustrative language and final disclosure. The Understanding Estimates section explains why tax expenditures are not necessarily equivalent to forgone revenue and that there is difficulty in summing expenditures or calculating totals. However, the illustrative language implies "revenue effects" on multiple occasions, which is contradictory for the user.

There should be further clarification on baseline provisions and the subjective nature of a normal tax system. A revenue effect compared with a normal tax system is not the equivalent of a deficit effect on the budget. It should be noted that multiple tax baselines are used in Treasury's publication, and they differ from the Joint Committee on Taxation's (JCT) baseline.

Should FASAB decide to include tax expenditure in its financial reports, I request you ensure the final disclosure include fully accurate information for the users. Since tax expenditures are not auditable and only being included for informational purposes, it is important that users are informed of the limitations to this information, as explained by both Treasury and JCT in their annual reports.

Specific examples of how to integrate Appendix B and provide complete information on the limitations on tax expenditures to the user are provided in the attached responses to the four questions posed in the exposure draft notice.

Sincerely,

Senator Michael B. Enzi
Chairman

Q1. The Board is proposing that disclosures in notes to the financial statements of the consolidated financial report of the U.S. Government (CFR) include a "plain language" definition of the term tax expenditures, examples of types of tax expenditures, and a description of how tax expenditures impact nonexchange revenue, tax collections, and refunds, as well as whether tax expenditure amounts are presented in the basic financial statements. These proposed disclosure requirements are presented in paragraphs 14-15 on page 14. An illustrative example of how these disclosures might be presented in the notes to the financial statements of the CFR is provided in Appendix D: Illustrations beginning on page 36.

Do you believe that these proposed disclosure requirements related to the notes to the financial statements in the CFR will be helpful to readers? Do you believe the placement of the proposed disclosures in the notes to the financial statements of the CFR is appropriate? Please explain the basis for your view and note any recommended changes in the requirements.

RESPONSE:

- Disclosure requirements: Paragraph 14 includes "how *budgetary* objectives can be achieved through the mechanism of tax expenditures." However, the illustrative Appendix D discusses *policy* objectives. As tax expenditures cannot be equated to forgone revenue or summed to total, the budgetary effect is unclear.
- Illustration: Appendix D should not state that tax expenditures reduce tax collections unless clarifying that it is in relation to a normal tax system's baseline. It is important to clarify that tax expenditures are not estimated and reported in financial statements because they cannot be summed to total and are not auditable.

Q2. The Board is proposing that management's discussion and analysis (MD&A) in the CFR include a discussion of tax expenditures, their general purpose, and how they impact the government's financial position and condition. The proposed standards also require discussion of other factors that may affect tax collections in order to place tax expenditure information in an appropriate context. The specific proposed requirements are presented in paragraph 17 and sub-paragraphs 17.a-17.e beginning on page 14. An illustrative example of how these proposed requirements might be presented in MD&A is provided in Appendix D: Illustrations beginning on page 32.

Do you believe that these proposed requirements related to MD&A will be helpful to readers? Do you believe the placement of the proposed requirements in MD&A in the CFR is appropriate? Please explain the basis for your view and note any recommended changes in the requirements.

RESPONSE:

- Disclosure requirement: Paragraph 17 includes "a description of how tax expenditures are treated for budgetary and financial reporting purposes, including their impact on the surplus (deficit), and their treatment with the federal budget process." As tax expenditures are treated within the federal budget process as relative to a normal tax system's baseline, that should be clarified for the user. The deficit effect is not provided in the Illustration.

- Illustration: This baseline concept should be integrated into the phrase that "tax expenditures are 'revenue reductions' in that the provisions reduce taxes owed, and, therefore revenue collected." The language would mirror statute more closely if it read: "tax expenditures are 'revenue losses' in that provisions reduce tax liability relative to a normal tax system's baseline." To add in the opening paragraph of The Government's Net Position that tax expenditures are part of the government's "bottom line" net operating cost implies they can be summed and are included in Table 4, even though they are not totaled.

Q3. The Board is proposing to encourage rather than require the presentation of a selection of major tax expenditure estimates, such as those published annually by the Department of the Treasury's (Treasury) Office of Tax Policy, as other information (OI) in the CFR. The proposed information to be encouraged is presented in paragraphs 19-20 and subparagraphs 20.a-20.c.

An illustrative example of how this proposed information might be presented in OI is provided in Appendix D: Illustrations beginning on page 38.

Statement of Federal Financial Accounting Concepts (SFFAC) 6 paragraph 5 provides that OI is information that accompanies basic information and required supplementary information (RSI), but is not required by a body that establishes generally accepted accounting principles. For additional information regarding OI, see Appendix C: Characteristics of Other Information beginning on page 30.

The Board's basis for reaching this proposal to encourage such information be included in OI is documented in Appendix A: Basis for Conclusions, beginning on page 16.

Appendix B: Tax Expenditures Explained beginning on page 23 includes important considerations behind the Board's proposal, including how Treasury's Office of Tax Policy prepares tax expenditure estimates and how those estimates can be used and interpreted.

a. Do you believe that the proposed information, as outlined in paragraphs 19-20 and subparagraphs 20.a-20.c would be helpful to readers? Please explain the basis for your view and explain any recommended changes.

b. Do you agree with the Board's rationale for encouraging the presentation of the proposed information as OI in the CFR, as provided in paragraphs A9-A12? Please explain the basis for your view.

RESPONSE:

a)

- Disclosure requirements: Paragraph 20 include "the general magnitude of tax expenditures and their impact on federal revenues (revenue effect) during the fiscal year." Again, this should state that it is a divergence from a normal tax system's baseline and that there is not an equivalent deficit effect. Appendix B has repeated the language from Treasury and JCT that tax expenditures are not necessarily equivalent to forgone revenue, so disclosing a revenue effect is contradictory. For example, the Other Information cannot sum to total the general magnitude, but instead provides a table of Treasury's top expenditures listed independently.

- Illustration: The Estimates section includes some limitations that were included in Appendix B and are supported by Treasury and JCT, but is not comprehensive. One major consideration is the significant judgment required to determine whether a provision is a tax expenditure, so it should also note that Treasury uses two different baselines, which also differ from JCT's baseline. Another major consideration is that estimates do not necessarily equal changes in federal revenues (or the deficit). The language should include why the list of major tax expenditures cannot be summed to total. This section should also include the statement from Appendix B that "a present-value alternative that considers the full life cycle of the taxable activities may be more useful for tax expenditures involving deferrals or other long-term revenue effects."

b)

- Informing the user of published estimates should be comprehensive. Figure 1 is an out of context table that list the largest 20 tax expenditures, "Ranked by Revenue Effect". It would be more accurate to refer to it as a baseline effect and to link to Treasury's full report. It should be noted that this table is a current revenue table, and Treasury also provides a present-value list that may be more appropriate. JCT also has a separate list that could be used for comparison.

Q4. This exposure draft (ED) proposes disclosure requirements and RSI to be included in the notes to the financial statements and MD&A sections of the CFR, respectively, that would support SFFAC 1 Objective 1, Budgetary Integrity, including Sub-objectives 1A and 1C; Objective 2, Operating Performance; and Objective 3, Stewardship.

More detailed discussion of these reporting objectives and sub-objectives and how they are supported by the proposed requirements in this ED can be found in the Purpose section beginning on page 10 and the Appendix A: Basis for Conclusions section beginning on page 16.

Appendix B: Tax Expenditures Explained beginning on page 23 provides additional background which may aid respondents' understanding of tax expenditures, their "plain language" definition, why they are important, how estimates are prepared, and considerations for understanding how estimates can be used.

Are there any other changes that you believe should be made to the proposed Statement? Please provide rationale for your answer.

RESPONSE:

- The Proposed Standards definition of baseline provisions could set up a larger discussion on the alternative and subjective nature of a normal tax system's baseline. It should explicitly state which baseline is being referenced in the disclosure requirements. Similar to how Appendix B discusses behavioral and economic effects, this definition could clarify the "impact of tax expenditures on tax revenues" assumes no behavioral response and is not necessarily the amount of revenue that would be raised if it were repealed.