

DECLARATION

I, the undersigned, declare that is my original work, prepared under guidance of “**Assessment of tax audit practice in Addis Ketema sub-city** “. All sources of materials used for the thesis has not been submitted either in part or in full to any other high learning institution for the purpose of earning any degree.

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St. Mary's University

**ST. MARY UNIVERSITY, SCHOOL OF GRADGUATE
STUDIES DEPARTMENT OF ACCOUNTING AND
FINANCE**

**ASSESSMENT OF TAX AUDIT PRACTICE: IN THE CASE
OF ADDIS KETEMA SUB-CITY**

**FOR THE DEGREE OF
MBA IN ACCOUNTING AND FINANCE**

BY:

BIRHANU ABEBE

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ACRONYMS

BPR – Business Process Reengineering

ECC – Ethiopian Chamber of Commerce

ERCA – Ethiopia Revenue and Customs Authority

OECD – Organization for Economic co-operation and Development

RAP – Repetitive Audit Procedure

SIGTAS – Standard Integrated Government Tax Administration System

VAT – Value Added Tax

ABSTRACT

The study was focused on assessing tax audit practice of Addis Ketema sub city. Mixed research approach and descriptive survey was employed. Questionnaire and interview were used to collect data. Questionnaire and interview was designed to forty tax auditors and seven revenue authority officials respectively. It is challenging to get secondary data from the authority due to documentation problem and unwillingness of some officials to provide the required data. But the researcher used different techniques to get the required data. The result of the study revealed that the Revenue Authority of Addis ketema extensively use comprehensive types of audit. Due to this the audit coverage of the revenue authority was too low, cases were selected based on associated risk but not used the standard risk identification criteria. The authority was not perform the audit work in predetermine time. Generally the revenue authority was not performing tax according to the standards.

Key words: Taxation, Tax Audit, Audit Effectiveness



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**ASSESSMENT OF TAX AUDIT PRACTICE: IN THE CASE
OF ADDIS KETEMA SUB-CITY**

**A THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTERS IN
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CHAPTER ONE

1 INTRODUCTION

1.1 Background of the study

The government of Ethiopia has several options to finance its public expenditures and pursue its fiscal policy. These options include imposing of taxes on businesses and persons, and non-tax revenues such as service fees, money prints, loans (both domestic and foreign institutions), property and investment income, privatization of public enterprises, and domestic and foreign grants.

Taxation is one of the important elements of in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago Lamer and Oat (2009). Taxation has gained important not only as a tool for raising revenue but also help to meet the administrative cost of governance, the provision of public services such as medical care, education, infrastructure, security and maintenance of law and order, but also as a tool available to planners, policy makers and implementers aiming to regulate the economy in order to bring about desired economic development (Diamond, 2008). Because of weak tax collection and administration developing countries are in difficult situation to provide these basic public goods and services from taxes (Damme, 2008). Tax administration is a complex and dynamic responsibility. On a regular basis, leaders are faced with new issues, conflicting priorities, taxpayer compliance and emerging commitments (Thomson, 2008).

According to Jenkins (2005), the government tries to design different strategies for collection of taxes and give great emphasis on policy and administration of taxes to solve the problem and to generate the required revenue for public expenditures. A good tax system should not affect the ability and willingness of the people to work,

save, and invest. If not, it will affect the development of trade and industry and the economy as whole. Thus, a sound tax system should contribute in the economic development of a country (Ramaswami 2005).

Effective tax administration tries to minimize compliance cost and increase revenue, minimizes distortion of resource allocation, and simplifies its administration (World Trade Organization 2003). Tax involves every aspects of income generating activities and consumption items, and requires not only governmental capacity of revenue authority but also needed involvement of private sectors through proper accounting and reporting (Tadros 2009).

Tax audit is a detailed investigation into the activities of a taxpayer to determine whether a taxpayer has been correctly declaring the tax liabilities. The inspection of taxpayer`s activities indirectly drives voluntary tax compliance, and directly generates additional tax revenue collections. As a result, both (compliance by the taxpayers and the additional tax revenue collected) help tax agencies to reduce the tax gap between the amount due and collected (Barreca and Ramachandran 2004).

Tax audit is an examination to determine whether a taxpayer has correctly reported and assessed their tax obligations Biber (2010). However, the role of an audit program in a modern administration must extend beyond merely verifying a taxpayer`s reported obligations and detection of discrepancies between a taxpayer`s declaration and supporting documentation. An effective audit program will have significantly wider impacts than just raising revenue directly from audit activities. By selecting the highest risk cases, efficiently detecting non-compliance, applying appropriate sanctions, and publicizing results of audit activity (either generally or specifically), taxpayers are put on notice that attempting to avoid tax will result in a high likelihood of detection and imposition of significant sanctions. In this manner, a well-planned audit program can provide the administration with significant leverage across the community rather than only impacting on the taxpayer selected for audit and collecting the tax that should have been paid in the first place.

1.2 Statement of the problem

The primary purpose of taxation is to raise revenue for government expenditures. However, government has several other ways to raise revenue (Morse 2005). Most of the world's governments practice to use taxation in order to raise most of its fiscal requirements. This is because tax is the most viable source of revenue.

However, the tax base of developing countries adversely affected by administration problems including poorly conceived tax policies and lack of certainty regarding future policy changes. In addition, tax administrations can also create problems for the tax payers as they impose onerous reporting and record keeping requirements, perform excessive inspections and audits, fail to deal with their corrupt employees, and failure to provide transparency in the operations of tax administration (Baurer 2005).

In reality, under inadequate tax administration including insufficient and ineffective audit program, the potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner (Edmiston and Bird 2004). It is unmoving under a number of challenges regarding to its operation and administration that are not yet resolved. Further, weak tax administration may make the tax system unfair in that honest taxpayers would bear heavier and disproportional burden. It, in turn, may have impact on the efficiency of tax operation, and also may encourage businesses to work in the illegal economy.

Ethiopian made different tax reform for improving revenue generation enhancing the efficiency of the tax administration and improving equity in the tax system. For instance, the replacement of VAT to the existing sales tax, due to high tax rates, the complexity of tax legislation, and complications in the procedures those taxpayers must follow in order to pay taxes, unsatisfactory treatment of taxpayers by tax officials, taxpayer ignorance of the benefit derived from public revenue, a negative image of public administration, Weakness in tax administration tax payers were eager to evade the tax. Tax evasion is the commission or omission of an act knowingly, with the intent to deceive, so that the tax reported by the taxpayer is less than the payable under the

low (Diamond, 2004). It significantly reduces the amount of collectible taxes, that is, the amount of required payment to governments. It also disables them from performing tasks that are constitutionally and legally assigned to them. In reality, under inadequate tax administration system, the potential amount of tax revenue in developing and traditional countries has not been collected in an efficient and equitable manner (Edmiston and Bird 2004).

Like many other jurisdictions, Ethiopia`s tax system is fraught with evasion. One factor that significantly contributes to tax evasion is lack of intensive audits and absence of predetermined audit criteria. Also, the low level of computerization in Ethiopian Revenue and Customs Authority ERCAengages evasion. These means that some tax procedures have to be conducted manually, making it harder to detect evasion (ERCA, 2010).

Annual report highlights in Addis Ketema sub-city in 2006 E.C there was tax evasion and gap between tax reported by taxpayers and actual taxable income. Tax reported by the taxpayer is less than the tax payable under the law. Increasing operating expenses, exaggerating non-VAT sales, incorporating unrelated expenses to business are the reason for decreasing taxable income. The report also shows that the Revenue Authority collects less revenue from business profit tax compared with the plan. This is due to lack of awareness about taxes by business men, low tax collection and administration system which leads to tax evasion and tax fraud and I effective tax audit (Revenue Authority 2006 annual report).

To solve the above problem effective tax auditing is so vital. Effective tax audit could assist in that direction to monitor tax payers in complying with tax procedures so as to reduce tax evasion and then to increase the revenue generation through tax by creating good tax administration and collection system. This study will focus on assessing Tax Audit practice performance of Revenue Authority.

1.3 Research questions

The research formulates the following research questions:

1. What types of tax audit are frequently performed in Addis Ketema Revenue Authority?
2. How the Sub-City select cases for audit?
3. What are the factors that delay effective tax audit program?
4. What are the existing performances of Tax Audit?

1.4 Objectives of the study

1.4.1 The General Objective

The general objective of this study is evaluating Tax audit practice in the case of Addis Ketema Sub-City.

1.4.2 1.4.2 Specific Objectives

The specific objectives of the study are:

- a) To identify types of tax audit frequently used in the revenue authority.
- b) To evaluate tax audit case selection techniques.
- c) To investigate factors that delay effective tax audit program in the revenue authority.
- d) To evaluate the existing performance of tax audit program of Addis Ketema sub-city.

1.5 Significance of the study

The study has different significances. In the first place, the Revenue Authority be aware of the existence Tax Audit performance, evaluating Tax Audit practice to make some adjustment in the procedure, strengthens and weakness of Tax Audit practice. Secondly, it may be helpful for the stake holders and Tax payers to have

knowledge on tax audit. Finally, it is an initiation for those who are interested to conduct a detailed and comprehensive study regarding tax audit practice.

1.6 Scope of the study

The scope of the study delimit to Addis Ketema Sub-City. The study focuses on the tax audit of practices Addis Ketema Sub-City on Category “A” and “B” Tax payers. The practice for category “C” taxpayers is not treating in this study because category “C” taxpayers are not required by the law to keep their records and they pay tax liability based on the assessment by the revenue authority. There is no document to audit the transaction. The study is limited to Addis Ketema Sub-City, and also makes to deal with data that could be manageable properly.

1.7 Limitation of the study

Shortages of adequate secondary data and the unwillingness of some officials to provide the required data are some of the limitations of the findings. Shortage of time and shortage of money also other limiting factors of the findings of the study. However, necessary precautions has made so that these limitations is not affect the findings of the study through taking appropriate sample size and triangulating different data collection methods.

1.8 Organization of the study

The research is structured in five chapters. The first chapter consists of introduction, statement of the problem being focused, objectives of the study, research questions, significance of the study, scope, and limitation of the study and organization of the thesis. The second chapter focuses on the review of different researchers and related literature dealing with the assessment of Tax audit. Third chapter present methodologies used in conducting the study and description of the study area, research design, data sources, sampling size and sampling procedures, data collection instruments, data collection procedures and methods of data analysis.

Chapter four is the main body of the study results and discussion of statistical data present in this chapter. Final chapter summarize the study in terms of summary, conclusions and recommendations of the study.

CHAPTER TWO

2 REVIEW OF RELATED LITERATURE

In the previous chapter, the main problems and objectives to be addressed in the study have been stated. This chapter presents the review of related literature.

The chapter is organized in different sections. The first section reviews theoretical studies on tax audit in a tax administration system while the next section presents the empirical evidence on tax audit and related issues. Finally, providing concluding remarks on the review of the literature and identifies the knowledge gap that has been addressed in the study.

2.1 Theoretical studies

Tax has been defined by different authorities and professionals in various ways. Theoretically, tax can be defined as an obligatory transfer of resources from the private to the public sector (Uremadu, 2000). According to Adesola (1998), tax is a compulsory levy which a government imposes on its citizens to enable it to obtain the required revenue to finance its activities. And the other scholars Lymer and Oats (2009) tax is defined as ‘a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives expenditure, or capital assets nothing specific in return’.

Taxpayers are grouped in to different categories under the law. According to Ethiopian proclamation number 285/2002, Taxpayers are classified into the following three major categories: Categories “A” Taxpayers, Categories “B” Taxpayers, and Categories “C” Taxpayers.

Categories “A” Taxpayers: Ethiopian Tax proclamation 285/2002 describes category “A” taxpayers as any company incorporated under the laws of Ethiopia or in a foreign country and any business having an annual turnover of Birr 500,000 or more. They are required to submit to financial statements like balance sheet and

profit or loss statements to Revenue Authority at the end of their accounting period. Balance sheet and profit or loss statement incorporate gross profit and the manner in which it's computed, general and administrative expenses depreciation expenses and provision and reserves (ECC, 2005).

Categories “B” Taxpayers: Unless not already classified in category “A”, any business having an annual turnover of over Birr 100,000 would be classified under category “B” taxpayers. This category of taxpayers should submit to the Revenue Authority profit and loss statement at the end of the accounting period similar to category ‘A’ taxpayers. And,

Categories “C” Taxpayers: are taxpayers that are not classified under Categories “A” and “B”, and businesses whose annual turnover is estimated up to Birr 100,000 are classified under this category of taxpayers. A standard assessment method should be used to determine the income tax liability of category “C” taxpayers. The taxpayer should pay the tax determined in accordance with standard assessment (EEC 2005).

The followingsubcategories discuss thoroughly about tax audit in a tax administration system that includes tax gap, overview of auditing, meaning of tax audit, the effective tax audit program, audit case selection methods, examination techniques to be applied for tax audit and audit work force capability.

2.1.1 Tax Gap

Tax Gap can be defined by different professionals. Adams (1921) defines that the difference between the taxes that the low seeks to collect and those in fact collected. Andreomi (1998) defines txa gap as if there were 100 percent compliance difference between the actual revenue collected and the amount that would be collected through there are some variations. Tax gap leads to low revenue collection. Andreomi (1998) represents tax gap happen by means of both tax avoidance and tax evasion. Similarly, compliance gap is also defined in (ERCA, 2000) as the break between the actual and potential tax revenue. Tax compliance may be seen in terms of tax avoidance and tax evasion. The two activities are usually distinguished in terms of legality, with avoidance referring to legal measures to reduce tax liability and evasion to illegal measures. Jemes (2000)

describes tax avoidances as the legal manipulation of an individual's affairs in order to reduce tax. However, if taxpayers go to inordinate lengths to reduce their tax liability, this could hardly be considered 'compliance', even if it were within the letter of the law. Since taxation is not always precise, Seldon (1979) in Jemes et al (2003) has also created the term 'tax evasion' to describe circumstances where the law might be unclear.

2.1.2 Overview of Auditing

As per Auditing and Assurance Standard: Basic principles governing an Audit (AAS 1) Audit published by the Institute of Chartered Accountant of India, Audit refers to the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such examination is conducted with a view to express an opinion thereon.

According to Spicer and Pegler (2008), "Auditing is such an examination of books of accounts and vouchers of business, as well enable the auditors to satisfy himself that the balance sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and that the profit and loss account gives true and fair view of the profit/loss for the financial period, according to the best of information and explanation given to him and as shown by the books; and if not, in what respect he is not satisfied".

2.1.3 Meaning of tax audit

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD 2006).

As Biber (2010), Tax audit is extending beyond verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Most taxpayer's report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected. Barreca and Ramachandran (2004)

noted that the purpose of tax audit is to check the evasion of tax ensure compliance in accordance with the laws and regulations.

2.1.4 Types of tax audit

There are different types of Tax Audit which are implemented in different countries. Ebrill (2001), Grandcolas (2005), Harrison and Biber (2010) noted that there are different tax audit programs. These are desk audit or verification, field audit, registration check, advisory audit, record keeping audit, refund audit, issue-oriented audit, comprehensive or full audit and fraud registration.

I. Desk audit or verification

Desk audit usually carried out annually and primarily based on: (1) A review of income tax and VAT returns, or basic ratios comparing with previous periods or other taxpayers in similar industries, and (2) the crosschecking of information included in tax payer files. It involves basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination. Information technology (IT) systems should provide strong support for these verifications (Ebrill 2010).

II. Field Audit

According to OECD (2006), field audit is types of audit focuses on detailed examination of taxpayers' books and records to determine whether the correct amounts were reported on the tax returns. The auditor may also obtain information from other sources such as banks, creditors, and suppliers, to confirm items on returns. The audit is conducted at taxpayers' place of business, home, or at the office of their accountant, attorney, or other person who may represent them. The auditor tries to select the place that is most appropriate under the circumstances and most convenient for them.

III. Registration check

Registration check is a form of unannounced visits to taxpayer's premises for new enterprises (mainly small and medium sized) to detect businesses operation outside the tax system and a quick check on businesses to establish that they are correctly registered. It should not take more than half a day (OECD 2006). According to Ebrill (2001) in this visit, the tax officer ensures that the tax taxpayer: (1) has a basic understanding of their obligations; (2) keeps appropriate records (book keeping review should be mandatory in case of voluntary compliance when the turnover of taxpayer is below the registration threshold); and (3) issues proper invoices when required by law.

IV. Advisory audits

It involves the auditors visit to newly established businesses. They advise them regarding tax types, filing of returns, payment of amount due, record keeping to be maintained, refund claims, risk of audit and sanctions of noncompliance. These visits are very appropriate when introducing new tax laws.

V. Record keeping audit

It is unannounced visits to the taxpayers' business premises to check whether the appropriate records are kept and VAT invoices are issued. The visit points out the obligations of the taxpayer regarding the keeping of records and followed up with penalties if the taxpayer continues to disregard record keeping requirements (OECD 2006).

VI. Refund audit

Refund audit should focus only on the period covered by the claim. A pre-refund audit should be undertaken to verify the taxpayer's entitlement to a refund prior to processing a first refund claim particularly for new

registrants. It is also carried out where the refund claim varies significantly from established patterns and trends. Audits of further claims should be carried out selectively Gradcolas (2005).

VII. Issue-oriented audit

According Gradcolas (2005), issue oriented audit focus on a single tax type and covers no more than one or two reporting periods. It should be directed at verifying items for which errors have been detected in the returns (atypical ratios, gross revenues, comparison of gross sales to imports). Single-issue audits are confined to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single-issue audits typically take less time to conduct and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance (OECD 2006).

VIII. Comprehensive or full audit

Ebrill (2011) defined comprehensive audit comprehensive examination of all information relevant to the calculation of taxpayer's tax liability for a given period. This audit may cover all tax obligations over a number of tax periods, or extended to several years up to the limit provided for in the law. All cases where serious underreporting or evasion has been detected under any of other audits should be forwarded to a unit responsible for undertaking comprehensive audits of all tax liabilities. The objective is to determine the correct tax liability for a tax return as a whole. As this audit is usually time consuming and costly to undertake, it should only be applied to those taxpayers if there is an indication of under reporting that may impact across taxes. It requires considerable resources and reduces the rate coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types.

IX. Fraud investigation

Fraud investigation is a type of tax audit that investigates criminal which arises from where the most serious cases of noncompliance. It helps to detect fraud, evasion, and criminal activity Krelove (2005). Fraud investigation requires special skill including meeting evidentiary requirements, seizure of evidences or records, testimony from key witnesses and preparing brief for courts. Hence, it should be undertaken in accordance with criminal procedure laws. OECD (2004) stated that, Revenue authorities should maintain a dedicated organizational unit responsible for the handling of serious cases of tax fraud or evasion. According to OECD (2006) the types of tax audit are categorized in different based on the scope and its intensity of the audit performed. Based on the scope and intensity there are different types of audit activities.

Full audits: The scope of a full audit is all encompassing. It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. The objective is to determine the correct tax liability for a tax return as a whole.

Limited scope audits: Limited scope audits are confined to specific issues on the tax return and/or a particular tax scheme arrangement employed by the taxpayer. The objective is to examine key potential risk areas of noncompliance. These audits consume relatively fewer resources than audits and allow for an increased coverage of the taxpayer population.

Single issue audit: single issue audits are confined to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single issue audits typically take less time to perform and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance.

In practice, the scope and nature of any audit activity undertaken for a particular taxpayer will depend on the available evidence pointing to the likely risks of non-compliance and a taxpayer's prior history. Extensive audit inquiries may also be justified simply because a taxpayer's financial and/or business activities are usually complex.

2.1.5 The Effective Tax Audit Program

The auditing program is a key for tax administration. The tax audit program provides visibility to the compliance and enforcement arm of the administration (Thomson 2008). The auditing and spot-checking of records, coupled with a system of adequate penalties for dedicated cases of fraud, is the universal method for tax control and the prevention of tax evasion. According to Tait (1988), effective tax auditing minimizes tax evasion and also helps tax agencies to achieve revenue objectives that ensure the fiscal health of country and individual states. It derives voluntary compliance and generates additional tax collections, both of which help tax agencies to reduce the tax gap between the taxes due and the amount collected (Barreca and Ramachandran 2004). Furthermore, a well-structured tax audit program can provide valuable support in gathering information on the health of tax system (including patterns of taxpayers' compliance behavior), educating taxpayers (improving future compliance), and identifying areas of tax law that require clarification or addressing deficiencies in law OECD 2006a).

Accurate and timely self-assessment and compliance with tax by taxpayers is achieved only through highly visible and effective audit programs, including the consistent application of strong sanctions where noncompliance is encountered. Taxpayers must feel that there is a good chance that unreported liabilities and other forms of non-compliance have been detected during an audit (Biber 2010). When an audit program is ineffective, it may result in the deterioration of tax compliance and a loss of credibility of the tax administration. Taxpayers may not be deterred from minimizing their tax liabilities if they believe that there is

a little chance of being audited (Ebrill et al. 2001). A good audit program employs strategies to optimize both the direct and the deterrent effects of audits. The first can be achieved by auditing a higher percentage of the large taxpayers (Biber 2010). Although the frequency of audit is a contentious issue, the judgment is always a delicate balance between the treat of audit to check the temptation to evade and the cost. Where the tax system is fairly well established, audit of 20-25 percent of registered traders a year are sufficient. However, it is not only can crude number of audits that is the most useful measure of need (Tait 1988). In case of VAT, Ebrill et al. (2001) stated that effective VAT audit program should cover a 25 to 30 percent of the taxpayers each year. In addition, VAT audit need to be closely coordinated with other tax liabilities especially income tax. Since most countries have integrated VAT and income tax administrations, the development of effective VAT audit program significantly improves income tax compliance.

The deterrent at all levels (Tait 1988). Through adequate audit strategy, tax administrations must foster, and not simply enforce, tax compliance. Tax compliance can be facilitated through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary. Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance EC 2006).

Voluntary compliance is generally enhanced by increasing the number of taxpayers audited than by auditing fewer taxpayers with large tax potential. Perversely, revenue is increased by concentrating on those taxpayers where a large amount of revenue is at risk. But there should be a careful planning when there is a widespread belief that most tax return are underreported, otherwise there may be an over selection of returns for audit, with the result that the inventory of work in process may increase to unmanageable proportions and make an orderly approach to an annual audit work plan impossible (Tait 1988). Thus, the actual number of audits planned

should depend on the audit resources available to the program. The international standards as to the total staff assigned to audit should be close to 40 percent of the total staff of the administration's (Biber 2010).

Further, audit capacities of field offices are determined calculating the number of returns that can be audited. The calculation made using estimates of the number of returns each tax auditor can reasonably be expected to complete during a given audit period. There should be an over selection of 25 percent to 30 percent of audit capacity (Tait 1988). With proper audit planning, strong supervision, and effective use of review staff as a training vehicle, it is not unreasonable to expect an office auditor to complete an average of 10 to 20 cases a month, and for a field auditor (exclusive of auditors dealing with controlled cases) to complete an average of 4 to 6 cases a month. Allocation of about 200 cases a year should be reasonable for experienced junior auditors, who should be eligible for advancement to senior auditor after four years of satisfactory service in that grade (Tait 1988). Therefore, planning an adequate audit strategy is a key success factor in post-fraud detection (where audits are intended to detect tax evasion and fraudulent claims) as well as proactively preventing tax frauds and evasions (Gupta and Nagadevara undated).

According to Biber (2010), effective planning is required to ensure that the audit program is adequately developed to: focus on and address the most significant risks, target noncompliant tax payers and not harass compliant taxpayers, make optimal use of limited resources and influence compliance across the border taxpayer community.

According to OECD (2006), effective audit plan should be:

1. Flexibility to allow for unusual audit issues, adequacy of internal controls and the adequacy of books and records;
2. Alignment with any quality assurance framework; and

3. A clear focus, with potential areas of concern noted during the preliminary review and audit procedures selected that can address the concerns.

2.1.6 Audit Case Selection Methods

Compliance risk is the failure to comply with the tax law by taxpayers whether due to their ignorance, carelessness, irresponsibility, deliberate evasion, or weakness in tax administration itself, and have been addressed only by enforcement through an audit-based approach (OECD 2004). However, tax administrations do not have sufficient resources to perform through on-site audits of activities of all taxpayers or comprehensive crosschecking of all invoices or transactions. Tax administration, with limited resources and relative large numbers of taxpayers to administer (especially in the small and medium enterprises), must design the audit program to deploy audit resources in a risk-based way with a view to achieve the most possible compliance and revenue objective (Thomson 2008 and OECD 2004). Regardless of how automated and efficient the audit process, audit effectiveness would not be realized under the selection of inappropriate audit candidates (Milack undated). Hence, managing an effective auditing program involves decision as to selection of best audit case strategy or combination of strategies. The selection strategies may vary by tax type. It may be based on either reported tax amounts or the industry type (Barreca and Ramachandra 2004).

Case selection through the use of risk management techniques is necessary to ensure that the audit program is fully in line with the administration's compliance strategy, and to set up the necessary audit trials to show why cases have, and have not, been made the subject of an audit (OECD 2006). Ebrill et al. (2001) noted that the most effective systems utilize taxpayer profiles and criteria to identify the highest risks for revenue. These systems are frequently based on the crosschecking of internal information. In tax administration, a risk is anything that can negatively affect the administration's ability to achieve its compliance and revenue objectives. Risk management is a formalized and systematic approach, based on sound analysis, designed to

set the best course of action under the uncertainty of risk. The technique involves identifying, assessing, understanding and acting on risks that impinge on the organization's ability to achieve its objectives (Thomson 2008).

Risk management starts with risk identification, which includes a rough estimation of risk related tax gap, the number of taxpayers involved and possible relations with other risk areas (EC 2006). The tax gap (the potential tax yield minus the actual tax revenues) reflects the financial extent of the risk field. Although the determination of tax gap is not easy, a rough estimation is usually done. The calculated gap can be further broken down into areas such as barely legitimate tax avoidance, fraud, serious noncompliance, error, and debt. This provides additional information on areas of risks that should be addressed. Strictly theoretical, the sum of aforementioned individual risks identified must be equal to the entire tax gap (EC 2006 and EC 2010). According to EC (2010) and Thomson (2008), compliance risk reduces tax yield, and can be categorized as register risk, filing risk, payment risk, and declaration risk. This classification makes tax administration in a stronger position to determine the appropriate treatment technique.

Register risk includes reduction of tax yield because ineligible taxpayers for tax registration become registered and/or remain registered when eligibility cases, fail to register by those that fulfill registration requirements, and registration with erroneous information. Payment risk and filing risk are closely related but they should be analyzed separately since the treatments may vary. Payment risk is non-payment of amounts due on tax returns and assessments whereas filing risk is failure of taxpayers to file their returns by the due date. In order to provide the correct preventive and corrective treatments there is a need to be able to target those taxpayers likely to file their returns late, or not at all. Finally, declaration risk is a risk that the amounts shown on the tax returns are incorrect by error or deliberate act and many tax administrations traditionally concentrated on this risk area with the intention of determining which cases should be selected for conducting audit activity (EC

2006 and EC 2010). In addition to compliance risk identification, in an efficient audit management structure, there are pre-audit cases management factors that need to be recognized to assure the taxpayers in that the burden of audits not fall disproportionately on any segment. These include inappropriate auditors` contact with taxpayers, audit cycle or enquiry window, materiality, and collectability (OECD 2006).

Inappropriate auditors: it is useful to have regulations to preclude individual auditors from repeatedly auditing the same taxpayer and to require an auditor to exclude itself from taking up an audit where they are acquainted with the taxpayer selected from audit. Such rules protect both auditor and the customer from the danger of such inappropriate contacts. The policy of repetitive audit procedures (RAP) may be used which holds that if a taxpayers is audited for non-business issues only (similar to an audit aspect) for the current year and the audit results in no additional taxes owed, the taxpayer is granted relief from audit for the next two years if no substantial changes take place. The intent is to eliminate non-productive and time consuming audits for tax authorities and to reduce the hardship associated with repetitive audits for fully compliant taxpayers (OECD 2006).

Audit Cycle or enquiry window: Regulations may be established to require that all audits must be started or completed within a predetermined timeframe. However, it gives certainty to taxpayers that after some period of time the danger of audit may pass. Thus, it needs to be supported by powers of discovery to overturn the enquiry window where substantial tax fraud is found (OECD 2006).

Materiality: OECD (2006) noted that business selected for audit was based on the level of noncompliant high-risk, the materiality of the projected tax consequence versus the auditor`s labor cost of pursuing the high-risk item may override the non-compliance aspect.

Collectability: The collectability concept implies that a taxpayer`s inability to pay a future proposed tax assessment would be sufficient basis for not conduction the audit. Those administrations that do not use this

concept report collectability is a secondary objective and should not diminish the primary objective of a correct assessment of tax liability. In addition, the limitation of collectability considerations to the current tax period may not provide a complete financial picture for the taxpayer as it excludes consideration of future payment potential (OECD 2006).

According to Barreca and Ramachandra (2004), Audit selection methods range from simple random selection to more complex rule-based selection, sophisticated statistical and data mining techniques. Selection strategies can vary by tax type and even within a single type. The common case selection methods include random selection of cases, screening or case review by auditors, rule base, and automated risk scoring systems, and data mining and statistical analysis.

Random selection: It has no bias in audit case selection, and useful to fight corruption. This method is perceived as fair by taxpayers. However, it clearly not focused on highest risks, may have high opportunity cost if used as sole case selection method (Vellutini 2010). Gupta (undated) noted, simple random selection has a major drawback in that both honest and dishonest taxpayers are equally treated since probability selection give equal chance of being selected for both. However, the criteria or information based selection system too has a drawback in that it presupposes certain clue of noncompliance, which may actually be sign of other things such as change in economic condition in that particular trade (OECD 2006).

Screening or case review by auditors: It is a traditional method by which audit cases have been selected, and dates from the time when there was little or no IT support, the data available was in any case limited, and the compliance risk management techniques at a strategic level less well developed. Such a methodology has a benefit that it makes full use of local knowledge, creates significantly less caseworkers resistance, can be used to attack specifically defined risks and can be operated substantially without IT support (OECD 2004a and OECD 2004b). Manual selection of audit cases is based on the auditors own knowledge of the taxpayers`

behavior and environment. However, it cannot find out patterns of noncompliance hidden in the history of noncompliance in the same area, sector, or as determined by other taxpayer attributes. It also favors rent seeking and corruption in the tax administration since it is discretionary and subjective approach (Vellutini2010).

Rule base automated risk scoring systems: It allows for the bulk processing and risk assessment of returns data. The data is reviewed against a set of risk indicators and the results be ranked in terms of the risk of noncompliance identified. Such system is an essential tool in facilitating the exclusion of bulk of returns with no or very low identified risks and allowing the resources for risk identification to concentrate their efforts only on those cases with significant identified risks (OECD 2004a). However, this system has its own inherent challenges. First, many of rules by which a case is scored are dependent on financial ratio analysis and other industry benchmarking that can be changed overtime. The rules also may be, in themselves, standard factors to be achieved when they become known within the population. Thus, attention needs to be given to continually update the risk rules. Second, the rules need to be responsive to the local knowledge of the front line staff who is working on the cases when selected. Final case selections need to be able to reflect the local knowledge of the caseworkers themselves whilst retaining appropriate priority within the case selection system. Automated selections with no opportunity to be influenced such local knowledge can create resistance and lead to suboptimal working once the cases are underway. In addition, the risk rules need to be responsive to the knowledge gained by front line workers from working their cases. Such knowledge can be about new risks, changes in commercial behaviors, or new technical tax devices and impact of that knowledge can be significantly leveraged if it can be captured within a flexible and developing set of risk rules. Third, the rules should bring together from dissimilar sources such as tax returns, third party information, and public domain information from internet. This level of analysis requires considerable investment in IT resources. Finally, the rules need to have the capacity to be changed reasonably and quickly to take in to account new strategic

appreciation of compliance risk. Once again, if the rules are themselves hardwired in to IT coding then this may be a resource intensive business (OECD 2004a).

Data mining and statistical analysis: It is becoming increasingly common to base case selection methodologies on the results from statistical analysis. As Barreca and Ramachandran (2004), data mining is the exploration and analysis of large quantities of data in order to discover meaningful patterns and rules. Organizations use this information to detect existing fraud and noncompliance and to prevent future occurrences. The use of data mining techniques identifies patterns of noncompliance in the past and those characteristics in the current population. It enables organizations to leverage their data to understand, analyze and predict noncompliant behavior. However, data mining requires significant investments in IT both hardware and software and it may be difficult to acquire accurate data on which IT programs can operate. It is a difficult road to go down when electronic infrastructure do not support such investments or the skills are not available to the tax administration (OECD 2004a). (OECD 2004b) noted, statistical analysis is often used to examine taxpayer data and to find the correction between the data and non-compliance. It typically involves using prior tax audits, which are then analyzed in conjunction with taxpayer data.

2.1.7 Examination Techniques

Biber (2010) noted that, there are different approaches to investigate and review the organization record depending on up on the area of risk, nature of the tax payers operation and the taxpayers condition. The decision regarding the type of tests to be undertaken as well as the records needed by the auditor to address specific issues is influenced by the nature of the taxpayer`s operations, adequacy of books and records and materiality of potential adjustments. (OCED 2006) indicated that there are different techniques used for tax audit examination. Those are analytical review, investigative approach, filed examination, and counter party examination.

Analytical review: An analytical review of financial statements and returns are often completed during the preliminary stages of audit. Ratios, such as gross profit and inventory turnover are used to test the accuracy of taxpayers` reported sales, cost of sales, or ending inventory. The unusual variances (abnormal deviation of calculated ratios from the previous experience) are noted and addressed during the interview with the taxpayer and additional audit procedures developed where necessary (OECD 2006).

Investigation approach: Auditors are encouraged to use an investigative approach in their audits. such an approach uses information obtained through observation, discussion, documents or records obtained from either the taxpayer or other sources. It requires judgment, imagination and using information outside the accounting records to perform the audit (OECD 2006).

Field examination: This is utilized when information gathered on significant events such as underhand trade, disguised transaction and other data concerning transactions. The examination also include on sight survey of current conditions of the taxpayer`s business through physical checks of original transaction records and vouchers assets and liabilities and other aspects of the business (OECD 2006).

Record examination: The main approaches to detect false accounting include the examination of books and documents conducted at the taxpayer`s business office or branches, counterpart examinations and examination of savings and deposit accounts (OECD 2006).

Counterpart examination: It is an examination performed based on third party information where warranted. (OECD 2006a) stated, information can be obtained during the course of an audit from third parties to verify the taxpayer`s income, for example: Financial institutions and public companies information on interest and dividend matched with what taxpayers report in their tax return, information from Government regarding social benefit payments, and employer information concerning salary and wages paid and tax deducted, both for income and non-monetary benefits.

2.1.8 Audit Workforce Capabilities

OECD (2006a) mentioned that, revenue bodies must manage and develop their audit workforce to deliver their planned outcomes through increasingly designing and implementing capability or competency models. Capability or competency model refers to a formal specification of the skills, knowledge, and attributes of staff that are required to perform a specific job in an efficient and effective manner. The model generally contains job descriptions, functional descriptions, and competency profiles using task-related competencies. It is typically supported by training and educational requirements to ensure and build capability. Different capabilities are required for work performed in different market segments or on clients exhibiting different behaviors towards tax compliance. Typical points of difference are capabilities required for noncompliant aggressive clients, audit work with large businesses (deeper and more specialized knowledge about specific regulations is required for this segment), performing system and electronic data base audits, and conducting criminal and cases (OECD 2006b).

Required capability: According to OECD (2006a) the required capabilities of auditors are generally identified by analyzing the activities required to perform particular audit tasks and through practice and experience. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex tax laws and conduct intensive examinations of taxpayers' books and records. Hence, revenue bodies pay close attention to the overall management of the tax audit function and particularly to the strategies and methods used for recruiting, developing and managing individual audit staff. Thus, tax auditors should have a capability to: conduct investigations, determine compliance, tax accounting and financial analysis, conduct research and analysis, make effective decisions under the law, effective communication, apply work processes and procedures, and manage own work and relationships (OECD 2006b).

Competency assessment: It is important for tax administrations to assess and evaluate the competencies of their staff. The direct manager commonly performs competency assessments during requirement and promotional processes on an annual or semiannual basis for those staff maintaining current positions (OECD 2006a). Assessments performed as part of recruitment processes are often performed by external specialists, human resource departments, and/or panels of internal subject matter experts. Other events triggering capability assessments include prior to performing a new type of work, prior to starting a new role, and ongoing informal assessments and learning and development activities (OECD 2006b).

Improving competency and addressing capability gaps: Revenue bodies may develop staff and address capability gaps through recruitment processes and the use of programs such as training and development programs, mentoring and coaching programs, accreditation models, job rotation and/or placement programs, career paths, knowledge sharing initiatives and knowledge tests. Capability gaps are typically gathered from various sources including quality management system results, performance system interviews and appraisals, client professionalism, satisfaction and other similar surveys, and training program evaluations (OECD 2006).

2.2 Empirical Study

A number of empirical studies examined tax administration in both developed and developing countries, tax audit in particular. All the above-mentioned studies examined tax audit. A brief review of each of these studies is presented in the following discussions.

Bright et al. (1988) studied statistical sampling for tax audit in United States of America. The study tried to review whether the use of statistical sampling for audit is a sufficient basis for determining the taxpayers' unpaid liability rather than reviewing all transactions to determine the exact amount of tax owed. The study used case studies, and relied on the cases and data from consumption taxes, primarily sales and use taxes.

The universe documented transactions available for audit are used as a sample frame. The study is conducted on three agencies including internal revenue service (IRS), the revenue department in New York.

The finding of the study by Bright et al. (1988) indicated that audit assessment based on appropriately drawn and analyzed statistical sample do not suffer from the defects that the courts have correctly concluded for assessments based on non-statistical samples. Without sampling, it may be literally impossible for a tax examiner with a limited staff to audit an entire period especially when dealing with a taxpayer who conducts a large volume of transactions. The study further indicated that sampling techniques allow improved economy in the use of government resources in that tax administration can be more efficient, fairer, and less intensive if the technologies used for identifying and measuring tax deficiencies are expanded to include controlled use of statistical sampling. The common interest of minimizing the duration of tax audit for both the tax administration and taxpayers can also be achieved with sampling techniques. However, statistical sampling cannot provide an exact determination of tax owed, and the uncertain adjustment may sacrifice too much revenue.

Collins and Plumlee (1991) studied the effect of tax audit schemes on the taxpayer's labor and reporting decision. The study also examined the impact of alternative tax rates and penalty levels on earned and underreported income. Experimental design was adopted, and laboratory labor setting was used to test the effects of audit schemes, tax rates, and penalty levels on underreported income and work effort. The three independent variables that were manipulated include; tax rate, audit scheme (the decision rule the taxing authority followed in determining reports to be audit), and penalty for underreporting. The audit scheme took on three levels that differ principally in the information used by the taxing authority to determine self-reports to be audited: random (no information), cut-off (reported income information), and conditional (both reported income and an estimate of true income).

The experimental results of the study by Collins and Plumlee (1991) indicated that audit schemes that incorporate some preliminary information signal sent by the taxpayer might be more successful in curbing underreporting than purely random audit models. Nonrandom schemes are most effective when tax rates are low and penalty levels are rather high. Further, reported income and actual income do vary at the same time in that electing to underreport also earn more actual income. In USA, Smith and Stalans (1994) also studied the negotiating strategies preferred by taxpayers and auditors for dealing with tax audit disputes. The study adopted a pre-audit open-ended interview conducted with a randomly selected sample of taxpayers and state tax auditors that drawn from four field offices of the Oregon Department of Revenue (DOR). For analysis purpose, the study used four general strategies based on the three choices. These strategies were go along, cooperate, actively assert, and hold firm.

The results of this study revealed that the strategic preferences of both taxpayers and auditors is influenced by the nature of the dispute, general taxpayer's attitudes toward taxpaying and tax administration, the difference in formal power, and the perceived role obligations of auditors. As the study results showed, tax auditors are more likely to include holding firm as one of their strategic choices. Whereas taxpayers who has an objective to minimize the time and effort they devote to the audit are more likely to prefer the cooperative strategies, but those taxpayers who believe that they can influence the decision making of the auditor are more likely to prefer the assertive strategies. The study further indicated that taxpayers who support taking advantage of loopholes and ambiguities in the tax law tend to prefer the assertive strategies, and those who want to minimize their involvement are more likely to prefer cooperative strategies. There was another study conducted in USA by Rhoades (1999). Rhoades (1999) studied the impact of multiple component reporting on tax compliance and audit strategies. The study modeled taxpayer compliance behavior and tax authority audit strategies within the context of a multidimensional report of taxable income, and analyzed the impact of component reporting requirements on taxpayer incentives to misstate the tax liability. The study developed a model on a strategic

tax reporting and detection in which taxpayers privately observe and report on two components of taxable income, denoted A and B. The sum of the two components represents the taxpayer's true taxable income. The results of the study revealed that the impact of multi-component reporting requirements on specific taxpayers depends critically on their evasion opportunity set. The study stated that taxpayers with multiple evasion opportunities made misstatement across income components to minimize both the direct and indirect effects of detection whereas those with limited evasion opportunities pursued them less aggressively in the multi-component model. Further, in auditing reports with multiple potential misstatements, the tax authority benefits from joint cost efficiencies, positive correlation of true values, and sequential audit strategies as a means to update its evasion expectations. The study tried to generalize that multi-component reporting requirements appear to deter evasion and increase revenue collections to tax authority.

In China, Chan and Mo (2000) studied the effect of tax-holidays (exemption and reduction) on foreign investors' tax noncompliance behavior in the China's developing economy. The study adopted case studies, and used tax audit data (585 cases of 1996 tax returns of foreign investment enterprises audited in 1997) collected from the tax bureaus of selected coastal areas of China that enjoy large foreign investment. The cases were selected at random. In this study, noncompliance was measured in terms of tax audit adjustment that is overstatement of cost of sales in the pre-holiday period and over-provision for staff welfare in the post-holiday period. The empirical results of the study by Chan and Mo (2000) indicated that a company's tax-holiday position affects noncompliance. Companies are least compliant during the pre-holiday period whereas most compliant during the tax exemption period. The study further indicated that domestic market oriented companies, service companies, and joint ventures are less compliant than export oriented companies, manufacturing companies, and wholly foreign-owned enterprises, respectively. Sen and Bala (2002) studied income tax audit operation in Bangladesh. The intent of the study was to conceptualize the term tax audit conducted by professional chartered accountants, and to give an overview of the prevailing tax scenario and

the operations of income tax audit. The methods adopted were experience survey and personal interview with tax officials in National Board of Revenue (NBR), and documentary analysis using documents such as Government statistical yearbooks and/or annual reports, and publications of the World Bank (WB) and the United Nations Development program (UNDP). The results of the study confirmed that Bangladesh is unable to raise enough resources through taxes. The ratio of tax revenue to GDP is usually low, only little more than 9 percent of GDP. The study also revealed that income tax audit is conducted both in mandatory and discretionary manner although the extent of income tax audit practice is awfully inadequate. The major reasons identified in the study were unawareness and undesirability of most assesses, and the hesitation of chartered accountant (CA) firms to take up the task of tax audit. The hesitation of CA firms is because the sensitivity of the tax audit task spreads not only in the relevant year, but also in the future years until the finalization of the audit. Moreover, some established CA firms are often reluctant to perform the audit of tax basis accounting due to inadequacy of information, lack of efficient personnel, absence of audit continuity over the years, and want of logistic supports to maintain track record of information for future reference in tax cases.

Arachi and Santoro (2007) studied the use of tax audit strategy as enforcement for small and medium enterprises (SMEs) in Italy. The study focused on a major innovation in the field of tax auditing of self-employed workers and small firms. The methods adopted was documentary analysis using documents such as the Italian Tax Agency reports and previous studies made in Italy. The main finding of the study by Arachi and Santoro (2007) was that tax enforcement for SMEs is always challenging since they usually operate on the border between the formal and the shadow economy. The study further showed that the distribution of firm size affects the optimal tax enforcement policy in two ways. First, there can be a relationship between firm size and the propensity to evade or to avoid taxes. Small traders may underreport the tax base, exploit loopholes in the tax system, choose an organizational form with preferential tax treatment, or operate outside the formal economy. Second, the costs and returns of tax auditing may depend on firm size. The study also argued that

business sector analysis might be a valuable policy tool for developing countries, which have a large shadow economy and a high share of microenterprises. In Ethiopia, there are two studies reviewed regarding tax audit. Yesegat (2008) studied VAT administration problems at large, VAT audit in particular, and Gebeyehu (2008) studied tax audit and its role in increasing government revenue in Ethiopia.

The study by Yesegat (2008) adopted an in-depth interview conducted with tax officials and surveys of taxpayers and tax practitioners conducted using semi-structured questionnaires. The main findings of the study regarding VAT audit is that the VAT audit rate is low that may be due to resource constraints, and the cases subject to audit are selected by audit selection committee based on a criteria including credit declaration, non-filing and unusual filing patterns, nil VAT declaration, and information from third parties. The study further revealed that the quality auditors (VAT administrators at large) are poor to achieve efficient and effective audit program. Based on the survey results, the study stated that tax administrators are not capable of handling audit cases quickly, lack confidence to make decisions and not have willingness to help taxpayers. In addition, the tax authorities have no sufficient number of VAT administrative personnel, which comprise only 10.4 per cent as to the proportion of the total employees at the Ethiopia Revenue and Custom Authority. The study by Gebeyehu (2008) was an attempt to trace out the basic concepts of tax audit, and analyze the significance and role of tax audit in increasing tax revenue and in strengthening tax administration capacity. The methods adopted include questionnaires (both open and close-ended), personal interviews, and document analysis by using documents such as published materials, annual reports, magazines and internet. The results of the study indicated that, in history, the highest ratio of tax to GDP in Ethiopia is 13 percent, which is registered in 2003/04. Most of the country's revenue is from non-tax sources such as grants. Revenue derived from taxes is dominated by indirect taxes. In general, the study mainly focused on the issues of personal income tax and business profit tax. The study stated that personal income tax does not need critical assessment other than checking whether the amount withhold by the employer is forwarded to the respective tax authority. Whereas,

business profit tax needs much effort to levy and collect due to the high-risk of understatement and evasion since most taxpayers use all mechanisms that could understate their tax liability. However, there is no sufficient and available statistics about the extent of assessment under the prevailing tax audit net. The type of tax audit performed by tax auditors is only desk audit. So far, there is no field audit although the problem of tax evasion bothers revenue agencies at different levels.

Appelgren (2008) studied the effect of information regarding different audit strategies on taxpayers' compliance behavior in Sweden. The study was conducted with the intent of examining whether the taxpayers in reality behave as expected by theory of tax audit. Experimental design was used to test the effect of information regarding different audit strategies on taxpayers' compliance behavior.

The principal finding of this study was that declared income increased significantly more in rational audit strategy group than in the control group. The results of the study indicate strongly that information concerning the use of rational audit strategies is superior to information concerning random audits, and that audit information, in general, is superior to no information. The information concerning the rational audit strategy reduces tax fraud compared to no information. According to this study, tax audits have an indirect deterred effect by which rational taxpayers adapt their behavior to the expected degree of auditing if they are made aware that they may be audited.

2.3 Conclusions to the literature review and knowledge gap

Tax audit practice is a current issue for both developing and developed countries. There is no sufficient theory regarding tax audit activities. In the theoretical review, to the knowledge of the researcher, there is no standard as to the percentage of audit methodologies to be conducted in a given tax authority. In addition, there is no adequate literature regarding the appropriate audit examination techniques to be used for checking the accuracy of tax returns in line with the level of economy and technological advancement, developing countries in particular. The empirical studies that have been reviewed in the preceding section focused on the different

audit strategies that affect tax compliance behavior, income tax in particular, and the use of sampling tax audit strategy for improving the tax audit coverage. In addition, most prior studies regarding tax audit issues tried to examine the possible audit strategies including the use of audit information for the purpose of compliance improvement and fraud detection, and the impact of component reporting requirements on taxpayer incentives to misstate the tax liability.

However, to the knowledge of the researcher, it is possible to conclude that although there have been a number of studies on tax audit related issues both in developed and developing countries, In Ethiopia, the two exceptions regarding tax audit issues are the study by Yesegat (2008) and Gebeyehu (2008) which have been reviewed in the preceding section. Even these studies did not assess exhaustively all tax audit activities in Ethiopia. The study by Yesegat (2008) was specific to VAT, and mainly focused on administrative capability issues. The study by Gebeyehu (2008) was specific to income tax in Addis Ababa City administration, and mainly focused on the way of increasing government revenue. Both of these two studies did not comprehensively examine issues regarding tax audit and its effect on tax revenue growth and compliance improvement by considering issues such as tax fraud investigations, types of audit performed and its suitability, appropriate case selection approaches, frequency of audit for other tax types, educational level and experience of tax auditors in Ethiopia. Based on these gaps in the literature together with the problems stated in section 1.2, the following grand research question is established. *“How is the tax audit practice in Ethiopia in respect of the type of audit performed and its suitability, appropriate case selection methods used, audit techniques applied, the frequency or rate of audit performed, and the experience and quality of audit staff resources?”* With this end, the next chapter discusses the research design and specific research methods that are applied for the study along with proper justification for the selection of appropriate research methods.

CHAPTER THREE

3 RESEARCH METHODOLOGY

In the previous chapter reviewed both theoretical and empirical studies, and it tried to give a brief conclusion and excavate the gap in the existing knowledge. This chapter presents research design used in this study.

The remaining discussion in this chapter is organized in different sections. in the first section description of the study area, next section research design, and research method adopted and sources of data finally concluding remarks and presented.

3.1 Description of the study area

Addis Ketema Sub-City is located in Merkato. It is served some area of Merkato taxpayers. According to the data from the Auditor office of the sub city`s the total numbers of taxpayers are 13956 from which there are 4,796 Category “A” taxpayers, 3,257 category “B” taxpayers and 5,903 category “C” taxpayers, in the sub city.

3.2 Research design

For this study, the researcher applied descriptive analysis using the fact that a descriptive research design is used to describe the data and characteristic about what is being studied. Descriptive survey also enables to obtain the current information. It is also used in fact finding studies and helps to formulate certain principles and give solutions to the problems concerning local or national issues. Descriptive survey method focuses on investigating the current status, practice, and problem related to tax audit of Addis Ketema sub city.

3.3 Research Method Adopted

This study incorporated both quantitative and qualitative research approaches (used mixed method) in order to generate the advantage of both approaches like; to address different objectives of the study, which cannot be achieved by single method and to enable one approach to inform another approach, either in design or in interpretation. It also helps to triangulate the findings of different approaches (either performed concurrently or sequentially) in an effort to provide greater confidence to the study.

Kerchar (2010) argues that (each strategy has its strength and weaknesses and the drive for mixed method research is to use one strategy to inform, validate, or compensate for the weaknesses of another. “In other words, the combination of both quantitative and qualitative methods is more realistic approach to gain a better understanding of the phenomenon under study.

3.4 Sources of Data

The data used in this study consists of both primary and secondary data. The primary data were collected through questionnaire and interview. The questionnaire comprised of both closed and open ended questions. Closed ended questions are quicker and easier both for respondents and researcher. Most of closed ended questions are designed on an ordinal level of measurement basis, and other are designed as multiple choice, some of the closed ended questions were a five scored likert scales (Kothari, 2004) to provide respondents a wider range of alternatives with end points where “5” with the statement strongly agree, and “1” indicates with the statement refer to strongly disagree. Adding open ended questions allows respondents to offer an answer that the researcher didn’t include in questions. And also, interviews were made for those most related tax officials.

Secondary data were also collected from the Revenue Authority annual report from 2005 – 2007 E.C, to number of tax payers registered, number of audited taxpayers, and gained revenue due to tax audit and

categories of tax payers which are selected for audit. In addition to annual report, tax declaration was used to collect data. While collecting and using these data for the study, more considerations were given to their time period, reliability, and relevance to the purpose of the study.

Thirteen questions were developed as a guide for the semi-structured interview sessions. These interview questions were formulated with reference to the topics under study. The interviews was designed and administered to seven tax representatives. The prepared interviews guide were verified and checked for its authenticity for the use in this study. The interview aims at eliciting information on the audit practice, regarding types of audit performed, case selection techniques, capability of the stuffs and the overall tax administration system.

Sample Design

In order to select the appropriate representative of the total population and to make the research findings more relevant and accurate, the sample design would be well structured.

Population and Sampling Procedure

Population of the study: The study population/participants were all Tax Auditors of Addis Ketema sub city Auditors Office. 40Tax Auditors were available in the sub city.

Sample: It is the portion of the study population and used when addressing the total population in the study is not possible. But in this case, since the numbers of Tax Auditors were small, the study assumed the data of all Tax Auditors taking as a sample. Or there was no need of taking sample from the frame, to get accurate and reliable information we need to use all the Auditors available in the Sub City. Therefore, the sampling frame and the sample was the same. Thus in this case the sample size was almost equal to the population which enabled to make appropriate generalization to the overall population.

Data Analysis

Survey can be either descriptive or analytic. descriptive survey describe data on available of interest, while analytic surveys operate with hypothesized predictor or explanatory variables that are tested for their influence on dependent variables (Coben et al. 2000). For this study, the researcher applied descriptive analysis using table and percentages.

3.5 Conclusions

In this chapter, research methodology options available to a researcher including quantitative, qualitative, and mixed method approach each using different knowledge claims, strategies of inquiry, and methods of data collection and analysis are discussed. The link of research questions and research methods adopted in this particular study is also presented with proper justification in method selection in line with the strength and weakness of each research method. Mixed research design is opted for the study that helps the researcher to achieve the research objectives, and the required data is collected through survey questionnaire, in-depth interview, and documentary analysis. With this end, the next chapter presents the results and analysis of the study.

CHAPTER FOUR

4 DATA ANALYSIS AND FINDINGS

Introduction

Tax administration authorities, are responsible the assessment, collection and implement of the tax laws or for their government. As the government`s principles revenue collecting agency, the performance and efficiency of the Revenue Authority agency has direct and immediate impact on the economy. (ERCA), Ethiopian Revenue, and Customs Authority give the authority in year 2011/12 to all sub cities Revenue Authority to collect revenue from category “A”, “B” and “C” taxpayers and assess as well as audit the mentioned taxpayers.

Due to less experience of the sub city administration, it faces different problems in administering taxes. The reasons are lack of awareness by taxpayers, inefficient tax audit, result in low audit coverage, tax policy and complexity of law, legal and economic environment, and availability of administrative inputs, skilled man power, and tax evasion. The revenue authority only focuses category “A” for audit and not considers other categories. As describe in the above, this study discusses and analyzes Tax Audit practice in Addis Ketema sub city.

4.1 Characteristics of the Respondents

4.1.1 Demographic characteristics

As table 1 show that the number of males and females Auditors under the age 35 years were 21 and 19 respectively out of these 52.50% were males and 47.50% were females. This indicates that Addis Ketema sub city recruit males’ equivalent to female Auditors.

Table 1 Back Ground Information of Tax Auditors

Age Group (years)	Male		Female		Total	
	Count	%	Count	%	Count	%
Less than 35 years	21	52.50%	19	47.50	40	100%
Above 36 years	-	-	-	-	-	-
Total	21	52.50%	19	47.50%	40	100%

4.1.1. Socio-economic status of respondent Tax Auditors

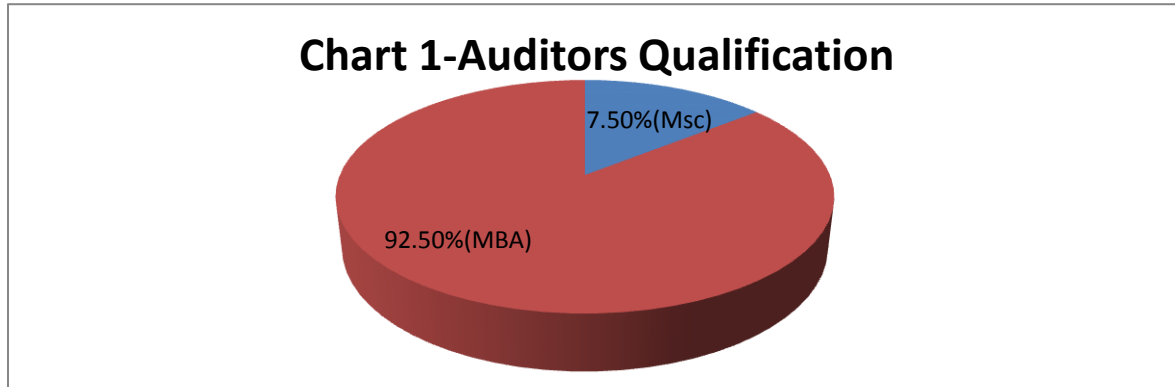
Educational levels, field of study and work experience of the tax auditors in general are the most important variables that can affect the performance of tax audit as well as tax administration system. In line with these attempts have been made to assess the educational level of the respondents, Field of study and work experience. Generally the respondent`s socio-economic status is presented in Table 2.

Table 2 Socio-economic status of respondents

S.N	Item	Level	Frequency	percentage
1	Educational back ground	BA/BSC	37	92.50
		MA/MSc	3	7.50
2	Field of Study	Accounting & Finance	35	87.50
		Economics	2	5
		Management	3	7.50
3	Work Experience as an Auditor	Less than 2 years	38	95
		2-5 Years	2	5

In regarding field of study, majority of the respondents are specialized in Accounting & Finance which accounts for 87.50% of the total respondents. The remaining 7.50% & 5.0% were specialized in management and Economics respectively. 95% of the respondent Tax auditors have service year range from less than 2 years, while 5% of the respondent have service year of above 2 years. In case of working experience, 95% of Addis Ketema Tax auditors have less work experience for the current position; this implies that the tax Auditors had no enough experience. As it is discussed on the above, the majority of the respondents have a good level of educational qualification that is BA or MSc Degree which enables the respondents to have idea

of the tax audit. In addition to this, majority of the respondents studied the field related to business which enables them to understand the implementation of taxes and related issues.



As it can be seen from the above chart out of 40 sample respondents, 92.50% have BA/BSc degree in different field of specialization, and the remaining 7.50% have MSc Degree. As indicated in the above Addis Ketema sub city Audit Administration has qualified audit staff, more than 92% of Auditors have BA degree.

4.2 Type of Audit performed

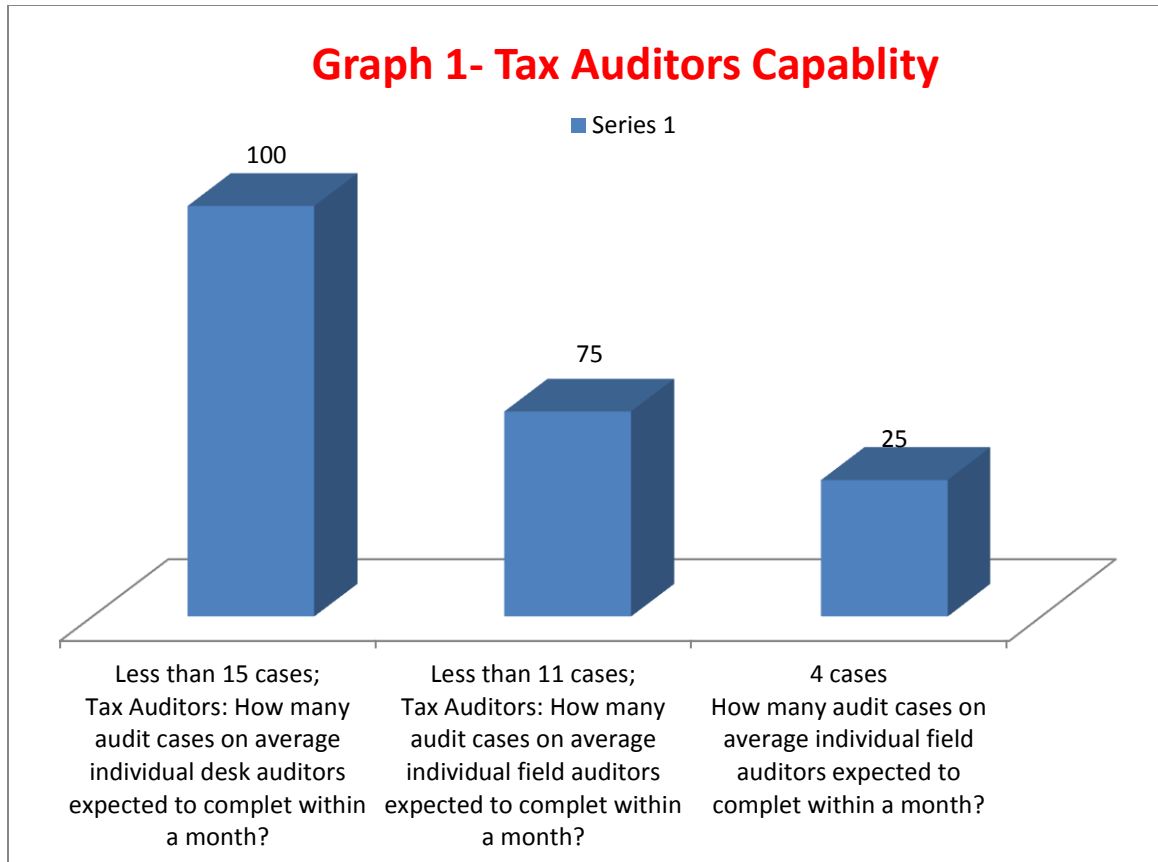
The survey results showed that Addis Ketema Sub City exhaustively conducts comprehensive audit (Full-Audit) 77.50%, desk audit (Verification) 22.50%. The survey further stated that comprehensive audit is conducted to ensure compliance on the taxpayers selected by risk criteria and third party information and on taxpayers those need to dispose over 50% of their business fixed assets or close the business. Addis Ketema sub city performed desk audit for data cleaning purpose to confirm whether the data submitted by taxpayers is genuine. As the responses of interview Addis Ketema sub city commonly used comprehensive audit to ensure compliance behavior of taxpayers and desk audit for data cleaning and increasing the number of audit coverage. This indicates that the sub city was not used different types of tax audit as per the strength of cases and business character.

S.N	Variable	Tax Auditors response	
		Frequency	%
1	Desk Audit	9	22.50
2	Field Audit		
3	Comprehensive Audit	31	77.50
4	Other		
	Total	40	100

Table 3. Type of Audit

4.1.2. Audit performed by Auditors

Graph 1 shows that, Tax Auditor`s responses concerning Audit performed by Tax Auditors. As it is clearly indicated on below graph, 75% of Tax Auditors reported that an individual desk auditor completes less than 15 cases on average per month. The result also showed that an individual field auditor performs less than 11 cases on average per month as responded by 75 % of Tax Auditors. The survey respondents further stated that most tax auditors conduct their audit work less than the standard. This shows that Tax Auditors perform their audit work without preparing pre-audit plan. Developing an Audit plan is necessary to determine the number of cases to be audited in the period by the offices, and to segment industry, tax types, and audit type (OECD, 2006).

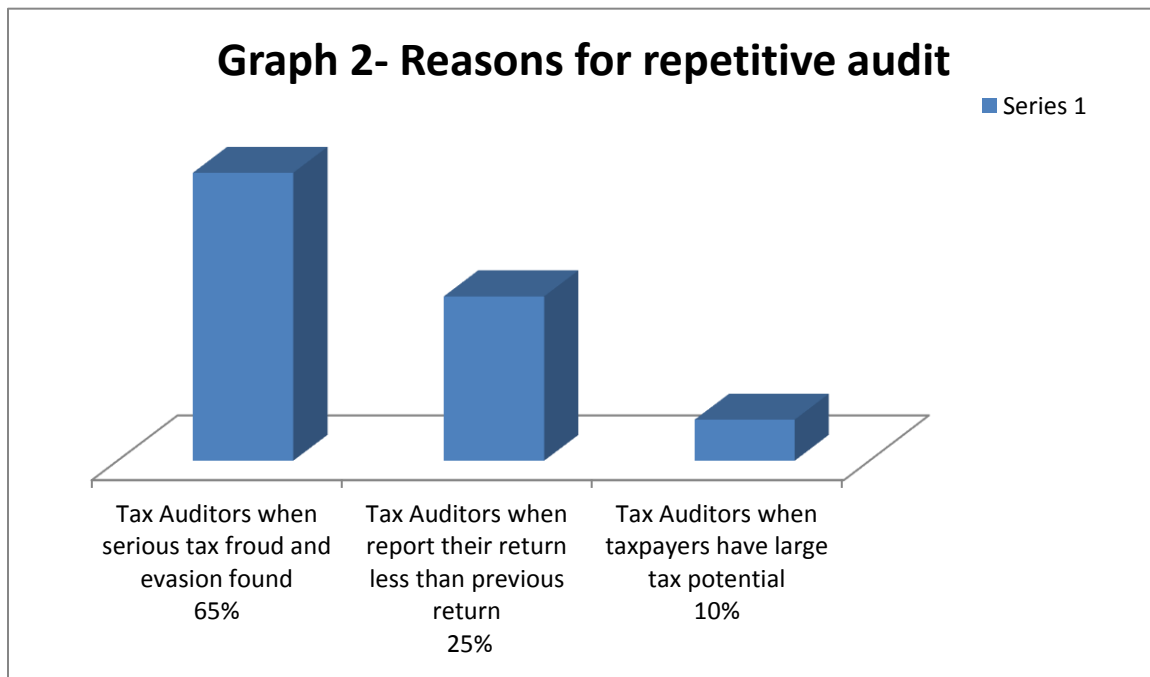


4.3 Case Selection

Table 4- Repetitive Tax Audit performed by the Revenue Authority

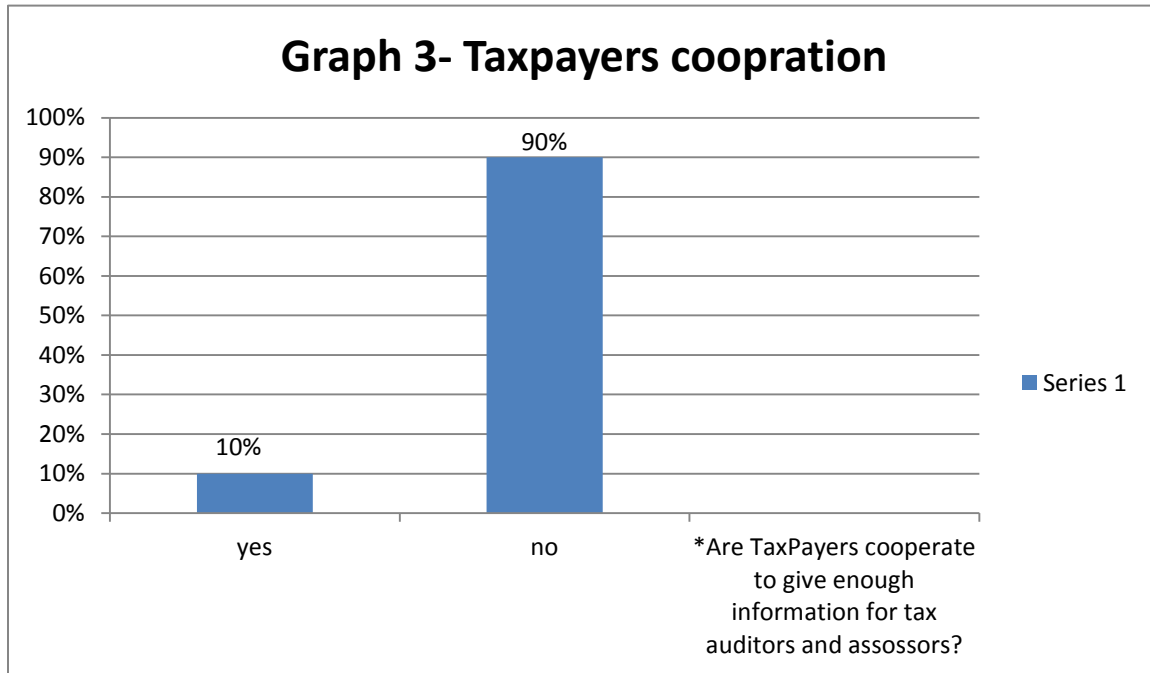
S.N	Item	Respondent		Frequency	Percentage(%)
1	Tax Auditors repetitively audit the same tax payer in consecutive period?	Tax Auditors	Yes	3	7.50
			Usually	0	0
			Sometimes	26	65
			No	11	27.50

Regarding audit frequency as shown in table 4, out of 40 respondents 65% of tax auditors stated that sometimes similar tax payers are selected for audit in consecutive years, 27.50% of the respondents stated that tax payers who were audited in previous years were not selected for the next audit, the remaining 7.50% respondents stated that there is a possibility to audit for consecutive audit periods. This implies that taxpayers are selected for audit for consecutive audit periods.



Regarding the reason for repetitive audit, 65% of respondent tax auditors were replied that when serious tax fraud and evasion found, the taxpayers company is selected for audit for a consecutive audit period. As it is clearly indicated in the above graph, 25% of tax auditors replied that taxpayers were selected for repetitive audit, when report their return less than previous return, only a small portion of respondent Tax Auditors 10% replied that repetitive tax audit found when taxpayers have large tax potentials.

Graph 2, inferred that repetitive audit on individual taxpayers were found. This situation might have effect on compliance behavior of taxpayers and Tax audit effectiveness.



Regarding taxpayers cooperation to give enough information for Tax Auditors and assessors, Graph 3 reveals that are not cooperate to give enough information regarding their businesses for Tax Auditors or Tax assessors. According to Table 5 and graph 3, Taxpayers were not fully cooperating for the effective tax administration system. They are not given enough information for tax Authority.

Table 5, Taxpayers cooperation to give information for Tax Auditors and assessor

Item		Tax Auditors	
		Frequency	Percentage
Are taxpayers cooperating to give enough information for Tax Auditors/ Tax assessors	Yes	4	10
	No	36	90
Total		40	100

According to Table 6, Tax Auditors and Investigators get information from different sources. Majority of respondents agreed that Tax Auditors get information from third party, by reviewing previous case history of taxpayer`s business profile. Table 6 showed that 67.50% of respondent Tax Auditors reported as Tax Auditors were getting information from third party like financial institution. 20% of respondent Tax Auditors replied that Tax Auditors get necessary information by reviewing the previous case history of Taxpayers, and 12.50% of respondent Tax Auditors replied that Tax Auditors were getting information from other business profile (related business sectors). Generally tax auditors get information from third party rather than other means of getting information regarding taxpayers business.

Table 6- Methods of getting information regarding taxpayers

SN	Item	Tax Auditors	
		Frequency	Percentage
1	By reviewing the previous case history of Taxpayers	8	20
2	Using information from third party such as financial institutions	27	67.50
3	Using business sector profile	5	12.50
	Total	40	

Table 7- deals with Tax Auditors access to get information held by taxpayers and others. 70% of respondent Tax Auditors replied that tax auditors and investigators have good access to information held by taxpayers and others.

Table7- Tax Auditors access for information

Item		Percentage				
		strongly agree	Agree	Neutral	Disagree	Strongly disagree
Tax Auditors and investigators have good access to information held by the taxpayers and others	Auditor		70		30	

Regarding case selection criteria on table eight, 27(67.50%) of the respondent Tax Auditors replied that taxpayers have been selected based on their associated compliance risk (compliance indicators) for audit purpose. Item 2 on Table 8, Tax Auditors oppose that case selection was not based on the availability of resources for audit or Revenue Authority. Item 3 on Table 8, shows that taxpayers select for tax audit was not based on taxpayer`s tax potential. (75%) of the respondent Tax Auditors replied that high tax potential of taxpayers was not a base for case selection. Item 4 Table 8 elicits that case selection is based on serious evasion and fraud. More than (80%) of the survey result shows that case selection was based on the commitment of serious evasion and fraud. As (82.50%) respondent tax auditor`s response, taxpayers select for audit when they commit serious fraud and evasion. Tax Auditors were not select cases manually based on their knowledge of taxpayer`s behavior and environment. (85%) of respondent Tax Auditors disagree that taxpayers were not

selected manually. Generally Table 8 depicted that Auditors selects cases based on associated risk, and commitment of tax fraud and evasion. As the interview result, Addis Ketema Sub city conduct Tax Audit based on service and associated risk. Service audit is un-planned audit which performed by auditors based on the interest of taxpayers. If taxpayers want to shut down their business or change type of business, they inform to Revenue Authority and the Authority assign Auditors to perform the Audit work.

Table 8 Case Selection

No	Item						
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Taxpayers (audited) are selected based on their associated compliance risk	Tax Auditor	67.50	32.50			
2	Case selection is based on the availability of resource for audit	Tax Auditors		7.5	5	87.50	
3	Selection is based on taxpayers high tax potential	Tax Auditor			15	75	10
4	Serious evasion and fraud are basis for selection	Tax Auditor		82.50		17.50	
5	Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment	Tax Auditor		15		85	

Item 1 on Table 9 depicts that Tax Auditors responses regarding case selection through screening and case review. Here, in this item, the result revealed that taxpayers were not selected through screening and case review method. 92.50% of respondent Tax Auditors agreed that to select cases for Audit screening and case review was not the base.

In table 9 item 2 the respondents were requested to rate on cases were selected randomly. Hence, high percentage 90% of Tax Auditors respondents said “disagree” and 10% “Strongly disagree”. The large portion of Tax Auditors rated on “disagree” and “strongly disagree”. This implies that Tax Auditors select cases non-randomly. This may be encouraging taxpayers to commit tax evasion.

Item 3 of Table 9 shows that respondent Tax auditors view in relation to case selection through data mining techniques. Accordingly, 100% of respondent Tax Auditors said “strongly disagree”. This indicates that Taxpayers selected for audit is not based on data mining techniques. The survey result shows that case selected for audit was not based on data mining techniques.

In table 9 item 4 the respondents were requested to rate on case selection by using statistical techniques and prior period audit. Hence, high percentage (87.50%) of respondent Tax Auditors said “strongly disagree”. This shows that Tax Auditors were not use statistical techniques to select taxpayers for tax audit. Respondent tax auditors were disagree for the issue that Tax Auditors select cases by using statistical techniques of prior period audit.

Item 5 in the same table, respondents were requested to rate their suggestions on identification on non-compliance taxpayers based on rule base and automated risk scoring system. The minority of the respondent Tax Auditors (60%) said “strongly disagree”. This implies that Taxpayers select for audit were without standard rule and automated risk identification system. Revenue Authority has 12points risk identification criteria, but Tax Auditors were not using these standard criteria. As the response of the interviewee, the reason

for not using the standard risk identification criteria was the complexity of the risk identification criteria and difficulty to understand.

According to the interview result Addis Ketema sub city was not used the standard risk identification criteria which are written on BPR manual due to complexity of the criteria. Currently they used the trend of delay in tax payment, non-filling tax returns, nil tax declaration, showing abnormal and repetitive loss report, profit significantly deviated from previous periods as identification criteria.

Table 9 Techniques of case selection

No.	Item	Percentage					
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Taxpayers selected for audit is through screening and case review	Tax Auditors				7.50	92.50
2	Tax Auditors select audit cases randomly	Tax Auditors				90	10
3	Taxpayers to be audited was selected through data mining techniques	Tax Auditors					100
4	Taxpayers to be audited selected using statistical techniques using prior tax audit results	Tax Auditors				12.50	87.50
5	Rule based and automated risk scoring system	Tax Auditors				40	60

As indicated in Table 10 below, tax auditors were not selecting any item of business frequently. Construction Company and real estate were not usually selected for tax audit. All respondent Tax Auditors 100 percent replied that “Strongly disagree” that Tax Auditors were not select construction company for audit. The case selection systems were not focus on any business type. It focuses only associated risk and the Revenue Authority has no strategy to segment the business based on similar character or riskiness of the business. Risk identification was based on riskiness of individual business rather than business in different segment. The finding revealed that no specific business is selected for tax auditors were not given priority to select Construction Company.

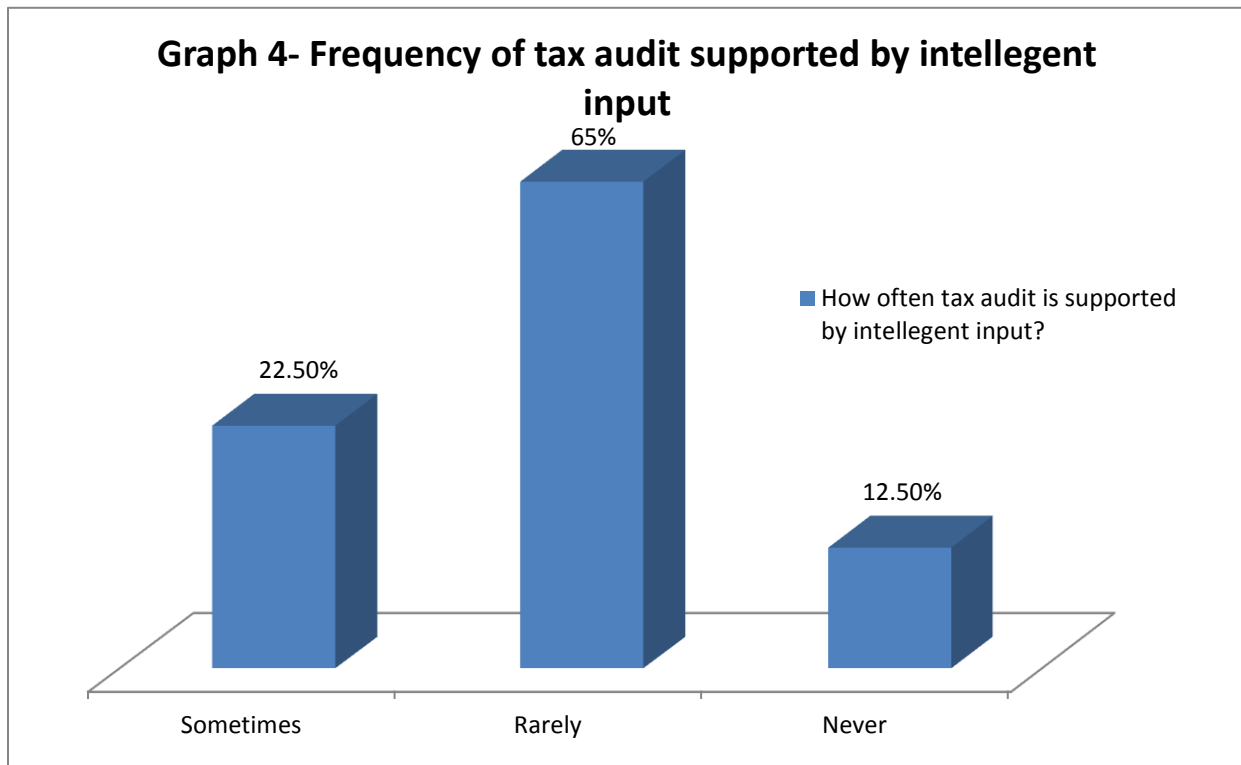
Item 2 of table 10 depicted that respondents were not agreed that financial sectors were selected for audit. This implies that Revenue Authority has no specific segment to give prior position for audit. According to the response of the interviewee, Revenue Authority has not use segmentation of business for audit and risk identification procedure.

Table 10 Type of business selected for audit

No.	Item	Percentage					
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Construction & Real estate sectors are most usually selected for audit	Tax Auditors					100
2	Financial sectors are most usually selected					95	5

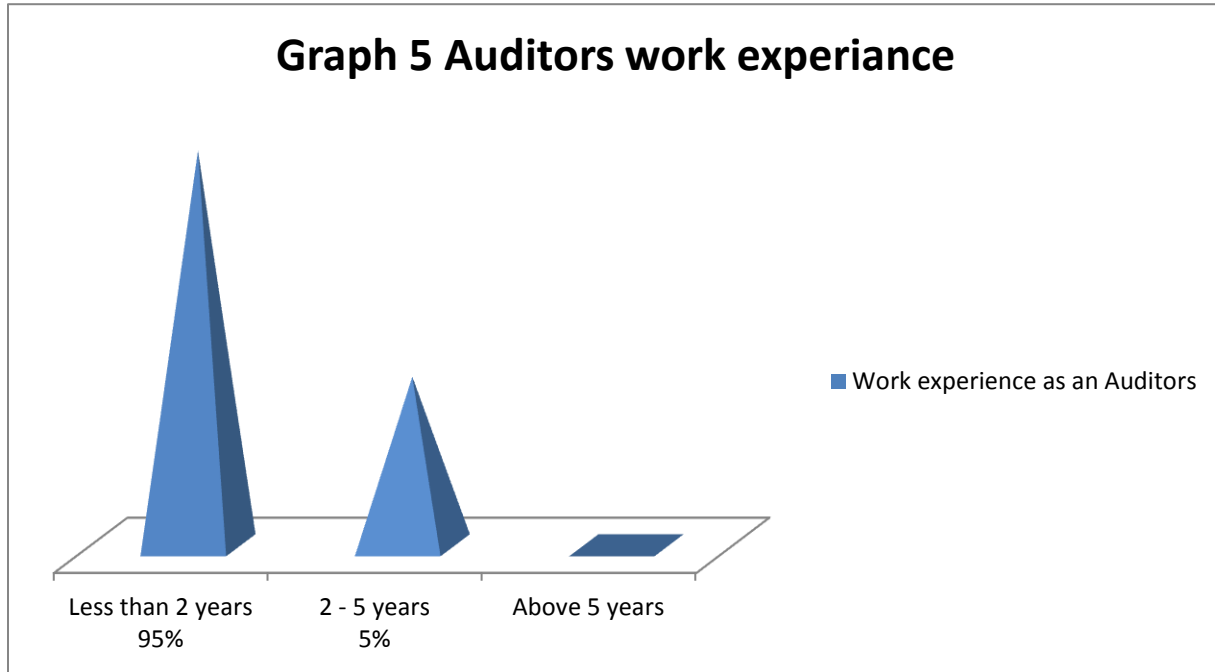
4.4 Effectiveness of Tax Audit

Audit effectiveness is dependent on Auditor`s capability and efficiency to perform audit activities in a well-organized manner, tax auditors resources allocated for audit and the Revenue Authority tax administration system. The other factors that affect the effectiveness of audit work are the link between intelligent information and tax audit.



The above graph depicted that how often tax audit work was supported by intelligent input. According to the result, majority of audit work was not supported by the information from the intelligent team. 65% of respondent tax auditors reported that the audit works performed by tax auditors were rarely supported by intelligent team information. 22.50% of respondent tax auditors replied that Addis Ketema sub city sometimes use intelligent team information for audit work. According to 12.50% of tax auditors response audit work performed by the auditors were not supported by the intelligent information. This result revealed that the sub

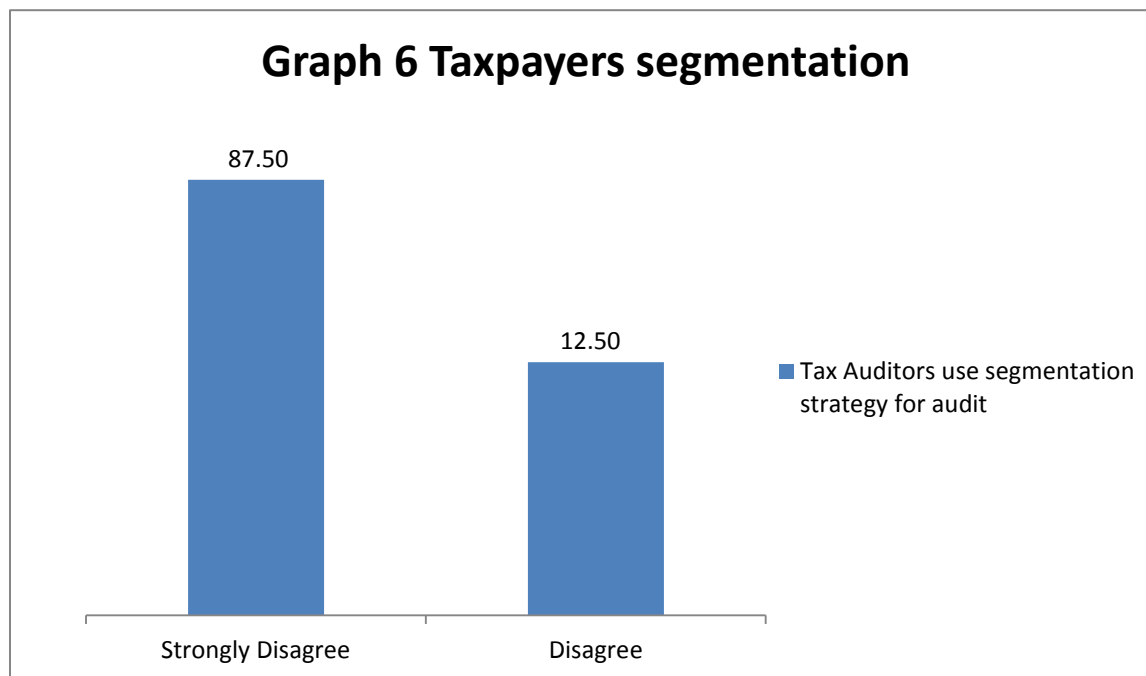
city Revenue Authority audit work was not as such supported by intelligent work/information and it leads to ineffective tax audit.



Regarding effectiveness of Tax Audit, the above graph depicted that audit effectiveness is depend on work experience of Tax Auditors. Accordingly, majority of the respondents agreed that educational back ground and work experience affect the effectiveness of audit. As 95 percent of the Tax Auditors, tax audit quality was affected by education and work experience. The survey result shown on table one and graph 5, Tax Auditors has no enough audit experience and more than 95% of survey respondents have an experience of less than two years in their current position.

The interview result also revealed that educational qualification and work experience affect the quality of tax audit. According to their response, Revenue Authority prefers to recruit Tax Auditors who have no experience auditors to minimize corruption. Tax rules, regulation, and directives are complex to understand easily and interpret. Additionally, it takes time for less experienced auditors to adopt with system and perform the audit

works in efficient manner because audit needs additional skills like statistical knowledge, communication approach, Economic as well as marketing knowledge and research and analysis.



As depicted in the above graph, 12.50% of respondent Auditors replied that “Disagree” that Addis Ketema sub city has taxpayer segmentation approach. As depicted in item two of table eleven and graph 6, 87.50% of Tax Auditors replied “Strongly Disagree” on the issue that the Revenue Authority use segmentation approach. This indicates that the sub city has no business segmentation strategy and also not customized its audit work to specific sectors and taxpayers segments, and currently not used a segmentation approach to conduct tax audit in order to provide a highly integrated and one spot customer service for taxpayers.

Segmentation of taxpayers might help the Authority to recognize the complexity levels of audit cases in audit activities and to distinguish the competency requirements, classification, and remuneration of tax auditors to plan staffing accordingly. Such appropriate allocation and compensation of tax audit staff might encourage tax auditors to conduct properly their audit activities, which might result in low audit performance in terms of coverage and quality.

Table 11 Factors affecting audit effectiveness

No.	Item	Percentage					
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Audit is performed based on audit manual	Tax Auditors				100	
2	Taxpayers can easily understand and be aware of the rules, forms	Tax Auditors		5	7.50	87.50	

Table eleven indicated that the view of respondent Tax Auditors regarding tax audit performed by the Revenue Authority was based on Audit manual. An audit manual is required to provide: (1) Consolidation of policies and procedures; (2) A reference guide for Auditors; (3) A training tool; (4) Consistency in approaches; and (5) Aid quality assurance, governance and accountability (OECD, 2006). In order to deliver quality outcomes, auditors need access to approved procedures, policies, and tools. Obviously, such products vary considerably with the variety and complexity of the regimes administered by individual tax administrations. Nevertheless it is possible to identify certain pre-requisites that must be in place if auditors are to be able to carry out their work efficiently. The first essential tool is a comprehensive audit manual. Such a tool can help to achieve consistency when dealing with taxpayers, the proper interpretation of legislation, and the correct use of operational procedures. It can also assist in the interpretation of information and in responding to requests for information by external bodies.

According to the result, 100 percent of respondent Tax Auditors agreed that Addis Ketema sub-city has no audit manual and Audit performed was without Audit manual.

Regarding registered taxpayer’s awareness level on tax rules and regulation, 87.50% of respondent Tax Auditors said ”Disagree”. This shows that tax rules and regulations are complex and it is difficult to understand easily by registered taxpayers.

According to table eleven, 5 percent Tax Auditors were agreeing that taxpayers easily understood rules and regulation of tax. The survey result shows that taxpayers were not easily understood laws and regulations regarding tax. It is a complex for taxpayers as well as for tax administrators.

Table 12 Audit Effectiveness

No.	Item	Percentage					
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Continuous and sufficient trainings for Tax Auditors	Tax Auditors				87.50	12.50
2	Apply standard risk identification criteria for identify highly risky business for audit	Tax Auditors				15	85
3	A continuous assessment to improve the capability or competency of staff and resources, auditors and investigators	Tax Auditors		20	15	55	10

4	The audit work to be started and completed within a predetermined timeframe	Tax Auditors		7.50			92.50
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Table twelve of item 1 depicted that views of Tax Auditors regarding the Revenue Authority provide continuous and sufficient training for Tax Auditors to increase their efficiency. 87.50 percent of respondent Tax Auditors Disagree on the issues of that tax authority provides continuous and sufficient training for the Auditors. The interview result also supports the responses given by Tax Auditors. As the responses of the interviewers Revenue Authority recruit less/no experience audit staff and provide only 10-15 days training before the auditors enter in to the audit work and give examination for the attendants of the training for assessing the efficiency of the auditors but not provide continuous and efficient training to upgrade less experienced staff. Addis Ketema Sub-City plan to provide training for auditors only twice a year. To maintain standards of auditing it is essential that revenue authority are given both initial training (classroom and on-the-job instruction) to bring auditors up to the required level and continued training so that there are kept up to date and relevant.

Majority of the respondents rated on “Disagree” for the questions that tax auditors use standard risk identification criteria for effective tax audit and sample selection for tax audit 85 percent of the respondents rated on “Strongly Disagree”. These shows that Tax Auditors were not use standard risk identification criteria. The Revenue Authority has risk identification criteria on the Business Process Reengineering (BPR) manual but the auditors were not using the standard criteria due to complexity of criteria.

According to BPR manual, the time to complete a single audit was 25-30 days. Due to complexity of taxpayers` business transaction and the size of tax payers business Addis Ketema sub city were not use the standard time complete the audit. As the result of the survey, tax auditors not start and complete the audit work as of BPR standard. More than 90 percent of the respondents agreed that the audit work was not start and

complete within predetermined time frame. This implies that the sub city has no standard time for complex and simple cases (Table 12).

Table 13 Addis Ketema Revenue Authority Tax Audit plans Vs Achievements

S.N	Year	No. of Taxpayers	No. of files to be audited	No. of files audited	Plan Vs Accomplishment	Planned Revenue	Revenue Obtained
1	2005	3,109	778	326	41.90%	450 Mil.	438 Mil.
2	2006	5,382	1,346	618	45.91%	500 Mil.	425 Mil.
3	2007	6,824	1,706	598	35.05%	236 Mil.	260 Mil.

Addis Ketema Tax Administration Authority Annual Report From 2005-2007 (Summarized). On the planned and Actual values are expressed in Millions.

As shown below on table fourteen 72.50 percent of respondent Tax Auditors, volume of tax audit was the indicator for effective tax audit. The respondents agreed that the effectiveness of tax audit was measured by the volume of tax audit or coverage of tax audit performed. According to table 13, the Revenue Authority of Addis Ketema performs 41.90 percent (Total No. of files Audited/Total No. of files to be Audited), when compared with total number of taxpayers are less than 11 percent (No. of files Audited/Total No. of Taxpayers registered) when compared with registered taxpayers (Category A and B). The report and the survey result show that the audit performed by the sub city was not satisfied as compared to the prediction. As indicated in the literature review in chapter two, in a fairly well established tax system, audit rate of 20 to 25 percent of registered traders a year are sufficient. However, Addis Ketema Administration Revenue Authority audited

only 326 taxpayers out of 3,109 registrants 10.50 percent, and has found tax revenue of birr 438 Millions in the 2005 E.C fiscal year. Similarly, in 2006 E.C fiscal year, the authority audited 758 taxpayers out of 5,782 registrants 11.50 percent, and found additional tax revenue of birr 425 Million (Table 13). It indicates that the revenue authority might detect compliance risk and get more additional tax revenue as the audit coverage is increased. Thus, there is low and insufficient audit rate in the revenue authority of Addis Ketema. The low audit rate (coverage) might be due to conducting extensive comprehensive audit mainly on taxpayers those with large tax revenue and complex transactions, along with insufficient audit resources including qualified tax auditors, equipment such as computers. Generally, audit performed by the authority was very low when compared with plan as well as the standard which is 20-25% of registered taxpayers.

As shows in the table fourteen below the effectiveness of tax audit was measured by productivity and yield of audit. Majority of the respondents reported that productivity and audit yield was indicator for audit effectiveness. More than 70% of the respondents agreed that the audit effectiveness was measured by productivity and yield of audit.

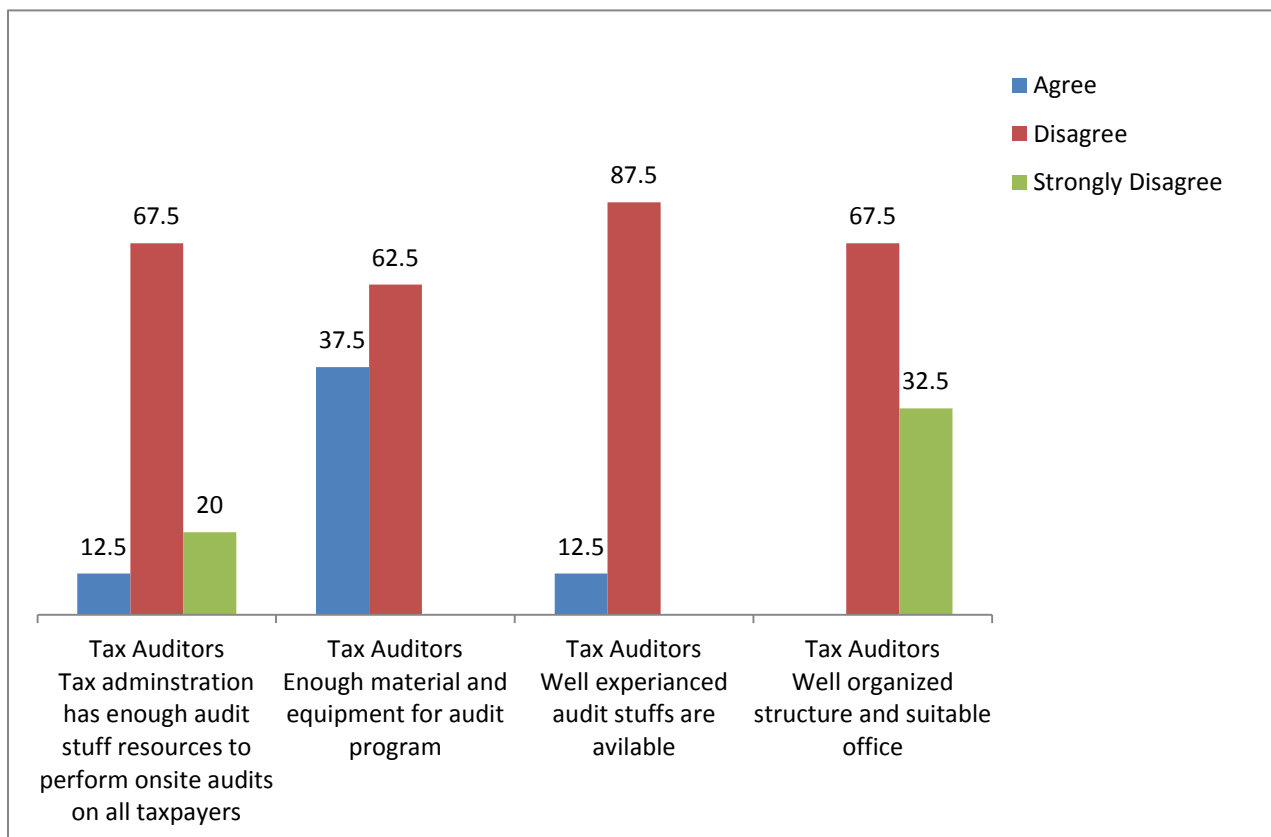
Table 14 Measurement of audit efficiency and effectiveness

S.N	Item	Percentage					
			Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
1	Effectiveness of tax audit is measured by volume of audit performed			72.50		27.50	
2	Effectiveness of tax audit is measured by productivity and yield of audit			100			

4.5 Audit Resources

Audit resources include audit stuffs, materials, and equipment needed for facilitating work. As OECD (2006), the Revenue Authority should have enough audit resources to perform effective audit and to minimize tax evasion and increase voluntary compliance. Auditor's qualification and capabilities, taxpayers awareness regarding tax rules and regulation and resources required for audit are factors that hinder audit effectiveness.

Graph 7 Audit Resource



According to the above graph, more than 65 percent of respondents indicate that Addis Ketema Revenue Authority has no enough audit staff to perform onsite audit on all taxpayers. Graph 7 indicates that only small portion of the respondents 12.50 percent of Tax Auditors were agreed that the authority has enough staffs to

conduct on site audit. The survey result on Table fifteen item one and Graph seven shows that the Revenue Authority has no enough audit staff to perform on site audit.

For the effective and efficient tax audit not only the skill and qualification of tax auditor`s but also adequate number of tax auditors, materials and equipment necessary for audit have greater impact. Table 15 item two, shows that Addis Ketema Revenue Authority has no enough materials and equipment to facilitate audit program. 62.50 percent of respondents were responded that the Authority have no well experienced audit staffs to perform audit. The result shows that Addis Ketema Revenue Authority has no suitable offices to perform Audits. The Revenue Authority has small and uncomfortable offices to perform audit work as well as to put taxpayers` document in a safe way. The office is also not safe to discuss with taxpayers and other people on tax related issues. Generally, Addis Ketema Revenue Authority has no enough audit staffs, no enough materials needed for audit and not have suitable offices. This leads to ineffective audit work.

Table 15 Resource of Tax Audit

S.N	Item	Percentage					
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Tax Administration has enough audit staff resources to perform on site audits on all taxpayers	Tax Auditors		12.50	67.50		20
2	Enough material and equipment for audit program	Tax Auditors		37.50		62.50	
3	Well experienced audit staffs are available	Tax		12.50		87.50	

		Auditors					
4	Well organized structure and suitable	Tax Auditors				67.50	32.50

4.6 Purpose of tax audit

According to table 16 item one, the primary purpose of Tax Audit is to ensure compliance behavior of taxpayers. (67.50) percent of the respondent tax auditors were agreed that tax audit performed in the Revenue authority is to ensure compliance behaviors of the taxpayers. According to the response of the taxpayers, revenue authority performed tax audit was not for ensuring compliance behavior of taxpayers. According to Table 16 item 2, majority of the respondent tax auditors agreed that tax audit was for assessing taxpayers and need additional revenue for Government.

Item three of table 16 depicted that, tax audits is not allow tax auditors to educate taxpayers on the application of tax laws, 55 percent of respondent tax auditors were not agreed on the issue that tax audit is for educating taxpayers. Only small portion agreed that tax audit is for educating taxpayers. The result reveled that tax audit was not allow tax auditors to educate taxpayers. 92.50 percent of respondent Tax Auditors replied that Tax Auditors perform tax audit to detect non-compliance behavior of taxpayers.

The interview with tax officials also showed that the purpose of tax audit is primarily to assess unreported income and additional revenue for the Government. The interview respondents further stated that the duty of taxpayers` awareness creation is unquestionable to increase voluntary compliance and mitigate compliance risks. As a result, Addis Ketema Revenue Authority tried to create tax awareness through electronic media, printed materials. However, taxpayers awareness creation through such mechanisms might depend on the literacy level of the target taxpayers and the accessibility of such materials to public within a given tax jurisdiction. The respondents further stated that taxpayers need compliance education to understand the

benefits of being compliant and the consequence of not being compliant. In addition, there is communication gap between Addis Ketema Revenue Authority and Taxpayers, which leads taxpayers to mistrust. The taxpayers do not have easy access to new rules introduced and amendments in the existing tax law, and do not get any clarification on the complex tax rules and regulations.

Tax audit is for reducing tax evasion and tax fraud. The survey result shows that tax audit is vital for reducing tax evasion. As 77.50 percent of respondent tax auditors tax audit has positive effect on reducing tax fraud and tax evasion. The respondent tax auditors give suggestion for the improvement of the overall tax administration and audit quality. Strength service delivery to create strong enforcement, make clear and accountable work environment must be created, create awareness give weekly/monthly meeting with taxpayers, given information through Radio and TV on local areas language, magazines, workshops, brushers, newspapers, house to house impressively and openly discusses with taxpayers to control tax evaders and corruption, recognize model taxpayers as well as tax officials, adjusting rules and regulations based on taxpayers feedback, monitor and evaluate the tax employees, creating tax day celebration, strengthen strong political commitment, penalty does not teach taxpayers instead education, respect every taxpayers as customer, make a notice before any harsh measurement. And give enough time for document preparation to taxpayers which were selected for tax audit.

Table 16- Purpose of Tax Audit

S.N	Item	Percentage					
			Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
1	The primary purpose of tax audit performed in tax administration is to ensure compliance in accordance with tax law	Tax Auditors		67.50		22.50	10
2	The primary purpose of tax audit performed in tax administrations is to assess and collect additional tax revenue.	Tax Auditors	72.50	27.50			
3	Tax audit performed in tax administrations is to educate taxpayers.	Tax Auditors		35	10	55	
4	Tax Auditors, investigators and assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer.	Tax Auditors		92.50		7.50	
5	Tax audit for reducing tax evasion and tax fraud.	Tax Auditors		77.50	12.50	10	

4.7 Techniques used to test the accuracy of return

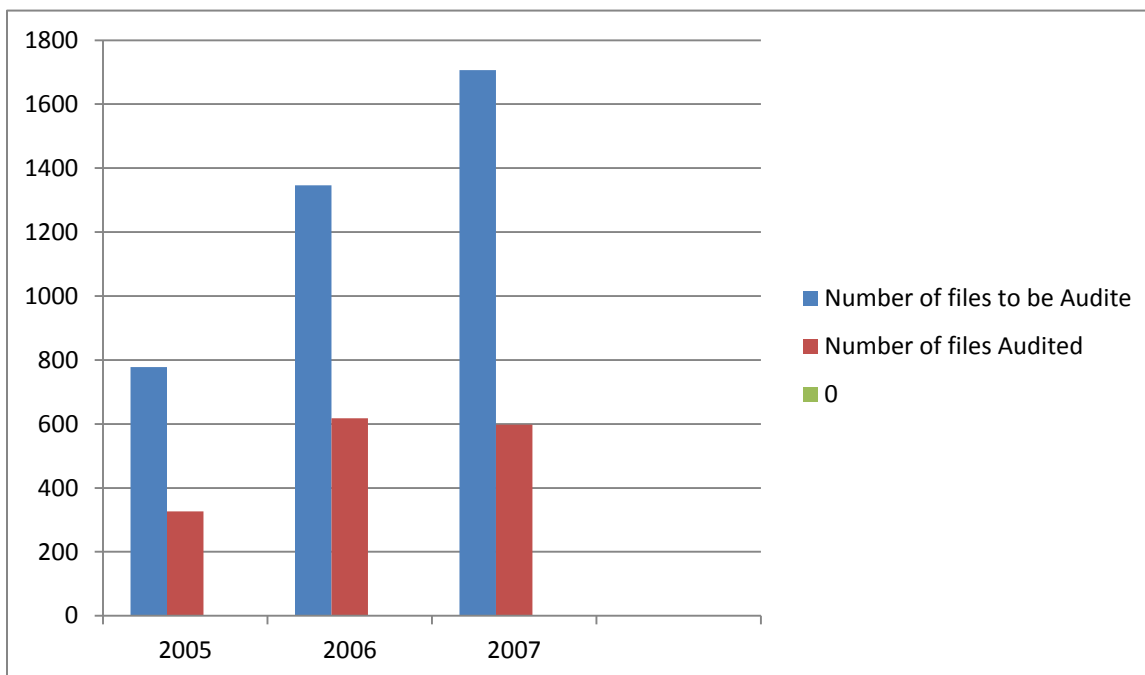
Regarding techniques used to check the accuracy of taxpayers record. More than 85 percent of the respondents agreed that the accuracy of tax returns have been tested through review of financial statements and returns, 47.50 percent of respondent tax auditors replied that observing, discussing and reviewing documents of taxpayers were the means for checking the accuracy and physical checks of businesses` current operation including transactions, assets and other aspects 62.50 percent were the means for checking accuracy. The survey result showed that Revenue Authority used different techniques for checking the accuracy (Table 17).

Table 17- Techniques of Checking Taxpayers

S.N	Item	Percentage					
			Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Review of financial statements and returns type of tests are conducted to check the accuracy of tax returns.			87.50	12.50		
2	Observing, discussing and reviewing documents of taxpayer`s are conducted to check the accuracy of tax returns.			47.50	17.50	35	
3	Physical checks of current transactions, vouchers, assets and other aspects type of tests are conducted to check the accuracy of tax returns.		12.50	62.50	5	20	

Graph 8- Audit Coverage

According to Graph 8, Addis Ketema Revenue Authority Covers less audit work when compared to plan. Additionally the authority was not give emphasis for all taxpayers but it gives emphasis only for a particular categories, category “A” and “B” in particular, the unaudited category of taxpayers would feel that their underreporting and other noncompliance activities have little chance of being detected due to less probability of being audited.



CHAPTER FIVE

5 SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 5.1. Summary

The key source of revenue for the Government is tax. However, the potential tax revenue is not collected due to absence of taxpayers` compliance with the tax law both deliberately and unknowingly. Thus, tax audit performed by Addis Ketema Revenue Authority is determine the taxpayers` collect tax liabilities for a particular accounting or tax period with examination of taxpayers` organizational procedures and financial records in order to assess compliance with tax laws and verify the true, fair, and reliable and accuracy of tax returns and financial statements. The analysis addresses the tax audit practice in Addis Ketema Revenue Authority with respect to the type of audit performed, effectiveness of audit program in terms of educating taxpayers and improving voluntary compliance and revenue performance, the appropriateness of case selection methods, examination techniques, and experience and capability of tax auditors.

Developing on the review of related literature as well as analysis and interpretation of the data, the findings are summarized and presented as follows:

- ❖ The primary issue to be considered in tax audit is designing audit plan. The Revenue Authority should plan before conducting audit and type of audit performed. Regarding the types of Audit, Addis Ketema Revenue Authority widely used comprehensive types of audit rather than other types of audit. An effective audit program should be with vigorous range of audit types directed to a wide range of taxpayers and tax types. Appropriate selection of tax audit types depends on the compliance risk needs to be addressed; the desired audit rate (coverage), audit quality, and the overall deterrent affect the needs to be accomplished. The results of the study revealed that Addis Ketema Revenue Authority

exhaustively conducts comprehensive audit with intensive examination of ten-year taxpayer data exclusion of other audit methodologies. Comprehensive audit is intensive and deep in its nature, consume high audit resources and result in low coverage of audit that affects the overall warning effect and future tax revenue. Such excessive examination of taxpayer data may create collision between taxpayers and tax official and auditors` error in such examination may also damage business activity that result in negative impact in economy, tax system in particular.

- ❖ Appropriate audit selection is a key to the effectiveness of tax audit program. Addis Ketem Revenue Authority selects taxpayers for audit based on associated risk. Addis Ketema Revenue Authority select cases based on deviation from previous period`s profit (underreporting income) and they think that it is an indicator for evasion. Economic factor, firm performance, management skills, and others are factors for reduction of profit but the authority was not considering the mentioned issues. As BPR manual Addis Ketema Revenue Authority has standard risk identification criteria but not implemented. However, case review method, data mining system, risk-based audit program, were not yet in place, and the audit functionality of SIGTAS is not being fully utilized for risk assessment.
- ❖ The other things to be considered for audit were grouping Taxpayers. Taxpayers have different characteristics and present different risks to Revenue Authority. Segmentation based on industry type or turnover is vital to improve revenue collection as well as to improve audit performance. In a tax administration context, segmenting the taxpayer population into sub-populations of taxpayers with similar characteristics and behaviors facilitates more precise identification and categorization of compliance risks. Thus, in turn, leads to a richer understanding of the true compliance risks and should ultimately assist in the specification and delivery of risk treatments. However, Addis Ketema Revenue Authority was not implemented this segmentation approach.

- ❖ Addis Ketema Revenue Authority tax audit activity is not properly supported by intelligence team product, even if the authority has intelligence department. And also, there is a delay in audit coverage of selected taxpayers due to these, there is an obstacle to improve revenue collection performance. Taxpayers were not willing to provide sufficient information from tax auditors and assessors regarding their business. The Authority gets information from third party and business profile.
- ❖ The effectiveness and efficiency of audit work was affected by staff qualification, experience, and resources for audit. Auditors have the ability to interpret rules and laws, analysis the compliance behavior of taxpayers, investigative and advisory skill. The survey and the interview result revealed that Addis Ketema Revenue Authority recruit qualified but less experienced audit staff.
- ❖ The number of auditors in Addis Ketema Revenue Authority was very less compared to the businesses. Similarly the Revenue Authority has no enough resources and equipment like computer and suitable office to conduct audit work. Regarding auditors` capability, the in-depth interview with tax officials should that auditors have not standardized knowledge regarding clarification of unclear tax rules and regulations, and are incoherent in giving information regarding identical tax issues. In addition, tax auditors lack willingness to give advising services to taxpayers rather they simply intimidate them by raising the consequence of not being compliant.
- ❖ The tax officials, auditors in particular, also fail to keep properly taxpayers data that have been already submitted by taxpayers, and they unnecessarily request taxpayers to submit the report yet again.
- ❖ The Revenue Authority recruits youngest people using their qualification and provide 10-15 days per work training regarding audit, tax laws and directives. Addis Ketema Sub City Revenue Authority provides training once a year to their people or customers related to tax issues. Continuous upgrading is necessary based on the gap and the need identified. The authority upgrade less experienced auditors by use different system like coaching, grouping with experienced auditors, evaluating through one to

five strategy and soon. This was is not sufficient for upgrading the performance of audit and need continuous and intensive training.

- ❖ According to BPR tax audit timeframe, Addis Ketema Revenue Authority has a rule that requires an individual audit case to be started and completed within 15-20 days period regardless of the complexity of the cases and the size of the taxpayers to be audited. In general as per the level of the researcher understanding and the finding what he has got in the previous chapters the researcher conclude that the allocation of equal period for both complex and simple cases might result operational inefficiency including decrease in audit quality and coverage although there is no standard timeframe for both complex and simple cases.
- ❖ The standard timeframe on the BPR manual was not sufficient to perform and conclude complex cases. Individual Auditors might not properly detect noncompliance due to time scarcity and the required audit quality might not be achieved; whereas auditors those expected to complete simple cases might complete even before the elapse of stated period and might consume working time improperly so that feasible audit coverage might be reduced.
- ❖ The primary purpose of tax audit performed in Addis Ketema Revenue Authority was to assess and additional revenue for the Government. According to Table 12 Tax Audit was for assessing taxpayers and need additional revenue for the Government. Tax Audit allows tax auditors to educate taxpayers on the application of tax laws, to identify improvements required for record-keeping and to identify areas of tax laws that taxpayers need clarification. Tax audits are not allowing tax auditors to educate taxpayers on the application of tax laws. Taxpayers' awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. Consequently, Addis Ketema Revenue Authority tried to create tax awareness through electronic media, printed materials. However, taxpayer awareness creation through such mechanisms might depend on the literacy level of the target

taxpayers and the accessibility of such materials to the public within a given tax jurisdiction. The respondents further stated that taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant.

- ❖ In addition, there is a communication gap between Addis Ketema Revenue Authority and taxpayers, which leads taxpayers to mistrust.
- ❖ Regarding examination techniques, various type of information might be reviewed namely tax returns, financial statements in Addis Ketema Revenue Authority. The techniques used to test the accuracy of tax returns include: examination of information from third parties banks and informant; analytical review of financial statements and returns; examination of taxpayers “records; investigation through observing, discussing and reviewing documents of taxpayers; and on sight survey of the taxpayers” current business condition through physical checks of current transactions, assets and other aspects. Field examination (on sight survey of business condition) is applied when a particular taxpayer needs to sell its business fixed assets or close the business. Effective auditing requires more than verifying that a taxpayer has correctly included a particular transaction in his books of account along with the adoption of investigative approach.
- ❖ However, the application of investigation approach is not as such in Addis Ketema Revenue Authority. The accuracy of taxpayers “tax liability is determined mainly through analytical review of financial statements and returns. Thus, Addis Ketema Revenue Authority may not be able to determine what wealth the taxpayers have accumulated but not documented or recorded in their books of accounts and financial reports without the conduct of appropriate investigation. It may not be also possible to Ethiopia Revenue and Custom Authority (ERCA) to establish the completeness, accuracy, credibility, and validity of taxpayers` declarations, disclosures and other financial arrangement.

5.2 5.2. Conclusion

To achieve the objectives of government revenue objective a well-structured tax audit program is vital to ensure the fiscal health of the country, and sustain the health of the tax system by reducing tax gap through voluntary compliance improvement and additional tax collections. Further, it might provide valuable support in identifying areas of the tax law that require clarification or addressing deficiencies in law, and to influence across the broader taxpayer community at all levels.

This paper has attempted to analyze current status, the performance of tax audit practice of the Addis Ketema Revenue Authority. In particular, the study explored types of tax audit performed, and effectiveness of tax audit and risk identification criteria for case selection. These investigations were addressed by employing survey questionnaires, semi structured interview given to tax officials and reviewing published and unpublished documents. Finally, on the basis of qualitative and quantitative analysis of data, the findings of this study are summarized as follows:

- ✓ Addis Ketema Revenue Authority audit used intensively comprehensive audit and the Audit program is unchanged and not used different types of audit in relation to simplicity and complexity of cases. Taxpayers are selected for audit based on risk criteria, and selected audit cases are expected to be performed within 15-20 days period regardless of the complexity of audit cases and the size of taxpayers. Taxpayers might be repetitively audited if there is an indication of serious tax fraud and when they report less tax return than previous return. As a result, there is unreasonably consumption of audit resources as well as increase the hardship associated with repetitive audits for fully compliant taxpayers. Corruption might also arise due to repetitive contact between the same taxpayers.
- ✓ Addis Ketema Revenue Authority did not adopt segmentation approach this result in low customer satisfaction, and increases both taxpayer compliance costs and tax administrative costs. However, tax

audit program is mainly focusing on Category of “A” taxpayers which large tax potential with less emphasis to medium and small category of taxpayer`s community. In addition, the audit coverage is unsatisfactory that might be due to inappropriate audit type adopted and resource constraint. Case selection was only based on associated compliance risk.

- ✓ The Revenue Authority of Addis Ketema not fully used automated risk score and previous case selection system (Random selection). Regarding audit staff, there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once they have given and held a particular position.

5.3 Recommendations

In light of the aforementioned conclusions of the study, the researcher wish to make the following recommendations to minimize the problems of Addis Ketema Revenue Authority tax audit program so that to improve voluntary compliance and to meet the revenue needs of the government.

- Addis Ketema Revenue Authority must adopt different ranges of audit types to increase the audit coverage and voluntary compliance having inadequate staff resources; the Addis Ketema Revenue Authority should adopt a wide range of audit methodologies rather than use of full comprehensive audit because to address risk and audit quality. The spot (issue) audit should be widely applied to increase the audit coverage, and education type audits that are not yet in place should be implemented to improve taxpayers` awareness and voluntary compliance. In addition, Addis Ketema Revenue Authority should give emphasis and assign adequate resources for investigation audit.
- The Addis Kettema Revenue Authority should design per audit procedure to select highly risky business. In addition to pre-auditing the authority should use data mining, case review and full

risk-based audit selection strategy that rewards taxpayers compliance with a light touch approach and openly demonstrates that valuable taxpayer resource is being deployed against the non-compliant.

- The Authority should use standard risk identification criteria to give priority for highly risky businesses and to encourage compliance taxpayers by minimizing taxpayers` compliance cost.
- Addis Kettinga Revenue Authority should give emphasis for taxpayer segments to improve future overall taxpayers` voluntary compliance that may affect future tax revenue, and to be capable to sustain confidence in the tax system and its administrations. And also perform audit work including other category of taxpayers`. Focusing only on category A taxpayer leads to tax evasion. Underreporting and other noncompliance activities have a good chance of being detected due to high probability of being audited.
- The Revenue Authority should perform audit activity in cooperation with the intelligence information. And should use Audit manual for better efficiency.
- Addis Kettinga Revenue Authority should revise the stated 15days audit period with the consideration of the complexity of cases and the size of the taxpayers to be audited. The authority should dispense more time for complex cases and audit of large taxpayers to properly detect noncompliance and achieve the required audit quality.
- Taxpayers have lack of awareness regarding tax rules, regulation directives and procedures & directives. This is due to level of awareness is dependent on taxpayers educational background and exposure. To increase the awareness level Addis Kettinga Revenue Authority should give great attention to educate communicates as well as taxpayers through different techniques like mass-media, preparing broacher and using different structures (School, Church, and Woreda

approach). In addition to this the revenue authority provides house to house education and discussion by considering the type and size of taxpayers.

- Addis Ketteema Revenue Authority should sufficiently use an investigative approach to check the accuracy of tax returns to establish what have not been recorded in the accounting system. It should use an investigatory approach to establish the completeness, accuracy, timeliness, credibility, and validity of taxpayers` declarations, disclosures, and other financial arrangements.
- To make effective audit the Addis Ketteema Revenue Authority audit should increase number and capability of audit staffs through appropriate need assessment and employees and identified gap. Auditors should have been taken continuous training so that their skill are kept up-to-date and relevant. Further, the authority should supply sufficient computers and other necessary audit resources for auditors.
- The Authority should use appropriate short cut techniques to increase the audit quality and coverage.

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Appendix

QUESTIONNAIRE

ST. MARY UNIVERSITY OF MSc PROGRAM IN ACCOUNTING AND FINANCE

This questionnaire is designed to meet the objectives of research titled “assessment of tax audit in the case of Addis ketema Sub City” Therefore; the data from the questionnaire will help the researched to obtain and valid information. Your open and genuine response is highly appreciated.

Do not write your name on the questionnaire.

the questionnaire has two parts: part 1 is about your personal information. part 2 is the overall questions about tax audit practice. Please each item carefully and give your honest response to each item.

Thank you for your cooperation

BirhanuAbebe

Part-1: Background information

Please provide your responses by making tick () in the relevant boxes.

1. Gender:

I. Male

II. Female

2. Age:

I. Less than 20 years

II. 21 – 35 years

- III.** 36 – 50 years
 - IV.** Above 51 years
3. Education status:
- I. Diploma
 - II. Degree (BSc/BA)
 - III. Masters (MSc/MA) and above
4. Field of study:
- I. Accounting and Finance
 - II. Economics
 - III. Management
 - IV. Others, Please specify
5. How long did you work as an auditor?

Part-2 Question regarding Tax audit practice

6. What type of audit are usually performed:
- a) Desk Audit
 - b) Field Audit
 - c) Comprehensive Audit
 - d) Issue Audit
 - e) Advisory Audit
 - f) Registration Audit
 - g) Refund Audit
 - h) Fraud Audit

- i) Other
7. How many audit cases on average an individual desk auditor has expected to complete within a month?
- a) Less than 15 cases
 - b) 15 to 30 cases
 - c) 30 to 45 cases
 - d) Above 45 cases
8. How many audit cases on average an individual filed auditor has expected to complete in a month?
- i. Less than 4 cases
 - ii. 5 to 6 cases
 - iii. 7 to 10 cases
 - iv. Above 10 cases
9. Tax auditors in Addis Ketema sub **city branch office audit the same tax payer in consecutive period?**
- a) **Yes**
 - b) **Usually**
 - c) **Some times**
 - d) **No**
10. If you answer for Q 9 is yes what is the condition those taxpayers may be audited?
- a. When taxpayers reported tax returns less than previous period return
 - b. When serious tax fraud case is found
 - c. When taxpayers have large tax potential
 - d. Other please specify----

11. What are the main activities that tax auditors, investigators and assessors expected to perform during an audit period?

- i.** Detecting noncompliance behavior of individual taxpayer
- ii.** Gather information on the health of tax system including compliance behavior
- iii.** Educating taxpayer`s
- iv.** Interpreting complex tax rules and regulations for taxpayers

12. How often tax audit is supported by intelligence input?

- i.** Always
- ii.** Sometimes
- iii.** Rarely
- iv.** Never

13. How do you evaluate the tax performance?

- a. Efficient
- b. Medium
- c. Weak
- d. I cannot evaluate

14. How do you evaluate the performance of tax audit in enforcing illegal trader?

- a. Excellent
- b. Good
- c. Fair
- d. Poor

15. Is there key performance indicator for tax audit?

- a. Yes

b. No

16. How tax auditors and investigators can get the required information?

- a. By reviewing the previous case histories of taxpayers
- b. Using information from third parties such as financial institutions
- c. Using business sector profile
- d. Others, please specify-----

17. Are taxpayers cooperating to give information for tax auditor/Assessor?

- a. Yes
- b. Sometimes
- c. No

Put a “?” mark in one of the columns provided for each possible indicator. Use the scales:

Strong (5), Agree (4), Neutral (3), Disagree (2), strongly disagree (1)

	Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
	Questions regarding Audit case business for audit					

18	Tax auditors and investigators have good access to information held by the tax payers and others?					
19	Selection is based on taxpayer`s cooperation to give essential information necessary for performing an audit.					
20	Taxpayers are selected based on their associated compliance risk.					
21	Case selection is based on the availability of resource for tax audit.					
22	Selection is bases on taxpayers high tax potential.					
23	Series evasion and fraud are basis for selection					
24	Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment					
25	Taxpayers selected for audit is through screening and case review					
26	Tax auditors select audit cases randomly without any analysis					

27	Taxpayers to be audited was selected through data mining techniques					
28	Taxpayers to be audited selected using statistical techniques using prior tax audit results					
29	Rule base and automated risk scoring system that identifies risk of noncompliance are the possible techniques in selecting taxpayers to be audited.					
30	Construction and real estate sectors business sectors are most usually selected for tax audit.					
31	Financial sectors business sectors are most usually selected for tax audit.					
	Question regarding the effectiveness of tax audit program.					
32	Education and experience on tax audit affect tax audit effectiveness.					
33	Use taxpayers segmentation for audit.					
34	Audit if performed based on audit manual					
35	Tax registered traders can easily understand and be					

	aware of the rules, forms and instruction regarding tax.					
36	Effectiveness of tax audit is measured by volume of the audit performed					
37	Effectiveness of tax audit is measured by productivity and yield of audit					
38	Continuous and sufficient trainings for tax auditors					
39	Apply standard risk identification criteria for identify highly risky business for audit					
40	A continuous assessment to improve the capability or competency of staff resources, auditors and investigators					
41	The audit work to be started and completed within a predetermined timeframe					
	Question regarding the purpose of tax audit					
42	The primary purpose of tax audit performed in tax administrations is to ensure compliance in accordance with tax law					
43	The primary purpose of tax audit performed in tax					

	administrations is to assess and collect additional tax revenue.					
44	The audit performed in tax administration is to educate taxpayers.					
45	Tax auditors, investigators and assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer.					
46	Tax audit is for reducing tax evasion and fraud					
	Question regarding tax audit resources					
47	Tax administration has enough audit staff resources to perform onsite audits on all taxpayers.					
48	Enough material and equipment for audit program.					
49	Qualified audit staff/well experienced staffs are available					
50	Well organized structure and suitable office					
	Questions regarding frequency of tax audit					
51	Every businesses audited once a year					
52	Every businesses audited once within two years					

53	Tax auditor or investigator usually performs the audit work repetitively					
54	Taxpayers that were audited in previous audit period and found no tax liability during an audit is not selected for the next audit					
	Question regarding techniques of checking taxpayers liability					
55	Review of financial statements and returns type of tests are conducted to check the accuracy of tax returns					
56	Observing, discussing and reviewing documents of taxpayer`s are conducted to check the accuracy of tax returns					
57	Physical checks of current transactions, vouchers, assets and other aspects type of tests are conducted to check the accuracy of tax returns.					