ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MBA IN ACCOUNTING & FINANCE PROGRAM

ASSESSMENT OF TAX AUDIT PRACTICE: THE CASE OF ETHIOPIAN REVENUE & CUSTOM AUTHORITY ADDIS ABABA MEDIUM TAXPAYERS NUMBER ONE BRANCH OFFICE

BY

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June, 2018

Addis Ababa, Ethiopia

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ASSESSMENT OF TAX AUDIT PRACTICE: THE CASE OF ETHIOPIAN REVENUE & CUSTOM AUTHORITY ADDIS ABABA MEDIUM TAXPAYERS NUMBER ONE BRANCH OFFICE

A Thesis Submitted to the

Partial Fulfillment of the Requirements for the Degree

Of MBA in Accounting and Finance

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June, 2018

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STATEMENT OF DECLARATION

I have carried out independently a thesis on "Assessment of Tax Audit Practice: The case of Ethiopian Revenue & Custom Authority Addis Ababa Medium Taxpayers Number One Branch Office" in partial fulfillment of the requirements for the Degree of MBA in Accounting and Finance with the constructive guidance and support of the research advisor.

This thesis is my own works that has not been presented for any degree or diploma program in this and any other institution, and that all source of materials used for the thesis have been duly acknowledged.

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STATEMENT OF CERTIFICATION

This is to certify that GIRUM MELESE has carried out a thesis on the topic entitled "Assessment of Tax Audit Practice: The case of Ethiopian Revenue & Custom Authority Addis Ababa Medium Taxpayers Number One Branch Office" under my supervision. In my opinion, this thesis is suitable for submission in partial fulfillment of the requirements for the Degree of MBA in Accounting and Finance.

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APPROVALS

The undersigned certify that they have read and hereby recommend to the St. Mary's University to accept the Thesis submitted by Girum Melese, and entitled "Assessment of Tax Audit Practice: The case of Ethiopian Revenue & Custom Authority Addis Ababa Medium Taxpayers Number One Branch Office" impartial fulfillment of the requirements for the Degree of MBA in Accounting and Finance.

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ABSTRACT

This study examines tax audit practice in the case of Ethiopian Revenue & Custom Authority Addis Ababa Medium Taxpayers Number One Branch Office. The study stands to answer the following research question "How audit cases are select, what types of tax audit are performed, what are the existing performances of tax audit and what are the main problems of the tax audit program performed in AAMTNO1BO?" In light of this research question the study adopts Descriptive analysis is a form of data analysis used for the study. The research instruments were survey with Audit team leaders, tax auditors and investigators, in-depth interviews with Audit team leaders and compliance & risk management team officials and documentary review on the last 4 years performance of the audit process are applicable constructs. The selected target participants of the study were all Tax Auditors of AAMTNO1BO, there are 60 Tax Auditors and 16 investigators were available in Addis Ababa medium tax payer's Number one branch office. The research questioner was distributed to those 76 respondents (Audit team leaders, Tax Auditors and investigators) only 70 of them are returned and The interviews was designed and administered to 15 tax officials (10 tax audit team leaders, 2 investigation audit team leaders, & 3 compliance & risk management team officials). Consequently, survey data was analyzed on descriptive statistics. Qualitatively interview and documentary evidences summarized and presented. The result of the study revealed that AAMTNO1BO exhaustively conduct comprehensive types of audit. Due to this consume audit resources improperly and the audit coverage of the revenue authority was too low, cases were selected based on ERCA risk selection criteria but the selection process is done manually and it is not automated selections, The Authority was not perform the audit work in predetermine time and the allocation of equal period for both complex & simple cases in addition absence of proficient and experienced tax auditors might result operational inefficiency. In the end, the study forwards the possible measures to be taken by AAMTNO1BO to mitigate problems in tax audit operation.

ACKNOWLEDGMENTS

First I'm grateful to my advisor Dejene Mamo (Asst. prof.) for his unreserved and genuine comment and advice through the development of this thesis. Secondly, I would like to thanks Addis Ababa Medium Taxpayers Number One Branch Office officials and special thanks to tax auditors, investigators and compliance & risk management team officials who has provided me the necessary information for this thesis. Finally my special thanks to my families for their unlimited and multi-dimensional support during this study.

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ABBREVIATIONS AND ACRONYMS

AAA:	American Accounting Association
AAMTNO1BO:	Addis Ababa medium tax payer's Number one branch office
EC:	European Commission
ERCA:	Ethiopian revenue and customs authority
FDRE:	Federal Democratic Republic of Ethiopia
GDP:	Gross Domestic product
IFAC:	International Federation of Accountants
ISA:	International Standard on Auditing
LTO:	Large Tax Payer's Office
MTO:	Medium Tax Payer's Office
OECD:	Organization for Economic Co-operation and Development
RAP:	Repetitive Audit Procedures
SIGTAS:	Standard Integrated Government Tax Administration System
STO:	Small Tax Payer's Office
TAE:	Tax Audit Effectiveness
UNDP:	United Nations Development Program
WB:	World Bank

CHAPTER ONE

INTRODUCTION

This chapter begins by presenting brief background of the study which is followed by the statement of the problem. Under the statement of the problem, the study states the reasons to carry out this study. Following the statement of the problem, the research questions are presented. After that, the general and specific objectives of the study finally, significance of the study, scope and limitation of the study including organization of the paper are presented.

1.1. Background of the Study

Revenue is probably the most important part of the government and most of its plans and policies also depend on the amount of revenue collected. Government has also given priority in reducing the budget deficit through the mobilization of internal resources. Taxation has gained importance not only as a tool for raising revenue but also help to meet the administrative costs 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 (DammeL, 2008). Developing countries are in difficult situation to provide these basic public goods and services from taxes due to weak tax collection and administration (DammeL, 2008).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 (Gebeyhu, 2008).

Among others, tax along with customs collections is an important source of revenue for every government, and it is a heart to a country's wellbeing (DammeL, 2008). In Ethiopia, however, total tax revenue performance has been relatively poor that accounts an average of 10.9 percent of gross domestic product (GDP) during 1990-94 and 12.9 percent of GDP during 2000-2006 (McKinley and Kyrili, 2009).

One of the measures of a country's tax system is GDP at current market price or tax/GDP ratio. A study of World bank report shows that ,developed countries average of Tax/GDP ratio is 34.8%, developing countries average is 25% and sub –Saharan average is 15.89%.from the report of 2003-2006 e.c shows on the last 4 years Ethiopia is below sub-Saharan average. This shows that tax administration corrective measures on the potential problems of tax administration is still a serious issue for all tax branch's makes it to achieve at least sub-Saharan average. Expanded domestic revenue base (especially taxation) offers a promise of greater autonomy in the future and a break from restrictive aid and loan conditionality. With this vision, recently, many poor countries have become preoccupied with improving tax systems. For instance, in the case of Ethiopia in an effort to increase the government's domestic revenue the government replaced the sales tax with Value Added Tax (VAT) & Turn over Tax (TOT). In addition, the Ministry of Revenue was established giving autonomy to the government's revenue organ, and the tax system is computerized. Furthermore, the Federal Democratic Government of Ethiopia is trying to improve its tax administration capacity which encompasses tax audit as one of its component (Gebeyhu, 2008).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, 2006a). The role of an audit program in a modern tax administration must extend beyond merely verifying taxpayers reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation (Biber, 2010). On the other hand, audit is not a very welcome procedure for both the taxpayers and the economy. Conducting audits involves costs to the tax department as well as to the taxpayer. Tax administration agencies should, therefore, use their scant resources very judiciously to achieve maximal taxpayer compliance, and minimal intrusion and costs. Among others, having effective tax audit program is a key success factor for cost minimization and detection of tax evasion and fraud as well as proactively preventing tax frauds (Gupta and Nagadevara undated).

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 administrative capacity of revenue authority but also the involvement of private sectors through proper accounting and reporting (Tadros, 2009). A tax audit in ERCA's context

is defined as: an activity or a set of activities performed by Tax auditors to determine at taxpayer's correct tax liabilities for a particular accounting or tax period, by examine of a taxpayer's organization procedures and financial records in order to assess compliance to tax laws and verifying the true, fair, reliable, and accuracy of tax returns, and financial statements (ERCA, 2010). Tax audit may increase tax revenue in two ways: directly through assessment of additional taxes, and indirectly by improving taxpayer compliance with the tax laws and regulations (Barreca and Ramachandran, 2004)

Tax administration carry out audits so as to verify that the taxpayer has complied with provisions of tax legislation. However, the role of an audit program in a modern tax administration goes beyond verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Audit can play a major role in improving tax administration and overall taxpayer compliance by impacting on taxpayer behavior. In addition to raising revenue directly from audit activities, by selecting the highest risk cases, efficiently detecting non-compliant tax payers, applying appropriate sanctions, and publicizing results of audit activity(either generally or specifically),taxpayers get the message that any attempt to avoid tax presents a high risk of detection and the penalty for non-compliant taxpayers is substantial (Domestic tax audit manual, 2014). In order to optimize use of resources to effectively meet the audit objectives, it is necessary to strategically plan the allocation of available resources to areas likely to have the greatest impact on compliance, while maintaining a balanced program across the taxpaying population. Intelligence, research, and analysis need to be used to define risk areas and audits need to be tailored to address the identified risks (Melat, 2016). The efficiency and effectiveness of audit activities can be greatly facilitated by a broad range of Support tools. Without competent staff tax audit activities will not achieve their objectives. Competency models and competency improvement activities help develop and manage the audit Workforce, Performance management is an important tool for shaping audit behavior and contributes to the attainment of audit program objectives. Monitor change in taxpayer compliance with record keeping, filing and payment obligations, as well as movements in reported tax subsequent to audit activities, as measures of the effectiveness of audit programs. (Ayalew, 2014)

1.2. Backgrounds of the Study Area

The Ethiopian revenues and customs authority (ERCA) is a body responsible for collecting revenue from custom duties and domestic taxes. ERCA was established by the proclamation NO.587/2008 on 14 July 2008, by the merger of the ministry of revenue, Ethiopian custom authority and the federal Inland Revenue authority. It established for the purpose of enhancing the mobilization of government revenues, while providing effective tax and customs administration and sustainability in revenue collection. According to 'the domestic tax audit manual of May, 2014 head quarter of Ethiopian revenue and customs authority (ERCA) segmented its tax payers into large tax payer's office (LTO), medium tax payer's office (MTO), small tax payer's office (STO). Addis Ababa medium taxpayer's Number one branch office is one of The Ethiopian revenues and customs authority branch's in Addis Ababa. Collect domestic taxes from sole proprietor trader whose annual turnover exceeds Birr one Million (1,000,000.00) and above and there trade address found in five sub city's kolfe keranyo , addis ketema , arada , ledeta and yeka sub cities for the rest five sub cities in Addis Ababa there is also other branch called Addis Ababa medium tax payer's Number two branch office. The Ethiopian revenue and customs authority Addis Ababa medium tax payers' Number one branch office established and begin their operation before 4 years in 2006 E.C The most important reasons for introducing medium Taxpayer branch office for Addis Ababa tax payers has been "to provide consistent and quality service to medium and high taxpayers, to secure revenue, to improve audit programs, to improve collections and management of tax debts, and also to act as models or pilots for testing new processes, procedures, structures and systems"(ERCA report,2014).

According to the data from the selected revenue branch office, there are 4,257Category "A" taxpayers, in Addis Ababa medium tax payer's Number one branch office. To improve the compliance of taxpayers the branch perform the tax audit in two department the tax audit and investigation audit; the tax audit department have ten audit teams under that there are 50 auditors and performs their work by selecting tax payers Those tax payers are being selected for audit as a branch level based on risk to revenue and compliance and giving service for those tax payers who want to audit for loan requirement, to participate in auction or to sell more than 50% of their fixed asset and investigation audit also have two investigation audit teams and 14 auditors,

involves the high risk tax payers and most serious cases of non-compliance with criminal asset implications.

1.3. Statement of the Problem

Tax is a vital component of resource mobilization. It provides governments with the funds needed to invest in development, relieve poverty and deliver public services. Furthermore, tax helps to develop and sustain the fiscal responsibility that is needed to promote growth. Adequate tax is essential to strengthening the effective functioning of the country. This is because tax is the most viable source of revenue.

Obviously, a properly designed and administered taxation system is very vital in generating revenue as well as increasing the tax base to the government of developed, developing, and transitional economies.

In Ethiopia, like any other developing countries, faces difficulty in raising revenue to the level required for the promotion of economic growth (Tesfaye, 2015). Hence, the country has been experienced a consistent surplus of expenditure over revenue for long period of time. To tackle this problem the government impose tax (direct and indirect), among others; as major and important sources of public revenue. However, this imposition of tax couldn't still bring the required result due to a number of reasons such as lack of clear understanding about the tax system by the tax payers, tax payers don't comply with their tax obligation, hostility between the tax payers and tax officials, negative attitude of tax payer towards the tax system, unsatisfactory treatment of taxpayers by tax officials, taxpayer ignorance of the benefit derived from public revenue, a negative image of public administration, that is, understating their taxable income by significant amount and related. For these reasons, the actual amount of tax couldn't be collected properly (Tadele, 2010).In addition Gebeyhu (2008) Argues that Weakness in revenue administration lead to inadequate tax collections and financing of the resulting budget deficit through borrowing or monetary expansion can cause an unsustainable increase in public debt and inflation, respectively.

Ethiopian revenue and customs authority Addis Ababa medium tax payers Number one branch office 2009e.c Annual report highlights there is tax evasion and a gap between tax reported by taxpayers and actual taxable income. Tax reported by the taxpayer is less than the tax payable under the law. Selling without sells receipt, increasing operating expenses, declaring illegal

purchase invoice, incorporating unrelated expenses to business are the reasons for decreasing taxable income. The report also shows that the Revenue Authority collects less revenue from direct & indirect taxes(83%) 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 in effective tax audit practice (Revenue Authority, 2009 e.c).

To mitigate such and so fraud problems, therefore, a successful audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue. To the greatest possible extent, tax systems should be supported by clear and straightforward laws and procedures that facilitate revenue collection, develop taxpayer's awareness, and minimize taxpayer's effort and compliance costs. The administration should be provided with appropriate enforcement tools, including conduct of effective audit.

This study is undertaken to solve the above problem a successful audit program is so vital. successful 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. Therefore it is very important to study on assessing Tax Audit practice performance of Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office in order to increase government revenue and assure economic stability. Besides, this study was brought up date to strengthen the proof of previous similar Study.

1.4. Research Questions

The study also tried to answer the following questions:

1. How Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office select cases for audit?

2. What types of tax audit are performed in Addis Ababa medium tax payer's Number one branch office?

3. What are the existing performances of Tax Audit in the selected revenue branch office?

4. What are the main problems of the tax audit program performed in Addis Ababa medium tax payer's Number one branch office?

1.5. Research Objectives

1.5.1 The General Objective

The general objective of this study was assessing the tax audit practice of Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office.

1.5.2 Specific Objectives

Specifically, this research paper tries to address the following issues:

- To assess tax audit case selection techniques
- To identify types of tax audit frequently used in the revenue authority
- To evaluate the existing performance of tax audit program of the revenue authority
- To Identifying the main problems of the tax audit program performed that affects tax revenue collection and taxpayers voluntary compliance in Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office.

1.6. Significance of the Study

The study helps different stake holders for different reasons as listed below among these. In the first place, the selected tax branch office understands the existing Tax Audit performance, evaluating Tax Audit practice to make some adjustment in the procedure and strengthens the weakness of Tax Audit practice. Secondly, it may be helpful for the Tax payers to have knowledge on tax audit. Finally, inform the policy makers to take the problems identified in to account by providing appropriate suggestions as well as it is an initiation for those who are interested to conduct a detailed and comprehensive study regarding tax audit practice and it can serve as an additional source of reference material for those who want to conduct a full time research.

1.7. Scope of the Study

The spatial scope of the study was delimited to Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office. The study focuses on the tax audit

practices in Category “A” Tax payers only. Because in this tax branch office there is only medium tax payers whose annual turnover exceeds Birr one Million (1,000,000.00) and above. Therefore the study doesn’t include Category “B” and “C” taxpayers and it was limited to in one branch office in Addis Ababa because of lack of time and money, and also makes to deal with data that could be handled and managed properly.

1.8. Limitations of the study

Shortages of adequate secondary data, absence of research fund, unwillingness and carelessness of some respondents while filling the questionnaires during data collection were considered as some of the constraints to the study as well as lack of experience of the researcher were other limitations of conducting this study. However, necessary precautions were made so that these limitations was not affect the findings of the study through taking appropriate sample size and triangulating different data collection methods.

1.9. Organization of the study

The research is structured into 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 is concerned with the review of different researches and related literature dealing with the assessment of Tax Audit. Third chapter is presented methodologies used in conducting the study and description of the study area, research design, data sources, data collection instruments, data collection procedures and methods of data analysis, the fourth chapter discusses the results and analysis of the findings of the study. Finally, the fifth chapter presents the summary, conclusions and recommendations based on findings.

CHAPTER TWO

REVIEW OF RELATED LETERATURE

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 three sections. The first section reviews theoretical studies on tax audit in a tax administration system while the second section presents the empirical evidence on tax audits and related issues. The final section provides concluding remarks on the review of the literature and identifies the knowledge gap that has been addressed in the study.

2.1. Theoretical Studies

An audit is the independent examination of financial statements of related financial information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon. (IFAC, 1993)

The American Accounting Association (AAA, 1973) has provided a broader definition of audit which refers to a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. In a narrower sense, audit is an “attestation communication” because it presents the auditor’s opinion or judgment concerning the degree of correspondence between accounting information and established criteria.

The tax audit function plays a critical role in the administration of tax laws in all countries. In addition to their primary role of detecting and deterring non compliance, tax auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the "public face" of are venue body. These factors, as well as the absolute size of the audit function inmost revenues bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function. (IFAC, 1993)

Historically, the audit function conducted by public accountants has been associated with this activity of attesting to financial statements. Tax audit (expected to be performed by public

accountants) can be thought of as an extension of this “attest function”. For tax purpose, one assessee is liable to file a return to the concerned assessing officer with supporting documents sometimes required by tax law for simultaneous submission with the return. The assessee is sometimes called for by the assessing officer under the tax law for producing the same. In this context, the question of tax audit may arise. And “tax audit” means to audit an assessee’s accounting and other documentary evidences to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in tax return and other required evidential statements regarding allowances and disallowance for deductions and all these are to be followed by an audit report giving the auditor’s opinion about the degree of correspondence between the information content in the tax return and the regulatory provisions of the existing tax laws. Thus, tax audit comprises the following: Accounts and other evidences are required to comply with the “tax basis of accounting”, i.e. as per requirement of tax laws;(AAA, 1973)

According to domestic tax audit manual (ERCA,2014) Audit is defined as the structured examination of a business relevant commercial systems, financial and non-financial records, physical stock and other assets, internally generated data and that produced independently of the business. And the main purposes of tax audit in ERCA are to: Establish the extent of a risk or risks and quantify any errors which may have arisen as a result, Improve future compliance, Support those who wish to comply and Deter non-compliance.

2.1.1 Theories of Auditing

Auditing theory helps explain why society needs auditing: the role and purpose of audit services in communication between a company and its environment. The agency theory is the most prominent of the existing theories.

1) Agency theory: Adams (1994) used agency theory to explain that it is in the interest of management to maintain a strong internal audit department. Implementation of audit recommendations is highly relevant to audit effectiveness (Van Gansberghe, 2005) and the management of an organization is viewed as the customer receiving internal audit services. As a result, management's commitment to use audit recommendations and its support in strengthening internal audit is vital to audit effectiveness (Sawyer, 1995).

Using agency theory, Xiangdong (1997) explained the role that internal audit plays in an economy and points out that internal audit has an advantage over external audit in obtaining information quickly and finding problems at an earlier stage; and Spraakman (1997), applying the theory of transaction cost economics, demonstrated how internal audit recommendations are important to the management of government organizations. Audit findings and recommendations would not serve much purpose unless management is committed to implement them. "Auditors are engaged as agents under contract but they are expected to be independent of the agents who manage the operations of the business. The primary purpose of audited accounts in this context is one of accountability and audits help to reinforce trust and promote stability" (Audit quality, 2005)

2) Positive Accounting Theory (PAT): Watts and Zimmerman (1978), seek to develop a positive theory of the determination of accounting standards. "Such a theory will help us to understand better the source of the pressures driving the accounting standard-setting process, the effects of various accounting standards on different groups of individuals and the allocation of resources, and why various groups are willing to expend resources trying to affect the standard-setting process"

3) Institutional theory: the concept of in stitulisation is related to organizations actions over time. Such actions are said to be legitimated within an organization and environment (Pfeffer, 1982). Institutional theory suggests that internal operating processes loosely coupled with the observable structures accomplish the real work of an organization. As a result, organizations with the appropriate structures in place will avoid deep investigations of their function by external auditors (Meyer and Rowan, 1977). Organizations are subject to rules and regulations to which they must conform in order to ensure their legitimacy and thus have access to resources and ensure their survival (DiMaggio and Powell, 1983). However, these rules and regulations don't necessarily guarantee that organizations will continue to operate efficiently (Meyer and Rowan, 1977; Scott, 2008). Institutional elements comprise the institutions and over time the institutional elements are given priority. The key point is to identify what institutional elements reinforce or undercut other elements (Scott, 2008). Functional pressure, political pressure and social sources are three possible factors that cause pressure on institutional common practices (Oliver, 1991)

4) Stewardship theory: Stewardship theory outlines a co-operative and optimistic view of relationships within the corporation by assuming that managers are good stewards and do not misappropriate corporate resources; their behavior is also conditioned by non-financial motives such as the need for recognition of their achievements and performance (Vanden et al, 2004). Thus the directors' role is to counsel and advice rather than to monitor the stewardship theory holds that no inherent, general problem of executive motivation exists. The model of man is based on a steward whose behavior is pro-organizational and collectivistic. Following the basic thoughts of stewardship theory, there is no need of implementing monitoring mechanisms. There is no need of engaging audit services in order to secure the reliability of information. However, within stewardship theory an audit could be of value as a means of assisting the executive's stewardship.

5) Stakeholder theory: Stakeholder theory explains the relationship between organizations and their external environment (Freeman, 1984). A stakeholder is defined as a human agency that can have an impact or affect organizations (Gray et al, 1996). Stakeholders represent the big umbrella for all individuals and parties that may have a direct or indirect interest in an organization. Direct stakeholders are shareholders, employees, investors, customers and suppliers whose interests are aligned with the company. An example of an indirect stakeholder is the government, which is indirectly affected by the company's function (Kiel and Nicholson, 2003). Due to this role of stockholders, organizations are not only accountable to shareholders only but also to stakeholders.

2.1.2 Types of Tax Audit

Audits can vary in their scope and the level of intensity to which they are conducted for this reason; various terminologies have evolved to describe different types of audit activity. (Forum on Tax Administration's Compliance Sub-group, Strengthening Tax Audit Capabilities: General Principles and Approaches, 16 October 2006)

1. 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. In some countries full audits are carried out as part of random audit programs that are used to gather data on the extent, nature and specific features of tax compliance risks, for

compliance research purposes and/or the development of computerized audit selection formulae. Given their broad scope, full audits are typically costly to undertake a substantial program of full audits will require considerable resources and reduce the rate coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types.

2. 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 non compliance. These audits consume relatively fewer resources than full audits and allow for an increased coverage of the taxpayer population.

3. Single issue audits – Single issue audits are confined to one item of potential non-compliance 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.

2.1.3 The Roles of the Taxpayer Audit Program

According to Forum on Tax Administration's Compliance Sub-group, Strengthening Tax Audit Capabilities: General Principles and Approaches,16 October 2006The tax audit program of a revenue body performs a number of important roles that effectively carried out & can make a significant contribution to improved administration of the tax system. These roles are described briefly hereunder:

- **Promote voluntary compliance:** The primary role of the audit program is to promote voluntary compliance by taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized.
- **Detect non-compliance at the individual taxpayer level:** By concentrating on major areas of risk (e.g. unreported cash income) and those individual taxpayers most likely to be evading their responsibilities, audits may bring to light significant understatements of tax liabilities, and additional tax revenue collections.
- **Gather information on the "health" of the tax system** (including patterns of taxpayers' compliance behavior): The results of normal audit activity may provide information on

the general well-being of the tax system. Audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance, that over time can be used to identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on future compliance improvement strategies, to refine automated risk-based case selection processes, and even support changes to tax legislation.

- **Gather intelligence:** Audits may bring to light information on evasion and avoidance schemes involving large numbers of taxpayers that can be used to increase major counter-abuse projects.
- **Educate taxpayers:** Audits can assist clarify the application of the law for individual taxpayers and to identify improvements required to recordkeeping and thus may contribute to improved compliance by taxpayers in the future.
- **Identify areas of the law that require clarification:** Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws' requirements and/or to better educate taxpayers on what they must do to comply into the future.

Given the broad range of roles to be performed a revenue body's audit program typically entails the largest allocation of a revenue body's total staff resources. From this perspective alone, the audit program represents a sizeable strategic investment that dictates the need for sound management policies and practices.

2.1.4 The Efficiency and Effectiveness Tax Audit

Audit effectiveness was measured by examining the amount of evidence selected for examination in relation to the total available evidence and an optimal level of evidence. Audit efficiency was then defined as audit effectiveness per unit of time by taking the audit effectiveness measure divided by minutes spent on the task. The key findings were that time pressure (manipulated by four levels of a time budget for the task) affected performance only at the extremes, with the highest time pressure group performing more efficiently than the auditors in the lowest time pressure group. Efficiency was also affected by audit program structure, with

high structure (more detailed audit procedures listed) being associated with increased efficiency. (International Journal of Finance vol.3, 1999)

Apostolou et al. (1993) defined audit efficiency as the ability to meet the budget and operationalized it as the percentage deviation between actual and budgeted hours. This research examined the effect of leader behavior on audit efficiency. Two leader behaviors—(1) facilitating cooperation and teamwork and (2) administering discipline—resulted in increased audit efficiency. On the other hand, showing consideration contributed to reduced audit efficiency. In addition in an economic sense, the concept of efficiency is rooted in the ideas of minimization of inputs, absence of waste, and least cost production methods Auditing practitioners tend to define efficiency as accomplishing the audit task in less time thereby increasing profitability.(Hollingshead, 1996)

In the US, an official form titled 'Cost Benefit Analysis' (Review of Cost Effectiveness of Investigations) is used to measure the cost benefit of continuing an audit. The form is being prepared at a predetermined stopping point in the audit (such as when 60 hours have been expended by the auditor). The form calculates cost benefit by assigning dollar values for the auditor's hourly labor costs and multiplying the cost by the hours projected to complete the audit. The auditor's total labor dollar cost is matched against the projected revenue anticipated (benefit of continuance). A negative cost benefit analysis may result in the early termination of the audit.

Collectibles is another factor for possible consideration. Some countries use collectability as a pre-contact consideration and other countries reported that it could become a factor during the course of the audit if bankruptcy were imminent. The collectability concept implies that a taxpayer's inability to pay a future proposed tax assessment would be sufficient basis for not conducting the audit. (Hollingshead, 1996)

Those administrations that do not use this concept report that 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.

2.1.5 Audit Case Selection Methods

The primary goal of revenue authorities is to manage and improve overall compliance with the tax laws, and in the process sustain confidence in the tax system and its administration. Tax audit is a sole treatment for compliance risk available to administrations that allows exercising effective sanctions (imprisonment and penalties and/or interest). It acts as a public sanction making the extent of the administration's enforcement powers visible within the community and encouraging others to comply. Compliance risk is the failure to comply with the tax law by taxpayers whether due to their ignorance, carelessness, recklessness, deliberate evasion, or weaknesses in tax administration itself, and have been addressed only by enforcement through an audit-based approach (OECD, 2004a). However, tax administrations do not have sufficient resources to perform thorough on-site audits of the activities of all taxpayers or comprehensive crosschecking of all invoices or transactions. Tax administration, with limited resources and relatively 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, 2004a). Accordingly, the first key to successful audit is the case selection methodology. It is critical to select audit candidates consistent with program objectives. Whatever the audit objectives have, the ability to narrow the pasture of potential audit candidates is necessary to achieve program objectives and optimal use of audit resources. 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 decisions as to the 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 Ramachandran, 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 trails to show why cases have, and have not, been made the subject of an audit (OECD, 2006a). Ebrill et al. (2001) noted that the most effective systems utilize taxpayer profiles and criteria to identify the highest risks for the 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 the 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 the 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 the 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 ceases, 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 return 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 case 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

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 for 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 taxpayer 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, 2006a).

Audit cycle or enquiry window Regulations may be established to require that all audits must be started or completed within 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, 2006a).

Materiality Although a noncompliant high-risk item may be selected for audit, 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 (OECD, 2006a).

Collectability The collectability concept implies that a taxpayer's inability to pay a future proposed tax assessment would be sufficient basis for not conducting the audit. Those administrations that do not use this concept report that 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, 2006a). Apart from the above pre-audit case management factors, there are two key elements necessary in effective translation of strategic priorities for risk treatments in to individual case selections for action; (1) accurate and timely data and information relevant to the compliance risks to be addressed, and (2) knowledge management and analysis techniques to analyze the base data and facilitate feedback in to the compliance risk management process.

Here, the main requirement is access to the data contained within individual tax returns. The essential information to case selection comes from previous case histories of the taxpayer concerned, information from third parties which can confirm the details shown on the tax return, and more generic taxpayer (business sector profile) (OECD, 2004a). Once required data accessed, some form of case analysis methods should be used to analyze the base data for selecting cases. 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 (Barreca and Ramachandran, 2004).

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). As 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.

Screening or case review by auditors: It is the 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 (Vellutini, 2010).

According to OECD (2004a), the challenges inherent in relying on caseworker selection are: it relies on a limited data set with no systematic cross reference to other data available within the administration's system; caseworkers regardless of their experience can miss aspects of noncompliance with which they are non-familiar; those with the knowledge to undertake such screening are usually those with the skills to undertake the substantive intervention. Thus, there is an opportunity cost in asking them to undertake such screening. Modern standards of propriety indicate that there should be a gap between those selecting cases and those functioning cases.

Rule base and 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 the 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 propriety within the case selection system. Automated selections with no opportunity to be influenced such local knowledge can crate 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 the 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 capability 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) stated, 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). As OECD (2004b) noted, statistical analysis is often used to examine taxpayer data and to find the correlation between the data and non-compliance. It typically involves using prior tax audits results, which are then analyzed in conjunction with taxpayer data.

2.1.6 Examination Techniques

A tax auditor applies various techniques to examine the books and records behind a return. The techniques to be used depend on the taxpayer and the tax regime concerned. As Biber (2010) noted, an effective case plan can be cognizant of a range of investigative and analytical approaches that may vary depending upon the area of risk and the circumstances of the particular taxpayer. 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. According to OECD (2006a), the techniques used for audit examination purposes include analytical review, investigative approach, field examination, record examination, and counterpart examination.

Analytical review: An analytical review of financial statements and returns are often completed during the preliminary stages of the 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.

Investigative 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.

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 the 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.

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.

Counterpart examination: It is an examination performed based on third party information where warranted. As 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 dividends 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; and
- ✓ Matching foreign source income.

2.2 Empirical Literature Review

This section reviews the empirical evidence on tax audit practice A number of empirical studies examined tax administration in both developed and developing countries, tax audit program in particular. For instance: Sen and Bala (2002), Arachi and Santoro (2007), Appelgren (2008), Ratto, (2012), Adediran S.A, (2013), Al_Frijat,(2013), Dieu, (2014), Yismaw, (2007) Gebeyhu(2008), Getaneh, (2011) and Ayalew, (2014), have been taken.

All the aforementioned studies examined tax audit. A brief review of each of these studies is presented in the following discussions.

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.

(Ratto, 2012) Argues that random audit programs provide income taxpayers with information that alters their perceptions of, and hence their behavioral responses, audits. Comparing samples of randomly selected audited and non-audited UK taxpayers, the evidence confirms predictions that audited taxpayers found to be “compliant” reduce their subsequent compliance. The opposite response is observed for taxpayers found to be “noncompliant.” The results highlight the importance of testing separately the responses of taxpayers facing different opportunities and incentives to evade tax in order to avoid conflating their different effects, and to reveal both positive and negative indirect revenue effects from random auditing.

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 experiment was measured as the change in declared income between years, and was conducted in 2003-04 on approximately 900 sole proprietors which are divided in to three groups (rational group, random group and control group) each with around 300 firms. The rational group members were informed that audit would focus on taxpayers declaring lowest income. The random group was told that audit would be at random whereas the control group 36 members received no information. Further, the sample was limited to men below the age of 55 in order to concentrate on a high-risk group (younger men are more fraudulent than women and older men). 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

The study of Adediran S.A, (2013) examines the impact of tax audit and investigations on revenue generation in Nigeria. The aim is to determine if tax audit and investigations can actually increase the revenue base of the government and if it can also stamp out the incidence of tax evasion. Data were collected through the primary sources from four hundred and ten

respondents who are staff of the Federal Inland Revenue Service and Edo State Board of Internal Revenue. Hypotheses formulated were tested with Pearson Correlation Coefficient using SPSS output data. The findings are that Tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. It was recommended that Tax audit and investigations should be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country.

(Al Frijat, 2013) The objective of the study was to show the tasks to be performed by AIS in the income tax department to improve the effectiveness of tax audit and collection. The researcher uses descriptive analysis and quantitative analysis .data was collected through interviews with senior managers and review of previous articles and recent official reports of income tax authority. The finding of the study shows that the study found that the AIS used in the income tax department positively influenced the effectiveness of tax audit and collection due to the existence of qualified human resources, an advanced computer system and competent control system.

(Dieu, 2014) The article seeks to explore the role of financial statements audit in promoting tax revenues growth in Rwanda in the broader perspective. Survey questionnaires as primary data collection instruments were distributed to all audit officers of Rwanda Revenue Authority equaling to 100 staff and followed both analytical research design. Secondary data included reports from Rwanda revenue authority from 2006 to 2010. The paper also examines preliminary empirical results on the relationship between financial statements audit and tax growth this paper supports the notion that the practices of audit of final books of accounts for both small and medium enterprises at institutional level are prerequisite for growth of tax revenues in the country. In conclusion, the results not only have the potential to contribute theoretically to public finance but also to the area of institutional performance.

There are also studies on audit and the factors affecting it in Ethiopia

(Yismaw, 2007)The main objective of the study was how audit quality, management support, organizational setting, auditee attributes and the interplay among them, influence audit effectiveness in a public Sector organization. Data were collected via questionnaires distributed

to internal audit personnel and an interview was conducted with the internal audit director. A review of relevant documents audit plans, audit programs, working papers, audit reports and audit manuals, all served as means of generating secondary data. The study was conducted on large public sector higher education institutions or university in Ethiopia with over 25,000 students. There are 14 auditors in the internal audit office of the university; the questionnaires' were distributed to all the auditors. The findings of the study shows .internal audit effectiveness is strongly influenced by internal audit quality and management support and organizational setting and auditee attributes don't have a strong impact on audit effectiveness.

The study by Gebeyhu (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.

The study of (Getaneh, 2011) examined the problems in tax audit practice in Ethiopia (the case of the federal government). The study was conducted to investigate the tax audit practice, and to Identify the main problems of the tax audit program performed that affects tax revenue collection and taxpayers‟ voluntary compliance in the Ethiopian tax system. The study adopted both quantitative and qualitative approaches. Specifically, the techniques used in the study include survey with tax auditors and investigators, in-depth interviews with tax officials and taxpayers, and documentary analysis.

(Ayalew, 2014)The main objective of the study was to examine factors affecting tax audit effectiveness of the Bahirdar city revenue office. It uses quantitative method of research approach. Data was collected through survey of questionnaire analysis of revenue offices tax auditors and taxpayer's analysis, auditors and taxpayer's selected based on simple random sampling method of census and lottery method. The study selected 333 sample participants from a total of 1518 observations, from this 265 were returned. Data was then analyzed on quantitative basis using Pearson's correlation, linear regression analysis and descriptive statistics. The finding of the study shows that; there is no statistical significance negative relationship between auditee attributes and tax audit effectiveness, There is no statistical significance positive relationship among organizational setting, top management support and tax audit effectiveness and there is strongly significance positive relationship among audit quality, organizational independence and tax audit effectiveness.

2.3 Summary and literature gap

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.

The researcher have got access to studies held on, Italy, UK, Sweden, Bangladesh, Nigeria , Rwanda and other few countries. in Ethiopia the study of (Gebeyehu,2008) and(Getaneh,2011) discuss tax audit practice of Addis Ababa city administration and Federal government .on the other hand the study of (Yismaw, 2007) measures internal audit effectiveness by focusing on public sector organizations. While recently the study (Ayalew, 2014) measures tax audit effectiveness of Bahirdar city administration revenue office.

Those studies examine issues regarding tax audit practice using different variables. But the Researcher wants to focus only on AAMTNO1BO. The main reason for selection of such tax branch office is their higher compliance risk and large tax potential and also is highly influential

in investment and other economic activities of Addis Ababa city in addition those studies did not comprehensively examine issues regarding tax audit practice by considering issues such as types of audit performed and its suitability, appropriate case selection approaches, audit techniques applied, educational level and experience of tax auditors in AAMTNO1BO.

Based on these gaps in the literature together with the problems stated the following research questions are established.

"How is the tax audit practice in Addis Ababa medium tax payer's Number one branch office in respect of the type of audit performed and its suitability, appropriate case selection methods used, audit techniques applied 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

RESEARCH METHODOLOGY

3.1. Research Design and approaches

Descriptive type research design is used in this research. Descriptive analysis is a form of data analysis used for the study. Because it is used to describe characteristics of objects, people, groups, organizations, or environments and describe an element of an ideas precisely due to that it is effective for the objective of the study. 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. The main forms of descriptive analysis used for the study are tabulation percentage and proportion. Descriptive survey method focuses on investigating the current status, practice and problem related to tax audit of Addis Ababa medium tax payer's Number one branch office.

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, to enable one approach to inform another approach, either in design or in interpretation. It also helps to triangulate the findings of different approaches.

3.2. Type of Data and Collection Techniques

The study was carried out by using two types of data. Those are primary and secondary data. The primary data were collect through questionnaire and interview. The structured questionnaire consists of closed ended questions to collect quantitative data from the respondents. Most of the closed ended questions were a five scored likert scales 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. And also, depth interviews were made for those most related tax officials. Twelve 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 15 tax officials (tax audit team leaders (10), investigation audit team leaders (2), & compliance & risk management team officials (3). The interview aims at eliciting information on the tax audit practice, regarding types of Audit

performed, case selection techniques, capability of the staffs and the overall tax administration system. Secondary data were also collect from the Addis Ababa medium tax payer's Number one branch office annual report from the past four fiscal years 2006-2009 E.C the time period limitation is due to the branch was established and operate its functions starting from 2006 E.C, number of tax payers registered, number of Audited taxpayers, and gained revenue due to tax audit which are selected for audit. In addition annual report and tax declaration were 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.

Questionnaires were pre tested by five team leaders analyzed respectively and the necessary correction were made and standardized before they were circulated to the respondents to test the validity.

3.3. Population and Sampling Procedure

The selected target population/participants of the study were all Tax Auditors of Addis Ababa medium tax payer's Number one branch office, there are 50 Tax Auditors, 10 tax audit team leaders, 14 investigation auditors and 2 investigation audit team leaders were available in Addis Ababa medium tax payer's Number one branch office.

Therefore, since the number of Auditors was small, the study assumed the data of all Tax Auditors & investigators taking as a sample or there was no need of taking sample from the frame. Thus in this case the sample size is equal to the population which enabled to make appropriate generalization to the overall population.

3.4. Methods of Data Analysis

In accordance with the data types, quantitative and qualitative data analyses were employed. The quantitative data were analyzed by tables, charts and graphs. The analysis of data involves computation of statistics such as ratios, frequency and percentage analysis methods are applied, where as the qualitative data analysis described qualitative data by themes.

3.5. Data Presentation

The collected and analyzed data was presented by using simple percentage, tables, proportions and figures.

CHAPTER FOUR

RESULTS AND ANALYSIS

4.1 Introduction

In the previous chapter the research methodology has been discussed, and the methods adopted for the study to attain the objective have been stated. This chapter represents the findings of the study conducted to assess the Tax audit practice in Addis Ababa medium tax payer's Number one branch office.

The subsequent discussion presents the results of survey, in-depth interview, and documentary analysis. Specifically, section 4.2 presents the survey outcomes. Section 4.3 presents the results of in-depth interviews with tax officials and the presentation of documentary analysis results in section 4.4.

4.2. Survey Results

The sample size for the survey was 76 tax auditors and investigators so that 76 questionnaires were distributed. Nevertheless, the survey response was collected from only 70 survey respondents. For this study, the response rate was 92.1 percent, while the remaining 7.9 percent of the questionnaires were not returned at all due to their workload as well as reluctance of respondents to complete and give back the questionnaires.

The remaining discussion in this section presents the survey outcomes regarding respondents' background information, types of tax audit, examination techniques, Measurement of audit efficiency and audit effectiveness, purpose of tax audit and audit resources.

4.2.1. Background Information of Respondents

The majority of respondents (67.1 percent) were under the age category of less than 30 years. Out of the total respondents, 54.3 percent were males and 45.7 percent were females. Regarding educational level, 95.7 percent of respondents were BA degree holders this shows the branch has a qualified audit staff. And the respondents studied Accounting & Finance (65.7 percent), Management (18.6 percent), and Economics (11.4 per cent). The rest 4.3 percent of respondents

studied other fields. Regarding occupation, 67.1 percent of respondents were tax auditors, 18.6 percent tax investigators, 11.4 percent tax audit&2.9 percent investigator team leader, in the case of audit experience before joining ERCA 97.1 percent of respondents have not any audit experience and regarding to working experience in their current job occupation55.7 percent of the respondents have less than two years experience, This implies that the tax auditors in Addis Ababa medium tax payer's Number one branch office had no enough experience for their current position (Table1).

Table 1: Background Information of Respondents

Variables	**N=70**	**Count (NO.)**	**Percent**
Gender	Male	38	54.3
	Female	32	45.7
Age	less than 30 years	47	67.1
	30-40 years	14	20
	40-50 years	7	10
	Above 51 years	2	2.9
Highest level of education	Certificate	-	-
	Diploma	-	-
	BSc/BA	67	95.7
	Msc/MA and above	3	4.3
Field of study	Accounting and Finance	46	65.7
	Economics	8	11.4
	Management	13	18.6
	Others	3	4.3
Current job occupation	Tax auditor	47	67.1
	Tax investigator	13	18.6
	Tax audit team leader	8	11.4
	Investigation team leader	2	2.9
Audit experience before joined ERCA	YES	2	2.9
	NO	68	97.1
Experience in current job occupation	Less than 2 years	39	55.7
	2 – 4 years	11	15.7
	4- 6 years	9	12.9
	Above 6 years	11	15.7

4.2.2. Types of Tax Audit Performed

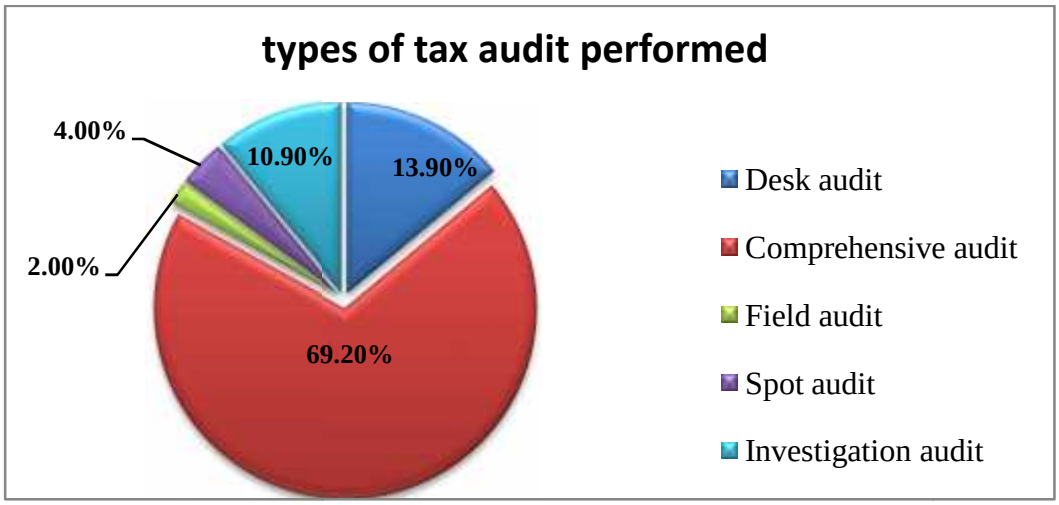
Table 2: Types of Tax Audit Performed

Types of tax audit performed	Frequency
Desk (office) audit	14
Field audit	2
Comprehensive audit	70
Issue (spot) audit	4
Refund audit	0
Fraud investigation	11

*Multiple answers were possible
**Figures do not add up

The survey results showed that AAMTNO1BO exhaustively conducts comprehensive audit (69.3 per cent of respondents) followed by desk audit (13.9 per cent of respondents). AAMTNO1BO also conducts fraud investigation (10.9 per cent), field audit (2 per cent), and spot (issue) audit (4 per cent) (Table 2). The survey respondents further stated that comprehensive audit is conducted using four-year taxpayer information to check whether taxpayers filed and paid the appropriate tax returns in line with the tax law and accounting principles. In AAMTNO1BO, 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 per cent of their business fixed assets or close their business. AAMTNO1BO performed desk audit for data cleaning purpose to confirm whether the data submitted by the taxpayers is genuine

Chart 1: Types of Tax Audit Performed in percent



4.2.3. Examination Techniques

The accuracy of tax returns have been tested through review of financial statements and returns (85.7 per cent); examination of information from third parties (40 per cent); examination of taxpayers‟ records (74.5 per cent); observing, discussing and reviewing documents of taxpayers (100 per cent); and physical checks of businesses‟ current operation including transactions, assets and other aspects (44.3 per cent). The survey result further showed that field examination (physical checks of taxpayer's assets and other aspects) is mainly used when a particular taxpayer needs to sell its business fixed assets or close the business (Table 3).

Table 3: Examination Techniques used to check the Accuracy of Tax Returns

Examination techniques used	**Frequency**	**Percent**
Review of financial statements and returns	60	85.7
Observing, discussing and reviewing taxpayers‟ documents	70	100
Physical checks of transactions, assets and others aspects	41	44.3
Examination of taxpayers‟ records	36	58.6
Examination of information from third parties	28	40

*Multiple answers were possible

**Figures do not add up

4.2.4. Measurement of audit efficiency and audit effectiveness

Table 4: Measurement of audit efficiency and audit effectiveness

	Item	NO. (Percentage)				
		S/Ag	Agree	Neutral	Disagree	S/disag
1	Tax auditors and investigators have good access to information held by the taxpayers and others	0 (0%)	6 (8.6%)	0 (0%)	64 (91.4%)	0 (0%)
2	Education and experience on tax audit affect tax audit effectiveness	67 (95.7%)	3 (4.3%)	0 (0%)	0 (0%)	0 (0%)
3	Is there a rule to start and complete the audit within a specified timeframe	64 (91.4%)	6 (8.6%)	0 (0%)	0 (0%)	0 (0%)
4	Audit is performed based on audit manual	0 (0%)	19 (27.1)	6 (8.6%)	45 (64.3)	0 (0%)
5	Is there Continuous and sufficient trainings/tutor regarding tax law and tax audit issues	0 (0%)	9 (12.9%)	0 (0%)	53 (75.7%)	8 (11.4%)
6	Management does provide enough support and encouragement for training and developing the tax auditors	0 (0%)	2 (2.9%)	0 (0%)	68 (97.1%)	0 (0%)
7	The audit work to be started and completed within a predetermined timeframe	0 (0%)	11 (15.7%)	0 (0%)	52 (74.3%)	7 (10%)
8	Effectiveness of tax audit is measured by volume of the audit performed	6 (8.6%)	64 (91.4%)	0 (0%)	0 (0%)	0 (0%)
9	Effectiveness of tax audit is measured by productivity and yield of audit	2 (2.9%)	68 (97.1%)	0 (0%)	0 (0%)	0 (0%)
10	Audit is supported by intelligence input	0 (0%)	2 (2.9%)	10 (14.2%)	58 (82.9%)	0 (0%)

Regarding taxpayers cooperation to give enough information for tax Auditors, Table 4 item one reveals that taxpayers are not cooperate to give enough information regarding their businesses for Tax Auditors or investigators. It shows that 91.4percent of respondents, Taxpayers were not cooperative to give sufficient information for Tax Auditors and Investigators. And small portion (8.6percent) of respondents replied that taxpayers were cooperating with Tax Auditors. Generally, as the above table item one the cooperation of taxpayers with tax auditors as well as investigators was low And Taxpayers were not fully cooperating for the effective tax administration system. They are not given enough information for tax Authority.

The above table item two 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. The survey result shown on table1, Tax Auditors has no enough audit experience and more than 55.7 per cent of survey respondents have an experience of less than two years in their current position. As indicated in item three of Table 4, 100 per cent of respondents showed that AAMTNO1BO has a rule that requires audit activities to be started and completed within a predetermined timeframe. The survey respondents further agree that to do comprehensive audit there is audit timeframe and it is based on Taxpayers annual transaction or taxpayer's segmentation, Large Taxpayers with annual turnover of above ETB. 15,000,000 has 30 days for three fiscal years, Medium taxpayers with annual turnover of above ETB 1,000,000 and less than ETB 15,000,000 has 25 days for four fiscal years and Small taxpayers with annual turnover of above ETB 100,000 and less than ETB 1,000,000, has 10 days for four fiscal years.

Ethiopian Revenue & custom Authority has an audit manual start from May 2014 but According to the result from the above table item four more than 64 percent of respondent disagreed that tax audit performed by the AAMTNO1BO was based on Audit manual that show AAMTNO1BO does not apply fully the audit manual and the Audit performed was without Audit manual.

As shows in the above table 4 item five and six, views of Tax Auditors regarding the Revenue Authority (AAMTNO1BO) provide continuous and sufficient training for Tax Auditors to increase their efficiency. 86 percent of respondent Tax Auditors disagree on the issues that tax authority provides continuous and sufficient training for the Auditors and 97 percent of respondents disagree on Management does provide enough support and encouragement for

training and developing the tax auditors. The survey result further shows that tax auditors not start and complete the audit work as of the standard of the authority, more than 84 percent of the respondents agreed that the audit work was not start and complete with in predetermined time frame. This implies that the Revenue Authority has no standard time for complex and simple cases and the timeframe is settled only based on amount of annual transaction.

As indicated in table 4 item eight, 100 percent of respondents, agreed that the effectiveness of tax audit was measured by volume of tax audit or coverage of tax Audit performed and also as shows in the same table item nine above 100 percent of respondents agreed that the audit effectiveness was measured by productivity and yield of audit.

The survey result on Table 4 Item 10 depicted that how 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. 82.9% of respondent tax auditors reported that the audit works performed by tax auditors were not supported by intelligent team information. This result revealed that the selected tax branch office was not as such supported by intelligent work/information and it leads to unsuccessful tax audit.

4.2.5 Purpose of Tax Audit

Table 5: Purpose of Tax Audit

	Item	**NO. (Percentage)**				
		S/Ag	**Agree**	**Neutral**	**Disagree**	**S/disagre**
1	The primary purpose of tax audit performed in tax administrations is to ensure compliance in accordance with tax law	3 (4.3%)	31 (44.1%)	6 (8.6%)	30 (43%)	0 (0%)
2	The primary purpose of tax audit performed in tax administrations is to assess and collect additional tax revenue.	66 (94.3%)	4 (5.7%)	0 (0%)	0 (0%)	0 (0%)
3	Tax audit performed in tax administrations is to educate taxpayers.	0 (0%)	2 (2.9%)	0 (0%)	64 (91.4%)	4 (5.7%)
4	Tax audit is for reducing tax evasion and tax fraud	0 (0%)	46 (65.7%)	0 (0%)	24 (34.3%)	0 (0%)

According to table 5 item one, the primary purpose of Tax Audit is to ensure compliance behavior of taxpayers. 48.4 percent of the respondent tax auditors were agreed that tax audit performed in the city revenue authority (AAMTNO1BO) is to ensure compliance behaviors of the taxpayers and 43% of respondents replied that to ensure compliance in accordance with tax law is not the primary purpose of tax audit. On the same table item2, 100 percent of the respondent tax auditors agreed that tax audit also conducted to assess and collect additional tax revenue. Item three of table 5 depicted that, tax audits is not allow tax auditors to educate taxpayers on the application of tax laws,97.1 percent of respondent tax auditors were not agreed on the issue that tax audit is for educating taxpayers.

Tax audit is for reducing tax evasion and tax fraud. The survey result shows that tax audit is vital for reducing tax evasion. As 65.7 percent of respondent tax auditors tax audit has positive effect on reducing tax fraud and tax evasion.

4.2.6 Audit Resources

Table 6: Audit Resources

	Item	NO. (Percentage)				
		S/Ag	Agree	Neutral	Disagree	S/disag
1	The number of auditors in tax audit and investigation audit are enough for a given amount of auditing work planned and needing to be done in the near future	0 (0%)	20 (28.6%)	0 (0%)	38 (54.3%)	12 (17.1%)
2	Enough material and equipment for audit program	0 (0%)	43 (61.4%)	0 (0%)	27 (38.6%)	0 (0%)
4	Well organized structure and suitable office	0 (0%)	39 (55.7%)	0 (0%)	31 (44.3%)	0 (0%)
3	Qualified audit staff /well experienced staffs are available	0 (0%)	5 (7.1%)	0 (0%)	54 (77.1%)	11 (15.7%)

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.

According to the above table 6, more than 70 percent of respondents indicate that the Revenue Authority (AAMTNO1BO) has no enough audit staff to perform a given amount of auditing work planned and needing to be done in the near future. For the effective and efficient tax audit not only the adequate number of tax auditor's but also skill and qualification of tax auditors, materials and equipment necessary for audit have greater impact. Table 6 item two, shows that AAMTNO1BO has enough materials and equipment to facilitate audit program. And on the same Table item 3 also 55.7 percent respondents were also responded that AAMTNO1BO has well organized structure and suitable office for tax audit but in the other hand more than92 percent of respondents were responded that the AAMTNO1BO have no well experienced audit staffs to perform audit.

4.3. In-depth Interview Results

As the responses of interview AAMTNO1BO 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 tax branch office was not used different types of tax audit as per the intensity of cases and business character the interview results also revealed that AAMTNO1BO critically conducts investigation audit based on the information that comes from various sources with evidence regarding the deliberate evasion or serious fraud.

Further, the in-depth interview with tax auditors shows that practically the purpose of tax audit merely focused to collect additional tax revenue and to increase audit volume these is done to mitigate annual plan of the selected revenue branch office.

Regarding methods of audit case selection, the interview with tax auditors AAMTNO1BO 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 and compliance & risk management team selects cases based on risk selection criteria.

In addition, the interview with compliance & risk management team showed that tax audit is conducted using information from SIGTAS (Standard Integrated Government Tax Administration System), intelligence team, and third parties such as banks. However, the use of SIGTAS does not provide reliable decision to assure appropriate risk selection due to absence of well-organized and clean data. For the purpose of audit case selection, the interview with compliance & risk management team showed that ERCA has partially implemented automated tax return filing systems and due to absence of well-organized and clean data SIGTAS has not been fully utilized for risk assessment. As a result, start from December 2006 e.c ERCA uses risk-based approach risk selection criteria manually.

According to the interview results the selection criteria is the same for all taxpayers segmentation (large taxpayers, medium taxpayers & small taxpayers)these is the main limitation of the selection criteria due to that, ERCA currently on July 2009 e.c formulated different risk selection criteria for each taxpayers segmentation. Based on The result of ERCA risk selection criteria taxpayers are classified high risk (red), medium risk (yellow) and low risk (green).TheAAMTNO1BO compliance & risk management team selects high and medium risk level taxpayers for tax audit but the tax audit department audited only high risk level of tax payers because of a small number of tax auditors. Regarding segments of taxpayers selected for audit, the interview with tax officials showed that ERCA currently used segmentation approach in place of tax type based approach (the previous tax administration model) to conduct tax audit in order to provide a highly integrated and one spot customer service for taxpayers. Taxpayers have been segmented into Large Taxpayers Office (LTO) include taxpayers with annual turnover of above ETB. 15,000,000, Medium include taxpayers with annual turnover of above ETB 1,000,000 and less than ETB 15,000,000, Small include taxpayers with annual turnover of above ETB 100,000 and less than ETB 1,000,000, and Micro Size taxpayers include taxpayers with annual turnover of below ETB. 100,000. The segmentation approach results in customer satisfaction and minimizes both taxpayer compliance costs and tax administrative costs. In our capital city Addis Ababa steel there is no a branch office for large tax payers but now there is a plan will established and begin their operation in the next year (2011 e.c) therefore Addis Ababa medium tax payer's Number one branch office and Addis Ababa medium tax payer's Number two branch office contain the city's large & medium tax payers. The in-depth interview with tax auditors further stated that, in addition to their large tax potential, medium taxpayers segment in

Addis Ababa has huge impact on investment and other economic participation in the city. Thus, the Ethiopian tax system prioritizes and provides quality and on time services for such taxpayers for the benefit of both taxpayers and the tax administration system. It is unquestionable to ERCA to deploy its scarce resources primarily in large taxpayers regardless of the significance of risks that need attention to be audited in other taxpayer segments though it is necessary to allocate tax audit resources for the conduct of audit in other taxpayers segment. Because large taxpayers can contribute a huge amount of tax revenue as well as have complex structure and multiple operating entities.

The interview respondents further stated risk criteria that include: the trend of delay in tax payment, non-filing tax returns, nil tax declaration, showing abnormal and repetitive loss report, profit significantly deviated from previous periods (underreporting income), report of too deviated margin from the sector, over claimed deductions, unusual credit and refund claim, and past case histories of taxpayers.

Regarding audit staff recruitment and development, the in-depth interview with tax auditors revealed that the Revenue Authority recruit less/no experience audit staff than experienced auditors Tax rules, regulation and directives are complex to understand easily and interpret. Additionally, it takes time for less experienced auditors to adopt with the 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.

Tax auditors and investigators are employed in AAMTNO1BO based on their level of education and cumulative grade point average (CGPA). Currently, ERCA hired a mass of youngest employees from newly graduated students, accounting and finance graduates as a tax auditor in particular. The interview respondents also stated that previous audit related work experience is preferable, and every recruited auditors and investigators should have good ethical behavior. In addition, at the time of recruitment, all candidate employees are expected to attend training regarding government policies and strategies, overall objectives and structure of ERCA, tax rules and regulations, and one week basic audit training (for candidate tax auditors). Nevertheless, the interview with tax auditors revealed that there is no a well-established model to make a continuous competency assessment. The in-depth interview with tax auditors further showed that tax auditors are categorized in to audit teams having their own team coordinators. Under each audit team, there are three levels of auditors: junior auditor, auditor, and senior auditor. The tax

audit team coordinators assign audit cases to their own team members based on the auditors experience and capability as well as the complexity of cases. The simple and medium cases are expected to be performed by junior auditors and auditors, whereas very complex cases are assigned to senior auditors. The tax 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.

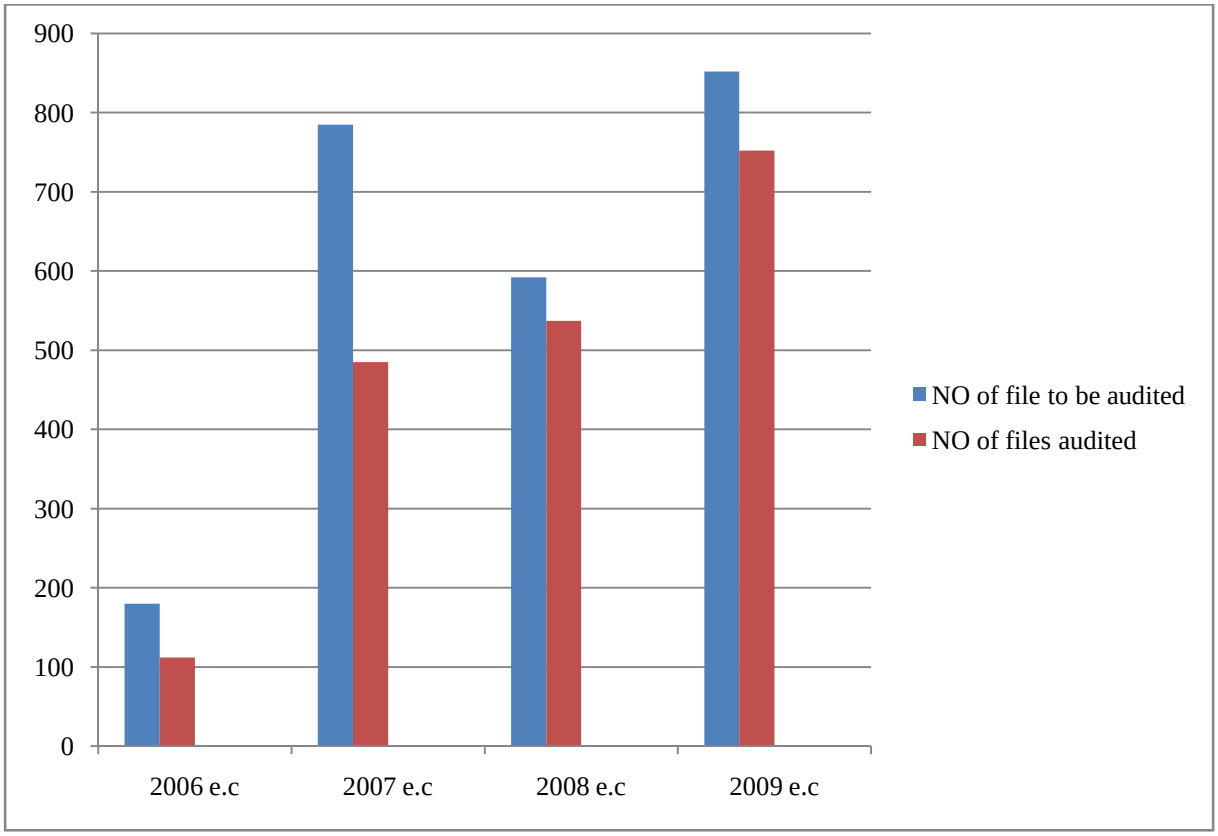
The in-depth interview with tax auditors also suggest that there is no anybody to evaluate tax audit performance only there is supervision committee to check some points yearly for the improvement of the overall tax administration and audit quality. Strength service delivery to create strong enforcement, make clear and accountable work environment must be created, create awareness give weekly/monthly meeting with tax payers, given information through Radio and TV on local areas language, magazines, workshops, brushers, newspapers and openly discusses with tax payers to curb tax evaders and corruption, recognize model tax payers as well as tax officials, adjusting rules and regulation based on tax payers feedback, monitor and evaluate the tax employees, strengthen strong political commitment, penalty does not teach tax payers instead education, respect every taxpayers as customer, make a notice before any harsh measurement And auditors should primarily focused to educate taxpayers and improve their voluntary compliance. The duty of taxpayer's awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks.

4.4. Documentary Analysis Results

Table 7: Audit Plan and Coverage for the Last 4 Years

YEAR	audit plan in number	audit plan in amount	execution in no.	execution in amount	audit coverage
2006 e.c	180	250 million	112	181 million	62.22
2007 e.c	785	350million	485	427million	61.78
2008 e.c	592	430 million	537	464 million	90.7
2009 e.c	852	650 million	752	522 million	88.26

Graph 1: Audit Plan and Execution of Files



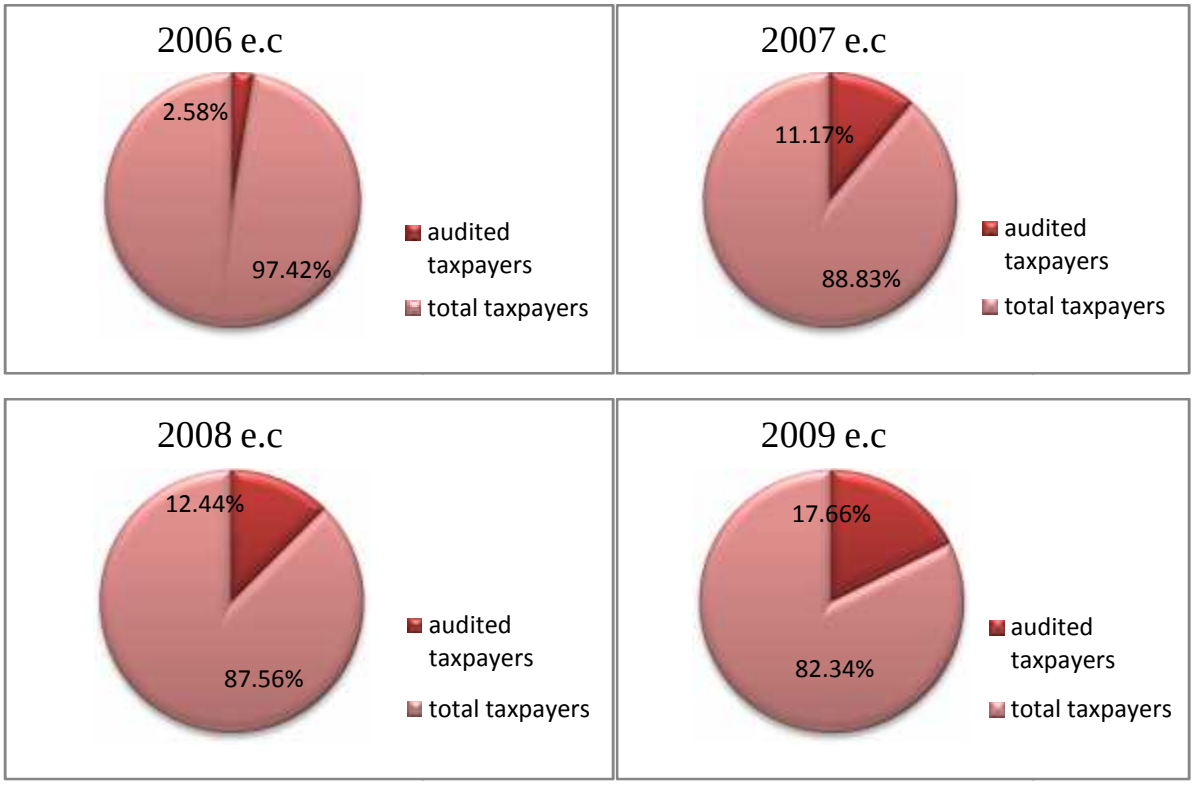
According to the AAMTNO1BO annual report document as the above table states on in each year the organization states its plan for audit but in the last 4 years the organization couldn't meet its objectives. As the researcher understand from the interviewee & reports there is high rate of employee turnover especially in the audit department. Regarding the audit report AAMTNO1BO has audited 112 taxpayers and found additional tax revenue of birr 181 million in 2006 e.c fiscal year. In 2007 e.c fiscal year, the authority covered 485 taxpayers and found additional tax revenue of birr 427million. In 2008 e.c fiscal year, the authority covered 537 taxpayers and found additional tax revenue of birr 464 million and AAMTNO1BO audited 752 Taxpayers and found additional tax revenue of birr 522 million in 2009 e.c fiscal year

Table 8: The Total Number of Taxpayers and Audited taxpayers

Item	Fiscal Year			
	2006 e.c	2007 e.c	2008 e.c	2009 e.c
Total number of taxpayers administered by ERCA	4,339	4,339	4,315	4,257
Total number of tax payers audited in ERCA	112	485	537	752

Regarding audit coverage, the total number of taxpayers administered by AAMTNO1BO was 4,339 in 2006 e.c and the authority covered 112 taxpayers through audit (2.58 per cent), in 2007 e.c the total number of taxpayers administered by AAMTNO1BO was the same with the past fiscal year and the authority covered 485 taxpayers through audit (11.17 percent), in 2008 e.c the total number of taxpayers administered by AAMTNO1BO was 4,315 and the authority covered 537 taxpayers through audit (12.44 percent) and the total number of taxpayers administered by AAMTNO1BO4,257 in 2009 e.c and the authority covered 752 taxpayers through audit (17.66 percent) (Table 8).

Chart 2: Tax Audit Coverage in percent



4.5. Analysis

This section presents the analysis and interpretation of the results having the necessary data collected and presented in section 4.2, 4.3 & 4.4 to come up with meaningful patterns

The first aspect of tax audit practice is the type of audit performed in AAMTNO1BO and its suitability in respect of improving voluntary compliance and increasing tax revenue for the city of Addis Ababa. An effective audit program should be with vigorous range of audit types directed to a wide range of taxpayers and tax types. Biber (2010) stated that the 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 effect that needs to be accomplished. As OECD (2006a) stated, the scope of tax audit may be narrow or broad depending on the specific risk relating to a taxpayer, and the limited audit resources should also be allocated towards the noncompliant to detect compliance risk, and to support those taxpayers who want to be complaint. However, the results of the study revealed that tax audit program remains undeveloped in AAMTNO1BO with an emphasis on comprehensive and desk audit with the exclusion of other audit methodologies (Table 2). As Biber (2010) stated, excessive examination might be appropriate to properly detect taxpayers‟ noncompliance when it has been applied to those taxpayers where there is an indication of underreporting that could impact across taxes. Nevertheless, AAMTNO1BO exhaustively conducts comprehensive audit with intensive examination of four-year taxpayer data across all tax obligations. As a result, AAMTNO1BO might consume audit resources improperly with exertion of much work force, tax audit staff in particular, on mass of transactions and intensive records even on reliable tax returns due to its concentration merely on comprehensive examination of four-year period documentation. As OECD (2006a) stated, such type of audit operation might result low audit coverage (rate) that affects, the overall deterrent effect (future improvement in taxpayers' voluntary compliance by encouraging compliant taxpayers and detecting noncompliant taxpayers through covering a wide range of taxpayers) and future tax revenue.

On the other hand, the practice of spot (issue) audit is almost nil (Table 2). AAMTNO1BO does not consider its audit activities to be on specific errors or compliance risks (transactions and vouchers or records) that concerns the tax system with respect to potential loss of tax revenue

due to evasion or fraud and other noncompliance activities. As a result, as Biber (2010) stated, the tax authority might suffer low audit coverage that minimizes tax revenue and overall voluntary compliance.

Moreover, in Ethiopia, there is a need to have taxpayers that might be registered voluntarily and discharge their tax obligations. As a result, tax audit is conducted, in AAMTNO1BO, primarily to ensure compliance in accordance with the tax law, to assess and collect additional tax revenue, check tax fraud or evasion, and educate taxpayers. The main activities of auditors and investigators during their audit work include detecting noncompliance of individual taxpayer and merely focused to collect additional tax revenue and to increase audit volume (Table 5).

Among others, creating taxpayers awareness might be necessary to increase voluntary compliance and to mitigate future compliance risks in Ethiopia. Because compliance risks might arise mainly due to taxpayers‟ lack of awareness as well as weakness in the tax administration, taxpayers‟ carelessness, and taxpayers‟ deliberate action. Consequently, as the in-depth interview with tax officials stated that AAMTNO1BO has not given much attention to educate taxpayers therefore AAMTNO1BO may not achieve the expected future voluntary compliance in the absence of services along with the taxpayer's lack of tax awareness. Without educating taxpayers and creating tax awareness, making power visible to the community might detect the deliberate evasions and frauds but not be a solution to create a compliant taxpayer those does not comply unknowingly. As EC (2006) stated, tax administrators should not simply enforce but must foster tax compliance through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary. Hence, implementation of severe penalty and enforcement to pay evaded tax may not be long-lasting solution to create fair and smooth tax system with high compliant taxpayers to AAMTNO1BO.

ERCA has conducted its audit activities Based on The result of ERCA risk selection criteria taxpayers are classified high risk (red), medium risk (yellow) and low risk (green). TheAAMTNO1BO compliance & risk management team selects high and medium risk level taxpayers for tax audit but the tax audit department mainly audited high risk level of tax payers because of a small number of tax auditors Along with less emphasis for medium and low risk taxpayers. The main reason for the selection of such level of taxpayers for audit purpose is their higher compliance risk and large revenue potential. This finding is confirmed by the in-depth

interview with compliance & risk management team and tax auditors, and the interview result showed that tax audit program in AAMTNO1BO focused chiefly on high risk level taxpayers they are highly influential in investment and other economical activities. In addition, AAMTNO1BO deployed undeniably its scarce resources primarily to taxpayers with large tax potential regardless of the significance of risks that need attention to be audited in other taxpayer segments. As a result, AAMTNO1BO may increase its tax revenue through audit of taxpayers those with large tax potential. However, as Tait (1988) stated, the deterrent effect of tax audit (improving voluntary compliance) is best achieved by extending the audit program to as many taxpayers as possible at all levels of taxpayers. Voluntary compliance is generally enhanced by increasing the number of taxpayers audited than auditing taxpayers with large tax potential. Thus, AAMTNO1BO may not improve future taxpayer's voluntary compliance that may affect future tax revenue, and may not be capable to sustain confidence in the tax system and its administrations in the absence of improving overall voluntary compliance. Further, AAMTNO1BO may increase short-term tax revenue by auditing taxpayers with large tax potential at the expense of decreasing future tax revenue and compliance at other segments of taxpayers. When AAMTNO1BO gives emphasis only for high risk level of taxpayers, the unaudited medium and low risk level of taxpayers would feel that their underreporting and other noncompliance activities have little chance of being detected due to less probability of being audited.

The other characteristic of effective tax audit program is a broad coverage of taxpayer groups (by size and sector) and compliance issues (Harrison and Krelove 2005). As indicated in the literature review in chapter two, in a fairly well established tax system, audit rate of 15 to 20 percent of registered traders a year is sufficient (Tait 1988). However, AAMTNO1BO audited only 112taxpayers out of 4,339 registrants (2.58 per cent), and have detected and found evaded tax revenue of birr181 million in the 2006 e.c fiscal year. Similarly, in the 2007 e.c fiscal year, the authority audited 485taxpayers out of 4,339 registrants (11.17 per cent), and found additional tax revenue of birr 427million (Table 7). It indicates that AAMTNO1BO 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 AAMTNO1BO. 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.

Regarding tax audit timeframe, AAMTNO1BO has a rule that requires an individual audit case to be started and completed and it is based on Taxpayers annual transaction or taxpayer's segmentation, Large Taxpayers with annual turnover of above ETB. 15,000,000 has 30 days for three fiscal years, Medium taxpayers with annual turnover of above ETB 1,000,000 and less than ETB 15,000,000 has 25 days for four fiscal years and Small taxpayers with annual turnover of above ETB 100,000 and less than ETB 1,000,000, has 10 days for four fiscal years (Table 4). As a result, as per the researcher's knowledge concerned, AAMTNO1BOtime allocation for audit cases is only based on taxpayers annual transaction there must be allocation of equal period for different types of business and both complex and simple cases these might result operational inefficiency including decrease in audit quality and coverage although there is no standard timeframe for both complex and simple cases. Tax auditors those expected to perform complex cases 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.

Regarding examination techniques, various types of information might be reviewed namely tax returns, financial statements, accounting records, customs declaration and other source documents in AAMTNO1BO. The techniques used to test the accuracy of tax returns include: examination of information from third parties banks and informants; 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 taxpayer's current business condition through physical checks of current transactions, assets and other aspects (Table 3). 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. As OECD (2006a), 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 AAMTNO1BO. The accuracy of taxpayer's tax liability is determined mainly through analytical review of financial

statements and returns. Thus, AAMTNO1BO 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 AAMTNO1BO to establish the completeness, accuracy, credibility, and validity of taxpayer's declarations, disclosures and other financial arrangement.

Moreover, effective and efficient tax audit practice depends on having capable and experienced audit staff resources. The in-depth interview with tax officials supports this assertion, and the interview result showed that ERCA yearly hired a mass of youngest employees, auditors in particular, based on their educational level and cumulative grade point average (CGPA), which is imperative to acquire successful tax auditors. However, having employees hired with high CGPA is not a guarantee for ERCA to have a qualified audit staff that might increase audit performance in terms of audit quality. As a result, AAMTNO1BO provides training and exam regarding tax law and tax audit issues at the time of recruitment before engaged in tax audit activities. Further, training is not enough only during recruitment. Rather, it is essential before, during, and after recruitment based on appropriate need assessment and gap identification. As noted in the literature, competency improvements should be integrated in to normal business activities, and auditors should have been given continuous training so that their skills are kept up-to-date and relevant (OECD 2006a). However, AAMTNO1BO provides inadequate training after recruitment and once the auditors held their required position (Table 4). The in-depth interview with tax officials also confirmed that there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once the employees have given and held a particular position

As a result, AAMTNO1BO does not have experienced and proficient tax auditors. As the results of the survey revealed, about 97.1 per cent of tax auditors have no any audit experience before employed in ERCA. In addition, about 55.7 per cent of the current tax auditors and investigators have an experience of less than two years (Table 1). This might be due to higher staff turnover in the tax authority, tax audit team in particular. The authority fails to retain proficient and well-trained auditors. As employees become more experienced, it is expected that they might become effective and need safe working environments. Hence, most tax auditors resign themselves from their position after two to four years of experience that might be due to workload without

additional benefits, unsafe atmosphere in work environment, absence of satisfactory allowance for fieldwork and absence of performance based promotion.

Regarding the capability, having proper audit planning, it is reasonable to expect an office auditor to complete an average of 1 up to 2 cases in a month, however, in AAMTNO1BO, an individual auditor has performed an average of less than 2 cases a month, and some auditor has performed more than 2 cases a month. An experienced junior tax auditor has also performed better This shows that tax auditors are not at the required level of operational capability to conduct tax audit. The operational incapability of tax auditor might be due to absence of using effective pre-audit plan and inadequate audit training.

The tax officials, auditors in particular, also fail to keep properly taxpayer's data that have been already submitted by taxpayers, and they unnecessarily request taxpayers to submit the report yet again. Such unreasonable request might create negative image about ERCA on the eyes of compliant taxpayers that affects the smooth operation of the tax system as well as increase taxpayer's burden and compliance costs so that they might hesitate to comply with the tax system in their future tax periods.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary of Major finding

Tax audit performed by Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office is to determine the taxpayers' correct 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 Ababa medium tax payer's Number one branch office with respect of appropriate case selection methods used, types of audit performed and its suitability, audit techniques applied and experience and capability of audit staff resources and effectiveness of audit program in terms of educating taxpayers and improving voluntary compliance.

Depending on the review of related literature as well as analysis and interpretation of the data, the findings are summarized and presented as follows: The AAMTNO1BO not fully utilize SIGTAS for risk assessment purpose and the selection possess was not automated, tax audit program remains undeveloped in AAMTNO1BO with an emphasis on comprehensive and desk audit with the exclusion of other audit methodologies, the branch might consume audit resources improperly with exertion of much work force on mass of transactions and intensive records even on reliable tax returns due to its concentration merely on comprehensive examination and such type of audit operation might result low audit coverage (rate) that affects, the overall deterrent effect (future improvement in taxpayers' voluntary compliance by encouraging compliant taxpayers and detecting noncompliant taxpayers through covering a wide range of taxpayers) and future tax revenue, The main activities of auditors and investigators during their audit work include detecting noncompliance of individual taxpayer and merely focused to collect additional tax revenue and to increase audit volume, AAMTNO1BO has not given much attention to educate taxpayers, AAMTNO1BO time allocation for audit cases is only based on taxpayers annual transaction there must be allocation of equal period for different types of business and both complex and simple cases and there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once the

employees have given and held a particular position As a result, AAMTNO1BO does not have experienced and proficient tax auditors.

5.2 Conclusions

Taxation is key source of revenue for the government of Ethiopia followed by external loan grants and assistances. In addition, taxation is used to allocate economic resources for government's priority by directing economic agents to the development goals foreseen by the government through the incentive schemes embedded within the prevailing tax laws. Nevertheless, the performance of tax revenue is relatively poor that accounts an average of 10.76 percent of GDP during the 2004/05 - 2008/09 fiscal years, which is caused by lack of voluntary compliance mainly due to paucity of taxpayer's awareness and the weakness in the tax administration itself, ineffective audit program in particular.

A well-structured tax audit program is vital to achieve revenue objectives that 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 the law, and to influence compliance across the broader taxpayer community at all levels.

This paper has attempted to analyze current status, the performance of tax audit practice of the Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office. 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 and 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:

AAMTNO1BOaudit 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. Further, the audit program performed in AAMTNO1BO could detect noncompliance behavior of individual taxpayers, and used as a compliance enforcement tool to collect unpaid or evaded tax return and to ensure the deterrent effect. Through audit, AAMTNO1BO utilizes its enforcement

powers in addressing tax revenue in arrears and evasion challenges, and makes its power visible to the community to encourage noncompliant taxpayers to comply. However, tax audit practice in AAMTNO1BO is a toddler tool in improving voluntary compliance through helping taxpayers to understand their tax obligations that could generate the right tax revenue at the right time.

Currently, taxpayers are selected for audit based on risk criteria, and selected audit cases are expected to be performed is based on Taxpayers annual transaction and it doesn't consider types of business & complexity of cases, Large Taxpayers with annual turnover of above ETB. 15,000,000 has 30 days for three fiscal years, Medium taxpayers with annual turnover of above ETB 1,000,000 and less than ETB 15,000,000 has 25 days for four fiscal years and Small taxpayers with annual turnover of above ETB 100,000 and less than ETB 1,000,000, has 10 days for four fiscal years. Moreover, the case selection decision start from December 2006 e.c ERCA uses risk-based approach risk selection criteria. the selection criteria is the same for all taxpayers segmentation (large taxpayers, medium taxpayers & small taxpayers) these is the main limitation of the selection criteria due to that, ERCA currently on July 2009 e.c formulated different risk selection criteria for each taxpayers segmentation. Based on The result of ERCA risk selection criteria taxpayers are classified high risk (red), medium risk (yellow) and low risk (green).TheAAMTNO1BO compliance & risk management team selects high and medium risk level taxpayers for tax audit however the tax audit department audited only high risk level of tax payers because of a small number of tax auditors. the unaudited medium and low risk level of taxpayers would feel that their under reporting and other noncompliance activities have little chance of being detected due to less probability of being audited.

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. There is also higher staff turnover in the tax authority, tax audit team in particular. The authority fails to retain proficient and well-trained auditors. As a result, AAMTNO1BO does not have experienced and proficient tax auditors. Tax auditors are not at the required level of operational capability to conduct tax audit and professional capability to give appropriate services to taxpayers. The incapability of tax auditor might be due to absence of using effective pre-audit plan, inadequate audit training and does not apply fully the audit manual procedure.

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 AAMTNO1BO tax audit program so that to improve voluntary compliance and to meet the revenue needs of the government.

- ✓ To increase the audit coverage and voluntary compliance having inadequate staff resources, the AAMTNO1BO should adopt a wide range of audit methodologies for instance Issue audit, Desk audit, Special audit projects, Advisory visit audits, Refund audits and Investigation audit rather than use of full comprehensive audit. The spot (issue) audit should be widely applied to increase the audit coverage, and Advisory visit audits that are not yet in place should be implemented to improve taxpayer's awareness and voluntary compliance. In addition, AAMTNO1BOshould give emphasis and assign adequate audit staff to increase audit coverage and revenue potential.
- ✓ Create a good work environment by encouraging relationship among tax auditors and taxpayers, with colleagues, and immediate supervisors so that they are motivated in performing tasks/activities in the office
- ✓ Increased accountability and an open and honest relationship with taxpayers are crucial for maintaining public trust and confidence in the performance of tax administration. Taxpayers must be able to expect a high degree of certainty in their dealings with revenue agencies. This can only be achieved when tax laws, regulations, procedures, and administrative guidelines are made public, easily accessible, and applied in a consistent manner by avoiding unstable tax laws which creates confusion not only for tax payers but also for tax auditors.
- ✓ The AAMTNO1BO should perform audit activity in cooperation with the intelligence information. And should use Audit manual properly for uniformity & better efficiency.
- ✓ AAMTNO1BO should revise the stated criteria that audit cases are expected to be performed with the consideration of types of business, the complexity of the 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.
- ✓ AAMTNO1BO 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.

- ✓ Vellutini, (2010) Argues that Manual cases selection favors rent seeking and corruption in the tax administration in this regard The AAMTNO1BO should fully utilize SIGTAS and use automated selections for risk assessment purpose. There must be also a specified time range within which the taxpayers are expected to present their report or information, to enforce especially non-volunteer taxpayers, and to get the necessary information as required for audit activities.
- ✓ AAMTNO1BO should increase the number and improve the capability of total audit staff resources to achieve required audit rate and audit quality that might improve overall compliance and future tax revenue performance. There should be appropriate need assessment and employees should have been given training based on the gap identified. Auditors should have been given continuous training so that their skills are kept up-to-date and relevant.
- ✓ AAMTNO1BO auditors should primarily focus to educate taxpayers and improve their voluntary compliance. The duty of taxpayer's awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. Consequently, AAMTNO1BO tried to create tax awareness through printed materials, websites (uploading information and accessed to the public) and some face-to-face discussion forum with taxpayers.
- ✓ Finally, it is clear that most taxpayers of any country do not want to pay taxes unless compelled by a situation where they are left with no option other than to pay the taxes. Therefore, for better tax compliance, a system should be designed that automatically extracts taxes rather than leaves the payment of taxes to the Voluntary choice and morality of taxpayers. To this view tax audit is one of the most powerful revenue administration tool that enforces tax payers to pay their tax liability without evasion. Therefore the tax audit function should be strengthened to minimize both deliberate and innocence tax evasion made by many tax payers with appropriate expertise and the necessary resources should be allocated for this tax administration function.

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APPENDIXES

Appendix A – Tax auditors and investigators survey instrument

QUESTIONNAIRE

St.Mary's University

Graduate Program (MBA) in Accounting and Finance

Questionnaire to be filled by Tax Auditors & investigators

Dear Participant

This questionnaire is designed to meet the objective of research titled "**Assessment of Tax audit practice** in Ethiopian revenue and customs authority Addis Ababa medium tax payer's Number one branch office.

Therefore; the data from this questionnaire will help the researcher to obtain reliable and valid information. Your open and genuine response is highly appreciated. Any information provided would only be used for academic purpose. As a result it would be kept confidential & utmost secrecy would be maintained. I thank you in advance for your cooperation.

Girum Melese

Part –I: Background information

Please provide your responses by marking a tick (√) in the relevant boxes

1. Gender: 1.Male ☐ 2. Female ☐

2. Age: 1. Less than 30 years ☐ 2. 31- 40 years ☐ 3. 41-50 years ☐

4. Above 51 years ☐

3. Education: 1. Certificate ☐ 2. Diploma ☐ 3. BSc/BA ☐

4. MSc/MA and above ☐

4. Field of study: 1. Accounting & finance ☐ 2. Economics ☐

3. Management ☐ 4. Others, please specify _____

5. Current job occupation: 1. Tax auditor ☐ 2. Tax investigator ☐

3. Audit team leader ☐

6. Did you have any audit experience before you joined the ERCA?

1. Yes ☐ 2. No ☐

7. How long did you work with your current job occupation as an auditor in the ERCA?

1. Less than 2 years ☐ **2.** 2 - 4 years ☐ 3. 4 - 6 years ☐ 4. Above 6 ☐

8. What types of audits are usually performed (multiple answers are possible)?

1. Desk (office) audit ☐ 2.Field audit ☐ 3.Comprehensive audit ☐

4. Issue audit ☐ 5.Advisory audit ☐ 6.Registration check ☐

7. Refund audit ☐ 8.Fraud investigation ☐ 9.Others, please specify _____

9.Which type of tests are conducted at Addis Ababa medium tax payer's Number one branch office to check the accuracy of tax returns (multiple answers are possible)?

1. Review of financial statements and returns☐

2. Observing, discussing and reviewing documents of taxpayers☐

3. Physical checks of current transactions, vouchers, assets and other aspects☐

4. Examination of taxpayer's record such as books and documents☐

5. Examination of information from third party such as financial institutions☐

Part - II Question regarding Tax audit practice

Put a "√" mark in one of the columns provided for each possible indicator. Use the scales: Strongly agree (5), Agree (4), Neutral (3), Disagree (2), strongly disagree (1)

	Statement	**Strongly Agree(5)**	**Agree (4)**	**Neutral (3)**	**Disagree (2)**	**Strongly disagree(1)**
	Questions regarding the successfulness of tax audit program					
10	Tax auditors and investigators have good access to information held by the taxpayers and others					
11	Education and experience on tax audit affect tax audit effectiveness					
12	Is there rule to start and complete the audit within a specified timeframe					
13	Audit is supported by intelligence input					
14	Audit is performed based on audit manual					
15	Is there Continuous and sufficient trainings/tutor regarding tax law and tax audit issues					
16	Management does provide enough support and encouragement for training and developing the tax auditors					
17	The audit work to be started and completed within a predetermined timeframe					
18	Effectiveness of tax audit is measured by volume of the audit performed					

19	Effectiveness of tax audit is measured by productivity and yield of audit					
	Questions regarding the Purpose of Tax Audit					
20	The primary purpose of tax audit performed in tax administrations is to ensure compliance in accordance with tax law					
21	The primary purpose of tax audit performed in tax administrations is to assess and collect additional tax revenue.					
22	Tax audit performed in tax administrations is to educate taxpayers.					
23	Tax audit is for reducing tax evasion and tax fraud					
	Questions regarding tax audit resources					
24	The number of auditors in tax audit and investigation audit are enough for a given amount of auditing work planned and needing to be done in the near future					
25	Enough material and equipment for audit program					
26	Well organized structure and suitable office					
27	Qualified audit staff /well experienced staffs are available					

Thank you for your cooperation

Appendix B -audit team leaders & compliance & risk management team officials in-depth interview instrument

1. How and in what condition desk audit, field audit, comprehensive audit, single audit, advisory audit, registration audit, record keeping audit, refund audit, and fraud investigation is performed in AAMTNO1BO? Which audit type is mostly performed? Why could it be?

2. What is the primary purpose of conducting an audit?

3. How audit cases are selected? What are the bases considered for selecting the audit case?

4. How the highest risk taxpayers could be identified?

5. How and by what criteria audit cases are assigned to senior and junior auditors?

6. Tax auditors in Addis Ababa medium taxpayer's number one branch office has appropriate audit plan in all there audits?

7. What are the primary criteria and preconditions to employ individuals as a tax auditor, investigator and to participate in tax audit activities?

8. Is there any continuous assessment on competency of tax audit staff? If yes, who performs the assessment? When and how these assessments are conducted? What about the continuous knowledge upgrading processes of staff resources?

9. Does Tax Auditors keep the documents of Taxpayers safely?

10. Could you tell me about the auditor's capability to clarify unclear rules and regulation, willingness to advise taxpayers and decision giving procedure of tax auditors?

11. Is there anybody to evaluate tax audit performance? Who and How?

12. What do you suggest for the improvement of Tax administration and tax audit program?