OUTSOURCING INCOME TAX RETURNS: CONVENIENT AND/OR CONTROVERSIAL

Sally Chaplin*

This paper investigates the outsourcing of income tax return preparation by Australian accounting firms. It identifies the extent to which firms are currently outsourcing accounting services or considering outsourcing accounting services, with a focus on personal and business income tax return preparation. The motivations and barriers for outsourcing by Australian accounting firms are also considered in this paper. Privacy, security of client data, and the competence of the outsourcing provider's staff have been identified as risks associated with outsourcing. An expectation relating to confidentiality of client data is also examined in this paper.

Statistical analysis of data collected from a random sample of Australian accounting firms using a survey questionnaire provided the empirical data for the paper. The results indicate that the majority of Australian accounting firms are either currently outsourcing or considering outsourcing accounting services, and firms are outsourcing taxation preparation both onshore and offshore. The results also indicate that firms expect the volume of outsourced work to increase in the future. In contrast to the literature identifying labour arbitrage as the primary driver for organisations choosing to outsource, this study found that the main factors considered by accounting firms in the decision to outsource were to expedite delivery of services to clients and to enable the firm to focus on core competencies. Data from this study also supports the literature which

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* Lecturer, School of Accountancy, Queensland University of Technology, Brisbane, Australia. The author wishes to thank Professor Kerrie Sadiq for offering her expertise, assistance, editing and encouragement with this paper. The author also wishes to acknowledge the support of Associate Professor Victoria Wise for her advice and editing assistance during this study. The constructive comments and suggestions made by the anonymous reviewers are also appreciatively acknowledged.

indicates that not all tax practitioners are adhering to codes of conduct in relation to client confidentiality.

Research identifying the extent to which accounting services are outsourced is limited, therefore significant contributions to the academic literature and the accounting profession are provided by this study.

1. INTRODUCTION

The development of information technology and information sharing via the Internet has resulted in a tendency by organisations to seek cost savings by outsourcing services previously performed within the organisation. The aim of this paper includes establishing to what extent outsourcing is occurring within accounting firms and to identity issues arising from outsourcing accounting services, including the outsourcing of income tax returns and client confidentiality.

In this paper a positivist approach has been adopted that analyses empirical data from a survey questionnaire that was mailed to a random sample of accounting firms within Australia. The results of the analysis indicate that the majority of Australian accounting firms are either currently outsourcing or considering outsourcing, and those firms currently outsourcing expect the volume of work being outsourced to increase. While the academic literature identifies labour arbitrage as a significant motivation for outsourcing[1], this paper suggests that accounting

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[1] See, for example, Deloitte Consulting, *Calling a Change in the Outsourcing Market: The Realities for the World's Largest Organizations* (Deloitte Development LLC, 2005); A Hoecht and P Trott, 'Innovation Risks of Strategic Outsourcing' (2006) 26 *Technovation* 672; Prasad Kakumanu and Anthony Portanova, 'Outsourcing: Its Benefits, Drawbacks and Other Related Issues' (2006) 9 (2) *Journal of American Academy of Business, Cambridge* 1; Sameer Kumar and A Samad Arbi, 'Outsourcing Strategies for Apparel Manufacture: A Case Study' (2008) 19 *Journal of Manufacturing Technology Management* 73; Sharon F Matusik and Charles WL Hill, 'The Utilization of Contingent Work, Knowledge Creation, and Competitive Advantage' (1998)

firms are outsourcing accounting services to enable them to focus on their core competencies rather than seeking a labour arbitrage rationale as their main focus. Client confidentiality is identified as an issue of concern and the competence of outsourcing providers is also highlighted in this paper.

The motivation for this paper is twofold. Firstly, as current data on this topic is scant, to contribute to the body of knowledge regarding the extent of the outsourcing of accounting services in Australia, and secondly, to raise awareness for practitioners, either currently outsourcing or considering outsourcing, on the requirements for compliance with the Tax Practitioners Board Code of Conduct in relation to client confidentiality.

2. BACKGROUND

The Australian Government Tax Practitioners Board has legislated a Code of Professional Conduct that lists the core principles of the code grouped into 5 categories:[2]

- Honesty and integrity
- Independence
- Confidentiality
- Competence

23 *The Academy of Management Review* 680-97; Peter Moller, 'Offshore or Off-track?' (2006) 17 (3) *Business Strategy Review* 91; ZA Quraeshi and M Luqmani, 'Towards a Framework for Effective Offshore Outsourcing Decision-making' (2007) 18 (36) *Journal of Global Business* 59; Larry Rittenberg and Mark Covaleski 'Internalization versus Externalization of the Internal Audit Function: An Examination of Professional and Organizational Imperatives' (2001) 26 *Accounting, Organizations and Society* 617; Suzanne Young, 'Outsourcing: Uncovering the Complexity of the Decision' (2007) 10 *International Public Management Journal* 307.

[2] Tax Practitioners Board, Explanatory Paper TPB 01/2010, Code of Professional Conduct.

- Other responsibilities

This paper will consider two of the core principles in relation to outsourcing of taxation services, namely; confidentiality and competence.

Confidentiality (Principle 6) states:

> Unless you have a legal duty to do so, you must not disclose any information relating to a client's affairs to a third party without your client's permission.

Competence (Principle 7) states:

> You must ensure that a tax agent service you provide, or that is provided on your behalf, is provided competently.

Confidentiality and competence is a general expectation clients would have when providing information to their accountant/tax agent. If the client's information was subsequently outsourced (whether it be onshore or offshore) without the prior knowledge of the client, then it would appear the Code has been breached. Likewise, unless the outsourcing firm has close contact with the outsourcing provider is would be difficult to assess the scope of the provider's expertise to ensure they are capable and competent in Australian taxation regulation and legislation to complete the task.

2.1 Accounting

It is difficult to determine precisely the number of accounting firms currently operating in Australia. The three recognised professional accounting bodies in Australia, CPA Australia (CPAA), the Institute of Chartered Accountants in Australia (ICAA) and the Institute of Public Accountants (IPA), have confidential data for member numbers. However, there is the possibility of duplication within the data as some members belong to one or more professional bodies. The most recent data on accounting firms in Australia is contained in a special report commissioned by the Australian Bureau of Statistics (ABS) in

2002 to identify the financial and business structure of 9,860 accounting firms operating in Australia.[3]

While the latest data on income received by accounting firms for the provision of income tax services is over ten years old, the ABS Report on Australian accounting firms shows that the largest income producing service for accounting firms was business taxation which accounted for approximately 36.7% of the AUD 7.7 billion accounting practice income. Personal accounting and taxation represented 18% of income and auditing and assurance represented 16.5%. The balance is made up of other services identified by the ABS and includes: management and business consulting (12.1%); insolvency, reconstruction and bankruptcy (6.2%); financial planning and investment advice (2.8%); and other (5.5%). A major expense for accounting firms is the cost of labour which accounted for 58.5% of all expenses in 2001-02, an increase from 54.7% in 1995-96.[4]

2.2 Taxation

Outsourcing is not a new concept, however the offshore outsourcing of accounting services by professional accounting firms is a more recent development. The literature suggests that accounting firms in the United States had initiated outsourcing income tax preparation by the early 2000s as accountants in India completed around 25,000 US tax returns in the 2002 tax year at an estimated cost saving of between USD 40,000 to USD 50,000 for every 100 returns outsourced. This number was expected to quadruple for 2004.[5] Updating these figures with current figures is difficult with searches of academic literature,

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[3] ABS, Accounting Practices Australia, report No. 8668.0 (2002) <http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/8F59B8C1CED4C4FDCA256D3300821991/$File/86680_2001-02.pdf>.

[4] Ibid.

[5] Leslie Haggin Geary, 2004, 'Guess which Jobs are going Abroad' <http://money.cnn.com/2003/12/30/pf/offshorejob/>.

professional literature and current news shedding little light on this subject.[6]

Although much of the data on outsourcing tax return preparation is US based, a confidential discussion paper, issued by the Australian Taxation Office in 2007, has since been made public by the Australian Professional Ethics Standards Board (APESB).[7] The purpose of the discussion paper was to engage with the tax agent and accounting industry to discuss the outsourcing of tax services including compliance issues and potential risks for taxpayers, the tax profession and the Australian Taxation Office. While updated literature on the outsourcing of accounting functions[8] is available, current literature with statistics on outsourcing of accounting services such as income tax return preparation is scant. Perhaps this information is being kept confidential as firms may not want to publicise the fact they are outsourcing local jobs.[9]

There is a plethora of current literature relating to US job losses as a result of outsourcing, such that, in 2012 President Obama introduced the *Bring Jobs Home Act* into the Senate

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[6] While the United States is noted as outsourcing taxation preparation in the early 2000s, evidence of Australian firms outsourcing emerged several years later, however, empirical data relating to the extent of Australian outsourcing could not be found. The Australian Bureau of Statistics (ABS) has advised that they are not currently planning another census of accounting firms in the near future, and firms are reluctant to publicise such data. Due to public reaction in the early 2000s, it is also difficult to find updated data for the US.

[7] Australian Professional Ethics Standards Board, Discussion Paper, 'Issues Impacting the Accounting Industry from Outsourcing' <http://www.apesb.org.au/uploads/attachment-8-a-outsourcing-discussion-paper.pdf>.

[8] The outsourcing by organisations of accounting functions includes accounts receivable, accounts payable and human resource management. In contrast to accounting functions, the outsourcing of accounting services includes those services offered by accounting firms such as auditing and taxation services.

[9] Justin Marks, 'The Outcry over Outsourcing: A Debate rages through State Capitols over the Loss of American Jobs to Foreign Countries' (2004) 30 (5) *State Legislatures*.

offering firms tax incentives for relocating jobs back to the US,[10] however, recent quantitative data relating to outsourcing by accounting firms is elusive. Further evidence of the early backlash over outsourcing, and therefore possible reluctance to publicise outsourcing figures, was substantiated by action in the US that led to legislation pending for 186 bills (in 2004) that aim to limit outsourcing offshore.[11] Perhaps the reluctance to publicise extends beyond jobs to ethical issues. This sentiment also relates to clients of Australian accounting firms' perception of outsourcing offshore. In a recent article in the CPA Magazine *Intheblack,* an Australian CPA was asked what she told clients about outsourcing, and is quoted as saying 'We said we'd made a decision to keep a cap on fees and would be using an outsourcing company based in Sydney,' ... 'We didn't say we had [offshore workers] because of client perception; their [limited] knowledge of [overseas workers] came from phone calls they received from call centres.'[12]

Outsourcing tax returns is not restricted to the larger accounting firms as third-party facilitator companies are assisting small and medium-sized accounting firms in the trend to offshore processing of accounting services.[13] The four leaders in the area of tax preparation in the US are Commerce Clearing

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[10] Scott A Hodge, 'Bring Jobs Home Act (HR 5542) – Legislation in Search of the Facts' (2012, May 14) < http://taxfoundation.org/blog/bring-jobs-home-act-hr-5542-legislation-search-facts>.

[11] Pete Engardio, Josey Puliyenthuruthel and Manjeet Kripalani, 'Fortress India?' (2004, August 16) 3896 *Business Week* 42

[12] Deborah Tarrant, 'Outsourcing: The Pros and Cons of Going Offshore' (2012) *Intheblack,* <http://www.itbdigital.com/tools-of-the-trade/2012/09/24/outsourcing-the-pros-and-cons-of-going-offshore/>.

[13] Cameron Cooper, 'The True Cost of Outsourcing' (2006) 77 (4) *Charter* 20; Thomas L Friedman, *The World is Flat: A Brief History of the Twenty-first Century* (Farrar, Straus and Giroux, New York, 2005); David Wessel, 'Barbell Effect – The Future of Jobs: New Ones Arise, Wage Gap Widens; Outsourcing, Technology cut Need for Rote Workers; Brainpower is in Demand; Hot Area: Massage Therapy' (2004, April 2) *Wall Street Journal* A1.

House (CCH), Outsource Partners International (OPI), SurePrep and Xpitax.[14] In Australia, predominant service providers include: Odyssey Resources Pty Limited, Ridge Business Management, Back Office Shared Services Pty Limited and MYOB Australia Pty Limited.[15]

While it is argued that both high-level skills and low-level skills jobs are suitable for outsourcing,[16] Robertson et al suggest that outsourcing compliance tax work enables firms to focus on the higher fee earning consultancy work, such as tax planning.[17]

Outsourcing offshore seems well suited to clearly defined, routine tasks.[18] Software development has allowed the preparation of tax returns to become one of these routine tasks. In this study the extent of outsourcing of taxation services and the motivation and risks of accounting firms outsourcing taxation services are investigated.

There appear to be several alternatives presently being used to facilitate the processing of tax returns by offshore outsourcing.

In Australia the three primary methods of outsourcing are:

- tax practices employing or contracting with accountants located overseas (outsourcing partner);

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[14] Jesse C Robertson et al, 'The Coming Accounting Revolution: Offshore Outsourcing of Tax Return Preparation' (2004) Working Paper Series <http://tradeinservices.mofcom.gov.cn/upload/2009/02/18/1234919965609_88311.pdf>.

[15] APESB, above n 7.

[16] Martin Fahy, 'Takeover Talks Highlight Offshore Option' (2007) Lateline, ABC, Australia, released 7 March 2007, Television Broadcast < http://www.abc.net.au/lateline/business/items/200703/s1865985.htm>.

[17] Robertson et al, above n 14.

[18] Gagan Ahluwalia, 'Your competitive landscape is changing' (2006) 22 *Accounting Technology* 6.

- tax practices contracting with a local service provider (third-party facilitator) who then employ or contract with accountants located overseas; and
- multinational firms using staff in their overseas offices (offshoring).[19]

Robertson et al identify six basic steps in the offshore outsourcing process.[20] The accountant collects the client's tax information and scans it into electronic files which are uploaded to the facilitator's website. The facilitator encrypts the files and makes them available to the outsourcing partner(s) who then prepare and review the income tax returns, and post the returns, work papers, notes, and reconciliations to the facilitator's website. Completed returns and documents are downloaded, reviewed and signed by the accountant and forwarded to the client for filing.

As technology and software continues to develop, new methods of tax preparation are evolving. The latest development is the automation of data entry, whereby scanned documents, such as a payment summary which shows the payments that have been made to employees and amounts withheld during a financial year or a dividend payment advice confirming the amount of the dividend that has been paid together with imputation credits relating to the dividend, is scanned and automatically uploads into the tax return, saving the labour of data entry.[21] Also saving on data entry is the online database facility that allows for direct downloading of data into the tax return. In Australia, commercial software is available that enables the tax agent to automate the tax return procedure,

[19] ATO, *ATO Tax Practitioner Forum Agenda* (2007, August 10).

[20] Robertson et al, above n 14.

[21] Antoinette Alexander, 'Look Ma, No Hands' (2007) 23 (8) *Accounting Technology* 22.
This article reports on the use of databases and technology by tax service firms in the US in keeping office files and information safe and sustainable and eliminating the time-consuming data entry process.

including electronic roll-over of previous year's tax returns and pre-fill data from the ATO database (including records such as BAS and IAS data).[22] However, if tax agents are outsourcing the tax return preparation process, than according to the Tax Practitioners Code of Professional Conduct, Principle 6 (Confidentiality), paragraph 79:

> In the absence of client authorisation or a legal duty to disclose, **any** disclosure of information relating to the affairs of a client will be a breach of this provision of the Code. This would include disclosure of client information to an offshore entity engaged by a tax agent or BAS agent to provide certain services to the agent. Where relevant information is to be disclosed to offshore or onshore entities by a tax agent or BAS agent, an agent should obtain client permission, such as in a letter of engagement, report, advice or other communication with the client.[23]

The ATO has free software available (e-tax) on its website for taxpayers who wish to complete their own income tax return.[24] The e-tax software also has the facility to pre-fill data from the ATO database including PAYG payment summary information, Centrelink payments, dividend details, bank interest received, health insurance cover and roll-overs from the previous year's tax return. Instructions for completing the e-tax return and links to Legislation assist the taxpayer to complete and electronically lodge the tax return themself.

In the US, new developments in software and downloading facilities coupled with new legislation requiring that clients give informed written consent to offshore outsourcing, has resulted in

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[22] Sage HandiSoft, 'ATO Pre-Fill Report Functionality' <http://www.sagehandisoft.com.au/TAX1118_ATO_PreFill/HandiTax_KnowledgeBase.aspx>; CCH iFirm, 'Australian Tax Software for Accounting Firms' <http://www.cchifirm.com.au/products/ifirm/tax/index>.

[23] TPB, above n 2.

[24] Australian Taxation Office, 'Lodging your Tax Return' <http://www.ato.gov.au/Individuals/Lodging-your-tax-return/E-tax/>.

SurePrep now also offering a service whereby the automation features described above are classified as 'standard documents' and outsourced, and tax returns not suitable for automation of data entry are classified as 'non-standard documents' and are left to the accounting firm for processing.[25]

2.3 Benefits and Motivation

There is evidence that an organisation's desire for realising only cost savings is changing.[26] There is emerging evidence that organisations are now concentrating on value-adding activities that offer customers speedy delivery combined with superior goods and services.[27] Organisations seeking a more strategic approach are moving beyond labour arbitrage towards 'transformational outsourcing', so in addition to labour savings, they also seek '…gains in efficiency, productivity, quality and revenues that can be achieved by fully leveraging offshore talent'.[28] This approach extends beyond looking for costs savings to positioning the organisation for growth.

The motivation to outsource varies from firm to firm. Duffy suggests that large firms will be seeking to cut costs while the smaller firms will be seeking to minimise capital investment and lower business risk.[29] With the growing trend of outsourcing taxation services overseas, accounting firms believe if they are not receiving the labour arbitrage from outsourcing that their competitors receive, they may price themselves out of the

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[25] David Wyle, 'Tax Outsourcing in 2008 and Beyond' (2008) 24 (2) *Accounting Technology* SR8.
[26] Robert Handfield, 'A Brief History of Outsourcing' (2006) *Supply Chain Management* <http://scm.ncsu.edu/public/facts/facs060531.html>.
[27] Engardio, Puliyenthuruthel and Kripalani, above n 11.
[28] Pete Engardio, Michael Arndt and Dean Foust, 'The Future of Outsourcing' (2006, January 30) 3969 *Business Week* 50.
[29] Hugh Duffy, 'Outsourcing: Threat or Opportunity?' (2006) 39 (11), *Practical Accountant* 10.

market.[30] Another reason accounting firms are embracing outsourcing is to relieve the pressure on staff during the busy tax season.[31] According to Mirchandani and Liggett, accounting firms are outsourcing accounting services such as bookkeeping, taxation, document management and IT services, allowing them to concentrate on value-added services to build and maintain their competitive advantage.[32]

Del Vecchio uses a more structured strategic approach by categorising the benefits into three categories comprising operational benefits, strategic benefits and financial benefits.[33] Other benefits associated with outsourcing of business activities identified from the academic literature[34] fit into Del Vecchio's three categories and are presented in Table 1.

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[30] Jay A Soled, 'Outsourcing Tax Return Preparation and its Implications' (2005) *The CPA Journal* <http://www.nysscpa.org/printversions/cpaj/2005/305/p14.htm>.

[31] Cooper, above n 13.

[32] Kishore Mirchandani and Jim Liggett, 'Using Outsourcing to stay on Top' (2002) 72 (6) *The CPA Journal* 18.

[33] Stephen C Del Vecchio, 'An analysis of the outsourcing decision' (2005) 10 *Corporate Finance Review* 21.

[34] See, eg, Michael Cant and Lucy Jeynes, 'What does Outsourcing bring you that Innovation Cannot? How Outsourcing is seen-and currently Marketed-as a Universal Panacea' (1998) 9 *Total Quality Management & Business Excellence* 193; Handfield, above n 26; Christine Harland et al, 'Outsourcing: Assessing the Risks and Benefits for Organisations, Sectors and Nations' (2005) 25 *International Journal of Operations & Production Management* 831; CK Prahalad and Gary Hamel, 'The Core Competence of the Corporation' (1990) 68 (3) *Harvard Business Review* 79; James Brian Quinn and Frederick G Hilmer, 'Make versus Buy: Strategic Outsourcing' (1995) 1 *The McKinsey Quarterly* 48; Rittenberg and Covaleski, above n 1; Larry Rittenberg, Wayne Moore and Mark Covaleski, 'The Outsourcing Phenomenon' (1999) 56 (2) *The Internal Auditor* 42; Kurt Sartorius and Johann Kirsten, 'The Boundaries of the Firm: Why do Sugar Producers Outsource Sugarcane Production?' (2005) 16 (1) *Management Accounting Research* 81; Bernadette Starzee, 'How to...Decide whether and what to Outsource' (2006, February 3) *Long Island Business News* 1; Robert M Weiss and Amir Azaran, 'Outward Bound: Considering the Business and Legal

Table 1 Categories of outsourcing benefits

Category	**Benefits**
Operational	• to free up internal resources for other purposes • to eliminate an in-house function that is time-consuming to manage or is out of control • to increase flexibility in dealing with changing market conditions and organisational requirements • to access short term labour
Strategic	• to allow management to focus on core competencies and strategic plans • to gain access to world-class capabilities • the supply of motivated staff and highly specialised skills • to strengthen international and cultural coverage • to provide expanded geographic coverage
Financial	• to reduce and control operating costs • to promote economies of scale that should result in cost savings for the same services, or improved services at lower costs • to reduce fixed costs and replace with variable costs

Source: Benefits summarised from the literature using Del Vecchio categories

Implications of International Outsourcing' (2007) 38 *Georgetown Journal of International Law* 735.

2.4 Risks and Barriers

Although outsourcing may provide a viable strategy for organisations, Del Vecchio warns there is 'competition that never sleeps' and care is required in the outsourcing process to prevent failure.[35] The three categories of benefits Del Vecchio identifies can also be applied to the risks of outsourcing. Operationally, if employees are not supportive of the outsourcing process, are not retrained appropriately or are not retained within the business, disruptions are likely to occur in the workplace. Strategically, incompatible corporate cultures, misjudging the market or flawed economic analysis can result in failure to achieve corporate objectives. If the projected revenues or cost savings do not materialise, the financial category of benefits may be jeopardised.

Loss of employee skills and knowledge has also been identified as a risk related to outsourcing tax returns. The preparation of income tax returns is often an entry level task of accounting graduates in accounting firms, and it is used to train junior staff to both understand the process and to understand their clients.[36] As the responsibility for reviewing and lodging tax returns rests with the accountant, the question arises as to how junior employees will build the knowledge and expertise to adequately sign off on the client's tax return if they are not given the opportunity or experience of having prepared tax returns.[37] McManus also raised this concern in his case study of a chartered accounting firm in Scotland that was trialling the outsourcing of accounting services to India.[38] The firm expressed concern that a lack of practical experience for graduate recruits could be a problem; if such junior employees

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[35] Del Vecchio, above n 33, 27.

[36] Gary S Shamis et al, 'Outsourcing, Offshoring, Nearshoring: What to do?' (2005) 199 (6) *Journal of Accountancy* 57.

[37] Ibid.

[38] Ken McManus, 'Is Outsourcing an Option for Chartered Accountancy Firms?' (2006, April) *Chartered Accountants Journal* 57.

do not receive the basic training in the completion of income tax returns, or other accounting services that may be outsourced, then firms will lose the necessary skill sets to re-establish the services within the firm. This practice could have ramifications by compromising the sustainability of some services within the accounting profession. Failure to retain skills within the organisation creates potential performance and sustainability issues, placing pressure on the likely future success of the organisation.[39]

In Table 2, Del Vecchio's strategic approach using the three categories of operational risks, strategic risks and financial risks are linked with the risks identified with outsourcing.[40]

Table 2 Categories of outsourcing risks

Category	**Risks**
Operational	• social costs including low morale, high absenteeism, lower productivity • reduced education and skill level of workers
Strategic	• loss of organisational control and stability • loss of unique 'local knowledge' • loss of competitive advantage with confidential information being entrusted to contingent workers (leakage) • theft and security issues

[39] F Franceschini et al, 'Outsourcing: Guidelines for a Structured Approach' (2003) 10 *International Journal of Benchmarking* 246; David E Hawkins, *Corporate Social Responsibility: Balancing Tomorrow's Sustainability and Today's Profitability* (Palgrave Macmillan, New York 2006).

[40] See, eg, Cant and Jeynes, above n 34; Hoecht and Trott, above n 1; Kakumanu and Portanova, above n 1; Matusik and Hill, above n 1; Rittenberg and Covaleski, above n 1.

Financial	• reduced costs not being realised

Source: Risks summarised from the literature using Del Vecchio categories

2.5 Privacy and Security

When information is outsourced, there is a heightened possibility of damage to the organisation through security breaches, loss of data and theft of data.[41] In addition to concerns over job losses in the US, legislation is also pending to restrict offshore data transmission as fears regarding privacy and security escalate.[42] Concerns over the security of information held at Indian call centres were raised by BBC News, which quoted David Fleming, National Secretary for Finance from Amicus, the UK's second-largest trade union and the largest private sector union, as saying 'It is only a matter of time before a serious crime is committed, which ruins the reputation of the British financial services industry'.[43] This comment was in response to reports of organised gangs offering Indian call centre staff one year's wages in return for access to UK credit card details. BBC News also reported that Capital One, a US credit card company, pulled out of India after call centre staff increased credit levels without authorisation. Oates raised the concern that with Amicus predicting 200,000 banking and personal finance jobs to be exported from the UK to India by 2008, customers will be forced to allow their personal details out of the UK.[44]

The Australian Federal Police (AFP) has also warned of the risks associated with outsourcing of information processing to

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[41] Kakumanu and Portanova, above n 1

[42] Engardio, Puliyenthuruthel and Kripalani, above n 11.

[43] Unite, 'The Union for Life' <http://www.unitetheunion.org/about_us.aspx>.

[44] John Oates, 'Indian Call Centres "Pose Security Risk"' (2004) <http://www.theregister.co.uk/2004/04/05/indian_call_centres_pose_security/>.

India. In March 2007, the AFP dismantled an Indian identity-crime syndicate operating in Melbourne and Sydney. Their concerns about the risks posed by sending personal information offshore prompted the AFP to open an office in India in 2007 to help fight identity theft.[45] According to Connors, the (then) Federal Police Commissioner, Mick Keelty, suggested that because India has no equivalent of Australia's privacy legislation, companies sending personal details offshore to India should be required by legislation to inform their customers when their data are shipped offshore. Although the Tax Practitioners Board and the professional accounting bodies require specific consent from clients indicating that a third-party service provider is used, it appears not all tax agents or accountants are advising clients that their tax return is outsourced.[46]

Identity fraud is prevalent in the US. Approximately 7 million US adults were victims of identity theft in 2002.[47] Consequently, AICPA has reminded its members that they are ultimately responsible for protecting clients' data. Nearly 31,000 Californians were victims of identity theft in 2002 prompting Californian legislators to introduce bills either banning the state from contracting with entities that outsource, or prohibiting the transmission of confidential financial information to workers located outside the US.[48] As a result, third-party facilitators (such as SurePrep) are now offering accounting firms the choice of outsourcing onshore.

In January 2008, the US Internal Revenue Service (IRS) announced new rules relating to the outsourcing of tax returns. From January 2009, written taxpayer consent must be obtained, and social security numbers obscured, before a tax return can be

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[45] E Connors, 'Data is Heroin to Criminals: Police Chief' (2007, March 27) *The Australian Financial Review* 34.
[46] Tiina-Liisa Sexton, '(Out)source of Concern' (2007) 77 (1) *Intheblack* 70.
[47] Jerry Ascierto, 'Outsourcing Guidance for CPAs' (2004) 73 (1) *California CPA* 20.
[48] Ibid.

outsourced to an offshore preparer.[49] As a result, more tax returns are now being prepared by onshore outsourcing centres.[50] A review by the Australian government concerning data protection may also lead to legislation in Australia to ensure clients are advised if their financial information is being sent offshore.[51] If the Australian scenario follows the rules and procedures adopted by the US, as identified by Wyle,[52] Australian accounting firms may return previously offshore outsourced services to be either processed by the firm or outsourced onshore, rather than advising clients that their work may be outsourced offshore.

3. METHODOLOGY

A positivistic approach and a quantitative methodology using a survey questionnaire were used for this study. From the 750 randomly selected accounting firms, responses totalled 158 (21.07%) with a usable response rate of 143 (19.07%) after follow-up and other procedures to enhance response rates were implemented.

Non-response analysis commonly used by management accountants[53] was adopted for this study. For mail surveys, it is expected that non-respondents will be similar to late respondents[54] and a comparison can be made between those who responded to the first mail-out (first wave) and respondents from

[49] Wyle, above n 25.
[50] Ibid.
[51] Michael Crawford and Paul Smith, 'New Focus on Data Protection', *The Australian Financial Review* (2008, May 20) <http://www.misaustralia.com/viewer.aspx?EDP/20080520000020683293>.
[52] Wyle, above n 25.
[53] Wim A Van der Stede, Mark Young and Clara Chen, 'Assessing the quality of evidence in empirical management accounting research: the case of survey studies' (2005) 30 *Accounting, Organizations and Society* 655.
[54] J Scott Armstrong and Terry S Overton, 'Estimating Nonresponse Bias in Mail Surveys' (1977) 14 *Journal of Marketing Research* 396.

subsequent follow-up requests (second and third wave)[55] to gauge whether the respondents are representative of the population. A Levene's test for equality of variances[56] was undertaken to test for non-response and confirm that the data, which have been analysed in this paper, are representative of the population.

4. FINDINGS

One of the motives behind this study is to determine the extent of outsourcing, both onshore and offshore which a review of the relevant literature was unable to establish. Of the 143 firms surveyed, the number of respondents currently participating in outsourcing was 30 (see Table 4). Of those respondents who indicated that their firm outsourced accounting services within Australia, 19 firms (63.3%) outsourced only onshore, and three firms (10%) outsourced both offshore and onshore. The remaining eight firms (26.7%) outsourced offshore.

Responses were received from every state within Australia with the distribution of respondents from capital cities (50.3%) slightly higher than regional respondents (44.8%). A further 4.9% indicated they operated in both capital and regional areas. The majority of respondents were small firms, which was expected based on the ABS Report (2002) that indicated that small firms made up the majority of accounting firms.

This study found that 21% of Australian accounting firms currently participate in outsourcing of accounting services. Table 3 shows the number of firms currently outsourcing

[55] EA Suchman and B. McCandless, 'Who Answers Questionnaires?' (1940) 24 *Journal of Applied Psychology* 758.
[56] Bryan Manly and RIC Chris Francis, 'Testing for Mean and Variance Differences with Samples from Distributions that may be Non-normal with Unequal Variances' (2002) 72 *Journal of Statistical Computation and Simulation* 633.

offshore, the number outsourcing onshore, and the number which are not outsourcing accounting services.

Table 3 Firms outsourcing accounting services

Outsourcing status	Frequency	Percent	Cumulative
Not currently outsourcing	113	79.0	79.0
Outsource offshore	8	5.6	84.6
Outsource onshore	19	13.3	97.9
Outsource both offshore & onshore	3	2.1	100.0
Total	**143**	**100.0**	

4.1 Offshore outsourcing

From the 143 respondents 2.1% indicated that they outsourced both offshore and onshore; 13.3% are currently outsourcing onshore; 5.6% outsource to an offshore location; 79% indicated they do not outsource accounting services. The data also showed that the majority of firms currently outsourcing accounting services expect that the volume of work being outsourced offshore and onshore will increase in the future. Of the respondents currently outsourcing offshore, 72.7% expected the volume of work being outsourced to increase and 54.5% of respondents currently outsourcing onshore expected the volume of work being outsourced to increase. The amount of each service outsourced offshore is shown in Table 4.

Table 4 Amount of service outsourced offshore

Services outsourced offshore	Service offered Freq	Outsourced Offshore Percent	Percentage per annum of service outsourced					Total %
			<10 %	0% to 30%	31% to 50%	51% to 70%	>70 %	
Business taxation	140	5.0	57.1	42.9				100.0
Bookkeeping & data entry	119	4.2	40.0	60.0				100.0
Personal accounting & taxation	135	3.0	25.0	50.0		25.0		100.0
SMSF	121	2.5	66.7	33.3				100.0
E-business	29	3.4	100	0.0				100.0
Corporate	94	1.1	100	0.0				100.0
Consulting	118	0.8	100	0.0				100.0

The service most frequently outsourced offshore is business taxation with five percent of respondents who offer this service indicating they have business taxation services that are outsourced offshore. The majority of firms (57.1%) that outsource business taxation indicated that less than 10% of their business taxation service was prepared offshore and 42.9% indicated that between 10% and 30% of their business taxation service was prepared offshore. Personal accounting and taxation was outsourced by 3% of the respondents; 25% outsourced less than 10% of personal accounting and taxation; 50% outsourced between 10% to 30%; and the remaining 25% outsourced 51% to 70% of the personal accounting and taxation service.

4.2 Onshore outsourcing

The services most frequently outsourced onshore are bookkeeping and data entry services, financial planning and investment advice, and audit and assurance. Business taxation was outsourced by 4.3% of the participating accounting firms and personal taxation 4.4%. Business taxation has 33.3% of firms outsourcing less than 10% of their work, and 33.3% outsourced more than 70%; whereas with personal taxation 50% of firms outsourced less than 10% of their work and 16.6% outsourced more than 70%. Table 5 shows the distribution of services outsourced onshore.

Table 5 Amount of service outsourced onshore

Services outsourced onshore	Service offered frequency	Outsourced onshore Percent	Percentage per annum of service outsourced					Total %
			<10%	0% - 30%	1% - 50 %	51% - 70%	>70%	
Financial planning & investment advice	52	15.4	25.0	12.5		12.5	50.0	100
Bookkeeping & data entry	119	6.7	25.0	50.0	12.5	12.5		100
Audit & assurance	95	6.3	66.7	16.7	16.6			100
Personal accounting & taxation	135	4.4	50.0	16.7		16.7	16.6	100
Business taxation	140	4.3	33.3	16.7	16.7		33.3	100
SMSF	121	4.1	20.0	20.0		20.0	40.0	100
Insolvency, reconstruction & bankruptcy	10	40.0	50.0				50.0	100
Corporate	94	4.3	50.0				50.0	100
Consulting	118	2.5	100.0					100
Actuarial	4	50.0					100.0	100

Forensic	16	6.3					100	100
E-business	29	3.4	100					100
Enterprise risk advice	31	3.2	100					100

4.3 Firms considering outsourcing

Of the 113 firms (shown in Table 3) that are not currently outsourcing accounting services, 35% indicated they may consider outsourcing in the future. These results are shown in Table 6.

Table 6 Firms considering outsourcing in the future

Service	Service offered frequency	Considering outsourcing onshore		Considering outsourcing offshore	
		Frequency	Percent	Frequency	Percent
Business taxation	140	5	3.6	6	4.3
Personal accounting & taxation	135	0	0.0	7	5.2
SMSF	121	11	9.1	4	3.3
Bookkeeping & data entry	119	7	5.9	7	5.9
Consulting	118	2	1.7	1	0.8
Audit & assurance	95	12	12.6	4	4.2
Corporate	94	1	1.1	1	1.1
Financial planning & investment advice	52	7	13.5	1	1.9
Enterprise risk advice	31	3	9.7	1	3.2
E-business	29	4	13.8	1	3.4
Forensic	16	3	18.8	1	6.3
Insolvency, reconstruction & bankruptcy	10	7	70.0	1	10.0
Actuarial	4	4	100.0	1	25.0

Taxation, and bookkeeping and data entry, are the services most likely to be considered for outsourcing offshore. Although the percentage of these services that may be outsourced is not included in this data, it is reasonable to expect that this future outsourcing may impact on local jobs for accountants and/or bookkeepers. Outsourcing these services may free up employees for other tasks and allow firms to value-add with other services with a view to building their competitive advantage, however, loss of employee skills and knowledge must also be addressed to ensure the future success of the organisation.

4.4 Motivations

The potential motivations in a firm's decision to outsource accounting services are established in this study. Survey data was designed and used to establish the motivations for outsourcing of accounting services identified by Australian accounting firms.

The review of the literature identified that a significant driver of offshore outsourcing was labour cost savings. Other key drivers identified for outsourcing included: staff shortages; high domestic salary rates; operational cost savings; capital expenditure savings; access to expertise; enabling a focus on core competencies; and timely delivery of services. The results shown in Table 7 indicate that the benefits in relation to outsourcing extend beyond cost savings.

Thirteen (56.5%) respondents indicated the most important factor in the decision to engage in outsourcing was to enable them to focus on their core competencies. This supports the claim that firms are seeking more than just cost savings.[57] It also supports the suggestion that outsourcing of non-core activities allows firms to focus on core activities.[58]

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[57] Handfield, above n 26.

[58] See, eg, Bill Blunden, *Offshoring IT, the Good, the Bad, and the Ugly* (Apress, Berkeley, CA 2004); Paul Davis, *What's this India Business?: Offshoring,*

Having access to special expertise and the relief of long-term staff shortages were both identified by respondents to the current study as the next most important factor (after the focus on core competencies) in the decision to outsource. Ten (41.7%) respondents indicated that these factors were important in the decision to outsource. The least important factors were rental savings and the use of outsourcing only during peak periods.

Table 7 Motivations for outsourcing

Importance in decision to adopt outsourcing	Very important		Moderately important		Of little importance		Unimportant		Total %
	Freq	%	Freq	%	Freq	%	Freq	%	
Provides access to special expertise	10	41.7	5	20.8	3	12.5	6	25.0	100.0
Enable a focus on core competencies	13	56.5	7	30.4	1	4.4	2	8.7	100.0
Resolves insufficient office space onshore	3	15.0	4	20.0	2	10	11	55.0	100.0
Relieves long-term staff shortages onshore	10	41.6	7	29.2			7	29.2	100.0
Is used only during peak periods			7	31.8	2	9.1	13	59.1	100.0
Provides rental savings			1	5.3	5	26.3	13	68.4	100.0

Outsourcing, and the Global Services Revolution (Nicholas Brealey International, London 2004); Harland et al, above n 34; Kakumanu and Portanova, above n 1; Tibor Kremic, Oya Icmeli Tukel and Walter O Rom, 'Outsourcing Decision Support: A Survey of Benefits, Risks, and Decision Factors' (2006) 11 *Supply Chain Management: An International Journal* 467; Mary Cecelia Lacity and Rudy Hirschheim, *Beyond the Information Systems Outsourcing Bandwagon: The Insourcing Response* (John Wiley & Sons, New York 1995); McManus above n 38; Quinn and Hilmer, above n 34; Starzee, above n 34; Edward Yourdon, *Outsource: Competing in the Global Productivity Race* (Prentice Hall, Upper Saddle River, NJ, 2005).

Relieves resource constraints	2	9.1	11	50.0	2	9.1	7	31.8	100.0
Provides salary savings	3	14.3	4	19.0	4	19.0	10	47.7	100.0
Speeds up delivery to clients	6	26.1	14	60.9	1	4.3	2	8.7	100.0

Although the previous literature referred to labour arbitrage as a primary motivation to outsource,[59] from the total of 30 firms there were 23.3% of respondents that identified salary savings as an important factor in the decision to outsource accounting services, compared to 66.7% of respondents who identified the focus on core competencies as important in the decision to outsource. The literature in Section 2 indicated that the outsourcing of accounting services is not restricted by firm size. The firm's motivations for outsourcing accounting services, based on firm size, that have been identified in this study are presented in Table 8.

Table 8 Motivations for outsourcing by firm size

Motivation	Small firms (24)		Medium and large firms (6)		Total	
	Freq	%	Freq	%	Freq	%
Provides access to special expertise	12	50.0	2	33.3	14	46.7
Enable a focus on core competencies	14	58.3	6	100.0	20	66.7
Resolves insufficient office space	6	25.0	2	33.3	8	26.7
Relieves long-term staff shortages	14	58.3	3	50.0	17	56.7
Is used only during peak periods	7	29.2	0	0.0	7	23.3
Provides rental savings	1	4.2	0	0.0	1	3.3
Relieves resource constraints	10	41.7	3	50.0	13	43.3
Provides salary savings	5	20.8	2	33.3	7	23.3
Speeds up delivery to clients	15	62.5	5	83.3	20	66.7

[59] Deloitte Consulting, above n 1; Hoecht and Trott, above n 1; Kakumanu and Portanova, above n 1; Kumar and Arbi, above n 1; Matusik and Hill, above n 1; Moller; Quraeshi and Luqmani, above n 1; Rittenberg and Covaleski, above n 1.

Respondents in this study were clearly concerned about the security of client data. However, the issue identified as the most likely reason that firms refrain from outsourcing is a lack of confidence in the outsourcing provider having competent staff. Providing a competent service, whether provided by the tax agent or a third-party on behalf of the tax agent, was identified in Section 2 as being one of the core principles of the Tax Practitioners Board's Code of Conduct. Table 9 summarises the four most likely reasons that accounting firms refrain from outsourcing.

Table 9 Reasons accounting firms refrain from outsourcing

Reason for not outsourcing	Freq	Yes		Not sure		No		Total %
		Freq	%	Freq	%	Freq	%	
Not confident of outsourcing service provider having competent staff	103	71	68.9	5	4.9	27	26.2	100
Not confident the outsourcing service provider offers security of client data	103	60	58.3	8	7.7	35	34.0	100
Not confident of the reliability of technology to ensure work completed within required time frames	94	38	40.4	19	20.2	37	39.4	100
Not confident the outsourcing service provider will adhere to the Privacy Act 1988	98	36	36.7	22	22.5	40	40.8	100

4.5 Advising clients

The current study found that at least 43.75 percent of accounting firms that responded to this question do not advise clients that their work will be outsourced, 46.7 percent of outsourcing firms did not respond to this question. Table 10 presents data on whether, and how, respondents advise clients that their work is being outsourced.

Table 10 Clients advised about outsourcing

How client advised that work outsourced	**Frequency**	**Percent**	**Cumulative Percent**
Verbally	2	12.5	12.5
In writing	7	43.75	56.25
Not advised	7	43.75	100.0
Total	**16**	**100.0**	

An ethical concern is that offshore outsourcing allows personal information to be accessed by overseas workers without the knowledge or informed consent of the client. Although it is acknowledged in the literature[60] that some clients were not aware that their work was being outsourced, the accounting professional bodies in Australia (CPAA, ICAA, NIA) recommended that their members advise clients if work was to be outsourced.[61] The data in Table 10 show seven (43.75%) firms do not advise their clients that their work is being outsourced despite a Tax Practitioners Board requirement that tax agents are required to obtain specific consent from

[60] Richard G Brody, John M Coulter and John Jewell, 'Losing the Public's Trust: Third-party Service Providers and Disclosure' (2006) 76 (9) *The CPA Journal* 66.
[61] Sexton, above n 46.

clients indicating use of a third-party service provider.[62] The true extent to which clients are advised of outsourcing may be understated as the 12 firms that did not answer this question may be demonstrating a reluctance to admit they outsource without advising the client, and two outsourcing firms indicated this was not applicable.

4.6 Privacy

India has been identified as the leading destination of outsourced services and because India has no equivalent of Australia's privacy legislation, the Federal Police Commissioner in 2007, Mick Keelty, suggested that companies sending personal details offshore to India should be required by legislation, to 'inform their customers when their data is shipped offshore'.[63] Keelty stated '…data that sits on your database is as good as a kilo of heroin…it is as good as any other commodity for an organised crime group and that's the way you have to look at it'.[64] The effect of privacy legislation on a firm's decision to continue outsourcing is presented in Table 11.

Table 11 Effect of privacy legislation

Response to privacy legislation	**Frequency**	**Percent**	**Cumulative Percent**
Would still outsource offshore	8	32.0	32.0
Would only outsource onshore	14	56.0	88.0
Would not outsource	2	8.0	96.0
Other	1	4.0	100.0
Total	**25**	**100.0**	

[62] TPB, above n 2, Principle 6.
[63] Connors, above n 45, 34.
[64] Ibid.

The majority (56%) of respondents indicated that if changes to legislation lead to mandatory disclosure, they would only outsource onshore. Eight (32%) indicated that they would still be prepared to outsource offshore, two (8%) indicated that they would cease outsourcing and one respondent in the 'Other' category indicated that they would still continue to outsource without advising the client that work was being outsourced offshore. If the Australian scenario follows that of the US, rather than advising clients that work may be outsourced offshore, Wyle suggests that firms will be prepared to repatriate the services either for processing by the firm or onshore outsourcing.[65]

5. CONCLUSION, LIMITATIONS AND RECOMMENDATIONS

The aim in this paper was to investigate the extent to which Australian accounting firms are outsourcing the preparation of income tax returns and identify issues associated with outsourcing those accounting services. Data from the ABS shows that taxation services represented the majority (54.7%) of the AUD 7.7 billion accounting practice income (ABS 2002). The study established that the services that accounting firms currently offer are actuarial, audit and assurance, bookkeeping and data entry, business taxation, consulting, corporate, e-business, enterprise risk advice, financial planning and investment advice, forensic, insolvency, reconstruction and bankruptcy, personal accounting and taxation, self managed superannuation funds, and executive search and selection.

Identifying which services were outsourced by accounting firms was addressed in this study. The highest frequencies for outsourcing offshore were taxation, followed by bookkeeping and data entry. The highest frequencies for services outsourced

[65] Wyle, above n 25.

onshore were taxation, financial planning and investment advice, and bookkeeping and data entry.

One of the most important factors in the decision to adopt outsourcing is to enable a focus on core competencies. Promptness of service to clients and resolving staff shortages were identified as the next most important factors in the decision to adopt outsourcing. Although labour arbitrage is identified in the academic literature as a common motive for outsourcing, this was not identified by firms as a significant factor in affecting the firm's decision to outsource.

It was found that the focus on core competence was the most important factor in deciding to continue outsourcing. A benefit realised by firms after they had started outsourcing was that outsourcing improved the delivery time of services for clients and this factor, together with resolving staff shortage problems, were important in the decision to continue outsourcing.

The statistical means indicated that almost one-third of small firms and one-quarter of medium and large firms intended to consider outsourcing in the future. There was no statistically significant relationship between firm size and the consideration of outsourcing. Small firms are more likely to outsource onshore, however there was no evidence that firms currently outsourcing onshore were more likely to consider outsourcing offshore.

Privacy, security of client data, and the competence of the outsourcing provider's staff have been identified as risks associated with outsourcing. The results of this study are consistent with these assertions. Privacy, security and competence of the outsourcing provider's staff provided significant results indicating firms are concerned about the security of client data, client privacy, and the competence of the outsourcing provider's staff. The study found that firms not currently outsourcing were significantly more concerned about the security of client data than firms that currently outsource accounting services. The reliability of the outsourcing provider's technology to ensure work was completed on time was not considered to be an impediment to outsourcing.

A controversial finding of this study is that outsourcing may occur without the knowledge or informed consent of the client. Both the Tax Practitioners Board and the professional accounting bodies have a code of conduct clause that relates to confidentiality. This study shows that outsourcing, which allows personal information to be accessed by a third party, is occurring and that some clients were not aware that their work was being outsourced. The study also revealed that some respondents were not willing to answer a survey question that requested them to state how they advised their client that work would be outsourced.

There was no significant difference in the geographical location of firms outsourcing with both capital city firms and regional firms participating in the outsourcing of accounting services. In the study it was found that the most frequently outsourced accounting service was taxation, which is consistent with the literature. Although the mean result suggested medium and large size firms are more likely to outsource offshore than small firms, the difference was not statistically significant. Small firms are more likely to outsource onshore than medium and large firms. Inhibitors to the outsourcing of services by accounting firms include ensuring the security of client data, the outsourcing provider not adhering to the *Privacy Act 1988* (Cth), and the outsourcing provider not having competent staff.

Identifying the extent, motivations and risks of outsourcing in relation to personal and business taxation services provides useful data, not only to tax professionals, but also to legislators and overseers. The literature on outsourcing provided by industry leaders such as the professional accounting bodies, Australian Taxation Office and the Australian Professional Ethics Standards Board has been discussed, along with the Codes of Conduct of these various bodies. Despite this, some accounting firms are still reluctant to be up-front with clients about sending tax return preparation work offshore, apparently dismissing the reality that they may be in breach of these Codes. This behaviour raises concern for the integrity of the accounting industry should a mishap occur with client data, and also raises the question, 'Who is overseeing compliance with the Codes?'

It is considered a limitation of any study using a sample approach that the sample may not be representative of the population. Another recognised limitation of survey studies is the response rate. The methodology adopted in this study was designed to minimise any issues relating to sampling, and suggestions and guidance from the literature to enhance response rates were adopted.

Other future research opportunities emanating from this study could involve using an alternate methodology, for example, a qualitative approach utilising an interview technique and concentrating on a smaller focus group to gain an in-depth understanding of the outsourcing process and how firms anticipate this practice could affect their firm and the accounting profession.