ST. MARY`S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

TAX AUDIT PRACTICE IN ETHIOPIA; CASE OF FEDERAL GOVERNMENT

BY

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JUNE, 2017

ADDIS ABABA, ETHIOPIA

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APPROVED BY BOARD OF EXAMINERS

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Abrahan G/giorgis (Ass.pro.). All source of materials used for the thesis have been duly acknowledge. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Ephrem Demessie Lemma ____________________

Name Signature

ENDORSMENT

This thesis has been submitted to st.mary's university college, school of graduate for examination with my approval as a university advisor.

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Advisor	**signature**
St.mary's university college, Addis Ababa	**June, 2017**

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List of abbreviations

CCTV	Closed Circuit Television
ERCA	Ethiopian Revenues and Customs Authority
EFIRA	Ethiopian Federal Inland Revenue Authority
EC	European Commission
FASB	Financial Accounting Standard Board
GNP	Gross National Product
GDP	Gross Domestic Product
IRS	Internal Revenue Service
IMF	International Monetary Fund
MoFED	Ministry of Finance and Economic Development
OECD	Organization for Economic Co-operation and Development
SIGTAS	Standard Integrated Government Tax Administration System
SAS	Self Assessment System
UN	United Nation

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Abstract

This study examines tax audit practice in Ethiopia (the case of federal government), and investigates key problems in tax audit operation regarding the appropriateness of audit type used, suitability of audit case selection methods and audit examination techniques used, The study adopts mixed method approach in order to achieve the research objectives and to answer research questions. Specifically, the techniques used in the study include questioner with tax auditors and investigators, in-depth interviews with tax officials and documentary analysis. With these research methods, the results of the study reveal that tax audit program remains undeveloped with slight range of tax audit activities performed targeting aptly specific risks. The tax audit program is a toddler tool in improving voluntary compliance and increasing future revenue performance through educating and helping taxpayers to understand their tax obligations. The study also shows low audit coverage, the absence of compliance risk-based audit case selection strategy, scarcity of audit resources, tax auditors in particular, and the absence of good interaction between tax auditors and tax payers. In the end, the study forwards the possible measures to be taken by the Ethiopian Revenue and Customs Authority to alleviate problems in tax audit operation.

CHAPTER ONE

INTRODUCTION

Nobody likes to pay taxes. Tax payments are compulsory and unrequited: people are legally obliged to make them but cannot expect any specific benefit in return like a piece of public property, or a preferential treatment in a public hospital. Why do people comply? One prominent answer is that people pay taxes because the government forces them to. The entire machinery of taxation operates under a deterrence approach (Feld et al,2006). That threatens non-compliant tax payers with audits, fines, and criminal punishment. An alternative answer holds that people pay taxes because society obliges them to. Taxes are at the heart of the social contract. They define what people owe to each other collectively.

According to this civic duty approach, it is feelings of public responsibility that moves people towards tax compliance (Kirchler et al, 2008). While deterrence threats and civic norms certainly raise tax compliance, they hardly ever ensure full compliance. Even in fairly well administered and integrated societies tax evasion is common. According to one estimate, for instance, the 28 member states of the European Union lose 864 billion Euros in annual tax revenues to tax evasion (Murphy 2012). Pressed by high spending requirements and high political obstacles to tax increases, some governments have recently experimented with recovering some of these losses through a new rewards approach to tax compliance. The idea is to curb tax evasion by providing positive rewards for individual tax compliance. The perhaps most prominent example of this trend is the spread of receipt-based VAT lotteries. These lotteries incentivize correct invoicing by allowing consumers to submit purchase receipts as lottery tickets (Fooken et al. 2014).

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). In Conducting an audit, various types of information will be reviewed namely, tax returns, financial statements, accounting records, customs declaration and other source documents. Generally, an audit will examine different issues identified as most significant in achieving an accurate assessment of a taxpayer's tax liability.

Tax audits usually focus on areas where there is a high risk with regard to the amount of tax paid and/or payable. Depending on the specific factors relating to a taxpayer, the scope of tax auditing will often vary. However, it is important to remember that the primary objective of an audit is to determine the correct amount of tax that ought to be paid. The above stated objective is very important to tax payers as well as to tax authorities and it helps ensure that taxpayers have confidence in the fairness of the audit process such that an audit could result in either an increase or a decrease of a taxpayer's tax liability. (ERCA, 2010)

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.

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).

1.1. Background of the study

Taxation provides governments with the funds needed to invest in development, relieve poverty and deliver public services. It offers an antidote to aid dependence in developing countries and provides fiscal reliance and sustainability that is needed to promote growth. Significant progress has been made by many developing countries but weak capacity, corruption and the missing reciprocal link between tax and public and social expenditures remain as challenges (IMF, 2011)

Many countries including Ethiopia have adopted a self-assessment system (SAS) of taxation. The tax return furnished by the taxpayers is deemed as final and accepted at face value. Tax compliance under the SAS is highly dependent on voluntary compliance i.e. honesty of the taxpayers in computing their tax payable. Another significant aspect of the SAS is tax audits (Isa and Pope, 2011).

Tax audit assists the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government. The 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. Most governments around the world include an agency that is charged with overseeing the process of tax collection from individuals and companies that reside within the jurisdiction (OECD, 2012). Tax audit has dual benefits for the tax authority: Through direct assessment of additional taxes and indirectly through awareness creation of taxpayers to comply with tax law, thus tax audit play invaluable role in both increasing the government revenue and improving the compliance of tax payer. This study intends to assess the tax audit practice in Ethiopia case of federal government (large, west Addis Ababa and east Addis Ababa tax payer's branch offices).

1.2. Statement of the Problem

Most of the world's governments practice to use taxation in order to raise most of its fiscal requirements. This is because tax is the most viable source of revenue. Under inadequate tax administration including insufficient and ineffective audit program, the Potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner (Edmiston and Bird, 2004). It is unmoving under a number of challenges regarding to its operation and administration that are not yet resolved. Further, weak tax administration may make the tax system unfair in that honest tax payers would bear heavier and disproportional burden. It, in turn, may have impact on the efficiency of tax operation, and also may encourage businesses to work in the illegal economy.

The perception on government spending; perception on equity and fairness of the tax system; penalties; personal financial constraint; changes on current government policies; and referral group (friends, relatives etc.) are factors that significantly affect tax compliance behavior.

However, gender and probability of being audited have no significant impact on tax compliance behavior (Tilahun A. 2014).

Empirical evidences on determinants of tax revenue in different countries, Lotz and Morss (1967) used the data of developed and developing countries to find the ratio of tax revenue to GNP. He used per capita GNP and openness for this. His results showed the positive and statistically significant effect for both per capita GNP and for openness.

Bahl (2003) by using the data of OECD and less developed economies explained the determinants of tax revenue. He used the non-agricultural share of GDP, openness and the rate of population growth all of which showed the positive and statistically significant result. Simple correlation between tax effort and the size of shadow economy showed the negative but statistically significant result.

Getaneh (2011) has studied the tax audit practice in Ethiopia; the case of the federal government. He founds that tax audit program remains undeveloped with an emphasis given to comprehensive and desk audit in addition 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, ERCA 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 and the incapability of tax auditor might be due to absence of using effective pre-audit plan and inadequate audit training as well as their lack of willingness. The study has not assessed some aspects of tax audit practices. Specifically, the audit techniques such as formal statements of taxpayers' rights and obligations in the audit context, audit outcome measures, and use of indirect methods to verify income of taxpayers was the untouched audit techniques.

Tax audit activities performed and measured responses in terms of additional revenue collection and voluntary compliance improvement. Tax policy development is currently focused on seven key priorities; implementing new proclamations, revising VAT tax code, revising excise tax code, revising turnover tax code, exploring a new property tax, exploring a new micro-enterprise tax code and reviewing exemptions incentives (MoFED, 2011) and Ethiopian revenues and customs authority investigated and revised income and business (profit tax) bracket (Tax Proclamation, 2016). So, this research intends to assess the tax audit techniques such as formal statements of taxpayers bill of rights, audit outcomes measures, indirect methods to verify income of taxpayers and the reduction of tax avoidance and tax evasion along with the revised declaration, proclamation and tax audit program on tax audit practice in Ethiopia; the case of federal government.

1.3. Research Questions

The researcher formulates the following research questions:

- ✓ What are the formal statements of taxpayers' rights and obligations and interaction between Taxpayer and Tax Auditor in the audit context of ERCA?
- ✓ Does have ERCA perform appropriate audit techniques?
- ✓ How tax audit is exercised in the reduction of tax avoidance and evasion?
- ✓ What look like the existing performance of tax audit program of ERCA?

1.4.1 The General Objective

The general objective of this study was assessing Tax audit practice in Ethiopia the case of Federal government.

1.4.2. Specific Objectives;-

The specific objectives of the study will be:

- ✓ To assess formal statements of taxpayers' rights and obligation and interaction between Taxpayer and Tax Auditor in the audit context of ERCA.
- ✓ To assess the audit techniques of ERCA.
- ✓ To evaluate tax audit exercise in the reduction of tax avoidance and evasion.
- ✓ To assess the existing performance of tax audit program of ERCA.

1.5. Definition of Terms

1.5.1 Tax ***"is simply defined as a financial charge or other levy imposed on an individual or a legal entity by government''*** **(Gebre worku, 2008).**

1.5.2 Auditing: *A systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria and communicating the results to interested users* Daseen and Wallage (1999).

1.5.3 Tax audit: a tax audit is a selected verification of tax-payers declared tax liabilities which always involves a review of the tax-payers business related transactions record systems, like books of accounts and its supporting documents, information obtained from third party concerning purchase, sales, expenses which are backed with objective evidence, general compliance pattern of the tax-payers to the income tax law proclamation e.t.c. the tax audit may finally results a reassessment of tax-payers tax declaration or the meaning of a tax audit is an examination of whether a tax-payer has correctly reported its tax liability and fulfilled other obligations. The purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations.

1.5.4 Federal Government tax-payers branch office: ERCA administers domestic tax in its 10 branches offices, large taxpayers' office, East Addis Ababa and West Addis Ababa are the branch incorporated tax-payers. According to Ethiopian revised proclamation number 979/2016, Taxpayers are classified into the following three major categories: Category "A" Taxpayers, Category "B" Taxpayers and Category "C" Taxpayers. Category "A" Taxpayers any business having an annual turnover of Birr 1,000.000 or more, any business having an annual turnover of over Birr 500,000-1,000,000 would be classified under Category "B" taxpayers and Category "C" taxpayers are taxpayers that are not classified under Categories "A" and "B", and businesses whose annual turnover is estimated up to Birr 500,000 are classified under this category of taxpayers.

1.5.5 Self-Assessment: is essentially an approach whereby taxpayers are required by law to keep books of records and to determine their taxable income, compute their tax liability and submit their profit tax returns based on existing tax laws and policy statements issued by the tax authorities. *''The basic feature of a self-assessment that is the taxpayer rather than the tax authority that is responsible for the assessment of tax liability''* (Tapan k.sarker, 2003).

1.5.6 Tax compliance: *''is defined as in its most simple form is usually cast in terms of the degree to which taxpayers comply with the tax law''* Tax compliance can be facilitated through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary. Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance (EC 2006). The degree of non-compliance may be measured in terms of the 'tax gap'. this represents the difference between the actual revenue collected and the amount that would be collected if there were 100 percent compliance.

1.5.7 Tax Avoidance: James (2000) describes tax avoidance as the legal manipulation of an individual's affairs in order to reduce tax. However, if taxpayers go to inordinate lengths to reduce their tax liability, this could hardly be considered 'compliance', even if it were within the letter of the law.

1.6. Significance of the Study

The study will have different significances. In the first place, ERCA 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 stake holders and Tax payers to have knowledge on tax audit. Finally, the study might have invaluable importance for future researchers who need to conduct a study in this and related fields.

1.7 Scope of the Study

The study was focused on the audit part of tax administration of Ethiopia in the case of the federal government excluding regional governments due to time and resource constraints. The study assess tax audit practice, and focus on the formal statements of taxpayers' rights and obligation and interaction between Taxpayer and Tax Auditor in the audit context, tax audit exercise in the reduction of tax avoidance and evasion, Audit techniques and performance of tax audit.

1.8 Limitations of the Study

Shortages of adequate secondary data and the reluctance of some officials to provide the required data were some of the limitations of the findings. Shortage of time, absence of research fund, not incorporated questioner and interview for to tax payers were also other limiting factors of the findings of the study. However, necessary precautions were made so that these limitations were not affecting the findings of the study.

1.9 Organization of the study

The study was composed of 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 are presented methodologies used in conducting the study and description of the study area, research design, data sources, sample size and sampling procedures, data collection instruments, data collection procedures and methods of data analysis. Chapter four is the main body of the study results and discussion of statistical data are presented in this chapter. Final chapter recapitulates the study in terms of summary, conclusions and recommendations of the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

The chapter discusses the theoretical perspectives of tax audit. It also presents the empirical evidences of various research studies carried out.

2.1. Theoretical Studies

2.1.1Meaning and concepts of Tax

According to Gupta (2007), tax is a compulsory levy which a government imposes on its citizens to enable it to obtain the required revenue to finance its activities. And the other scholars Lymer and Oats (2009) tax is defined as ‘a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives expenditure, or capital assets, for which the taxpayer receives nothing specific in return’

2.1.2 Overview of Auditing

Awe (2008) defines auditing as an independent examination of the books and accounts of an organization by a duly appointed person to enable that person give an opinion as to whether the accounts give a true and fair view and comply with relevant statutory guidelines. The American Accounting Association (1971) in its Statement of Basic Auditing Concepts in Hayes, Schilder, Daseen and Wallage (1999) described auditing as: a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria and communicating the results to interested users. Akinbuli (2010)

2.1.3 Meaning of tax audit

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD 2006).As Biber (2010), Tax audit is extending beyond verifying a taxpayer’s reported obligations and detection of discrepancies between a taxpayer’s declaration and supporting documentation. Most taxpayer’s report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected. Barreca and Ramachandran (2004) noted that the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations.

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, 2014).

2.1.4 Objective of Tax Audit

USAID (2011) stated that Purpose of Tax Auditing because most of the taxes administered are self assessed by the taxpayers, an audit program is essential in providing for the following objectives: To assure all citizens of the state that the tax is being enforced uniformly; To deter tax evasion and carelessness in self assessments; and To promote accuracy in self assessments through aid extended to taxpayers with respect to the interpretation of the law and rules and regulations adopted there under.

The overall objective is to improve the compliance of taxpayer's whether they declare the correct amount of tax and paid at the right time .the expectation by a taxpayer of an audit should have a deterrent effect and encourage the taxpayer to declare as far as possible a credible tax return .it also improves the taxpayer's understanding and awareness of the relevant taxes. (ERCA, 2014) The main purposes of tax audit in ERCA are: -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.

2.1.5 Category of Taxpayers

Taxpayers are grouped in to different categories under the law. According to Ethiopian revised proclamation number 979/2016, Taxpayers are classified into the following three major categories: Category "A" Taxpayers, Category "B" Taxpayers and Category "C" Taxpayers Category "A" Taxpayers: Ethiopian Tax proclamation 979/2016 describes category 'A' taxpayers as any company incorporated under the laws of Ethiopia or in a foreign country and any business having an annual turnover of Birr 1,000.000 or more. They are required to submit to balance sheet and profit or loss statements to Revenue Authority at the end of the year. Balance sheet, profit and loss statement incorporate gross profit and the manner in which it is computed, general and administrative expense depreciation expenses and provisions and reserves (ERCA, 2016).

Category “B” Taxpayers: Unless not already classified in category “A”, any business having an annual turnover of over Birr 500,000-1,000,000 would be classified under Category “B” taxpayers. This category of taxpayers should submit to the Revenue Authority profit and loss statement at the end of the year similar to category ‘A’ taxpayers. And Category “C” taxpayers are taxpayers that are not classified under Categories “A” and “B”, and businesses whose annual turnover is estimated up to Birr 500,000 are classified under this category of taxpayers. A standard assessment method should be used to determine the income tax liability of category C taxpayers. The taxpayer should pay the tax determined in accordance with standard assessment (ECC 2005).

2.1.6 Tax Knowledge

Tax knowledge is an essential element in a voluntary compliance, tax system (Kasippilai, 2000), particularly in determining an accurate tax liability (Palil, 2005); Saad et al., 2003). Studies undertaken in Malaysia (Loo, 2006); Loo et al., (2008) also suggested that tax knowledge to be the most influential factor to determine taxpayers‟ compliance behavior under the self-assessment system.

2.1.7 Tax Gap

Tax gap can be defined by different professionals. Adams (1921) defines that the difference between the taxes that the law seeks to collect and those in fact collected. Andreoni (1998) defines tax gap as if there were 100 percent compliance difference between the actual revenue collected and the amount that would be collected though there are some variations. Tax gap leads to low revenue collection and represents tax gap happen by means of both tax avoidance and tax evasion. Similarly, compliance gap is also defined in (FIRA, 2000) as the break between the actual and the potential tax revenue. Tax compliance may be seen in terms of tax avoidance and tax evasion. The two activities are conventionally distinguished in terms of legality, with avoidance referring to legal measures to reduce tax liability and evasion to illegal measures. James (2000) describes tax avoidance as the legal manipulation of an individual’s affairs in order to reduce tax. However, if taxpayers go to inordinate lengths to reduce their tax liability, this could hardly be considered ‘compliance’, even if it were within the letter of the law. Since taxation is not always precise, Seldon (1979) in James et al (2003) has also coined the term ‘tax Evasion’ to describe circumstances where the law might be unclear.

2.1.8 Types of Tax Audit

According to OECD, (2006) 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. The types of audits are defined by the three major factors, namely: - (ERCA, 2014)

a) The audit scope and intensity

b) The period(s) under examination

c) The location of the audit activity

The major types of audit in ERCA are described below:-

2.1.8.1 Comprehensive audit/Full audit:-

Is all encompassing in scope and entails an in depth examination of all information relevant to the calculation of a taxpayer’s tax liability for all tax type for a given period. Given the broad scope, comprehensive audit is typically costly to undertake in terms of time and resources, and thus reduces the rate coverage of taxpayers that could otherwise be audited. The scope of a full audit is all-encompassing and 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 (OECD, 2006). Comprehensive audit is classified into very complex, complex and simple. This classification will depend on a number of factors ranging from size, group, trade or profession, volume of records or transactions, nature of business to location. In practice the scope and nature of any comprehensive audit activity to be undertaken will depend on the available evidence pointing to the likely risks of non-compliance and a taxpayer’s history .an audit may also be classified and Justified as complex or very complex because of the taxpayer’s financial and/or business activities which are unusually complex.

2.1.8.2 Issue Audit:-

This is limited scope audit that may be confined to specific issues in tax return and/or a particular tax type. The objective here is to examine key potential risk areas of noncompliance. This type of audit is recommended because it consumes relatively fewer resources than comprehensive audits and allows for an increased coverage of the taxpayer population .the audit will normally focus on a single tax type, period or item.

2.1.8.3 Desk Issue Audit:-

This can be conducted in relation to specific issue(s) of a taxpayer or enterprise when the auditor is confident that all the necessary information can be ascertained by conducting an examination in the office. All the required or relevant information or data may be accessed from internal sources or official reference without the need to contact the taxpayer.

2.1.8.4 Field Issue Audit:-

this is the escalation of a desk audit into afield activity or exercise .it is important to remember that the audit is limited to key issues of compliance or to a tax type or period. Field issue audit is commonly used in examining whether a taxpayer has met his/her obligation in respect of vat/tot and excise tax, withholding tax or income tax normally for a specified tax period (ERCA, 2014)

Care should always be taken to guard against being derails and thus progressing field issue audits into comprehensive audits. The objective of the field issue audit is to focus on a shorter period for a single tax item for a faster and effective outcome. This audit type should therefore be the commonest and most effective audit type to be utilized for faster results (ERCA, 2014)

2.1.8.5 Desk Audit:-

is used as preliminary examination of declarations analyzing accuracy, completeness, and ratios and crosschecking information to determine if further audit or investigation is warranted.

2.1.8.6 Special Audit Projects:-

Audits can be organized as a separate project for a targeted or specific group of tax payer's in a given period to verify compliance in the sector. These audit projects may cover an industry, trade, profession or a line of business. This will consist of specific checks and are used to address a particular risk or to establish the degree of non-compliance in a particular sector, industry or trade. For this audit type to be effective, all taxpayers in the targeted sector must be considered and handled with in the shortest time possible (ERCA, 2014)

2.1.8.7 Advisory Visit Audits:-

all registered tax payers or business need to be visited with the aim of offering advice on tax obligation and the taxpayer's rights, and any other development pertinent to the tax system and administration .it is highly recommended that auditors carry out these audits to keep abreast with compliance trends of their taxpayers and offer timely advise so as to improve compliance. These audits are expected to be spontaneous and hence should not take more than a day (ERCA, 2014)

2.1.8.8 Refund Audit –

Refund audit should focus only on the period covered by the claim. A pre-refund audit should be undertaken to verify the taxpayer's entitlement to a refund prior to processing a first refund claim particularly for new registrants. It is also carried out where the refund claim varies significantly from established patterns and trends. Audits of further claims should be carried out selectively Grandcolas (2005).

2.1.8.9 Investigation Audit:-

involve the most serious cases of non-compliance with criminal implications. Require special skills in investigation and evidentiary requirements as they often involve seizure of records, taking testimonies from witness and preparing briefs for courts (ERCA, 2014)

2.1.8.10 De-registration Audits:-

in order to establish outstanding obligations or liabilities, de registration audit will be conducted for all reported cases of cessation of business, winding up or uncertainty .the audit will focus on determining taxes due and any other pertinent issues. The objective of deregistration audit is to ensure orderly exit from the tax register with the attendant obligations and liabilities sorted out (ERCA, 2014)

2.1.9 Tax Audit Policies

According to USAID (2011) Tax Policy

- The underlying cause of some appeals comes from a lack of clarity in legislation, regulation, decrees and the number of appeals due to draconian penalties. According to California State Board of Equalization (2016) and Biber, (2010) Field auditing is of great importance in efficient administration of self assessed taxes. It assists in ensuring uniform enforcement and detects and aids in the timely correction of reporting errors. This type of audit program has resulted in the correction of tax underpayments and overpayments of many millions of dollars. In addition, there are educational benefits to the taxpayer which cannot be readily measured in terms of dollars but which undoubtedly are responsible for a large portion of the self declared tax that would not otherwise be paid. The state adopted the original version of the following statement of tax audit policies.

2.1.10 Tax Audit Techniques

In the small and medium enterprise sector, in particular, there is a great risk that the auditor will see no clear audit trail or adequate records to support a proper calculation of the tax liability. Indirect methods of verification and re-calculations of profits are therefore essential tools to bring audits to an effective conclusion.

2.1.11 Source and Application of Funds Method

The Source and Application of Funds Method of reconstructing income to determine the actual tax liability is an analysis of a taxpayer's cash flows and comparison of all known expenditures with all known receipts for the period. Net increases and decreases in assets and liabilities are taken into account along with nondeductible expenditures and nontaxable receipts. The excess of expenditures over the sum of reported and nontaxable income is unreported taxable income.

2.1.11.1 Bank Deposits and Cash Expenditures Method

The Bank Deposits and Cash Expenditures Method compute income by showing what happened to a taxpayer's funds. It is based on the theory that if a taxpayer receives money, only two things can happen: it can either be deposited or it can be spent. This method is based on the assumptions that: Proof of deposits into bank accounts, after certain adjustments have been made for nontaxable receipts, constitutes evidence of taxable receipts Outlays, as disclosed on the return, were actually made. These outlays could only have been paid for by credit card, check, or cash. If outlays were paid by cash, then the source of that cash must be from a taxable source unless otherwise accounted for. It is the burden of the taxpayer to demonstrate a nontaxable source for this cash.

2.1.11.2 Markup Method

The Markup Method produces a reconstruction of income based on the use of percentages or ratios considered typical for the business under examination in order to make the actual determination of tax liability. It consists of an analysis of sales and/or cost of sales and the application of an appropriate percentage of markup to arrive at the taxpayer's Gross Receipts. By reference to similar businesses, percentage computations determine sales, cost of sales, gross profit or even net profit. By using some known base and the typical applicable percentage, individual items of income or expenses may be determined. These percentages can be obtained from analysis of relevant declared items in tax returns, official data of Government statistical bodies or industry publications.

2.1.11.3 Unit and Volume Method

In many instances Gross Receipts may be determined or verified by applying the sales price to the volume of business done by the taxpayer. The number of units or volume of business done by the taxpayer might be determined from the taxpayer's books as the records under examination may be adequate as to cost of goods sold or expenses. In other cases, the determination of units or volume handled may come from third party sources. This method for determining the actual tax liability has been effectively applied in carryout pizza businesses, coin-operated laundry mats, and mortuaries.

2.1.11.4 Net worth Method

The Net worth Method for determining the actual tax liability is based upon the theory that increases in a taxpayer's net worth during a taxable year, adjusted for nondeductible expenditures and nontaxable income, must result from taxable income. This method requires a complete reconstruction of the taxpayer's financial history, since the Government must account for all assets, liabilities, nondeductible expenditures, and nontaxable sources of funds during the relevant period. The theory of the Net worth Method is based upon the fact that for any given year, a taxpayer's income is applied or expended on items which are either deductible or nondeductible, including increases to the taxpayer's net worth through the purchase of assets and/or reduction of liabilities.

2.1.12 Audit Case Selection Methods

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 2004). 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 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 2006). 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.

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 (OECD 2006).

2.1.13 Risk Assessment

2.1.13.1 Need for Risk Based Approach

No tax administration has, nor should have the resources to control 100% of their taxpayers and transaction base .instead they increasingly rely on risk management methodologies to allocate better the available scarce resources in order to achieve an optimal compliance strategy. (ERCA,
2014) Risks are those events that could negatively impact on organizations ability to deliver on its mission. Risk assessment must therefore be an integral part of the entire audit process and should involve;-

* A review of the economy to identify risk prone sectors
* A review of the sectors to profile the various operators there in; and
* A profile of the operators in order to identify risky trends or behavior

Risk assessment should also involve a review of the internal systems within an organization to obtain a picture of any in-house factors that influence the non-attainment of audit objectives.
The adoption of risk based approaches goes beyond audit case selection and applies to more than direct revenue risk .a tax administration will usually have as part of its objectives, the need to deliver a certain amount of revenue to the government to meet budget objectives, but this will usually be supplemented by other objectives such as improving compliance; maintaining expenditure with in a specific budget; minimizing tax payer compliance costs; and maintaining community confidence in the tax system(often an important political objective).the administration therefore has to manage the risks failing to achieve each of these objectives and not just the risks of non-compliance .

2.1.13.2 Analyzing Risk and File Assignment

Selecting file for audit should always be based on sound risk assessment .sound risk assessment includes evaluating the potential collectability of a debt that could arise as a result of an audit action. Difficulty to collect a potential debt is only one aspect to consider in selecting a file for audit or closing a file early. The collection of an assessment is an important final step in the audit process. Audit files are assigned from the inventory of files selected by the concerned team and from other sources. The team coordinator generally assigns audit files to the individual auditors based on gross revenue of the taxpayers and categories established for each group and level of auditors.

In addition to gross revenue, the following factors must be considered when assigning audit files in order to be transparent:-

- The nature of the audit
- Rotation or specialization of auditors
- Training and development of auditors
- Idle or on duty of auditors(work in process)

ERCA is emphasizing the risk based approach. So every audit will be directed towards this approach, which is more explained as follows:-

Given the nature of the audit process, every audit assignment presents a different challenge to ERCA, with no two audit assignments being the same. For example, no two entities are the same in terms of business sector , location ,size ,employees , governance issues , ethos , and complexity of operations .there is no one single approach to auditing which ensures the performance of a perfect audit .however , it is generally accepted that for most entities of size , the risk based audit approach will minimize the possibility of audit objectives not being met. Auditors to adopt a risk based approach to audit in so doing; it requires auditors to make risk assessments of material misstatements at the financial statement and assertion level, based on appropriate understanding of the entity and its environment including internal controls.

2.1.13.3 Review of Role of Audited Financial Statement

The federal government office auditor relies on external audit report but their report and opinions differ from the ERCA. Auditor’s report because the position of the taxpayer’s representative can legitimately differ from that of the tax authority. The federal government office auditors wouldn’t accept without question the validity of external auditor’s financial statements where judgments may have been made favorable to the taxpayer on legal or accounting issues. (ERCA, 2014).

The auditor then obtains copies of the audited financial statements, supporting opinion, notes and schedules and the letter of engagement. The letter is necessary to determine .the letter is necessary to determine if the taxpayer placed any limitations on the scope of the auditor’s assignment. Sometimes the external auditor will make a disclaimer as to the accuracy certain aspects of the financial statements by indicating a reliance on the taxpayer representations rather than conducting an independent verification.

2.1.13.4 Review of Internal Controls

The establishment of internal controls is the responsibility of management of the taxpayer concern. The evaluation of internal controls is primarily the responsibility of the taxpayers internal audit department and the external auditor. The tax authority can point out weakness in internal controls which may have led to an assessment for additional taxes but usually cannot insist on the taxpayer introducing stronger control measures. (ERCA, 2014)

The tax auditor must review the system of internal control and internal checks to determine possible areas of weakness or to establish methods of determining if the taxpayer is deliberately manipulating the records to minimize tax liabilities .the auditor will conduct his verification1 activities in accordance with his/her findings .the audit checklist and the audit working papers dealing with the specific aspects of the taxpayer's operations include tests of the internal control system and internal checks.

2.1.14 Risk, Materiality and Sampling

2.1.14.1 Audit Risk

Audit risk is defined as the risk that the auditor may unknowing fail to appropriately modify an opinion on financial statements that are materially misstated .audit risk can be thought of in terms of the following three component risks; (ERCA, 2014)

Inherent risk is the susceptibility of an assertion to a material misstatement, assuming that there are no related internal controls. Control risk is the risk that a material misstatement that could occur in an assertion will not be prevented or detected and corrected on a timely basis by the entity's internal control.

Internal control consists of five components:

1. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
2. Risk assessment is the entity‘s identification and analysis of relevant risks to achievement of its objectives, forming basis for determining how the risks should be managed.
3. Information and communication are the identification, capture, and exchange of information in a form and time frame that enable employees to carry out their responsibilities.
4. Monitoring is a process that assesses the quality of internal control performance over time.

5. Control activities are the policies and procedures that help ensure that management directives are carried out. Detection risk is the risk that the auditor will not detect a material misstatement that exists in an assertion.

2.1.14.2 Materiality

Materiality is one of several tools the auditor uses to determine that the planned nature, timing, and extent of procedures are appropriate .as defined in financial accounting standard board (FASB). Materiality represents the magnitude of an omission or misstatement of an item in a financial report that, in-light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.

2.1.14.3 Audit Sampling

Sampling is used to test the information and transactions to increase the efficiency and effectiveness of the audit. Cost and time constraints don't usually permit 100% verification of the taxpayer's information nor does the relative risk warrant 100% verification .however, in rare situations 100% verification may be required. (ERCA, 2014) Successful sampling depends on the auditor knowing the population, which must not be too variable .the auditor must know the objectives of the exercise, and have planned the sampling correctly .because of its complexity and (relative to file interrogation) lower accuracy, statistical sampling is a last resort for testing, and should only be considered when file interrogation is not possible or appropriate.

2.1.15 Condition for Good Tax Audit

For the tax inspector to carry out a good audit exercise, the following conditions must be fulfilled. (ERCA, 2014)

1. The tax auditor must be familiar with the environment in which he works. It is a condition which is highly critical that the tax inspector must be properly schooled in the political, economic, social, cultural and religious environment of the taxpayer. A good knowledge of his environment will affect the decision made by him.

2. The tax officials should be motivated to carry out tax audit, he should be properly trained and have experience in his area. The tax inspector should not be carried away by corrupt practices that render the aim of the tax audit useless.

3. The tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.

4. Specialization should be encouraged. The cases should be grouped. This will allow the tax audit staff to become specialist in specific field.

5. The manner in which the audit is being carried out should be changed. The use of computer should replace the manual process as this will go a long way in facilitating the job and helping to preserve information for a long time. This will improve the efficiency of the exercise (Ogundele, 1999).

2.1.16 Standards of Competency for an Experienced Tax Auditor

Tax auditor should Ability to apply the following basic knowledge and, special knowledge to practical situations, prepare professional audit reports with particular reference and judicious use of time.

2.1.17 Tax Avoidance and Tax Evasion

Universally accepted definitions of tax avoidance and tax evasion do not exist. According to Slemrod and Yitzaki, (2002) define tax avoidance as an activity that a person or a business may undertake to reduce their tax in a way that runs counter to the spirit and the purpose of the law, without being strictly illegal. UN (2002) defined a set of "signposts" which include e.g. "transactions or arrangements which have little or no 'economic' substance or which have tax consequences not commensurate with the change in a taxpayer's (or a group of related taxpayers') economic position". Tax evasion, in contrast, is usually defined as a violation of the law. According to Fuest and Riedel (2009) Tax avoidance and tax evasion are widely believed to be important factors limiting revenue mobilization. Tax revenue losses due to tax avoidance and tax evasion can occur for a number of reasons. Existing estimates of these revenue losses distinguish between a domestic and an international component of tax avoidance and tax evasion. The domestic component of tax evasion and avoidance would include, for instance, non-declared or under-reported income from work or domestic business activities. The international component of tax avoidance and evasion includes practices like transfer price manipulation by multinational firms or the holding of financial assets in offshore bank accounts by private individuals with the purpose of concealing capital income.

According to IMF (2014) Tax revenue could be boosted by broadening the tax base (especially by promoting private sector activity), strengthening customs and tax administration. The expansion of cash registry machine should continue and be strengthened with unannounced site visits by inspectors to minimize fraudulent or tax avoidance behaviors by tax payers. ERCA's news paper magazine, (2016) state that Ethiopian Revenue and Customs Authority prosecutors on allegations of misappropriating register machines' operation. ERCA's prosecutors claim that the defendants are guilty of tax evasion though the misuses of sales register machines. Though the case is still under investigation, current charges include illegal transactions of 167 million birr and damage to or evasion of 27 million birr in VAT and 51 million birr of income tax.

2.1.18 Taxpayers' Bill of Rights

Every taxpayer is liable for the correct amount of tax that is due under the law, Understanding how the system works is every taxpayer's right and responsibility and well informed taxpayers can get faster results by knowing their rights and exercising them quickly (Navada, 2012). According to California State Board of Equalization (2016) the law guarantees that the rights, privacy, and property of taxpayers are protected during the course of assessment and collection activity. Tax auditors should be familiar with the provisions of the law Understanding Your Rights as a Taxpayer, which explains procedures, remedies, rights, and obligations of taxpayers must be provided to taxpayers at the beginning of every audit. Confidential information contained in records must be treated in strict confidence. The only exception is when the Governor, by general or special order, authorizes other state officers, tax officers of another state, the Federal Government (if a reciprocal agreement exists), or any other person to examine the records maintained by the. Requests for information of a confidential nature should be referred to a supervisor. According to IRS, (2014) and the Navada, (2012) Legislature has declared that each taxpayer has the right:

2.1.18.1 The Right to Be Informed

Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

2.1.18.2 The Right to Quality Service

Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

2.1.18.3 The Right to Pay No more than the Correct Amount of Tax

Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

2.1.18.4 The Right to Challenge the IRS's Position and Be Heard

Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

2.1.18.5 The Right to Appeal an IRS Decision in an Independent Forum

Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court.

2.1.18.6 The Right to Finality

Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

2.1.18.7 The Right to Privacy

Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and are no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

2.1.18.8 The Right to Confidentiality

Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

2.1.18.9 The Right to Retain Representation

Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

2.1.18.10 The Right to a Fair and Just Tax System

Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

2.1.19 Formal Statements of Rights of the Tax Payer and Obligations in the Tax Audit

According to sokenu,(2016) in an attempt to eliminate bias there is the need for a clear understanding of the respective roles and responsibilities of both tax officials and the taxpayers from the outset of the audit. to this end many revenue bodies have elaborated these responsibilities in formalized administrative documents (e.g. official statements of administrative practice, code of conduct etc) and lagos state internal revenue service has public enlightenment programmers, radio and television jingles as well as a web site.

2.1.19.1 **Interaction of Taxpayer and Tax Auditor**

Consistent with the purpose of tax auditing as outlined above, there is no occasion for the tax auditor to harass taxpayers or to give the impression that the object of the audit is to find errors in the taxpayers’ self assessments. The taxpayer should be assured that the tax auditor’s function is to determine whether the amount of tax has been reported correctly. The tax auditor should aid the taxpayer in gaining a correct understanding of the law and demonstrate that we are as willing to recommend a refund of an overpayment as we are to propose a deficiency determination. Care should be taken to inform taxpayers regarding taxpayers’ rights and privileges in connection with such determinations. The tax auditor should constantly keep in mind that it is our policy to administer the law fairly and uniformly, with minimum annoyance and interference in taxpayers’ business affairs, as well as at the lowest cost consistent with good tax administration.

2.1.19.2 **Professional Status of Tax Auditors**

Tax auditors are engaged in professional assignments. They are called upon to exercise their highest skill and best judgment throughout the performance of their official duties. All audits should be made in accordance with approved auditing and accounting principles. Sound professional judgment must be exercised in making tests that are representative in scope and character to ensure that the results are representative of the actual business operations during the audit period. Tax auditors are also expected to perform their duties with dignity and courtesy regardless of the industry being audited, the size of the business, the sophistication of the records, or any other consideration. Tax auditors must perform their duties with integrity and propriety, and do all in their power to ensure that their words or actions cannot be interpreted otherwise. Auditor Tenure, there are two opposing views on the effects of auditor tenure on audit quality. One states that as the auditor–client interaction lengthens, the auditor may develop a close interaction with the client and become more likely to act in favor of management, thus reducing audit quality. This view supports mandatory audit partner rotation. The other view is that as auditor tenure lengthens, auditors increase their understanding of their clients' business and develop their expertise during the audit, resulting in higher audit quality, (Tepalagul and Ling, 2013).Shockley (1981) report that auditors do not regard tenure exceeding 5 years as reducing independence. Bamber and Iyer (2007) point out that the incentive of the individual audit partner may conflict with that of the audit firm. They find that long partner tenure increases the likelihood of the auditor acquiescing to the client's preferences and that audit firm tenure is associated with the decreased likelihood of auditor concessions. Taken together, these results imply that, unlike an audit partner, an audit firm has stronger reputation incentives to remain independent**.**

2.1.20 Audit Case Selection Methods

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 2004). 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 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 2006). 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.

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 (OECD 2006).

2.1.21 Examination Techniques

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

***2.1.21.1 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 (OECD 2006).

***2.1.21.2 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 (OECD 2006).

***2.1.21.3 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(OECD 2006).

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

***2.1.21.5 Counterpart Examination*:** It is an examination performed based on third party information where warranted. OECD (2006) 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.

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

2.1.23 Audit Outcome Measures

According to OECD, (2006) Audit program is designed to deliver a number of benefits to the administration of a community's taxation system. These include enforcing compliance, educating taxpayers, minimizing disruption to compliant taxpayers and targeting non-compliant taxpayers to ensure a return on the resources allocated to audit activities. Other positive effects are also sought, such as influencing compliance in the broader community, providing a level of assurance that the system is working as intended, promoting public confidence by providing a high profile compliance program and displaying the fairness of the compliance processes. These benefits all contribute towards the desired outcome of audit work, which is to increase taxpayer compliance. Objective measures of the amount of non-compliance within the economy – so called tax gap measures. These can also be run on a sector specific basis; Measures of changes in customer behavior over time – particularly around filing and payments risks; Measures of customer awareness and attitude to audit and non-compliance; and Measures of the quality of audit processes – testing adherence to published policies and procedures and the technical accuracy of decisions.

Quality outcomes have generally been measured in terms of adherence to correct audit procedures, and appropriate application of tax law. It is also possible to measure quality outcomes from audit activity in terms of the taxpayer reaction to the audit process. It is difficult for a taxpayer to be neutral when it comes to assessing an unfavorable audit outcome. With this reservation, customer satisfaction surveys can provide useful information on how the audit activity is considered among the public.

2.1.24 Evaluation of audit activities

According to OECD, (2006) Audits are a major program activity in any revenue body and their efficiency and effectiveness should therefore be kept under constant review. a comprehensive and holistic approach to the evaluation of audit activities, ensuring that they employ a robust set of measures to gauge the direct and indirect results. One revenue body's approach, with an emphasis on measuring the outcomes achieved, is described in the following example: An outcomes-based performance standard for audit activities a comprehensive performance standard designed to encompass the impacts and outcomes from tax audit activity.

The key elements are as follows:

2.1.24.1 Compliance Review Task:

The objective is to measure taxpayers' compliance behavior following an audit via a post-assessment audit review. The key measures to be used are:-The % of taxpayers reviewed found to be compliant and the trend compared to the previous year's result. The % of taxpayers who changed their behavior compared to those who needed to change their behavior, and the trend compared to the previous year's result, Analysis of the types of change in behavior.

2.1.24.2 Compliance Tracking Analysis:

The key measures to be used are where audited taxpayers' Assessed income tax and GST increases to a greater extent than that of the control group, The ratio of late payment penalties to payments due and returns filed shows greater improvement compared to the control group.

2.1.24.3 Taxpayer Education Provided:

The objective is to measure the education provided to influence taxpayers to comply with their tax obligations. The key measures to be used are: Derived from QMP: - The % of taxpayers who received education about compliance risks that did not result in a discrepancy; the % of times education was provided in relation to discrepancies. The % of taxpayers who were provided with education in the previous audit; The % of taxpayers who received education in the previous audit, compared to the % of compliant taxpayers who were not given education in the previous audit. Results will be calculated for each year and compared to the previous year(s) to establish attend.

2.1.24.4 Survey of Audited Taxpayers:

The objective is to measure businesses' understanding, expectation and perception of audits; their suggestions for improvement; and the likely effect of audit on future compliance behavior. The key measures to be used are:-Taxpayers' expectations of frequency of audit, Perceptions of IRD's professionalism, Level of influence audits are perceived to have on future compliance. Whether the audit was helpful in meeting future tax obligations.

2.1.24.5 Media profile:

The objective is to measure audit's profile in the media as this is linked to compliance. The key measures to be used are:-Initially, the number of audit-driven or audit-related media items will be tracked, a deliberate and structured media strategy for Audit will be developed and we will measure actions taken against it to enhance Audit's profile, or actions taken against a wider organizational media strategy encompassing Audit.

2.1.24.6 Voluntary disclosures:

The objective is to measure voluntary disclosures, as they show improved voluntary compliance as the taxpayer self-corrects their incorrect tax position. The key measures to be used are:-The % change in the number of cases opened and closed, the value of discrepancies and the volume of business hours spent on voluntary disclosures (made when an audit is not underway) compared to previous benchmarks, The % of voluntary disclosure cases (made when an audit is not underway) that result in spin-off audit cases, Number of voluntary disclosures and the % of value of voluntary disclosures (made when an audit is underway) compared to discrepancies found during all risk audits will be assessed to form a benchmark to compare to future results.

2.2. Empirical studies

This topic of the research covers topics about the findings of different researchers about the determinants of tax revenue in different countries separately and as panel date done in sub Saharan African countries, regional wise and zonal wise, finally about tax in case of Ethiopia. Each finding by researchers was summarized separately and was used to analyze with what the researcher did.

Lotz and Morss (1967) used the data of developed and developing countries to find the ratio of tax revenue to GNP. He used per capita GNP and openness for this. His results showed the positive and statistically significant effect for both per capita GNP and for openness. Tanzi (1987) found only the per capita income effect positive and significant by taking the data of only developing countries.

Bird et al. (2008) found that Latin American countries show consistently lower tax effort compared to other developing or transition countries. Performance in African countries shows a mixed trend. Some countries collect as little as half while others collect up to 2 to 3 times what they would be expected to (OECD, 2010). The latter group include to a large degree of those countries having a high share of resource-related tax revenue. Thus, estimates of tax effort for some resource-rich countries turn out to be quite sensitive to whether resource-related tax revenues are considered or not. Using a tax effort measure that excludes resource-related tax revenues is revealing: more than half of the African countries (22 out of 42) collect more or what is expected. This suggests that in quite a number of countries domestic revenue mobilization is not constrained by the tax system but more by GDP growth and broader development.

From a policy perspective there is an important distinction between countries with a substantial share of resource-related tax revenues and those without. Resource revenue provides an opportunity for reducing distortion taxation that may have a negative impact on economic activity, but it also provides the opportunity for maintaining highly inefficient subsidy programmed (Collier et. al., 2009). Bornhorst et al. (2009) found that countries that receive large revenues from the exploitation of natural resource endowments are likely to reduce their domestic tax effort considerably. This is not necessarily worrying as reduced domestic tax burden could foster private sector activities consistent with an improvement in development prospects.

In Ethiopia there are some researches done on tax issues with different titles among them some of them are mentioned below.

Tilahun A. (2014) on the title Determinants of Tax Compliance Behavior in Ethiopia: The Case Of Bahir Dar City Taxpayers with the objective to identify factors that determine tax compliance behavior has been open for empirical investigation. Accordingly the researcher used one-way ANOVA, two samples and one sample T- test, the data was collected using structured questionnaire. The results revealed that perception on government spending; perception on equity and fairness of the tax system; penalties; personal financial constraint; changes on current government policies; and referral group (friends, relatives etc.) are factors that significantly affect tax compliance behavior. However, gender and probability of being audited have no significant impact on tax compliance behavior. Finally, the researcher concluded that older people will comply less if there is no equity and fairness in the tax system and any changes in government policy on fuel prices, electricity and water rates are not favorable.

Yesegat (2008) studied VAT administration problems at large, VAT audit in particular, the study adopted an in-depth interview conducted with tax officials and surveys of taxpayers and tax practitioners conducted using semi-structured questionnaires. The main findings of the study regarding VAT audit is that the VAT audit rate is low that may be due to resource constraints, and the cases subject to audit are selected by audit selection committee based on a criteria including credit declaration, non-filing and unusual filing patterns, nil VAT declaration, and information from third parties. The study further revealed that the quality auditors (VAT administrators at large) are poor to achieve efficient and effective audit program. Based on the survey results, the study stated that tax administrators are not capable of handling audit cases quickly, lack confidence to make decisions and not have willingness to help taxpayers. In addition, the tax authorities have no sufficient number of VAT administrative personnel, which comprise only 10.4 per cent as to the proportion of the total employees at the Ethiopia Federal Inland Revenue Authority (EFIRA).

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. The sample size for the survey was 65 tax auditors and investigators so that 65 questionnaires were distributed. Nevertheless, the survey response was collected from only 55 survey respondents due to their workload as well as negligence. The data was analyzed with the use of the SPSS software the finding of the study shows that; Tax audit program remains undeveloped with an emphasis on comprehensive and desk audit with the exclusion of other audit methodologies. There was a slight range of tax audit activities performed targeting aptly specific risks, which might result in less proportionate and measured responses in terms of additional revenue collection and voluntary compliance improvement. Further, the audit program performed in ERCA was 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, ERCA 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 ERCA was a toddler tool in improving voluntary compliance through helping taxpayers to understand their tax and customs obligations that could generate the right tax revenue at the right time and the researcher recommended ERCA should give emphasis and assign adequate audit staff to investigation audit, and it was better to conduct such audit type in all branch offices, they must foster tax compliance through improving services to taxpayers to create fair and smooth tax system with high compliant taxpayers, The authority should make SIGTAS accessible to tax auditors, and should fully utilize it 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 and Finally, ERCA 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.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

Introduction

This chapter basically describes how the study was carried out, what type of the data collection methods was used, what type of techniques was used for analysis and presentation. It is a very important chapter as it provides reasons to why a particular method of research, sampling, data collection and data analysis was chosen; it also gives the design of the study, population and its area of which the research is based. In short this chapter is concerned with research designs, which are the master plan specifying methods and procedures for collecting and analyzing collected data.

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

3.1 Research Approach

There are three basic approaches to research, viz., quantitative approach, qualitative approach, and mixed research approach. The former involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis in a formal and rigid fashion. Creswell (2009) noted that quantitative approach employs strategies of inquiry such as experiments and surveys, and collect data on predetermined instruments that yield numeric data that can be analyzed using statistical procedures. It is a means for testing objective theories through examining the relationship among variables. It is advantageous as it, procedurally, follow scientific approach, tests reliability and validity of the instrument. It minimizes bias from the researcher's influence and employs large sample size. Hence, the results can be believed on and the results can be generalized to larger population. However, it is not capable to address issues which cannot be quantified. So that, it may has limited scope.

Qualitative approach to research is concerned with subjective assessment of attitudes, opinions, and behavior and attempts to get an in-depth opinion from participants. Apart from this, it facilitates responses, and provides data in-depth with leading respondents. Research in such a situation is a function of researcher's insights and impressions. Such an approach to research generates results either in non-quantitative form or in the form which are not subjected to rigorous quantitative analysis (Kothari 2004).

Kerchar (2010) argues that "each strategy has its strength and weaknesses and the drive for mixed method research is to use one strategy to inform, validate, or compensate for the weaknesses of another." In other words, the combination of both quantitative and qualitative methods is a more pragmatic approach to gain a better understanding of the phenomenon under study. In this study, in order to achieve the research questions stated a both qualitative and quantitative approach was used through questionnaire and interview.

3.2 Population

The study population/participants were all Tax Auditors and investigators of Federal government branch office. According to ERCAs' human resource (2017) 185 tax auditors and investigators, large taxpayer's branch office, East Addis Ababa and west Addis Ababa branch office. Tax auditors and investigators 47, 68 and 70 respectively were available.

3.3 Sample

It is the portion of the study population and used when addressing the total population in the study is not possible. But in this case, since the numbers of Tax Auditors were small, the study assumed the data of all Tax Auditors taking as a sample. Thus in this case the sample size was almost equal to the population which enabled to make appropriate generalization to the overall population.

3.4 Sources of Data

The data used in this study consists of both primary and secondary data.

3.4.1 Primary data

The primary data were collected through questionnaire and interview. The questionnaire comprised closed questions. Closed ended questions are quicker and easier for respondents and researcher and to get more relevant information. Most of the closed ended questions are designed on an ordinal level of measurement basis, and others are designed as multiple choice, some of the closed ended questions were a five scored likert scales (Kothari, 2004) to provide respondents a wider range of alternatives with end points where '5"with the statement strongly agree, and "1' indicates with the statement refer to strongly disagree. Six 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 three tax officials. The prepared interviews guide were verified and checked for its authenticity for the use in this study. The interview aims at eliciting information on the tax audit practice, regarding types of Audit performed, case selection and tax audit techniques and formal statements of taxpayers and tax auditor relationship.

3.4.2 Secondary data

Secondary data were also collected from ERCA annual report from 2014-2017 G.C. In addition to annual report, tax declaration and BPR manual 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.

3.5 Data Collection Methods

3.5.1 Questionnaire Instruments

Questionnaire instruments include self-administered questionnaire, structured interview and structured observations (Creswell 2009). This study used questionnaire, which is a widely used and useful instrument for collecting survey information. As Wilson and McLean (1994) stated, questionnaire could provide structured information, being administered without the presence of the researcher, and often comparatively straightforward to analyze. The researcher can select several types of questionnaire, from highly structured (closed ended) to unstructured (open ended). Structured questionnaire is appropriate to gather straightforward and uncomplicated information. It is easy to classify and quantify, require less time and effort, and ingenuity to answer. Nevertheless, it is tedious and time consuming to prepare questions. The researcher also may not have a full range of responses to prepare closed ended questionnaire. In addition, the respondents have no chances to express their own views, and to qualify, develop or clarify their own answers. On the other hand, unstructured questionnaire gives a greater insight and understanding of the topic being studied. However, it may be difficult to classify and quantify and must be carefully interpreted. Thus, the use of either mere structured or unstructured questionnaire has its own flaws. To mitigate the limitations of both types of questionnaire, semi-structured questionnaire is a powerful tool (Cohen et al. 2000). Dawson (2002) also stated that researchers tend to use a combination of both open and closed questions. Such questionnaires begin with a series of closed questions, with boxes to tick or scales to rank, and then finish with a section of open questions for more detailed response. As a result, the researcher employed semi-structured questionnaire for survey data collection.

3.6. Methods of Data Analysis

In accordance with the data types, quantitative and qualitative data analyses were employed. The quantitative data were analyzed by Statistical Package for Social Science (SPSS), whereas the qualitative data analysis described qualitative data by themes.

3.6.1 Qualitative aspect: in-depth interview and documentary analysis

Qualitative research is used to describe or explain what is happening within a study area. Qualitative method mainly includes three kinds of data collection: in-depth interview, direct observation, and written documents (Patton 2003). For this study, data is collected through in-depth interview and documentary analysis. The following discussions present the in-depth interview and document study.

3.6.1.1 In-depth interview

An interview is a purposeful discussion and/or conversation with two or more people, and helps the researcher to gather valid and reliable data that are relevant to achieve research questions and objectives. Interviews might be structured (using standardized questions), semi-structured, and unstructured (in-depth) conversations (Saunders et al. 2003). Structured interview uses pre-established questions, asked in a predetermined order, using a standard mode of delivery. On the other hand, unstructured interview attempts to draw out information, attitudes, opinions, and beliefs around particular themes, ideas, and issues without the aid of predetermined questions (Leary 2004).

This study applied in-depth interview to explore the data that is unclear for the researcher and the information that have not been collected through survey and document analysis by allowing the interview to remain flexible. Thus, in-depth interview is conducted with three higher tax officials of ERCA, with the intent of gathering information that needs clarification and not be achieved through other techniques. In order to help to hold experienced or concerned respondents, convenience sampling is used.

3.6.1.2 Documentary analysis

Document analysis is the collection review, interrogation, and analysis of various forms of text as a primary source of research data. It refers to both a data collection method and a mode of analysis (Leary 2004). Document analysis is a tool conducted using documents such as written materials, organizational or program records, official publications and reports, news papers, a minutes of meeting, and personal documents (diaries, artistic works, letters, photographs and journals) (Patton 2003). As Creswell (2009) noted, use of documentary analysis has its own strengths and limitations. The strengths are enables the researcher to obtain the language and words of participants, can be accessed to the researcher at a time conveniently, represents data which are thoughtful (participants given attention when compiling them), and economical (it saves the time and expense of transcribing). Whereas, the limitations include incompleteness, lack of accuracy (the documents may not be authenticated), requires transcribing or optically scanning for computer entry, not all people are equally articulate and perceptive, and may be protected from private access.

In addition to the data obtained through other methods, this study employed a descriptive analysis of documents such as periodical tax audit reports, proclamations, tax audit policy, and others documents that are relevant for the study. The document analysis is applied for examining the number of taxpayers audited in a given fiscal year, the amount of additional tax revenue through audit, the background information of the study area, and as a supportive for other tax audit activities in Ethiopian tax system.

3.7 Data Presentation -The researcher used simple percentage to present the data findings.

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1. Introduction

In the preceding chapters, the review of relevant literature helped this study to understand the problem and design an appropriate research approach to deal with. The previous chapter also discussed the research design employed to achieve the objectives of the study. In this chapter, the study analyzes the collected data using various statistical tools and presents the results and discussion accordingly. This chapter is organized in two sections. The first sub section presents the result which in turn includes descriptive statistics. The second section is dedicated to the interview and review of document. Questionnaires were sent to 185 tax auditors of the three federal government branch offices that which are on job until June 12, 2017.The data collection do not take more than one week, as the researcher was former employee of the ERCA. At the end of the collection process, the researcher received 157 respondents from the 185 questioners sent to the tax auditors due to their workload as well as negligence. For this study, the response rate was 84.9 percent, and it is rationally fine. The data collected from the returned questionnaire were entered into SPSS (Statistical package for social science software) tool version 20 for analysis.

According to ERCA (2014), the authority is established with a mission to promote voluntary compliance of taxpayers, ensure integrity and develop skills of the employees, support modernization, facilitate trade and investment, harmonize taxes and customs administrating system, broadening tax base and decreasing tax rate, and contribute to the economic development and social welfare through effective tax revenue collection. Accordingly, ERCA has made a wide range of organizational and institutional reforms with the aim of strengthening revenue mobilization, enhancing operational efficiency, and improving voluntary compliance. For instance, process improvement, integrating and modernizing revenue administration, tax audit in particular, with new technology is ongoing.

Tax audit in the context of ERCA is defined as an activity or a set of activities performed by tax auditors to determine the taxpayer's correct tax liabilities for a particular accounting or tax period. Tax auditors examine taxpayers‟ organizational procedures and financial records in order to assess compliance with tax laws and verify the true, fair, reliable, and accuracy of tax returns and financial statements (ERCA 2014). The subsequent discussion presents the results of survey, in-depth interview, and documentary analysis.

4.2. Background Information of Respondents

Table 4.1 Background information of respondents

Variables	N=157	Count	Percent
Gender	Male	104	66.2
	Female	53	33.8
Age	Less than 30 years	126	80.3
	31-40 years	31	19.7
Education Level	Diploma	28	17.8
	BSc/BA	121	77.1
	MSc /MA and above	8	5.1
Field of study	Accounting and Finance	104	66.2
	Management	53	33.8
Work experience as Auditor	Less than 2 years	47	29.9
	2-4 years	110	70.1

Source: Questionnaire Results, 2017

The majority of respondents 80.3 per cent were under the age category of less than 30 years. Out of the total respondents, 66.2 per cent were males and 33.8 per cent were females. Regarding educational level, 77.1 per cent of respondents were BA degree holder, 17.8 per cent attended diploma and 5.1 percent MA degree holder. Majority of the respondents are specialized in Accounting and Finance which accounts for 66.2 percent and Management (33.8 per cent). As indicated in Table 4.1, 70.1 of the respondent Tax Auditors have service year ranging from 2- 4 years, while 29.9 of the respondent have service years less than 2 years. This shows that above 70 per cent of ERCA Tax Auditors has good work experience for the current position. As it is discussed on the above, the majority of the respondents have a good level of educational qualification that is BA or BSc degree, diploma and Msc Degree which enables the respondents to have idea of the Tax Audit. Moreover, majority of the respondents studied the field related to business which enables them to understand the implementation of taxes and related issues. (Table 4.1)

4.3 tax Audit Practice

Table 4.2 Types of Tax Audit Performed

	Variable	Frequency	Percent
1	Desk audit	25	15.9
3	Comprehensive audit	101	64.3
4	Issue audit	31	19.7
	Total	157	100.0

Source: Questionnaire Results, 2017

The survey results showed that ERCA systematically conducts comprehensive audit 64.3 percent, issue 19.7 percent and desk audit 15.9 percent. The survey further stated that comprehensive audit is conducted to ensure compliance on the taxpayers selected by risk criteria and third party information and on taxpayers those need to dispose over 50 per cent of their business fixed assets or close the business. ERCA performed issue audit for one item of potential noncompliance that may be apparent from examination of a taxpayer's return and desk audit for data cleaning purpose to confirm whether the data submitted by the taxpayers is genuine. However, the outcomes of the study revealed that tax audit program remains undeveloped in ERCA with an emphasis on comprehensive and desk audit with the exclusion of other audit methodologies. In addition, as Tait (1988) stated, such excessive examination of taxpayer data may create collision between taxpayers and tax official, and auditors' error in such examination may also damage business activity that result in negative impact on the economy, tax system in particular. On the other side, the practice of issue audit is almost nil (Table 4.2).ERCA does not consider its audit activities to be on specific errors or compliance risks (transactions and vouchers or records) that alarms the tax system with respect to potential loss of tax revenue due to evasion or fraud and other noncompliance activities.

Table 4.3- ERCA repetitively audit the same taxpayer in consecutive periods

S.N	Item		Frequency	percent
1	Tax auditors repetitively audit the same tax payer in consecutive period?	Yes	31	19.7
		Sometimes	101	64.3
		No	25	15.9
		total	157	100.0

Source: Questionnaire Results, 2017

Regarding audit frequency as show in Table 4.3, out of 157 respondents 64.3 percent of tax auditors stated that sometimes similar tax payers are selected for audit in a consecutive years, 15.9 percent of the respondents stated that tax payers who audit in previously were not selected for the next audit, the remaining 19.7 percent respondent stated that there is a possibility to audit similar tax payers in consecutive years.

Further, as OECD (2006) stated, a taxpayer that is audited for the current year, and the audit results in no additional taxes owed should be granted relief from audit for the next two years except if substantial changes take place such as serious tax fraud. Similarly, in ERCA, taxpayers have been sometimes selected for audit in a given period although those taxpayers were audited in the preceding period and have no evaded tax liability owed in that period (Table 4.3).

Table 4.4 Tax Audits conducted

S.N	Item	Frequency	Percent
1	When taxpayers reported tax returns less than previous period return.	25	15.9
	When serious tax fraud case is found.	132	84.1
	Total	157	100.0

Source: Questionnaire Results, 2017

Regarding the reason for repetitive audit, 84.1 percent of respondent tax auditors were replied that when serious tax fraud and evasion found, the taxpayers company is selected for audit for a consecutive audit period. As it is clearly indicated in the above table, 15.9 percent of Tax Auditors replied that taxpayers were selected for repetitive audit, when report their return less than previous return. The audit is conducted when serious tax fraud is found and taxpayers report tax return less than previous audit period (Table 4.4). Thus, it might be appropriate to conduct audit on the same taxpayers repetitively when serious tax fraud is found regardless of the taxpayers' compliant history. However, the taxpayers' tax returns might differ and be reduced due to economical and/or operational factors. The taxpayers' report of less tax return is not necessarily being a sign of being noncompliant. Thus, ERCA might unreasonably consume its audit resources that make the tax audit program nonproductive and time-consuming as well as increase the hardship associated with repetitive audits for fully compliant taxpayers.

Table 4.5: Main activities of auditors and investigators during tax audit

S.N	Item	Frequency	Percent
1	Detecting noncompliance behavior of individual taxpayer.	48	30.6
	Educating taxpayer's	56	35.7
	Interpreting complex tax rules and regulations for taxpayers.	53	33.8
	Total	157	100.0

Source: Questionnaire Results, 2017

The survey result also showed that the main activities of tax auditors and investigators in ERCA is educating taxpayers (35.7 percent of respondents), Interpreting complex tax rules and regulations for taxpayers (33.8 percent of respondents) and 30.6 percent of respondents detecting noncompliance behavior of individual taxpayers (Table 4.5). The central activities of auditors and investigators during their audit work include educating taxpayers, Interpreting complex tax rules and regulations and detecting noncompliance of individual taxpayer, (Table 4.5). Among others, creating taxpayers' awareness might be essential to increase voluntary compliance and to soften future compliance risks in Ethiopia. Because compliance risks might arise mainly due to taxpayers' lack of awareness as well as fault in the tax administration, taxpayers' negligence, and taxpayers' deliberate action.

Table 4.6 : An Outcomes-based performance standard for audit activities

S.N	Item	Frequency	Percent
1	By using compliance review.	47	29.9
	By using compliance tracking analysis.	79	50.3
	By using voluntary disclosure.	31	19.7
	Total	157	100.0

Source: Questionnaire Results, 2017

Regarding the outcomes based performance standards, 50.3 percent of respondents by using compliance tracking analysis, 29.9 percent of respondents by using compliance review and the remaining 19.7 percent of respondents) by using voluntary disclosure. Further, ERCA has an outcomes-based performance for audit activities by using Compliance tracking analysis the key measures to be used are where audited taxpayers' Assessed income tax and increases to a greater extent than that of the control group then, ratio of late payment penalties to payments due and returns filed shows greater improvement compared to the control group (Table 6), by using Compliance review task to measure taxpayers' compliance behavior following an audit via a post-assessment audit review and Voluntary disclosures measure, as they show improved voluntary compliance as the taxpayer self-corrects their incorrect tax position.

Table 4.7: Methods of getting information regarding taxpayers

S.N	Item	Frequency	Percent
1	By reviewing the previous case history of taxpayers	48	30.6
	Using information from third parties such as Financial institutions, Venders and suppliers.	31	19.7
	Using business sector profile	78	49.7
	Total	157	100.0

Source: Questionnaire Results, 2017

According to Table 4.7, Tax Auditors and Investigators get information from different sources. Majority of respondents agree that Tax Auditors get information from business sector profile, 49.7 percent of the respondents, get necessary information by reviewing previous case history of taxpayers and taxpayer's business profile, 30.6 percent of the respondents and 19.7 percent of the respondents from third party such as financial institutions, vendors, suppliers and other agency.

Table 4.8: Taxpayers cooperation to give information for Tax Auditors and assessor

S.N	Item		Tax auditors	
			Frequency	percentage
1	Are taxpayers cooperating to give enough information for Tax Auditors /Tax assessors?	Yes	126	80.3
		No	31	19.7
	Total		157	100.0

Source: Questionnaire Results, 2017

Regarding taxpayers' cooperation to give enough information for tax Auditors and assessors, Table 4.8 reveals that taxpayers are cooperate to give enough information regarding their businesses for Tax Auditors or Tax assessors, 80.3 percent of respondents and 19.7 percent of respondents' tax Auditors replied that taxpayers not were cooperates to give information for Tax assessor and Tax Auditors. This shows Taxpayers cooperate to give essential information compulsory for audit.

Table 4.9 - Tax Auditors access for information

S.N	Item	Percentage				
		S/disagree	Disagree	Neutral	Agree	S/Agree
1	Tax auditors and investigators have good access to information held by the taxpayers and others.	3.8		20.4	75.8	

Source: Questionnaire Results, 2017

Table 4.9 deals with Tax Auditors access to get information held by taxpayers and others. 75.8 percent of respondents Tax Auditors replied that tax auditors and investigators have good access to information held by taxpayers and others. This result indicated that auditors and investigators have good access to information kept by taxpayers.

Table 4.10 –Case selection

S. N	Item	Percentage				
		S/disagree	Disagree	Neutral	Agree	S/Agree
1	Selection is based on taxpayer' high tax potential.		19.7		49.7	30.6
2	Tax payers selected for audit is through screening and case review.		19.7		64.3	15.9
3	Audit is performed based on audit manual.			19.7	33.8	46.5
4	Continuous and sufficient trainings for tax auditors.	14		15.9	70.1	

Source: Questionnaire Results, 2017

Regarding Case selection criteria, 49.7 per cent of the respondent Tax Auditors replied that taxpayers have been selected based on taxpayers' high tax potential for audit purpose. Item 2 on Table 4.10, 64.3 percent of Tax Auditors agree that case selection was based on the screening and case review audit. Item 3 on table 4.10 shows that 46.5 percent of respondents strongly agree that audit was performed based on audit manual. And 19.7 percent of respondents were neutral. Item of 4 of table 4.10, 70.1 percent of respondents was strongly agree about continuous and sufficient trainings for tax auditors. Based on taxpayer data, audit case is selected in ERCA based taxpayer' high tax potential through screening and case review performed based on audit manual (Table 4.10).

Table 4.11 Tax Audit Techniques

S. N	Item	Percentage				
		S/disagree	Disagree	Neutral	Agree	S/Agree
1	The expansion of cash registry machine should continue.					100.0
2	Re-calculations of profits are essential tools to bring audits to an effective conclusion.				49.7	50.3
3	Reconstructing income to determine the actual tax liability.				69.4	30.6
4	The bank deposits and cash expenditures showing what happened to a taxpayer's funds.				39.5	60.5
5	Taxpayers have the right to know what they need to do to comply with the tax law.				19.7	80.3
6	Every tax payers is liable for the correct amount of tax is due under the law.	14			19.7	66.3
7	Taxpayers have the right to raise objections and provide additional documentation in response to formal proposed actions.				15.9	84.1
8	Taxpayers have the right to expect the tax system to consider facts and circumstances.			14	35.7	50.3

Source: Questionnaire Results, 2017

Concerning audit techniques, Item one on the table indicated that 100 percent of the tax auditors were completely or strongly agree the expansion of cash registry machine should continue for audit techniques. Item two shows 50.3 percent of the respondents were strongly agree about the re-calculations of profits are essential tools to bring audits to an effective conclusion as audit techniques. Item three elicits that 69.4 percent of the respondents agree about reconstructing income to determine the actual tax liability. Item four on table, the survey result showed that 60.5 percent of tax auditors strongly agree bank deposits and cash expenditures have a good technique to know what happened to taxpayer's funds. This implied bank account of tax payers' movement was essential to determine whether a fund was correctly used for the business or personnel cases. Item five the survey result showed that 80.3 percent of the respondents believed taxpayers have the right to know what they need to do comply with the tax law of the ERCA. Item six results exhibited 66.3 percent of the respondents strongly believed that every tax payers were liable for the correct amount of tax is due under the law of ERCA. Item seven on the table indicated that 84.1 percent of the respondents assumed Taxpayers have the right to raise objections and provide additional documentation in response to formal proposed actions. Finally item eight replied that 50.3 percent of the respondents confirmed that Taxpayers have the right to expect the tax system to consider facts and circumstances (table 4.11) various types of information might be reviewed namely, reconstructing income to determine the actual tax liability, taxpayer's funds bank deposits and cash expenditures are very necessaries and indirect way to authenticate the accounts. This implied that ERCA go all necessaries steps to justify exact amount expected from taxpayers. 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 taxpayers' current business condition and ERCA aggressively expand cash registry machine. On the same table 4.11Taxpayers' have the right to know what they need to do to comply with the tax law, raise objections and provide additional documentation in response to formal proposed actions and expect the tax system to consider facts and circumstances since tax audit used professional judgment with reasonable justification.

Table 4.12: Interaction between tax auditor and taxpayers

S.N	Item	Percentage				
		S/disagree	Disagree	Neutral	Agree	S/Agree
1	There is no occasion for the tax auditor to harass taxpayers.	19.7	44.6		15.9	19.7
2	The tax auditor should aid the taxpayer in gaining a correct understanding of the law.	19.7				80.3
3	The tax auditor should constantly keep in mind that it is our policy to administer the law fairly and uniformly.	19.7				80.3
4	All audits should be made in accordance with approved auditing and accounting principles.	19.7			16	64.3
5	Sound professional judgment must be exercised in making tests that are representative of the actual business operations during the audit period.			19.7	30	50.3
6	Customer satisfaction surveys can provide useful information on how the audit activity is considered among the public.	19.7		16		64.3
7	Quality audit outcomes measured in terms of adherence to correct audit procedures, and appropriate application of tax law.				35.7	64.3

Source: Questionnaire Results, 2017

Regarding the interaction between tax auditor and taxpayers, item one on the table below, 44.6 percent of respondents disagree or opposed the occasions of tax auditor harass taxpayers. Item two on the table, replied that 80.3 percent of the respondents suggested that Taxpayers have aided by tax auditor for the correct understanding of the law. Item three on the table, showed that 80.3 percent of the respondents strongly agree that tax audit policy administered the law fairly and uniformly for majority of tax payers. Item four on the table, 64.3 percent of the respondents were concluded that tax audit made with approved auditing and accounting principles and 19.7 percent of the respondents were not agree or opposed with approved auditing and accounting principles. Majority of the tax auditors were guided by approved auditing policy documents. Item five on the table, 50.3 percent of the respondents were ruled by sound professional judgment and tests the representativeness of the actual business operation during audit period. This means beside professional judgment tax auditor were justified each transaction or activities done. Item six on the table, 64.3 percent of the respondents replied to get the public reflection about the tax audit activities information was collected by using survey of the taxpayers. Item seven on the table, 64.3 percent of the respondents suggested that quality outcomes measured in terms of adherence to correct audit procedures and appropriate application the law of ERCA. The majorities of tax auditor has harass tax payers and haven't decent relationship. On the same table, Taxpayers have aided by tax auditor for the correct understanding of the law, tax auditors administer the law fairly and uniformly.

Table 4.13 tax evasion and avoidance

S.N	Item	Percentage				
		S/disagree	Disagree	Neutral	Agree	S/Agree
1	series evasion and fraud are basis for selection				19.7	80.3
2	Tax avoidance and tax evasion are important factors limiting revenue mobilization.			19.7	30.6	49.7
3	Tax audit is for reducing tax evasion and tax fraud.				19.7	80.3

Source: Questionnaire Results, 2017

As indicated in table 4.13 below, More than 80 percent of the survey result shows that case selection was based on the commitment of serious evasion and fraud. As 80.3 percent respondent tax auditors' response, taxpayers select for audit when they commit serious fraud and evasion. Item two on table, 49 percent of respondents strongly agree that tax avoidance and tax evasion were a serious factors limiting revenue mobilization. Tax audit is for reducing tax evasion and tax fraud. The survey result shows that tax audit is vital for reducing tax evasion. As 80.3 percent of respondent tax auditors tax audit has positive effect on reducing tax fraud and tax evasion.

Regarding the tax evasion and tax avoidance, any tax in a tax system is vulnerable for evasion and fraud, which has become the concern of many countries. Like, Ethiopia Tax audit is for reducing tax evasion and tax fraud Because Tax avoidance and tax evasion are factors limiting revenue mobilization, therefore, series evasion and fraud are basis for selection.

4.3. In-depth Interview Results

The in-depth interview with tax officials suggested that *"ERCA performs profoundly comprehensive audit. However, along with the start of the discharge of the risk-based taxpayer selection structure. Audit methodologies especially desk audit and others such as field audit and issue audit come to existence in branch offices."* The interview results also exposed that ERCA seriously conducts investigation audit in all branch offices based on the information that comes from third party, financial institution, Spy and diverse sources with evidence regarding the premeditated evasion or serious fraud.

The in-depth interview with tax officials further confirmed that *''tax auditors of ERCA has conducted its audit activities mostly on category, ''A'' along with less stress for category ''B" and category ''C" taxpayers. The main reason for the selection of such category of taxpayers for audit purpose is their higher compliance risk and large revenue potential. At present, segmentation approach is accepted and would provide one spot customer service that might result customer satisfaction, and minimizes both taxpayer compliance costs and tax administrative costs.''* However, tax audit program is mainly directed to specific segments and sectors those have large tax potential with less emphasis to medium and small category of taxpayers' community. In addition, the audit coverage is inadequate that might be due to inappropriate audit type adopted and resource limitation.

Regarding taxpayers' awareness creation, tax officials suggested that *''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 , house to house impressively and openly discusses with tax payers to restrain tax evaders and fraud, recognize model tax payers as well as tax officials, adjusting rules and regulation based on tax payers feedback, monitor and evaluate the tax employees, creating tax day celebration, strengthen strong political commitment, penalty does not teach tax payers instead education, respect every taxpayers as customer, make a notice before any harsh measurement.''*

Regarding formal statements of taxpayers' rights and obligations in-depth interview with tax auditors showed that *''Taxpayers have the right to know what they need to do to comply with the tax law, the right to raise objections and provide additional documentation in response to formal proposed actions, the right to expect the tax system to consider facts and circumstances, the right to receive prompt, considerate, and professional assistance, the right to pay only the amount of tax legally due, including interest and penalties, and apply all tax payments properly. And every taxpayer is liable for the correct amount of tax that is due under the law, not to commit forbidden actions like, tax evasion and tax avoidance, illegal trade and other restricted by the tax law of the country.''*

Concerning interaction between Taxpayer and Tax Auditor in the audit context, in-depth interview with tax officials revealed that *''ERCA's ethics principles clearly shape the way of approach while dealing with taxpayers', there is no occasion for the tax auditor to harass taxpayers or to give the impression that the object of the audit is to find errors in the taxpayers' self assessments. All staffs movements in office are under CCTV camera control and out of working hours still not contact with customers because the authority expects illegal actions or restricted relationship may results unfavorably condition for tax audit program and limit resource mobilization. Therefore, tax auditors should limit themselves and Care should be taken. And also the taxpayers should not contact informally and deal about the way of sinking tax liability.*

Finally, about the anybody or the department who evaluate tax audit performance, in-depth interview with tax auditors showed that there is a body or a department who established at directorate level in head office, control and supervise the performance of each individuals, team and branches widely and tax auditors and ERCA performance measure by external federal tax auditors with the help of taxpayers' compliance level and planned resource mobilization achievements. Based on external federal auditors finding and recommendation *the branch offices made correction and put relevant recommendation in to procedures and principle for next progress.''*

4.4 Documentary analysis results

During document analysis, the researcher see the ERCA's annual report, As stated in annual report (2015/16), ERCA has no emphasis and do not assigned enough number of auditors for the conduct of investigation audit in its new organizational structure and there is no specified time range within which taxpayers are expected to present their data and to enforce non-volunteer taxpayers to submit the data on time.

Regarding audit coverage, the total number of taxpayers administered by ERCA was 28,863 in 2014/15 fiscal year. According to ERCA Human resource, 2017, the total number of taxpayers registered was 29,185, of which 23,684 (81.2 per cent) were registered at Addis Ababa branch offices (LTO, Addis Ababa East and Addis Ababa West). The rest 5,501 (18.8 per cent) were registered out of Addis Ababa branch offices. Besides, the number of tax audit staff during 2014/15 and 2016/17 was 301 and 254.

In addition, there is shortage of computers, network cables, sockets at office and laptops, cars and audit manpower for field audit work. There is also absence of separate workroom to keep the information that might be used for conducting investigation audit. Even the existing computers are detected by viruses and do not accept flash and CD to enter the softcopy information that comes from altered sources. Moreover, the tax auditors have not even aware with the system due to absence of adequate training (ERCA annual report 2015/16).

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 INTRODUCTION

This chapter provides the conclusions and recommendations in line with the findings of the study. The chapter is structured in two sections. The first section deals with conclusions where as the second section presents some recommendations suggested as a solution to problems that have been identified in the study.

5.1. 1Conclusions

Taxation is key basis 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 financially viable agents to the development goals foreseen by the government through the incentive schemes surrounded within the current tax laws. Nevertheless, the performance of tax revenue is relatively poor that accounts not more than 13 percent of GDP during the 2014/15 – 2016/2017 fiscal years, which is caused by lack of voluntary compliance mainly due to rareness of taxpayers' awareness and the weakness in the tax administration itself, ineffective audit program in particular.

To achieve revenue objective and ensure the strength of the economy a well structured tax audit program is a central issue and sustain the health of the tax system by reducing tax gap through voluntary compliance perfection and additional tax collections. additional, it might provide valuable support in identifying areas of the tax law that require explanation or addressing deficiencies in the law, and to influence compliance across the broader taxpayer community at all levels.

Thus, the study assessed the problems in tax audit practice in Ethiopia (the case of the federal government). The study was conducted to look into 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 questioner with tax auditors and investigators, in-depth interviews with tax officials and documentary analysis. In particular, the findings from the discussions are concluded in the following paragraphs:-

ERCA focused on comprehensive and desk audit with the keeping out of other audit methodologies that's why tax audit program remains undeveloped. There is insignificant range of tax audit activities performed targeting suitably specific risks, which might result in less balanced and measured responses in terms of additional revenue collection and voluntary compliance enhancement.

Further, the audit program performed in ERCA 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. In the course of audit, ERCA 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 ERCA is a toddler tool in improving voluntary compliance through helping taxpayers to understand their tax and customs obligations that could generate the right tax revenue at the right time.

Presently, segmentation approach is adopted and would provide one spot customer service that might result customer satisfaction, and minimizes both taxpayer compliance costs and tax administrative costs. However, tax audit program is mainly directed to specific segments and sectors those have large tax potential with less emphasis to medium and small category of taxpayers‟ community. In addition, the audit coverage is unsatisfactory that might be due to inappropriate audit type adopted and resource constraint.

Further, taxpayers are selected for audit based on risk criteria, and selected audit cases are expected to be performed within 25 days period stated in the standard of tax audit regardless of the complication of audit cases and the size of the taxpayers. Taxpayers might be repetitively audited if there is a sign of serious tax fraud and when they report less tax return than previous periods. As a result, there is unfairly consumption of audit resources as well as increase the hardship associated with repetitive audits for entirely compliant taxpayers.

The potential amount of tax revenue that might be found with the target taxpayer and the prospect of collecting evaded tax return, is the secondary objective of tax administration, have been also considered for conducting audit. Furthermore, the case selection decision is based the information from SIGTAS, earlier period case histories of taxpayers, third parties such as banks , informants, vendors and intelligence team.

Nevertheless, the use of SIGTAS does not give reliable decision to assure appropriate risk selection due to absence of efficient and fresh data. Further, there is no specified time range within which the taxpayers are expected to present their data.

To check the correctness of tax returns, various types of information might be reviewed namely tax returns, financial statements, accounting records, customs declaration and other source documents. The accuracy of taxpayers' tax liability is determined mainly through compliance tracking analysis. However, the application of investigation approach is not as such in practice, and it might be difficult to determine what wealth the taxpayers have accumulated but not documented or recorded in their books of accounts and financial reports.

Regarding audit techniques, ERCA go all necessaries steps to justify exact amount expected from taxpayers by using indirect methods like, reconstructing income, bank deposits and cash expenditures. Additionally, 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 are used to test the accuracy of tax returns. ERCA aggressively expand cash registry machine to control business activities.

Taxpayers' have the right to know what they need to do to comply with the tax law, raise objections and provide additional documentation in response to formal proposed actions and expect the tax system to consider facts and circumstances since tax audit used professional judgment with reasonable justification. The majorities of tax auditor has harass tax payers and haven't decent relationship even if, they are under obligation and strong commitment. Respectful treatment of taxpayers by tax officials has been shown to promote tax compliance (Feld and Frey 2007). Fair procedures, equal treatment of taxpayers at the individual and group level, the avoidance of overly inquisitive audits, and a user-friendly tax administration are also hypothesized to increase tax compliance (Kirchler *et al.* 2009): The easier it is for citizens to comply with the tax system, the less likely it is that they feel alienated and harassed by it. Various governments experiment with administrative reforms to make life easier for taxpayers (Alm *et al*. 2010).

ERCA Tax audit is for reducing tax evasion and tax fraud Because Tax avoidance and tax evasion are factors limiting revenue mobilization, therefore, series evasion and fraud are basis for selection. If tax evasions and avoidances take place/occur in this branches it adversely affects the government's revenue, To mitigate such problems, therefore, a successful audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue, and to improve its tax administration and tax potential.

5.1.2 RECOMMENDATION

In light of the aforementioned conclusions of the study, the researcher wish to make the following recommendations to minimize the problems of ERCA tax audit program so that to improve voluntary compliance and to meet the revenue needs of the government. Therefore, the researcher has tried to present briefly the following recommendations:

- ERCA must adopt different ranges of audit types to increase the audit coverage and voluntary compliance having inadequate staff resources, should adopt a wide range of audit methodologies rather than use of full comprehensive audit because to address risk and audit quality.
- The spot issue audit should be widely applied to increase the audit coverage, and education type audits that are not yet in place should be implemented to improve taxpayers' awareness and voluntary compliance. In addition, ERCA should give emphasis and assign adequate resources for investigation audit.
- Tax administrators, auditors in particular, should not simply enforce and intimidate taxpayers by raising the consequence of not being compliant. However, they must foster tax compliance through improving services to taxpayers to create fair and smooth tax system with high compliant taxpayers.
- ERCA should revise the stated 30 days for large tax payers and 21 days for other tax payers audit period with the consideration of 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.
- Tax payers have lack of awareness regarding tax rules, regulation directives and procedures and directives. This is due to level of awareness is dependent on taxpayers educational background and exposure.
- To increase the awareness level ERCA should give great attention to educate communities as well as taxpayers through different techniques like mass-media, preparing broacher and face to face discussions.

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

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APPENDIX

Appendix 'A'

St. Merry University

College of Business and Economics

School of Management and Accounting

M.Sc. program in Accounting and Finance

Questionnaire to be filled by Tax Auditors

This questionnaire is designed to meet the objective of research titled "Tax audit practice in Ethiopia; the case of Federal Government" The researcher is Ephrem Demessie who is currently an MSc (in accounting and finance) student at the st.merry University. Therefore; the data from this questionnaire will help the researcher to obtain reliable and valid information. Your open and genuine response is highly appreciated.

Do not write your name on the questionnaire.

The questionnaire has two parts: Part -I is about your personal information. Part-II is the overall questions about Tax audit practice. Please read each item carefully and give your honest response to each item.

Thank you for your cooperation!

Ephrem Demessie

Tel. 0910-041865

Email -ephremdemessie@cbe.com.et

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. How long did you work as an auditor?

   1. Less than 2 years ☐ 2. 2-4 years ☐ 3.4-6 years ☐ 4. Above 6 ☐

Part - II Question regarding Tax audit practice

6. What types of Audit are usually performed?

   1. Desk Audit ☐ 2. Field Audit ☐ 3. Comprehensive audit ☐

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

   7. Refund Audit ☐ 8. Fraud investigation☐ 9. Other ☐

7. Tax auditors in ERCA repetitively audit the same tax payer in consecutive period?

   1. Yes ☐ 2. Usually ☐ 3.Sometimes ☐ 4. No ☐

8. If your answer for Q 9 is yes what is the condition those taxpayers may be audited?

   1. When taxpayers reported tax returns less than previous period return ☐

2. When serious tax fraud case is found ☐

3. When taxpayers have large tax potential ☐

4. Other please specify…………………….

9. What are the main activities that tax auditors, investigators and assessors expected to perform during an audit period (multiple answers are possible)?

1. Detecting noncompliance behavior of individual taxpayer ☐

2. Gather information on the health of the tax system including compliance behavior ☐

3. Educating taxpayer's ☐

4. Interpreting complex tax rules and regulations for taxpayers ☐

10. How do you evaluate an outcomes-based performance standard for audit activities? (Multiple answers are possible)

1. By using Compliance review ☐ 2. By using Compliance tracking analysis ☐

3. by using Taxpayer education provided ☐ 4. By using Survey of audited taxpayers ☐

5. By using Media profile ☐ 6. By using Voluntary disclosures ☐

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

1. By reviewing the previous case histories of taxpayers ☐

2. Using information from third parties such as financial institutions ☐

3. Using business sector profile ☐

4. Others, please specify ___________________________________

12. Are taxpayers cooperate to give information for tax auditor/Assessor?

1. Yes ☐ 2. No ☐

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)

Questions regarding Audit case business for audit

No.	**Statements**	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**
		1	**2**	**3**	**4**	**5**
13.	Tax auditors and investigators have good access to information held by the taxpayers and others.					
14	Selection is based on taxpayers' high tax potential.					
15	Tax payers selected for audit is through screening and case review					
16	Audit is performed based on audit manual.					
17	Continuous and sufficient trainings for tax auditors.					
Questions regarding the audit techniques						
18	The expansion of cash registry machine should continue.					
19	Re-calculations of profits are essential tools to bring audits to an effective conclusion.					
20	Reconstructing income to determine the actual tax liability.					
21	The Bank Deposits and Cash Expenditures showing what happened to a taxpayer's funds.					
22	Taxpayers have the right to know what they need to do to comply with the tax laws.					

23	Every taxpayer is liable for the correct amount of tax that is due under the law.					
24	Taxpayers have the right to raise objections and provide additional documentation in response to formal proposed actions.					
25	Taxpayers have the right to expect the tax system to consider facts and circumstances.					
Questions Regarding Interaction between Taxpayer and Tax Auditor in the Audit Context						
26	There is no occasion for the tax auditor to harass taxpayers. .					
27	The tax auditor should aid the taxpayer in gaining a correct understanding of the tax law.					
28	The tax auditor should constantly keep in mind that it is our policy to administer the law fairly and uniformly.					
29	All audits should be made in accordance with approved auditing and accounting principles.					
30	Sound professional judgment must be exercised in making tests that are representative of the actual business operations during the audit period.					
31	Customer satisfaction surveys can provide useful information on how the audit activity is considered among the public.					
32	Quality audit outcomes measured in terms of adherence to correct audit procedures, and appropriate application of tax law.					
33	**Questions Regarding Tax Evasion and Avoidance.**					
34	Series evasion and fraud are basis for selection.					
35	Tax avoidance and tax evasion are important factors limiting revenue mobilization.					
36	Tax audit is for reducing tax evasion and tax fraud.					

Appendix ‘B’

Tax officials in-depth interview instrument

1. Which audit type is mostly performed? Why could it be?
2. Which category of taxpayers and sectors are usually selected for tax audit? What would be the reason behind this selection?
3. What are the formal statements of taxpayers’ rights and obligations?
4. How is your Interaction between Taxpayer and Tax Auditor in the audit context of ERCA?
5. Is there a way to use the indirect methods to verify income of taxpayers? What are?
6. Is there anybody to evaluate tax audit performance? Who and How?
7. Does have ERCA perform appropriate audit outcome measures? What are key criteria?
8. How tax audit is exercised in the reduction of tax avoidance and evasion?
9. What are the challenges of tax administration? What do you suggest for the improvement of Tax administration and tax audit program?