ST. MARY'S UNIVERSITY,

SCHOOL OF GRADUATE STUDIES

SCHOOL OF BUSINESS

TAX AUDIT PRACTICE IN ETHIOPIAN REVENUE AND CUSTOMS AUTHORITY: CASE OF ADDIS KETEMA SUB CITY

BY

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Statement of certification

This is to certify that Kidist Tsegaye has carried out a thesis on the topic entitled "Tax Audit Practice in Ethiopian Revenue and Customs Authority: The case of Addis Ketema Sub City" and submitted in partial fulfillment of General Business Administrationunder supervision of the research advisor.

This thesis is suitable for submission in partial fulfillment of the requirement for the MSc Degree in General Business Administration,which complies with the regulations of the University and meets the acceptedstandards with respect to originality and quality.

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Statement of declaration

I, Kidist Tsegaye, have carried out independently a research thesis "Tax Audit Practice in Ethiopian Revenue and Customs Authority: The case of Addis Ketema Sub City" in partial fulfillment of the requirement of the M.SC program in General Business Administrationwiththe guidance and support of the research advisor.

This study is my own work that has not been submitted for any degree or diploma program in this or any other institution, and that all references materials contained therein have been duly acknowledged.

Name Kidist Tsegaye

Signature ____________

Abstract

This study examines tax audit practice in Ethiopian Revenue and Custom Authority (the case of Addis Ketema Sub City), and investigates key problems in tax audit operation regarding the appropriateness of audit type used, audit rate, aptness of audit case selection methods and audit examination techniques used, and the experience and capability of audit staff resources. 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 survey with tax auditors and team leaders, in-depth interviews with the section headof tax audit and department of risk management 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 inadequacy of compliance risk-based audit case selection strategy, scarcity of audit resources, tax auditors in particular, and absence of proficient and experienced tax auditors. In the end, the study forwards the possible measures to be taken by the Ethiopian Revenue and Customs Authority of Addis Ketema Sub City to mitigate problems in tax audit operation.

Key words: tax audit, voluntary compliance, tax gap, pre audit case management

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List of abbreviations

ANOVA	Analysis of Variance
A/K/S/C	Addis Ketema Sub City
EC	European Commission
ECC	Ethiopian Chamber of Commerce
ERCA	Ethiopian Revenue and CustomsAuthority
IRS	Internal Revenue Service
IT	Information Technology
OECD	Organization for Economic Co-operation and Development
RAP	Repetitive Audit Procedures
SIGTAS	Standard Integrated Government Tax Administration System
VAT	Value Added Tax

CHAPTER ONE: INTRODUCTION

1. Background of the study

The primary economic goal of developing countries is to increase the rate of economic growth, in order to bring them to levels of per capital real income comparable to those of developed countries. Attaining this goal depends on the developing government's ability to provide additional basic government services, particularly in education, public health, and transport, and on achieving higher rates of capital formation in production facilities, whether undertaken in governmental or private sectors. The key to economic growth is, of course, the transfer and better utilization of resources, not merely the shift in the location of money (Taylor, 2005). Most developing countries are dependent on external resources to finance their development endeavors. As a result, the budget problem becomes more aggravated from time to time. To change this situation, they should exploit and strengthen their domestic resource base to bring about sustainable development. Otherwise, it is difficult to achieve profound growth depending on external sources. External sources, with their uncertainty, instability and unsuitability, could not be taken as the major sources of development.

According to Cobham (2005), Government revenues sourced from various tax and non-tax receipts. The oldest and ultimately the only sustainable source of development finance is taxation. As such, the longer-term goal must be to put government revenues on a sustainable footing, consistent with the levels of expenditure demand. Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago. It becomes an issue of worldwide concern, from the time of its inception. This is due, in great part, to effects on the life of virtually every human being (Lymer A. and Oats L., 2009).Taxation is a compulsory levy imposed on a subject or upon his property by the government to provide security, social amenities and create conditions for the economic well-being of members of any particular society;it is a major player in every economy of the world (Ola, 2001; Appah, 2004; Nwezeaku, 2005; Aguolu, 2007).Four key issues must be understood for taxation to play its functions in the societyfirst, a tax is a compulsory contribution made by the citizens to the government and this contribution is for general common use. Secondly, a tax imposes a general obligation on the taxpayer. Thirdly, there is a presumption that the contribution to the public revenue made by the taxpayer may not be equivalent to the benefits received. Finally, a tax is not imposed on a citizen by the government because it has rendered specific services to him or his family (Nzotta, 2007).

Developing countries are in difficulty to collect tax efficiently, because of many serious problems they face as to tax design and administration. They are also in trouble to provide basic social services from taxation (Damme, 2008). To reap the proceeds from taxation, the administrative aspect of a tax system must be given attention because how well a tax administration system performs depends on how well it achieves the goals for which it should be held accountable. An efficient and effective tax administration system would enhance a high level of taxpayer voluntary compliance, which in turn would result in a high collection of potential tax revenue (Fischer, 1991). Therefore, measuring the tax administration performance as well as improving it, is essential especially for developing countries like Ethiopia.Any tax in a tax system is vulnerable for evasion and fraud, which become the concern of many countries(Alemu and Deresse, 2009). Tax fraudtypically considered as any intentional, illegal reduction of tax payments, which usually takes the form of underreporting income, sales or wealth, or overstating deductions including failure to file appropriate tax returns (Schneider , Braithwaite & Reinhart, 2001).

An audit will examine the issues seen as most significant to achieving an accurate assessment of a taxpayer's tax liability. Typically, these issues will include any indications of significant unreported income (for example, as may be suggested by a very low ratio of net/gross business income ratio computed from a taxpayer's return) or potentially over-claimed deduction items that may be apparent from an examination of a taxpayer's tax return and other information(OECD., 2006). As Biber (2010), Tax audit is extending beyond verifying a taxpayer 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. Several developing countries do not yet have effective audit programs due to: insufficient numbers of the required highly skilled and appropriately paid audit practitioners, absence of a sound institutional audit practice, illegal cooperation between taxpayers and auditors, lack of clear political support for the tax administration, and the deficiency of appropriate legal and judicial environment. Additionally, these countries have a tendency to offset weak tax audit by adopting complex procedures, such as increased filling requirements and massive crosschecking. This in turn might result administrative difficulties and increase the compliance cost of taxpayers (Hellenrstein, 2005).

The proper amount of tax must be collected on a timely manner for successfully improving and maintaining steady economic progress of a nation. To do this, the enforcement powers of the tax administration, including tax audit, must be applied judiciously and in an evenhanded fashion (Baurer, 2005). The tax administration is required to audit some or all its taxpayers to check the evasion of tax and ensure compliance. A tax audit is a detailed exploration into the activities of a taxpayer to determine whether he/she has been correctly declaring the tax liabilities. Audits indirectly drive voluntary compliance and directly generate additional tax collections, both of which help tax agencies to reduce the 'tax gap' between the tax due and tax collected. Audit plays the pivotal role in the administration of tax and achieving the revenue objectives, ensuring the fiscal health of country and ensures a level playing field for an honest taxpayer (Gupta and Nagadevara, n.d).

Ethiopia needs increased tax revenues to reduce the high poverty levels of its populace. One way of condensing poverty is to generate higher revenues that will finance public expenditure. In addition, taxes would help in reducing the country's debts. It is one thing to know that taxes can help finance government expenditure and quite another to have a system that actually collects and manages tax revenue effectively. The responsibility to collect revenue for the federal government rests with the Ethiopian Revenue and Customs Authority (ERCA). Currently, ERCA have many branches, from them Addis Ketema Sub City ERCA branch is one of the branch that accomplish its mission and objectives. The branch collects revenue from domestic tax revenue; and in the domestic tax collection, activities there are two processes: customer service process and tax assessment and collection enforcement process. The previous process contains tax payers registration and identifications, tax appeal and tax payer education and information service delivery and the later process contains return filing and payment, tax revenue accounting, tax assessment,tax audit and tax refund business activities. However Addis Ketema Sub City Revenue Authority collects less revenue from business profit tax compared with the plandue to different reasons; to solve the problem effective tax audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue.

Hence the objective of the study is, hence to investigate tax audit practice and identify the main problems of tax audit program performed in Addis Ketema Sub city Branch of Ethiopian Revenue and customs authority. Regarding the type & the frequency of tax audit performed, audit coverage achieved, audit case selection methods, examination techniques applied, the effectiveness of audit program in terms of enlightening voluntary compliance & tax revenue performance and the skills & experience of tax auditors. The introduction part incorporates eight sections; background of the organization, background of study, research questions, statement of the problem, objectives of the study, significances of the study, scope and limitation of the study and organization/structure of the study.

1.1. Background of the organization

In Ethiopia, the responsibility for the administration of tax programs, as well as the delivery of economic and social benefits rests with the Ethiopian Revenue and Customs Authority (ERCA). According to article 3 of the proclamation No. 587/2008, the Authority is looked upon as "an autonomous federal agency having its own legal personality". The Authority came into existence on 14 July 2008, by the merger of the Ministry of Revenue, Ethiopian Customs Authority and the Federal Inland Revenue Authority who formerly were responsible to raise revenue for the Federal government and to prevent contraband. Reasons for the merge of the foregoing administrations into a single autonomous Authority is to build a modern organization that is committed to leadership and client service.

- **Country Tax policy**

Ethiopian tax policy is based on taxpayers' voluntary compliance i.e. self-assessment. It is geared towards promoting investment, supporting industrial development; and broadening the tax base and decreasing the tax rate, at least maintaining the current reduced tax rates compared to most other countries, in view of financing the ever-growing needs of the government expenditure. ERCA has the mission for accomplishment of these policy objectives.

- **ERCA`s Vision, Mission and Values**

ERCA's Vision: "To be leading fair and modern tax and customs administration in Africa by 2020 that can be financing the Government expenditure through domestic tax revenue collection". Mission: "To promote the voluntary compliance of the taxpayers, ensure integrity and develop the skill of the employees, support modernization, trade and investment facilitation and harmonization of the taxes and customs administration system, contribute to the economic development and social welfare through effective revenue collection". There needs to be clear accountability for strategic management and support of the audit program at headquarters level and delivery of the program at Branch offices

- **Role of the Branches offices**
  - ✓ Develop operational plans aligned to corporate goals and objectives.
  - ✓ Select cases for audit based on established risk criteria.
  - ✓ Allocate audit cases to staff according to experience and skills
  - ✓ Implement internal systems to ensure quality audits
  - ✓ Identify training needs and inform headquarters
  - ✓ Monitor and evaluate the achievement of operational plans on a regular basis
  - ✓ Conduct the audit on selected tax payers, and undertake analysis of compliance
  - ✓ Implement compliance projects that is appropriate to the office

- **Tax audit policy and Strategy**

The main purposes of Tax Audit in ERCA is to establish the extent of a risk or risks and quantify any errors which may have arisen as a result, improve future compliance, support those who wish to comply, and deter non-compliance. The main principles of ERCA tax audit policy and strategy are facilitation vs. control, taxpayer relationship, and improved tax audit management & auditor professionalism. The mission, vision and value statements of ERCA form the backbone of the tax audit policy and strategy. The key guiding principles of the tax audit policy and strategy are drawn directly from these statements. They are-

- ✓ Fair and modern tax administration
- ✓ Effective revenue collection
- ✓ Promote voluntary compliance
- ✓ Develop the skill of ERCA's employees

1.2. Statement of the problem

With the increasing task of the government, the role of taxation in economic development has become even more significant. Such goals addressed through taxation like maintaining and expanding adequate system of social services, the curtailing of unnecessary consumption of luxury items, the maintaining of economic stability and the raising of funds for capital formation are justified. In general, the fundamental principle of the tax structure is the mobilization of economic surplus. Weak tax administration may make the tax system unfair in that honest taxpayers would bear heavier and disproportional burden. It, in turn may have impact on the efficiency of tax operation, and may encourage businesses to work in the illegal economy. The tax system in Ethiopia is not only meant to raise revenue for current expenditures but also aims at directing economic agents to the development goals foreseen by the government through the incentive schemes embedded within the prevailing tax laws (Jebessal and Quincke, 2005).

Accurately designed and administered taxation system is very important in generating revenue as well as increasing the tax base to the government of developed, developing and transitional economies. The tax base of developing countries adversely affected by administration problems including poorly conceived tax policies and lack of certainty regarding future policy changes. In addition, taxpayers as they impose onerous reporting and record keeping requirements perform excessive inspections and audits, fail to deal with their corrupt employees, and failure to provide transparency in the operations of tax administration (Baurer, 2005).

Like many other jurisdictions, Ethiopia's tax system is fraught with evasion. One factor that significantly contributes to tax evasion is lack of intensive audits and absence of predetermined audit criteria; to the greatest possible extent, tax systems should be supported by clear and straightforward laws and procedures that facilitate revenue collection, develop taxpayers' awareness, and minimize taxpayers effort and compliance costs. The administration should be provided with appropriate enforcement tools, including conduct of effective audit. Effective tax audit is important, because it assist the government in collecting appropriate tax revenue necessary for budget maintaining economic & financial order and stability. In addition effective tax audit ensure that satisfactory returns are submitted by the tax payers, organize the degree of tax avoidance and tax evasion, ensure strict compliance with tax laws by tax payers, improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government (ERCA, 2014).

Addis Ketema Sub City Revenue Authority office 2014/15 Annual report shows that the Revenue Authority collects less revenue from business profit tax (63.78 percent) compared with the plan. This is due to lack of awareness about taxes by businesspersons, low tax collection and administration system. To solve the problem Effective tax audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue. Effective tax audit could assist in that direction to monitor tax payers in complying with tax procedures so as to reduce tax evasion and then to increase the revenue generation through tax by creating good tax administration and collection system. Hence, to create effective and fair tax system, it is vital to address the administration that affects it. However, this study is limited to the issues regarding tax audit.

1.3. Basic research questions

The researcher formulates the following research questions:

1. Does A/K/S/C perform appropriate range of tax audit types targeting noncompliant taxpayers?
2. Does A/K/S/C have adequate tax audit resources, tax audit staff in particular?
3. What is the degree of the frequency and/or rate of tax audit performed?
4. Does audit case selection methods and audit techniques used appropriate?
5. What looks like the experience and capability of auditors participated in audit practices?
6. What are the main weaknesses and strengths of the tax audit program performed as compared to international standards?

1.4. Objective of the study

The study has both general and specific objectives.

1.4.1. General objective

The general objective of the study is to investigate tax audit practice and identify the main problems of tax audit program performed in Addis Ketema Sub city Branch of Ethiopian Revenue and customs authority.

1.4.2. Specific objectives

The specific objectives of the study are:

- To assess the existing performances of tax audit program of ERCA Addis Ketema Sub city
- To examine the experience and capability of auditors participated in audit practices
- To identify the degree of the frequency and/or rate of tax audit performed
- To evaluate audit case selection methods & audit techniques used
- To evaluate the performance of tax audit program in line with international standards
- To identify the main weakness and strength of the tax audit program performed and provide feedback

1.5. Significance of the study

The research is expected to identify the main problems of tax audit program performed, that affects tax revenue collection and taxpayers' voluntary compliance in the Addis Ketema Sub city branch and will recommends mechanisms for improvement. Thus, the study will have different significances. First, ERCA Addis Ketema Sub city branch might be able to comprehend the existing tax audit performance, and learns some lessons & builds some corrective measures for the weaknesses of tax audit practice based on the recommendations that enhance the performance in the revenue generation process. Second, it may be helpful for the taxpayers and other similar branch offices to have knowledge on tax audit practices. Finally, the study will help others broaden the skill regarding tax audit practice and it may give some highlights that would serve as a basis for further study.

1.6. Scope and limitation of the study

The study focuses on the audit part of the tax administration Addis Ketema Sub city branch of ERCA, which exclude other branches of ERCA; it examines the existing performances or tax audit practice by identifying the main weakness and strength of the tax audit program performed in Addis Ketema Sub city branch of ERCA.The results of the study may suffer from some limitation, since the paper emphasis on the type of tax audit and the frequency/rate of tax audit performed, audit coverage achieved, audit case selection methods used, examination techniques applied, the effectiveness of audit program in terms of enlightening voluntary compliance & tax revenue performance and the skills & experience of tax auditors specifically.In addition, thereis absence of incorporating the audit practice of other branches of ERCA Despite the probable limitation, the researcher made the maximum effort to design the research as properly as possible and to achieve the specified objectives.

1.7. Organization/Structure of the study

The study organized in to five chapters. Chapter 1 incorporates the introduction part including background of the organization, background of study, research questions, statement of the problem, objectives of the study, significances of the study, methods adopted and delimitation / Scope of the study. The review of related literature and different researches dealing with the assessment of Tax Audit reviewed and presented in the second chapter. In the third chapter, the research design including the methodology adopted and techniques used in data collection and analysis are presented. Consequently, the results and analysis of the study findings discussed in the fourth chapter. Finally, the conclusion and recommendations based on findings presented in the fifth chapter.

CHAPTER TWO: LITERATURE REVIEW

The first chapter introduced the problem to be investigated in this study along with its purpose. In order to put the study within the context of the existing literature, the subsequent section of this chapter present the review of both theoretical and empirical studies related tax audit practice. Recognizing and understanding the underlying concepts of tax audit practice is essential, in order to vouch results and analyses. Hence, chapter two serves as background for this study by describing concepts of tax audit. The review has three sections. Section 2.1 presents the theoretical under-pinning related to meaning & concepts of tax, types of tax audit, effective tax audit program, audit case selection methods, examination techniques and audit workforce capabilities since they are allied to the research question and need further elucidation. This is followed by the review of empirical studies regarding tax audit practice and related issues from the extant literature in section 2.2. Finally, conclusions on the literature review and identification of the knowledge gap are presented in section 2.3.

2.1. THEORETICAL STUDIES

2.1.1. Meaning and concepts of Tax

Various authorities and professionals in several ways have defined tax. Conceptually, taxes are a compulsory contribution made by individuals and corporate bodies to the government of a given country with a view to complementing and/or providing income for the government (Aguolu, 2002). Taxes are a form of compulsory levy imposed by the government or other tax raising body, on income, expenditure, or capital assets for which the taxpayer receives nothing in return (Lymer and Oats, 2009; Anyaduba, 2006). The fact that the taxpayer may not receive anything in return for the tax payments differentiates taxes from other compulsory payments like charges, tolls, or other levies for which the payer expects specific and/or commensurate services (Ogbonna, n.d; Palil, 2010). The taxpayers only expect to have the benefit of living in a relatively educated, healthy and safe society (Fagbemi, et al., 2010), like every other members of the same society, whether tax paying or not.

- **Classification of tax payers**

All legal entities are required to register their financial activities in the books of journal and ledger as prescribed in the Commercial Law and are obliged to keep their accounting books and the relevant supporting documents in accordance with the accepted accounting principles and standards. According to Ethiopian proclamation number 285/2002, taxpayers are classified into three major categories based on the type of their legal obligations for records keeping: Category "A" Taxpayers, Category "B" Taxpayers and Category "C" Taxpayers.

Category "A" Taxpayers:

As of Ethiopian Tax Proclamation, 285/2002 "Category A" taxpayers as any company incorporated under the laws of Ethiopia or in a foreign country and any business having an annual turnover of Birr 500,000 or more, have the obligations to recording their business activities in the books of journal & ledger and keeping the supporting documents. They are required to submit Balance sheet, profit & loss statement incorporate gross profit and the manner in which it is computed, general and administrative expense, depreciation expenses, provisions, and reserves to the Revenue Authority at the end of the year.

Category "B" Taxpayers:

Unless not already classified in category "A", any business having an annual turnover of over Birr 100,000 would be classified under Category "B" taxpayers. This category of taxpayers should submit to the Revenue Authority profit and loss statement at the end of the year similar to category 'A' taxpayers.

Category "C" taxpayers

Category C includes owners of businesses, which are not subject to the obligations of Categories "A" and "B", and businesses whose annual turnover is estimated up to Birr 100,000 are classified under this category of taxpayers. A standard assessment method should be used to determine the income tax liability of category C taxpayers. The taxpayer should pay the tax determined in accordance with standard assessment (ECC 2005).

- **Tax Compliance**

Tax compliance is however a much wider concept than just the willingness to pay. It is a term that has come to be viewed from many perspectives including economics, legal, and also psychological (Palil, 2010). According to Fagbemi*et al*., (2010), tax compliance is when a person seeks to comply with the tax law by full disclosure of all relevant information on all tax claims, and also (seeks) to pay the right amount, at the right time and place required by the law.

Verboon and Dijke (2007) stated that tax compliance is the willingness of individuals to comply with relevant tax authorities by paying their taxes. Tax compliance can be defined as an ability of a tax liable body to submit accurate, complete and satisfactory returns in conformity with tax laws and regulations of the state to the authority for the purpose of tax assessment (Badara, 2012). Sarker (2003) also reported that tax compliance is the degree to which a taxpayer complies (or fails to comply) with the tax rules of his country. It therefore means that compliance requires that the taxpayer complies with the laws, by declaring the correct income, claiming the correct deductions, reliefs and rebates and then paying all taxes on time (Palil, 2010), without having to wait for follow-up (enforcement) actions from an authority (Singh, 2003). A comprehensive list of the obligations required of a compliant taxpayer include: registering with the revenue authority as required, filing the required returns on time, accurately reporting tax liability, paying any outstanding taxes as they fall due and maintaining all records as required. Failure to satisfy any one or more of these obligations results in non-compliance and is considered as posing a risk to revenue collection McKerchar and Evans (2009).

- **Tax gap**

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).

A tax gap is the difference between tax liability in any year and the amount of tax that is paid voluntary and on time; it has three components — non-filing, underreporting of tax owed, and underpayment. The three components are mutually exclusive and add up to the total tax gap. The non-filing gap is the tax not paid on time by taxpayers who have a legal requirement to file a tax return, but do not file on time. The underreporting gap is the tax owed by taxpayers who file returns on time, but underreport the amount of tax they owe. The underpayment gap is the loss of revenue owed by taxpayers who file returns on time, but do not pay their reported tax due on time. The largest component of the tax gap is underreporting (Toder, 2007). The tax gap is the difference between estimated potential tax revenue and actual tax revenue (Kariuki, 2013).

A tax gap happens by means of both tax avoidance and tax evasion. Tax evasion in illegal practices to escape from taxation,to this end, taxable income, profits liable to tax or other taxable activities are concealed, the amount and/or the source of income are misrepresented, or tax reducing factors such as deductions, exemptions or credits are deliberately overstated.Tax evasion is typically considered as any intentional, illegal reduction of tax payments, which usually takes the form of underreporting income, sales or wealth, or overstating deductions (Schneider, Braithwaite & Reinhart, 2001). Tax avoidance, takes place within the legal context of the taxsystem that is individuals or firms take advantage of the tax code and exploit“loopholes”, i.e. engage in activities that are legal but run counter to thepurpose of the tax law. Usually, tax avoidance encompasses special activitieswith the sole purpose to reduce tax liabilities(Alm and Vazquez, 2001 and Chiumya, 2006).Alternatively, exploiting the loopholes in the tax laws to reduce tax liabilities by arranging ones tax affairs using tax shelters in the tax law, and avoiding the tax traps in the tax laws (Soyode and Kajola, 2006). It generally entails getting around the law, without necessarily breaking it (Gilak, 2012).

2.1.2. Overview of auditing

The concept of auditing might be explained as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicate the results to interested users (Eilifsen and McKee 2006). Audit is an examination of a company’s financial statements and the accounting systems, controls, and records that produced them, in order to render an independent professional opinion about whether they have been presented fairly, in all material respects, in conformity with generally accepted accounting principles (Belverd E.Needles and Marian Powers, 2007).

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. Auditing will enable the auditors to satisfy themselves that the balance sheet is properly drawn up, to give a fair view of the business profit & loss account for the financial period, according to the best of information and explanation given to them Spicer and Pegler (2008).

2.1.3. Meaning and concepts of tax audit

A tax audit is a systematic examination of business`s relevant commercial system to determine whether a taxpayer's declaration states the tax liability correctly and complying with the provisions of the tax laws and related subsidiary legislations. It involves examination of financial statements, books of accounts and vouchers of a taxpayer by tax auditors to ascertain whether the taxpayer has accurately considered revenues and expenses when determining the taxes shown in the declarations as per the requirements of the tax laws. It also involves other approaches such as observation of premises, direct monitoring of receipts in cash businesses, use of mark-up techniques and analysis of key ratios(ERCA, 2014). Tax audit is the independent examination of the returns submitted by taxpayers to the relevant tax authorities to ascertain the level of tax compliance by taxpayers (EBIMOBOWEI, 2013).

Tax audit is the examination of an individual or organization's tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. An audit will examine the issues seen as most substantial to achieving an accurate assessment of a taxpayer's tax liability. Generally, these issues will include any signs of significant unreported income (for example, as may be suggested by a very low ratio of net/gross business income ratio computed from a taxpayer's return) or potentially over-claimed deduction items that may be apparent from an examination of a taxpayer's tax return and other information (Kircher, 2008). Tax audit is important because it assist the government in collecting appropriate tax revenue necessary for budget, maintain economic & financial order and stability, and ensures that the taxpayers submit satisfactory returns. Furthermore, 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 tax audit is essential Ola (2001). Most taxpayers' 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 might be applied when they are detected (Biber 2010). Thus, tax audit results in increased tax revenue in two ways: (1) directly through assessment of additional taxes; and (2) indirectly by discouraging underreporting of liabilities by all taxpayers. Moreover, 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.

2.1.4. Types of tax audit

Audit is the examination of accounting documents and of supporting evidence for the purpose of reaching an opinion concerning their propriety. It is an examination intended to serve as a basis for an expression of opinion regarding the fairness, consistency, and conformity with accepted accounting principles of statement prepared by a corporation or other entity for submission to the public or to other interested parties. Tax audit is therefore a means of ensuring compliance with the tax laws. The primary purpose of tax audit is to maintain the confidence in the integrity of the self-assessment system. It helps to improve voluntary compliance by detecting and bring to book those who do not pay the correct amount of tax Adesina (2005).

Modern tax administrations have developed a range of audit "products" to provide a more tailored response to the risk being addressed through the audit activity. Various terminologies have evolved to describe different types of tax audit activity; Audits can differ in their scope and the level of intensity to which they are conducted. As Harrison and Krelove (2005), (Zamaróczy, undated), Ebrill et al. (2001), Biber (2010), OECD (2006a) and Grandcolas (2005), Adediran, Alade&Oshode (2013) a typical range tax audit program in a function based administration includes desk audit or verification, field audit, registration check, advisory audit, record keeping audit, refund audit, issue-oriented audit, comprehensive or full audit and fraud investigation. The following briefly reviews these tax audit types.

Desk audit or verification: this type of audit can be conducted in relation to specific issue audits of a small enterprise or employee when the auditor is confident that all necessary information can be ascertained by accompanying the examination in the office. Based on (1) basic ratios comparing (with previous periods or other taxpayers in similar industries), or a review of income tax & VAT returns, and (2) the crosschecking of information included in the taxpayer files. It involves basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination. Information technology (IT) systems should provide strong support for these verifications. It is usually carried out annually and can be used as a preliminary examination of declarations, analyzing ratios and cross checking information to determine if further investigation is warranted.

Field Audit: It is a detailed examination of taxpayers' books and records to determine whether the correct amounts were reported on the tax returns. The auditor may also obtain information from other sources such as banks, creditors and suppliers, to confirm items on returns. A field audit usually includes one or more of the following taxes: income, franchise, sales and use, withholding, and excise taxes. The audit is conducted at taxpayers‟ place of business, home, or at the office of their accountant, attorney, or other person who may represent them. The auditor tries to select the place that is most appropriate under the circumstances and most convenient for them.

Registration check: This type of audit is a quick check on businesses to establish that they are correctly registered for all their taxpaying obligations. Information from the business license office, customs, third parties or other audit activities may alert the administration that a check is necessary (Zamaróczy, undated). It uses the form of unannounced visits to taxpayer's premises to detect businesses operating outside the tax system. stated, during this visit, the tax officer ensures that the taxpayer: (1) has a basic understanding of their obligations; (2) keeps appropriate records (book keeping review should be mandatory in case of voluntary compliance when the turnover of the taxpayer is below the registration threshold); and (3) issues proper invoices when required by law. This type of visit is a quick check on businesses to establish that they are correctly registered. It should not take more than half a day Ebrill et al. (2001).

Advisory audits: A visit to newly established businesses advising them of their obligations in terms of tax types, filing of declarations, payment of amounts due, and records to be maintained, risk of audit and sanctions of noncompliance. This is particularly necessary when introducing new laws.

Record keeping audit: is a check on enterprises that may have a reputation of not keeping adequate records. The visit would point out the obligations of the taxpayer with regard to keeping of records and the consequences of failing to do so. These audits should be followed up and penalties imposed if the taxpayer continues to disregard record keeping requirements. Auditors may unexpectedly visit the taxpayers' business premises to check whether the VAT invoices are issued and appropriate records are kept. The visit spectacles the obligations of the taxpayer regarding the keeping of records, and followed up with penalties if the taxpayer continues to disregard record keeping requirements.

Refund audit: Verifying the taxpayer's right to a refund prior to processing the refund. Usually undertaken for first refund claims as well as where the refund claim varies significantly from established patterns and trends. Refund audit carried out particularly for new registrants in addition it should emphasis only on the period covered by the claim.

Issue-oriented audit: It should be directed at verifying items for which errors have been detected in the returns (atypical ratios, gross revenues, comparison of gross sales to imports). It should focus on a single tax type and covers no more than one or two reporting periods.

Single-issue audits: this type of audit focused on a single tax type, single aspect or a single period; given their narrow scope, single-issue audits typically take less time to conduct and can be used to review large numbers of taxpayers involved in similar schemes to conceal noncompliance. For instance, it may confine to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. The auditor may be only examining whether the taxpayer has met obligations in respect of employment tax, VAT, or examining a specific expense claim.

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

Fraud investigation: Involve the most serious cases of non-compliance with criminal implications. Criminal investigation arises where the most serious cases of noncompliance that have criminal implication-fraud, evasion, and criminal activity- are detected. Such investigation requires special skills in investigation and evidentiary requirements as they often involve seizure of records, taking testimonies from witnesses and preparing briefs for courts. Hence, it should be undertaken in accordance with criminal procedure. Tax authorities should maintain a dedicated organizational unit responsible for the handling of serious cases of tax fraud or evasion.

2.1.5. The effective tax audit program

Tax administration should be effective in the sense of ensuring high compliance by taxpayers, and efficient in the sense that administrative costs are low relative to revenue collected. Good tax administration requires strong technical capacity by the administrative agency but also a well-designed tax. Tax audit is one of the longest standing and accepted compliance strategies in tax administration. The tax audit program provides visibility to the compliance and enforcement arm of the tax administration (Thomson 2008). Factor that significantly contributes to tax evasion and tax avoidance is lack of intensive audits and absence of predetermined audit criteria; to mitigate such and so fraud problems, therefore, an effective audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue (Bello, 2014).

A well-structured tax audit program can provide valuable support in gathering information on the health of the tax system (including patterns of taxpayers' compliance behavior), educating taxpayers (improving future compliance), and identifying areas of the tax law that require clarification or addressing deficiencies in the law (OECD 2006a).

When an audit program is vain, it may result in the deterioration of tax compliance and a loss of credibility of the tax administration. Taxpayers may not be deterred from minimizing their tax liabilities if they believe that there is a little chance of being audited. There are several reasons for ineffective audit programs that are evident in varying degrees in several countries. First, audit typically requires higher level of skills than those needed for most other tax administration tasks, and such skills are sometimes in short supply. Second, the possibility of collusion between taxpayers and tax officials is significant during an audit. Moreover, auditor's errors may damage business activity that makes governments reluctant to support comprehensive audit programs. The development of an effective tax audit program typically addresses coverage (percentage of taxpayers to be audited), selection of audit cases, methods (types of audits to be performed, duration of audit, approaches taken by auditors), staffing and training (staff resources needed to implement the audit program and the training provided for them), and monitoring activities Ebrill et al. (2001).

Accurate and timely self-assessment and compliance with tax by taxpayers achieved only through highly visible and effective audit programs, including the consistent application of strong sanctions where noncompliance is encountered. Taxpayers must feel that there is a good chance that unreported liabilities and other forms of non-compliance have been detected during an audit (Biber 2010). The auditing and spot-checking of records, coupled with a system of adequate penalties for detected cases of fraud, is the universal method for tax control and the prevention of tax evasion. Furthermore, tax audit helps tax agencies to achieve revenue objectives that ensure the fiscal health of the country and individual states. It derives voluntary compliance and generates additional tax collections, both of which help tax agencies to reduce the tax gap between the taxes due and the amount collected (Barreca and Ramachandran 2004).

A good audit program employs strategies to optimize both the direct and the deterrent effects of audits. The first can be achieved by auditing a higher percentage of the large taxpayers (Biber 2010). Although the frequency of audit is a contentious issue, the judgment is always a delicate balance between the treat of audit to check the temptation to evade and the cost. Where the tax system is fairly well established, audits of 15 percent to 20 percent of registered traders a year are sufficient. However, it is not only the crude number of audits that is the most useful measure of need.Voluntary compliance is generally enhanced by increasing the number of taxpayers audited than by auditing fewer taxpayers with large tax potential. Perversely, revenue is increased by concentrating on those taxpayers where a large amount of revenue is at risk. But there should be a careful planning when there is a widespread belief that most tax returns are underreported, otherwise there may be an over selection of returns for audit, with the result that the inventory of work in process may increase to unmanageable proportions and make an orderly approach to an annual audit work plan impossible (Tait 1988).

Through adequate audit strategy, tax administrations must foster, and not simply enforce, tax compliance. Tax compliance can be facilitated through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary. Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance (EC 2006).In order to optimize use of resources to meet effectively the audit objectives, it is necessary to plan strategically 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. It is essential that audit plans developed in an integrated fashion with the involvement of audit management to ensure that there is a matching of the number of case targets to resource availability (Zamaróczy, undated).

Biber (2010) noted that effective planning is required to ensure that the audit program is effectively developed to: (1) focus on and address the most significant risks; (2) target noncompliant taxpayers and not harass compliant taxpayers; (3) make optimal use of limited resources, and (4) influence compliance across the broader taxpayer community. Thus, the actual number of audits planned should depend on the audit resources available to the program. The international standards as to the total staff assigned to audit should be close to 40 percent of the total staff of the tax administrations. Further, audit capacities of field offices are determined by calculating the number of returns that can be audited. The calculation made using estimates of the number of returns each tax auditor can reasonably be expected to complete during a given audit period. There should be an over selection of 25 percent to 30 percent of audit capacity. It is reasonable to expect an office auditor to complete an average of 10 to 20 cases a month. and for a field auditor (exclusive of auditor s dealing with controlled cases) to complete an average of 4 to 6 cases a month with proper audit planning, strong supervision and effective use of the review staff as a training vehicle. Allocation of about 200 cases a year should be rational for experienced junior auditors, who should be entitled for advancement to senior auditor after four years of satisfactory service in that grade (Tait 1988). Therefore, planning an adequate audit strategy is a key success factor in post-fraud detection (where audits are intended to detect tax evasion and fraudulent claims) as well as proactively preventing tax fraudsand evasions (Gupta and Nagadevaran.d).

According to OECD (2006a), audit plan provides a path to follow to ensure that the audit is performed effectively and efficiently. However, it should not be treated as set in stone once created. Case planning must be a flexible tool and the original audit plan should be reviewed and updated regularly during the course of the audit. Thus, characteristics of effective audit plans are:

- Flexibility to allow for unusual audit issues, adequacy of internal controls and the adequacy of books and records
- Alignment with any quality assurance framework; and
- A clear focus, with potential areas of concern noted during the preliminary review and audit procedures selected that can address the concerns identified.

2.1.6. Audit case selection methods

Today's tax agencies typically lose some percentage of total revenues due to tax evasion and other types of noncompliance known as the "tax gap" Brown et al , (2003: 4).Revenue authorities' aims to manage and improve overall compliance with the tax laws and in the process sustain confidence in the tax system and its administration. Tax audit is a sole treatment for compliance risk available to administrations that allows exercising effective sanctions (imprisonment and penalties and/or interest). It acts as a public sanction making the extent of the administration's enforcement powers visible within the community and encouraging others to comply (OECD 2004a). However, tax administrations do not have sufficient resources to perform thorough on-site audits of the activities of all taxpayers or comprehensive crosschecking of all invoices or transactions. Tax administration, with limited resources and relatively large numbers of taxpayers to administer (especially in the small and medium enterprises), must design the audit program to deploy audit resources in a risk-based way with a view to achieve the most possible compliance and revenue objective (Thomson 2008).

Accordingly, the first key to successful audit is the case selection methodology. It is critical to select audit candidates consistent with program objectives. Whatever the audit objectives have, the ability to narrow the pasture of potential audit candidates is necessary to achieve program objectives and optimal use of audit resources. Regard less of how automated and efficient the audit process, audit effectiveness would not be realized under the selection of inappropriate audit candidates (Milackn.d). Hence, managing an effective auditing program involves decisions as to the selection of best audit case strategy or combination of strategies. The selection strategies may vary by tax type. It may be based on either reported tax amounts or the industry type (Barreca and Ramachandran 2004).Case selection through the use of risk management techniques is necessary to ensure that the audit program is fully in line with the administration's compliance strategy, and to set up the necessary audit trails to show why cases have, and have not, been made the subject of an audit (OECD 2006a). Ebrill et al. (2001) noted that the most effective systems utilize taxpayer profiles and criteria to identify the highest risks for the revenue. These systems are frequently based on the crosschecking of internal information.

In tax administration, a risk is anything that can negatively affect the administration's ability to achieve its compliance and revenue objectives. Risk management is a formalized and systematic approach, based on sound analysis, designed to set the best course of action under the uncertainty of risk. The technique involves identifying, assessing, understanding, and acting on risks that impinge on the organization's ability to achieve its objectives (Thomson 2008). Risk management starts with risk identification, which includes a rough estimation of the risk related tax gap, the number of taxpayers involved and possible relations with other risk areas (EC 2006).

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. However, tax administrations do not have sufficient resources to perform thorough on-site audits of the activities of all taxpayers or comprehensive crosschecking of all invoices or transactions. Tax administration, with limited resources and relatively large numbers of taxpayers to administer (especially in the small and medium enterprises), must design the audit program to deploy audit resources in a risk-based way with a view to achieve the most possible compliance and revenue objective (Thomson 2008 and OECD 2004a).

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). As OECD (2006a) stated in addition to compliance risk identification, in an effective 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 falls disproportionately on any segment. These include inappropriate auditors' contact with taxpayers, audit cycle or enquiry window, materiality, and collectability.

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

Audit cycle or enquiry window: A tax audit should be started and completed within a predetermined timeframe. However, where complexities arise or substantial tax fraud is disclosed during the audit, the timeframe may be adjusted with the approval of the supervisor. (Zamaróczy, undated). Regulations may be established to Audit cycle however, it gives certainty to taxpayers that after some period of time the danger of audit may pass. Thus, it needs to be supported by powers of discovery to overturn the enquiry window where substantial tax fraud is found.

Collectability: The collectability concept implies that a taxpayer's inability to pay a future proposed tax assessment would be sufficient basis for not conducting the audit. Those administrations that do not use this concept report that collectability is a secondary objective and should not diminish the primary objective of a correct assessment of tax liability. In addition, the limitation of collectability considerations to the current tax period may not provide a complete financial picture for the taxpayer as it excludes consideration of future payment potential.

Materiality: Although a noncompliant high-risk item may be selected for audit, the materiality of the projected tax consequence versus the auditor's labor cost of pursuing the high-risk item may override the non-compliance aspect. The supervisor may take where the auditor's labor cost is projected to outweigh the expected tax consequence from an audit, the decision to stop the audit. A cost/benefit analysis form should be filled and endorsed by all those involved in the decision to terminate the audit; furthermore, the attendant facts should be comprehensively documented, signed off and placed in the audit file(Zamaróczy, n.d).

Apart from the above pre-audit case management factors, there are two key elements necessary in effective translation of strategic priorities for risk treatments in to individual case selections for action. (1) Accurate & timely data and information relevant to the compliance risks to be addressed, and (2) knowledge management and analysis techniques to analyze the base data and facilitate feedback in to the compliance risk management process. Here, the main requirement is access to the data contained within individual tax returns. The essential information to case selection comes from previous case histories of the taxpayer concerned, information from third parties, which can confirm the details shown on the tax return, and more generic taxpayer (business sector profile) (OECD 2004a).

Once required data accessed, some form of case analysis methods should be used to analyze the base data for selecting cases. Audit selection methods range from simple random selection to more complex rule-based selection, sophisticated statistical and data mining techniques. Selection strategies can vary by tax type, and even within a single type (Barreca and Ramachandran 2004). The common case selection methods include random selection of cases, screening or case review by auditors, rule base and automated risk scoring systems, and data mining and statistical analysis.

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

Screening or case review by auditors: It is the traditional method by which audit cases have been selected, and dates from the time when there was little or no IT support, the data available was in any case limited, and the compliance risk management techniques at a strategic level less well developed. Such a methodology has a benefit that it makes full use of local knowledge, creates significantly less caseworkers resistance, can be used to attack specifically defined risks and can be operated substantially without IT support.The challenges inherent in relying on caseworker selection are, it relies on a limited data set with no systematic cross reference to other data, available within the administration's system. Caseworkers regardless of their experience can miss aspects of noncompliance with which they are non-familiar and those with the knowledge to undertake such screening are usually those with the skills to undertake the substantive intervention. Thus, there is an opportunity cost in asking them to undertake such screening. Modern standards of propriety indicate that there should be a gap between those selecting cases and those functioning cases (OECD 2004a and OECD 2004b). Manual selection of audit cases is based on the auditors own knowledge of the taxpayers' behavior and environment. However, it cannot find out patterns of noncompliance hidden in the history of noncompliance in the same area, sector, or as determined by other taxpayer attributes. It also favors rent seeking and corruption in the tax administration since it is discretionary and subjective approach (Vellutini 2010).

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

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

2.1.7.Examination techniques

A tax auditor applies various techniques to examine the books and records behind a return. The techniques to be used depend on the taxpayer and the tax regime concerned. As Biber (2010) noted, an effective case plan can be cognizant of a range of investigative and analytical approaches that may vary depending upon the area of risk and the circumstances of the particular taxpayer. The decision regarding the type of tests to be undertaken as well as the records needed by the auditor to address specific issues is influenced by the nature of the taxpayer's operations, adequacy of books and records, and materiality of potential adjustments. According to OECD (2006a), the techniques used for audit examination purposes include analytical review, investigative approach, field examination, record examination, and counterpart examination.

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

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

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

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

Counterpart examination: It is an examination performed based on third party information w here warranted. Information can be obtained during the course of an audit from third parties to verify the taxpayer's income, for example:

- Financial institutions and public companies information on interest and dividends matched with what taxpayers report in their tax return;
- Information from Government regarding social benefit payments, and employer information concerning salary and wages paid and tax deducted, both for income and non-monetary benefits; and
- Matching foreign source income

2.1.8.Audit workforce capabilities

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

Required capability

The required capabilities of auditors are generally identified by analyzing the activities required to perform particular audit tasks, and through practice and experience. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex tax laws and conduct intensive examinations of taxpayers' books and records. Revenue bodies pay close attention to the overall management of the tax audit function, and particularly to the strategies and methods used for recruiting, developing and managing individual audit staff. Thus, tax auditors should have a capability to: conduct investigations, determine compliance, tax accounting and financial analysis, conduct research and analysis, make effective decisions under the law, effective communication, apply work processes and procedures, and manage own work and relationships In addition to the required core capabilities, greater attention and emphasis is needed on soft skills and other attributes. These include behavioral and motivational competencies, personal attributes such as work and integrity, feeling for the detection of fraud and irregularities, observe and detect relevant indicators in surroundings, identifies patterns and describes their significance to the situation, and effective observational skills. Familiarity with basic accounting, bookkeeping, and business and industry practices is also generally expected for all staff. Moreover, the required capabilities of audit managers and directors are typically identified based on the notion of coaching, communication, and leadership skills. The required capabilities for audit managers and directors often focused on leadership and management skills, technical expertise, advanced audit skills, achievement orientation, ability to develop and coach others, high level communication skills, and ability to make strategic decisions.

Competency assessment

It is important for tax administrations to assess and evaluate the competencies of their staff. The direct manager commonly performs competency assessments during recruitment and promotional processes on an annual or semiannual basis for those staff maintaining current positions. External specialists, human resource departments and/or panels of internal subject matter experts often perform assessments performed as part of recruitment processes. Other events triggering capability assessments include prior to performing a new type of work, prior to starting a new role, and ongoing informal assessments and learning and development activities. Assessment methods used include knowledge-based assessments administered online, formal tests and exams to attain a recognized qualification, peer reviews, a tutor to support and assess newly hired staff, and technical evaluations. The measurement and tracking process of the audit workforce provides management with tangible information of the resource and capability mix or trends across the whole audit workforce, providing valuable data for workforce and succession planning. Many revenue bodies indirectly attain a measure of the competency level of their audit workforce by considering: key performance indicators and results, quality assurance results, client or professionalism survey results, quantity of audits performed, training course and other assessment results. Further, tax administrations may record the skills (including qualifications) and areas of expertise of individual staff. Using and sharing this information across the organization, tax administrations may better allocate work and identify specialist resources or skills.

Improving competency and addressing capability gaps

Responsibility and accountability for improving auditors, audit managers and audit directors commonly lies with the staff member in question and their direct manager and/or local management team. Competency improvement should be integrated (not be seen as extra task) into normal business activities. Together with tax auditing or training departments, human resource departments (where applicable) often have joint responsibility and be significant contributors to the improvement process. 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.

Tax administrations must recruit audit staff specifically to carry out tax audits. To attract the right staff in increasingly competitive and skilled labor markets, effective recruitment policies are essential. Audit staffs are generally recruited either fully trained so they can be effective in post very quickly, or selected because they have strong potential to become auditors through in-house training and education. A minimum standard of specific academic qualifications, such as a diploma or degree or being a chartered accountant, is often required for some grades of audit staff. There is also an assessment of applicants against competencies relevant to their audit work in the areas of problem solving, analytical skills, interpersonal skills, self-management, decision making and oral and written communications. Further, all auditors required to have computer skills with other more specialized skills, such as legal experience or specific types of tax knowledge being needed for posts that are more technical.

In order to maintain standards of auditing it is essential that auditors are given both initial training (classroom and on-the-job instruction) to bring auditors up to the required level, and continued training so that their skills are kept up to date and relevant. The extent and nature of this training and the balance between the two varies according to need, and relates to the recruitment and development policies adopted. Initial training varies depending on the level of qualifications and experience expected of new recruits. For instance, recruit staff without professional qualifications need much more extensive initial training in tax law and auditing, in-house testing is generally used to confirm that trainees reach the required standard. To deliver ongoing training and development, a number of methods are used including training courses; computer based training packages, memos, guidance notes, self-study packs, facilitated workshops and discussion forums, on-the-job training, coaching and mentoring, and virtual university and learning tools. As a rule, continuing professional training is not normally examinable and the amount of training undertaken varies between countries and over time.

2.2. Empirical studies

A number of empirical studies examined tax administration in both developed and developing countries, tax audit program in particular. For instance, (Iwarere and Henry, 2015), Gebeyehu (2008), Kleven et al., (2010), Appelgren (2008), (Modugu and Anyaduba, 2014), Kuo-Wei Hsu et al., (2015),and Drogalas et al., (2015), have been taken; a brief review of each of these aforementioned studies is presented in the following discussions.

(Iwarere and Henry, 2015) Examine the effects of tax audit on revenue generation in Federal Inland Revenue Service, Abuja experience. The main objective of this study is to examine the effects of tax audit on revenue generation in Federal Inland Revenue Service.It tries to determine the relationship between the tax audit and revenue generation in Federal Inland Revenue Service. The Data collected through questionnaire and review of several publications that are relevant to the study, was presented using tables and percentages; for the test of hypotheses and analysis of Variance (ANOVA).The study revealed that tax audit has significant effects on revenue generation in Federal Inland Revenue Service. This implies that tax audit ensures arithmetic accuracy of all figures in account and computation in taxpayer's records; tax audit ensures compliance with tax laws, rules and regulations by the taxpayers. The study also revealed that tax audit has a positive relationship with the revenue generation in Federal Inland Revenue Service. This means that an increase in tax audit increases revenue generation from taxes; an increase in tax audit increases tax bases for the government and an increase in tax audit reduce tax fraud in the tax system. This is in part in agreement with there is a positive relationship between the audit and the voluntary compliance. Furthermore, the authors suggested that tax audit should be carried out on a routine basis to ensure that actual revenue collected is what the relevant tax authority remits to the government. Tax audit prevents tax evasion by the tax evaders and avoiders. Internal mechanism to check and monitor the staff of the tax audit department should be put in place to minimize the level of corruption and enhance effectiveness of the tax audit.

The study by Gebeyehu (2008) was an attempt to trace out the basic concepts of tax audit, and analyze the significance and role of tax audit in increasing tax revenue and in strengthening tax administration capacity. The methods adopted include questionnaires (both open and close-ended), personal interviews, and document analysis by using documents such as published materials, annual reports, magazines and internet. The results of the study indicated that, tax audit practice as seen in Addis Ababa City Administration carried out mainly based on internal documents produced by taxpayers. It is clear that, documents internally produced cannot be a reliable source of information. Furthermore, the type of tax audit performed by tax auditors is only desk audit. So far, there is no field audit, which may assist to the affective and efficient audit operation. The author concluded that most taxpayers of any country do not want to pay taxes unless compelled by a situation where they are left with no option other than to pay the taxes. Therefore, for better tax compliance, a system should be designed that automatically extracts taxes rather than leaves the payment of taxes to the voluntary choice and morality of taxpayers. To this view tax audit is one of the most powerful revenue administration tool that enforces taxpayers to pay their tax liability without evasion. The author suggested that governments should to curb not only the tax evasion but also the tax avoidance by applying effective and efficient tax audit based on reliable evidences and documents for effective and efficient revenue collection. The tax collection system should be designed in such a way that not only the tax evasion but also the tax avoidance becomes difficult for the taxpayer. Moreover, the tax audit function should be strengthened to minimize both deliberate and innocence tax evasion made by many tax payers with appropriate expertise and the necessary resources should be allocated for this tax administration function.

Kleven et al., (2010), Analyzes a randomized tax enforcement experiment in Denmark, at realistic a stratified and representative sample of individual income tax filers was selected for the experiment. Half of the tax filers were randomly selected to be thoroughly audited, while the rest were deliberately not audited. Micro-simulations as well as laboratory experiments was used, using comprehensive administrative tax data, empirical results remarkably well with the basic AS-model that tax evasion is substantial and responds negatively to an increase in the perceived detection probability coming either from a prior audit or from a threat-of-audit letter. Thus the authors suggests that rigorous tax enforcement is a much more effective tool to combat tax evasion than lowering marginal tax rates. Furthermore, the authors’ present findings such as prior audits substantially increase self-reported income, implying that individuals update their beliefs about detection probability based on experiencing an audit.

Appelgren, (2008) studied the effect of information regarding different audit strategies on taxpayers‟ compliance behavior in Sweden. The study was conducted with the intent of examining whether the taxpayers in reality behave as expected by theory of tax audit. Experimental design was used to test the effect of information regarding different audit strategies on taxpayers‟ compliance behavior. The experiment was measured as the change in declared income between years, and was conducted in 2003-04 on approximately 900 sole proprietors which are divided in to three groups (rational group, random group and control group) each with around 300 firms. The rational group members were informed that audit would focus on taxpayers declaring lowest income. The random group was told that audit would be at random whereas the control group members received no information. Further, the sample was limited to men below the age of 55 in order to concentrate on a high-risk group (younger men are more fraudulent than women and older men). The principal finding of this study was that declared income increased significantly more in rational audit strategy group than in the control group. The results of the study indicate strongly that information concerning the use of rational audit strategies is superior to information concerning random audits, and that audit information, in general, is superior to no information. The information concerning the rational audit strategy reduces tax fraud compared to no information. According to this study, tax audits have an indirect deterred effect by which rational taxpayers adapt their behavior to the expected degree of auditing if they are made aware that they may be audited.

The study by (Modugu and Anyaduba, 2014)examines the impact of tax audit and other qualitative attributes on the tax compliance level of companies in Nigeria. were The research instrument (questionnaires) is administered on the staff of the State Board of Internal Revenue of the selected states (Lagos- Southwest, Edo-South South, Jos-North Central, Kano- North West and Adamawa – North east) in five geo-political zones and their corresponding Federal Inland Revenue Services. Ordered Logistic Regression technique was employed to analyze the responses. The result showed that there exist positive relationships between tax audit and tax compliance. This means that the compliance rate rises if the tendency of being tax-audited is high. If the taxpayers are informed that their fillings will be closely examined, there is a tendency for the taxpayers behavior to change in response to an increased probability of been tax audited. The result also revealed that the probability of being audited, perception on government spending, penalties and enforcement, the joint effect of tax audit and penalties have a tendency to significantly influence tax compliance in Nigeria. Therefore, the authors recommend that the relevant authorities should seek more pragmatic and effective means of enhancing the impact of tax audits on corporate tax compliance in Nigeria in order to consolidate on government's revenue.

Kuo-Wei Hsu et al., (2015),Present Data Mining Based Tax Audit Selection a case study of a pilot project that was developed to evaluate the use of data mining in audit selection for the Minnesota Department of Revenue (DOR). Models were trained and tested using real-world data. The Internal Revenue Service (IRS) estimated the gap between revenue owed and revenue collected it is critical for the government to reduce the gap and the fundamental process for doing so is audit selection. The authors present a data mining based approach (i.e. classification models) for improving audit selection process at the DOR and describe the manual audit selection process used at the time of the pilot project for Sales and Use taxes, discuss the data from various sources, address issues regarding feature selection, and explain the data mining techniques used. Since data play a vital role in any data mining project, considerable attention was paid to data pre-processing, cleaning, and reformatting. Results from the pilot project revealed that the data mining based approach could increase efficiency in the audit selection process. Moreover, the report results from actual field audits performed by auditors at the DOR, and results validated the usefulness of the data mining based approach for audit selection. The impact of the pilot project would be a refinement of the manual audit selection process and tax assessment procedures for other types of taxes. The authors suggested that improving the efficiency of audit selection and further the productivity of the tax assessment process is an essential component of driving revenue growth for the DOR as well as the government.

Drogalas et al., (2015)studied the Tax audit effectiveness in Greek firms, Tax auditors' perceptions; the aim of this study is to examine the relationship between tax audit effectiveness, tax legislation and the use of specialized information system tools. The research design was based on a questionnaire, survey methodology was used as one of the most appropriate methods in the collection of primary data and a series of open-ended interviews were also conducted with experts in tax audits in order to identify themes that were important for the research. The authors use the ability of public tax auditors to track tax infringements as a measure of tax audit effectiveness. Over two hundred structured questionnaires were constructed and distributed to tax auditors, who work in Greek public taxation agencies. Factor Analysis and multiple regression analysis were employed in order to examine the hypotheses. The objective of this study was to highlight significant factors that contribute to increased tax auditing effectiveness. The authors specifically, outline the importance of technology and law legislation on tax auditors' performance. The results demonstrate that the use of information system tools can enable tax auditors to track properly tax infringements, thereby contributing to increased tax audit effectiveness. On the contrary, complexity and constant changes in tax legislation, makes it difficult for tax auditors to be effective in their work. Furthermore, level of education, work experience and training of tax auditors enhance their ability to track tax infringements. Based on the results the authors suggest that tax auditors' training enhance their ability to perform audit controls; constant changes in tax legislation inhibit tax auditors from being effective in their work. Consequently, tax authorities should also consider continuous training in the form of educational seminars.

CHAPTER THREE: RESEARCH DESIGN

The preceding chapter presented reviews of literature on tax audit practice with respect to the theoretical perspectives and prior empirical studies; it tried to give a brief conclusion and excavate the gap in the existing knowledge. This chapter outlines and explains the methodology employed to achieve the research objective. It is organized in four sections, in the first section the research objective and questions are presented as a means to connect the research questions to the particular research methodology adopted. The second section provide a brief overview of the research approaches, followed with the methodology adopted with proper justification for adopting a certain method, which in turn include sampling design and actual data collection tools, data presentation & analysis techniques used in the study. Concluding remarks are presented in the fourth section.

3.1. Research approaches

Research approach is the general framework for the study that links, knowledge claims, strategies of enquiry and specific methods. The research approach implicitly reflects the researcher attitude as to how knowledge is constructed and also commands what method to be employed in the study. As noted in (Creswell, 2009), there are three research paradigms; these are quantitative research, qualitative research, and mixed research, based their assumption towards knowledge creation on post-positivism, social constructivism and pragmatic philosophical grounds respectively. These approaches are different in terms of their philosophical assumptions as well as techniques used in data collection, analysis and interpretation, and will be discussed in the subsequent paragraphs. The author also noted that the selection of a research design involves the considerations of the worldview assumptions the research brings to study, the nature of research problem, procedures of inquiry, the researcher's experience, audiences for the study, and data collection methods, analysis and interpretation. Thus, the following sections reviewed the aforementioned characters for each type of research designs in which it helps to adopt the fitted research method for this study.

Qualitative research approach: is "an inquiry process of understanding" where the researcher develops a "complex, holistic picture, analyzes words, reports detailed views of informants, and conducts the study in a natural setting" (Creswell, 2002, p. 15). Qualitative approach attempts to get an in-depth opinion from participants. Apart from this, it facilitates responses, and provides data in-depth with leading respondents; it explores attitudes, behaviors and experiences through methods such as in-depth interview and/or focus group discussion which use narrative, phenomenological, ethnographies, grounded theory and case studies (Dawson, 2002). It is capable to generate a theory by addressing issues, which cannot be quantified. It also explores issues, which are not studied in the past properly. However, this approach has been given less than a fair sense of appreciation. It has been criticized for lack of scientific rigor, small samples, subjective and nonreplicable efforts (Creswell, 2007). In this approach, the bottom up or inductive exploratory method are used; it is used primarily for the purposes of description and exploration and to gain an understanding of how people think and experience their lives. In qualitative research, data is collected from those immersed in everyday life of the setting in which the study is framed. It is based on qualitative data which during analysis are examined for patterns, themes, and holistic features.

Quantitative researchapproach: this approach employs strategies of inquiry such as experiments & surveys and collects 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 and generalized to larger population. However, it is not capable to address issues which cannot be quantified. So that, it may has limited scope Creswell (2009). Quantitative researchapproach generates statistical data through the use of large scale survey research, using methods such as close-ended questionnaires and/or structured interviews (Dawson, 2002). This approach is based upon an empirical cycle that has a deductive nature Jonker and Pennink (2010). contended that the essence of quantitative research is to use a 'theory' to frame and thus understand the problem at hand. Quantitative purists believe time and context free generalizations are desirable and possible, and real causes of social scientific outcomes can be determined reliably and validly (Johnson and Onwuegbuzie, 2004). It is grounded in the basic attitude that knowledge about reality can also be obtained 'through the eyes of the researcher', who elaborates theory based on findings. For the researcher conducting quantitative research implies the need to carefully operationalizing a theory and subsequently measuring it by means of variables and questions.

Mixed research approach:is the blend of both qualitative and quantitative approaches; that attempts to corroborate & complement findings and takes a balanced approach to research. It employs strategies of inquiry that involves collecting data either simultaneously or sequentially to best understand the research problem. A mixed methods approach is one in which the researcher tends to base knowledge claims on pragmatic grounds (e.g., consequence-oriented, problem-centered, and pluralistic). It employs strategies of inquiry that involve collecting data either simultaneously or sequentially to best understand research problem. The data collection also involves gathering both numeric information (e.g., on instruments) as well as text information (e.g., on interviews) so that the final database represents both quantitative and qualitative information (Creswell, 2009). Mixed approach includes the use of theory deductively in theory testing and verification, or inductively in an emerging theory or pattern (Mertens 2003 cited in Creswell, 2007). Therefore, the combination provides an expanded understanding of the research problems. It utilizes the strengths and overcomes the weaknesses of the two continuum approaches. Mixed approach characterized by its time-intensive nature of analyzing both numeric and text data.

3.2. Population of the study

ERCA is responsible for the administration of tax programs, as well as the delivery of economic and social benefits; Addis Ketema Sub City is one of ERCA's branches that stand to achieve the revenue authority vision and mission. A/K/S/C have a total number of 394 employees among them 42 of them are currently working at tax audit department. The study population/participants are all Tax Auditors, team leaders', section head of tax audits and team leader of risk management department of Ethiopian Revenue and Customs Authority A/K/S/C. 37 Tax Auditors, 4 team leaders, 1 section head and 1 team leader of risk management are available in the revenue authority.

3.3. Research Design

For this study, the researcher applied descriptive analysis using the fact that a descriptive research design is used to describe the data and characteristic about what is being studied. Descriptive survey enables to obtain the current information, it is also used in fact finding studies and helps to formulate certain principles and give solutions to the problems concerning local or national issues. Descriptive survey method focus on investigating the status, practice and problem related to tax audit of Ethiopian Revenue and Customs Authority a case study in A/K/S/C.

3.4. Research methods used

Research methods are the techniques used to collect data. In this study, the researcher adopted mixed methods approach, as discussed in the previous section, which are employed concurrently in collecting and analyzing data. There are different tools available to the researcher to collect the required data including questionnaires, observation, interview, and document analysis. For this study, the researcher apply quantitative (survey) and qualitative (in-depth interview & document analysis), and are discussed in the following sub-sections.

3.4.1. Quantitative aspect: survey

Survey design is a research method that provides a quantitative or numeric description of trends, attitudes, or opinions of participants with the intent of generalizing from a sample to a population (Creswell, 2009). Typically, survey gather data at a particular point in time with the intention of describing the nature of existing conditions, or identifying standards against which existing conditions can be compared, or determining the relationships existed between specific events;surveys are useful to gather information and data on attitudes, preferences, beliefs, predictions, behavior and experiences (Cohen et al., 2000).

Survey research has its own strengths and weaknesses. The strengths of survey research include; highly flexible, possibly cover a wide range of research questions, describe an existing situation, easy to guarantee respondents" anonymity (for instance, questionnaires may lead to more candid answers), easier to generalize findings, and efficient in gathering large amounts of data at reasonably low cost and effort . The limitations include that it is difficult to come to deeper understanding of processes and contextual differences through questionnaires, which are standardized and by their nature limited in length and depth of responses (Muijs, 2004).

This thesis has an objectiveof describing the aptness of audit case selection methods and techniques used, the degree of the frequency of tax audit performed, experience and capability of tax auditors, and examining the performance of tax audit program in line with international standards. Thus, survey method of quantitative approach is appropriate and employed for this study. The remaining discussion in this section is thoroughly about survey instruments design, and data analysis techniques.

Survey instruments

Survey instruments include self-administered questionnaire, structured interview and structured observations (Creswell, 2009). The study uses questionnaire, which is a widely used and useful instrument for collecting survey information.Questionnaire as a tool for data collection has its own advantages and limitations. The advantages found from the literature includes that the data collected through the use of questionnaire are efficient, reliable because of anonymous, honest, economical (in terms of time and money), quick (even possibly mailed), consistent (little scope for bias), offers the possibility of standardizing and comparing scales, and enables the anonymity of the data sources to be preserved. Nevertheless, the major limitations are nonflexible (no longer possible to backtrack once the administration phase is under way), lack of qualitative depth, low response rate, inability to offset a lack of sufficient data or an error in the scale used (Thiétart et al., 2001 and Cohen et al., 2000). 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 apply semi-structured questionnaire, and distributed for 36 auditors and 4 team leaders of ERCA A/K/S/C, for survey data collection.

3.4.2. Qualitative aspect: in-depth interview and documentary analysis

Qualitative research 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, the data's are collected through in-depth interview and documentary analysis. The following discussion in this section is comprehensively present about sample design, in-depth interview and document study.

In-depth interview

An interview is a purposeful discussion and/or conversation with 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 apply semi-structured interview using a pre-established questions asking in a predetermined order, using a standard mode of delivery; in addition information, attitudes, opinions, and beliefs, 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. There is a tradeoff between depth and breadth, given limitation of time and money (Patton, 2003). Thus, in-depth interview are conducted with tax audit section head and risk management team leader.

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, newspapers, 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, the study employed a descriptive analysis of documents such as periodical tax audit reports, proclamations, tax audit manuals, tax audit policy, taxpayers' interviews & exit conference and others documents that are relevant for the study. The document analysis are applied for examining the number of taxpayers audited in a given fiscal year, the feedbacks of taxpayers, 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 A/K/S/C.

To sum up, in order to achieve the research questions stated in the previous section, the researcher will use both qualitative and quantitative approach (mixed approach) in collecting and analyzing data as discussed in the following section. The selection of one over the other approach for the conduct of the study is based on the research problem (issue or concern that needs to be addressed), the researcher's own personal experience and the will and support of the audiences (Creswell, 2009).

Data analysis

Surveys can be either descriptive or analytic. Descriptive surveys simply describe data on variables of interest, while analytic surveys operate with hypothesized predictor or explanatory variables that are tested for their influence on dependent variables (Cohen et al., 2000). For this study, the researcher applies descriptive analysis using tables and percentages.

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION

Currently, like other governments the government of Ethiopia seeks to raise revenue mainly through taxation in order to pay its expenditures, on infrastructure development in particular. According to ERCA (2010), the Ethiopian Revenue and Customs Authority is established with a mission to promote voluntary compliance of taxpayers, ensure integrity & develop skills of the employees, support modernization, facilitate trade & 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 should made a wide range of organizational and institutional reforms with the aim of strengthening revenue mobilization, improving voluntary compliance and enhancing operational efficiency tax audit in particular. 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 2010).

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. Furthermore it discussed the research methodology employed to achieve the objectives of the study. As it is mentioned before, the main objective of this study is to investigate the tax audit practice, and to identify the main problems of the tax audit program performed that affects tax revenue collection in Ethiopian Revenue and Customs Authority (the case of Addis Ketema Sub city). This chapter presents the results and analysis of the data collected using different methods and presents the results and discussion accordingly. This chapter presents the result of survey, in-depth interview, and documentary analysis and discussion of results. The analysis addresses the tax audit practice in Ethiopia with respect to the type of audit performed, effectiveness of audit program in terms of educating taxpayers and improving voluntary compliance and revenue performance, the appropriateness of case selection methods, examination techniques, and experience and capability of tax auditors.

The survey was conducted with 36 tax auditors and 4 team leaders so that 40 questionnaires were distributed. Nevertheless, the survey response was collected from only 35 survey respondents because five of the tax auditors were on respite. Accordingly, the response rate was 87.5 percent, and it is rationally fine; further, the interview was conducted with the tax audit section head and risk management department.

4.1. Background information of respondents

Out of the total respondents, 54.29 per cent were males and 45.71 per cent were females, among them 31.43 per cent were under the age category of less than 25 years, 48.57 per cent were 25-35 years, 14.29 per cent were 36-45 years and 46-55 years & above 55 years were 2.86 per cent respectively. Regarding educational level, the majority of the respondents have a good level of educational qualification that is 97.14 per cent of respondents were BA degree holder, and 2.86 per cent attended MSc/MA, this 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. Where majority of the respondents are specialized in Accounting and Finance, which accounts for 77.14 per cent and the remaining 5.71 per cent management, 5.71 per cent Economics, 2.86 percent business administration and the rest 8.57 per cent of respondents studied other fields. Regarding occupation, 42.86 percent of respondents were junior tax auditors, 45.71 percent senior tax auditors, 11.43 per cent are tax audit team leaders.

Table 4.1 Background information of respondents

Variables	N = 35	Count	Percent
Gender	Male	19	54.29
	Female	16	45.71
Age	Less than 25 year	11	31.43
	25-35 years	17	48.57
	36-45 years	5	14.29
	46-55 years	1	2.86
	Above 55 years	1	2.86
Highest level of education achieved	Certificate	-	-
	Diploma	-	-
	BSc/BA	34	97.14
	MSc/MA and above	1	2.86
Field of study	Accounting and Finance	27	77.14
	Management	2	5.71
	Economics	2	5.71
	Business administration	1	2.86
	Other	3	8.57
Current job occupation	Junior Tax auditor	15	42.86
	Senior Tax auditor	16	45.71
	Tax audit team leader	4	11.43
	Tax audit section head	-	-

Source: Survey outcomes and own computations

4.2. Purpose of tax audit

As Barreca and Ramachandran (2004) noted the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations. According to table (Table 4.2) the survey result showed that the primary purpose of tax audit is detecting noncompliance behavior of individual taxpayers (91.43% per cent of respondents), 71.43 percent of the respondent tax auditors agreed that tax audit performed in ERCA A/K/S/C is to check the evasion of tax.

As stated by Biber (2010), the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Besides 17.14 percent of respondent were agreed on the issue that tax audit is for educating taxpayers and 34.29 percent of respondent believe that tax audit also conducted assessing & collecting additional tax revenue. The in-depth interview with tax audit section head, also showed that tax needs to be based on voluntary registration, and should encourage taxpayers to voluntarily discharge their tax obligations. As a result, the purpose of tax audit is primarily to educate taxpayers and improve their voluntary compliance. The interview results also revealed that there is a responsible unit, tax crime investigators team, for the investigation of serious tax fraud or evasion. Furthermore, tax crime investigator and intelligence team handles serious fraud case through third party information and physical participation as a customer (neutral person) in unexpected way.

Table 4.2 Purpose of tax audit performed in ERCA A/K/S/C

purpose of tax audit	frequency	percent
To check the evasion of tax	25	71.43
To create awareness to taxpayers	6	17.14
To ensure compliance in accordance with tax law	32	91.43
For assessment and collection of additional tax revenue	12	34.29

Source: Survey outcomes and own computations (multiple answers were possible)

4.3. Category of taxpayers usually audited

An important factor in an effective audit program is the identification of specific segments and sectors of taxpayers to be selected for audit. As the in-depth interview with tax audit section head showed, ERCA used a segmentation approach to conduct tax audit in order to provide a highly integrated and one spot customer service for taxpayers. Such segmentation of taxpayers might help ERCA to recognize the complexity levels of audit cases in audit activities. Grouping taxpayers by their common character is appropriate since taxpayers have varied characteristics and risks to tax revenue that might require different audit treatment including staff allocation based on case complexity Biber (2010).

As of Ethiopian Tax Proclamation, 285/2002 any company incorporated under the laws of Ethiopia or in a foreign country and any business having an annual turnover of Birr 500,000 or more categorized under "Category A" Unless not already classified in category "A", any business having an annual turnover of over Birr 100,000 would be classified under Category "B" taxpayers. Category C includes owners of businesses, which are not subject to the obligations of Categories "A" and "B", and businesses whose annual turnover is estimated up to Birr 100,000 are classified under this category of taxpayers.

Regarding the size of taxpayers selected for audit, most of the respondents (94.29 per cent) replied that ERCA selected category "A" taxpayers for audit purpose; whereas 57.14 per cent of respondents replied that ERCA audited category "B" (Table 4.3). The main reason for the selection of such category of taxpayers for audit purpose is their higher compliance risk and large revenue potential. This finding is confirmed by the in-depth interview with tax audit section head, and the interview result also showed that tax audit program in A/K/S/C focused chiefly on large taxpayers those that can contribute to tax revenue and are highly influential in investment and other economic activities. In addition, ERCA deployed undeniably its scarce resources primarily to taxpayers with large tax potential regardless of the significance of risks that need attention to be audited in other taxpayer segments. As a result, ERCA may increase its tax revenue through audit of taxpayers those with large tax potential. However, as Tait (1988) stated, the deterrent effect of tax audit (improving voluntary compliance) is best achieved by extending the audit program to as many taxpayers as possible at all levels of taxpayers. Voluntary compliance is generally enhanced by increasing the number of taxpayers audited than auditing taxpayers with large tax potential. Thus, ERCA may not improve future taxpayers' voluntary compliance that may affect future tax revenue, and may not be capable to sustain confidence in the tax system and its administrations in the absence of improving overall voluntary compliance. Further, ERCA may increase short-term tax revenue by auditing taxpayers with large tax potential at the expense of decreasing future tax revenue and compliance at other segments of taxpayers.

When ERCA gives emphasis only for a particular segments or categories, Category "A" in particular, the unaudited category or segment of taxpayers would feel that their underreporting and other noncompliance activities have little chance of being detected due to less probability of being audited. As the in-depth interview with tax audit section head showed regarding business sectors selected for audit, ERCA conducts audit usually on importers, merchandising, manufacturing, and construction sectors due to their large tax revenue at risk. The in-depth interview with tax audit section head further stated that, in addition to their large tax potential, large taxpayers segment has huge impact on investment and other economic participation. Thus, the Ethiopian tax system prioritizes and provides quality and on time services for such taxpayers for the benefit of both taxpayers and the tax administration system. It is unquestionable to ERCA to deploy its scarce resources primarily in large taxpayers regardless of the significance of risks that need attention to be audited in other taxpayer segments though it is necessary to allocate tax audit resources for the conduct of audit in other taxpayers segment. Because large taxpayers can contribute a huge amount of tax revenue as well as have complex structure, multiple operating entities with international business dealings. Thus, as OECD (2006a) stated, tax revenue can be increased by concentrating on as many taxpayers as possible at all levels taxpayers where large amount of revenue is at risk.

Table 4.3 Category of taxpayers usually audited

category of taxpayers is most usually audited	frequency	percent
Category A	33	94.29
Category B	20	57.14
Category C	-	-

Source: Survey outcomes and own computations (multiple answers were possible)

4.4. Types of Audit performed in A/K/S/C

The first aspect of tax audit practice is the type of audit performed in ERCA and its suitability in respect of improving voluntary compliance and increasing tax revenue for the federal government of Ethiopia. An effective audit program should be with vigorous range of audit types directed to a wide range of taxpayers and tax types. The survey results showed that ERCA exhaustively conducts comprehensive audit (94.29 per cent of respondents) followed by desk audit (77.14 per cent of respondents). ERCA also conducts fraud investigation (37.14 per cent) and refund audit (14.29 per cent). As Biber (2010) stated, excessive examination might be appropriate to properly detect taxpayers' noncompliance when it has been applied to those taxpayers where there is an indication of underreporting that could impact across taxes.

Nevertheless, the in-depth interview with section head of tax audit, ERCA exhaustively conducts comprehensive audit with intensive examination of five-year taxpayer; in which comprehensive audit is conducted using five-year taxpayer information to check whether taxpayers filed and paid the appropriate tax returns in line with the tax law and accounting principles. As a result, ERCA might consume audit resources improperly with exertion of much work force, tax audit staff in particular, on mass of transactions and intensive records even on reliable tax returns due to its concentration merely on comprehensive examination of five-year period documentation.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. As OECD (2006a) stated, such type of audit operation might result low audit coverage (rate) that affects the overall deterrent effect (future improvement in taxpayers' voluntary compliance by encouraging compliant taxpayers and detecting noncompliant taxpayers through covering a wide range of taxpayers) and future tax revenue. In addition, such excessive examination of taxpayer data may create collision between taxpayers and tax official, and auditors' error in such examination may damage business activity that result in negative impact on the economy, tax system in particular. ERCA performed desk audit for data cleaning purpose to confirm whether the data submitted by the taxpayers is genuine.

The interview results also revealed that ERCA critically conducts investigation audit based on the information that comes from various sources with evidence regarding the deliberate evasion or serious fraud. ERCA has a responsible unit that handles serious cases of tax fraud or evasion. However, the number of auditors assigned for such audit practices is inadequate to perform audit activities in all cases. Further, there is no a special workroom for investigation audit to keep the information secret and conduct the audit in safe work environment. Education type audits such as advisory audit (especially to newly established businesses), registration check, record keeping audit and Field Audit have not yet in place in ERCA A/K/S/C (Table 4.4). ERCA does not consider its audit activities to be on specific errors or compliance risks (transactions and vouchers or records) that concerns the tax system with respect to potential loss of tax revenue due to evasion or fraud and other noncompliance activities. As a result, as Biber (2010) stated, the tax authority might suffer low audit coverage that minimizes tax revenue and overall voluntary compliance.

As OECD (2006a) stated, the scope of tax audit may be narrow or broad depending on the specific risk relating to a taxpayer, and the limited audit resources should be allocated towards the noncompliant to detect compliance risk, and to support those taxpayers who want to be complaint. However**,** the results of the study revealed that tax audit program remains undeveloped in ERCA with an emphasis on comprehensive and desk audit with the exclusion of other audit methodologies (Table 4.4).

4.4 Types of Audit performed

Types of Audit are usually performed in A/K/S/C	frequency	percent
Desk Audit	27	77.14
Registration Audit	-	-
Fraud investigation	13	37.14
Issue audit	-	-
Refund Audit	5	14.29
Comprehensive audit	33	94.29
Field Audit	-	-
Advisory audit	-	-

Source: Survey outcomes and own computations (multiple answers were possible)

4.5. Access to information for performing an audit

As 62.86 per cent of survey respondents replied, auditors have good access to information kept by the taxpayers and other parties but 37.14 per cent of the respondents respond that there is no good access of information held by the taxpayers and others for auditors. Furthermore in in-depth interview with the tax audit section head, auditors in particular, have sufficient powers to enter a business premise, seize documents, gather information from third parties such as financial institutions, and generally enforce payment of tax when due. Taxpayers do not cooperate to give essential information necessary for audit as replied by 65.71 per cent of respondents but 34.29 per cent of them response was the reverse (Table 4.5).

According to Table 4.5.1, Tax Auditors get information from different sources. Majority of respondents agreed stated that if tax payers do not provide the required documents of their business auditors could audit the taxpayer's business by reviewing the financial statement if the margin is low they will reject the financial statement. Hereafter, they will assess the tax using the estimated daily income or else converting the cost of goods sold to sales or the reverse by the pre-determined margin of the business by the government (74.29 percent of respondent). 37.14 percent of respondent said that auditors get information from reviewing the previous case histories of taxpayers concerned, using information from third parties such as financial institutions (11.43 percent of respondent) and 31.43 percent of respondent replied that Tax Auditors get necessary information of Taxpayers from business sector profile. Furthermore, the interview with tax audit section head showed that ERCA has sufficient powers to enter business premise, seize documents, gather information from third parties such as banks, and generally enforce payment of tax. In addition, tax audit is conducted using information from intelligence team, third parties such as banks and SIGTAS; it is an integrated package with modules necessary to manage all taxes and licenses including a risk selectivity module (ERCA 2010). However, the use of SIGTAS does not provide reliable decision to assure appropriate risk selection due to absence of well-organized and clean data.

Table 4.5 access of information & taxpayers' cooperation

access of information & taxpayers cooperation	yes		no	
	frequency	percent	frequency	percent
a tax auditor have good access to information held by the taxpayers and others	22	62.86	13	37.14
taxpayers cooperate to give essential information necessary for performing an audit	12	34.29	23	65.71

Source: Survey outcomes and own computations

Table 4.5.1 Methods of getting information regarding taxpayers

If taxpayers do not provide the required document how tax auditors can audit	frequency	percent
By reviewing the previous case histories of taxpayers concerned	13	37.14
Using information from third parties such as financial institutions	4	11.43
Using business sector profile	11	31.43
Others	26	74.29

Source: Survey outcomes and own computations (multiple answers were possible)

4.6. ERCA repetitively audit the same taxpayer in consecutive periods

OECD (2006a) stated that 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 as 31.43 per cent of respondents stated that in the current period taxpayers that were audited in the previous period are selected for audit, 48.57 per cent of respondents replied that sometimes this might befall. 14.29 percent of the respondents do not agree with this where as 5.71 percent of the respondents utters neutral (table 4.6). According to table 4.6.1 as 51.43 per cent of respondents, repetitive audit is performed when taxpayers have large tax potential in addition, 37.14 and 11.43 per cent of respondents stated that such audit is performed serious tax fraud is found with taxpayers and when taxpayers report less tax return than the previous period respectively. 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 vary and be reduced due to economical and/or operational factors. The taxpayers' report of less tax return is not necessarily being an indication 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.

As of the in-depth interview sometimes ERCA repetitively audit the same taxpayer in consecutive periods; as a result, the same auditor might sometimes perform audit activities on the same taxpayers repetitively in different audit periods. As OECD (2006a), stated, individual tax auditors should be prohibited from repeatedly auditing the same taxpayer, and should exclude themselves from taking up an audit where they are familiar with the taxpayer selected for audit. Hence, this per-audit case management factor may expose auditors headed for inappropriate contact with the taxpayers.

4.6 ERCA repetitively audit the same taxpayer in consecutive periods

ERCA repetitively audit the same taxpayer in consecutive periods	frequency	percent
Yes	11	31.43
Sometimes	17	48.57
Neutral	2	5.71
No	5	14.29

Source: Survey outcomes and own computations

Table 4.6.1 Conditions to audit repeatedly the same taxpayer

Conditions to repetitively audit the same taxpayer in consecutive periods	frequency	percent
When serious tax fraud case is found	13	37.14
When taxpayers have large tax potential	18	51.43
When taxpayers reported tax returns less than previous period return	4	11.43

Source: Survey outcomes and own computations

4.7. Taxpayer compliance with the tax system in Ethiopia

The majority of respondents (54.29 per cent) stated that taxpayers do not comply with the taxsystem 14.29 per cent of respondents agree taxpayers compliance with the taxsystem and 22.86 per cent of respondents replied that sometimes taxpayers might comply with the taxsystem. 8.57 percent of the respondents were impartial (table 4.7). Further, the taxpayers' compliance risk is characterized by underreporting income (88.57 per cent), nonpayment of tax returns when due (34.29 per cent), and failure to register as required by tax law (20 per cent), and non-filing tax returns (54.29 per cent) (Table 4.7.1). As 82.86 per cent of respondents showed, the above compliance risks arise mainly due to taxpayers' lack of awareness. It may also arise due to weakness in tax administration, taxpayers' carelessness, and taxpayers' deliberate action as responded by 77.14 per cent, 68.57 per cent, and 22.86 per cent of respondents, respectively (Table 4.7.1).

Creating taxpayers awareness might be necessary to increase voluntary compliance and to mitigate future compliance risks in Ethiopia. Nevertheless, according to the document of taxpayers exit audit conference attested that taxpayers lack awareness**;** regarding the tax type to which their business is liable, goods and services exempted from tax, negative upshot of contraband trade, and reporting & filing requirements of the tax law. Further taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant. In addition, there is a communication gap between ERCA and taxpayers, which leads taxpayers to mistrust. The taxpayers do not have easy access to new rules introduced and amendments in the existing tax law, and do not get any clarification on the complex tax rules and regulations. Consequently, as the in-depth interview with tax audit section head stated that the duty of taxpayers' awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. Consequently, ERCA has tried to create tax awareness through printed materials and some face-to-face discussion forum with taxpayers. Thus, taxpayers in such cases may not be aware about the Ethiopian tax system, and voluntary compliance might not be achieved in ERCA due to the absence of advising and law elucidation services through reasonable physical contacts with taxpayers.

The in-depth interviewswith tax audit section head also revealed that since education type audits such as advisory audit (especially to newly established businesses), registration check, and record keeping audit have not yet in place in ERCA. As a result, taxpayers might not be well-informed regarding the newly introduced tax rules and amendments made on the existing tax regulation to keep-up taxpayers with updated tax knowledge and to encourage complaint taxpayers as well as to detect noncompliant taxpayers those operate in illegal economy. In such condition, as per the literature, it is appropriate to implement well-organized educational type audits and advising services to encourage taxpayers those needs to comply, and detect compliance risk of noncompliant taxpayers. Moreover, there is a need to have taxpayers that might be registered voluntarily and discharge their tax obligations.

ERCA A/K/S/Cmakes its power visible- Through audit, ERCA utilizes such enforcement powers in addressing the revenue arrears and evasion challenges it faces, and makes its power visible to the community and encourages noncompliant taxpayers to comply. Moreover, noncompliant taxpayers that have been considered as a big fish are subject to penalty, and have been enforced to pay the evaded tax with such penalty and interest to maximize their future compliance as well as to educate others to comply by publicizing such enforcement. However, ERCA may not achieve the expected future voluntary compliance in the absence of services along with the taxpayers' lack of tax awareness. Without educating taxpayers and creating tax awareness, making power visible to the community might detect the deliberate evasions and frauds but not be a solution to create a compliant taxpayer those does not comply unknowingly. As EC (2006) stated, tax administrators should not simply enforce but must foster tax compliance through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary. Hence, implementation of severe penalty and enforcement to pay evaded tax may not be long-lasting solution to create fair and smooth tax system with high compliant taxpayers to ERCA.

Table 4.7 taxpayer's compliance

taxpayers of ERCA A/K/S/C comply with the tax system in Ethiopia	frequency	percent
Yes	5	14.29
Sometimes	8	22.86
Neutral	3	8.57
No	19	54.29

Source: Survey outcomes and own computations

4.7.1 Taxpayers noncompliance behavior and its reason

Noncompliance behavior of taxpayers	frequency	percent
Non-filing tax returns	19	54.29
Underreporting of income	31	88.57
Fail to registered when required	7	20
Registering of ineligible taxpayers	-	-
Non-payment of tax return on time	12	34.29
Reasons for the noncompliance behavior of the taxpayers		
Taxpayers' carelessness	8	22.86
Taxpayers' deliberate action	24	68.57
Taxpayers' lack of awareness	29	82.86
Weakness in tax administration itself	27	77.14

Source: Survey outcomes and own computations (multiple answers were possible)

4.8. Other tax audit practices

The sole mechanism to treat taxpayers' compliance risk might be tax audit for compliance risk available in ERCA A/K/S/C as responded by 62.86 per cent of respondents though 11.43 per cent of respondents opposed this assertion and 25.71 respond neutral (Table 4.8). According to the interview with the tax audit section head, the key source of revenue for the government of Ethiopia is tax followed by external loan grants and assistances. However, the potential tax revenue is not collected due to absence of taxpayers' compliance with the tax law both deliberately and unknowingly. Thus, ERCA used tax audit to determine the taxpayers correct tax liabilities for a particular accounting or tax period with examination of taxpayers' organizational procedures and financial records in order to assess compliance with tax laws and verify the true, fair, reliable, and accuracy of tax returns and financial statements.

The audit program performed in ERCA can detect noncompliance behavior of individual taxpayers and gathering information on the health of the tax system regarding the taxpayers' compliance behavior and areas of weaknesses in the tax law for clarification and amendment (addressing the deficiencies in the tax law) this finding coincides with the statements of OECD (2006a). Taxpayers believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit as responded by 88.57 per cent of respondents in which 11.43 per cent of respondents are neutral. As presented in the results section (Table 4.8) the finding coincides with the statement of Biber (2010), that taxpayers might feel that there is a good chance of being seized in their underreporting and other forms of noncompliance activities that might be due to application of strong sanctions where noncompliance is encountered. Thus, tax audit is used as a compliance enforcement tool to collect unpaid or evaded tax return and to ensure the deterrent effect. ERCA A/K/S/C used tax audit as a compliance enforcement tool to collect unpaid taxes from taxpayers and to ensure the deterrent effect (improving future compliance).

Regarding the audit timeframe, 85.71 per cent of respondents showed ERCA has a rule that requires audit activities to be started and completed within a predetermined timeframe, 40 percent of respondents also believe that taxpayers are aware of the audit time frame but 31.43 percent of the respondent disagree with this (Table 4.8). The tax audit section head further stated, ERCA has an edict that requires an individual case to be started and completed period regardless of the complexity of the cases and the size of the taxpayers to be audited. Accordingly, an auditor should complete a desk audit within 5 days, comprehensive audit within 22 days and investigation audit within 40 days audit; however A/K/S/C audit activities expected to be started and completed within 5 days. As per the researcher's knowledge the audit timeframe should not be allocated equal period for both complex and simple cases; this might result operational inefficiency including decrease in audit quality because tax auditors those expected to perform complex cases might not properly detect noncompliance due to time scarcity and the required audit quality might not be achieved. Whereas auditors those expected to complete simple cases might complete even before the elapse of stated period and might consume working time improperly so that feasible audit coverage might be reduced.

Table 4.8 Other tax audit practices

	Yes		Neutral		No	
	frequency	percent	frequency	percent	frequency	percent
Do you think taxpayers may believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit?	31	88.57	4	11.43	-	-
Do you think a tax audit is a sole treatment for compliance risk available in ERCA A/K/S/C?	24	68.57	7	20	4	11.43
Is there audit manual to perform the audit work	29	82.86	6	17.14	-	-
Is there any standard in ERCA A/K/S/C that requires the audit work to be started and completed within a predetermined timeframe?	30	85.71	5	14.29	-	-
Are taxpayers aware for the standard?	14	40	10	28.57	11	31.43

Source: Survey outcomes and own computations

4.9. Tax audit Effectiveness

As 37.14 percent of respondent, productivity and yield of audit was the indicator for effective tax audit. 14.29 percent of respondent agreed that the effectiveness of tax audit was measured by volume of tax audit or coverage of tax Audit performed. Both productivity & yield of audit as well as volume or coverage of tax Audit, performed measured the effectiveness of tax audit, as 48.57 percent of respondents respond. In addition, the in-depth interview with the tax audit section head confirmed that the potential amount of tax revenue that might be found with the target taxpayer and the capability of that particular taxpayer to pay tax owed have been also considered before conducting tax audit in ERCA. However, the primary objectives of revenue authorities is proper assessment of tax liability, improvement of overall compliance with tax laws, and in process sustain confidence in the tax system (OECD 2004a). Thus, the collection process of evaded tax revenue is the secondary objective that comes after founding and detecting the evaded tax on a certain taxpayer. In addition, the collectability consideration only to the current tax period excludes taxpayers' future payment potential that might not provide a complete financial picture for taxpayers. It might not also help ERCA to bring noncompliant taxpayers to the tax system.

Table 4.9 Effectiveness of tax audit

How does the effectiveness of tax audit is measured?	frequency	percent
By productivity and yield of audit	8	22.86
By volume of the audit performed	5	14.29
Both by volumes of audit & productivity	22	62.86

Source: Survey outcomes and own computations

The other characteristic of effective tax audit program is a broad coverage of taxpayer groups (by size and sector) and compliance issues (Harrison and Krelove 2005). According to According to ERCA A/K/S/C annual report, the revenue authority of A/K/S/C performs 63.78 percent when compared with plan and the audit performed by the Revenue Authority of A/K/S/C was very low. The total number of taxpayers administered by ERCA A/K/S/C was 16,341 in 2013/14 fiscal year. Until July 7, 2015, the total number of taxpayers registered was 16,466. Out of those tax payers only 1,362 (8.33 percent) and 1,640 (9.96) of them should maintain books and records of their business record information (financial statement and other supporting documents) for the fiscal year of 2013/14 and 2014/15 respectively. As indicated in the literature review in chapter two, in a fairly well established tax system, audit rate of 15 to 20 percent of registered traders a year is sufficient (Tait1988). However, ERCA has audited 206 taxpayers (15.12per cent), and found additional tax revenue of birr 139.28 Million during 2013/14 fiscal year. In 2014/15 fiscal year, the authority covered 287 taxpayers (17.50 per cent) through audit and found additional tax revenue of birr 198.31 Million (Table 4.9.1). This indicates that ERCA might detect compliance risk and get more additional tax revenue as the audit coverage is increased. Thus, there is low and insufficient audit rate in ERCA. As a result of the in-depth interview with the tax audit section head, the low audit rate (coverage) might be due to conducting extensive comprehensive audit mainly on taxpayers those with large tax revenue and complex transactions, along with insufficient audit resources including qualified tax auditors, and equipment's such as computers.

Table 4.9.1 ERCA A/K/S/C annual report

Data	**2006**	**percentage**	**2007**	**percentage**
Total number taxpayers of A/K/S/C	16,341		16,466	
tax payers who maintain books and records[1]	1,362	8.33	1,640	9.96
audited tax payers[2]	206	15.12	287	17.50
total Planned Revenue	246.33		310.93	
total obtained Revenue [3]	139.28	56.54	198.31	63.78

The data is obtained from annual reports of ERCA of the fiscal year 2013/14 and 2014/15.

[1]The percentage of taxpayers who maintain books and record is determined by taking the proportion of taxpayers who maintain books to total number taxpayers of A/K/S/C in each fiscal year.

[2] The percentage of audited taxpayers is determined by taking the proportion of taxpayers audited to total number of registered taxpayers (taxpayers who maintain books and records) in each fiscal year.

[3]The percentage of total obtained Revenueis determined by taking the proportion oftotal obtained Revenue to total Planned Revenue.

4.10. Tax audit staff resource

4.10.1. Criteria to recruit and give a position an audit staff

Regarding staff resources, the total staff assigned to audit should be close to 40 per cent of the total staff of the tax administrations (Biber 2010). However, A/K/S/C have a total number of 394employees among them 42 of them are currently work at tax audit department. This shows that audit staff resource is insufficient in which the proportion of tax audit staff to the total number of employees in the ERCA is about 10.67 per cent. Having insufficient tax auditors results ineffective audit program. The required level of audit quality and audit coverage might not be achieved. There might be a possibility of missing opportunities and imperfect detection of compliance risks due to workload on staff resources. Besides effective and efficient tax audit practice depends on having capable and experienced audit staff resources.

Segmentation of taxpayers might help ERCA to distinguish the competency requirements, classification, and remuneration of tax auditors to plan staffing accordingly. Such appropriate allocation and compensation of tax audit staff might encourage tax auditors to conduct properly their audit activities, which might result in higher audit performance in terms of coverage and quality. As the survey result, A/K/S/C tax auditors have been hired and held their current position based on their educational level achieved (34.29 per cent), field of study completed (11.43 per cent), training & exam attended (17.14 per cent) and past work experience (14.29 per cent). 22.86 percent of the respondents reply that they have their current position through promotion and transfer from other staffs of ERCA A/K/S/C (Table 4.10.1).

The in-depth interview with the section head of tax audit result showed that ERCA currently hired a mass of youngest employees, auditors in particular, based on their educational level and cumulative grade point average (CGPA), which is imperative to acquire successful tax auditors. However, having employees hired with high CGPA is not a guarantee for ERCA to have a qualified audit staff that might increase audit performance in terms of audit quality and rate. In addition ERCA has no enough audit staff resources, for instance there is shortage of computers, network cables, and sockets. There is also absence of separate workroom to keep the information that might be used for conducting investigation audit. In addition, most tax auditors have no access for the SIGTAS, and are not even familiar with the system due to absence of adequate training.

Table 4.10.1 Criteria for the position of tax audit

How and by what criteria the position that currently you hold is provided to you?	Frequency	Percentage
Based on education level achieved	12	34.29
Based on your field of study completed	4	11.43
Based on exam and training attended	6	17.14
Based on your past work experience related to your position	5	14.29
Others	8	22.86

Source: Survey outcomes and own computations

4.10.2. Tax auditor's experience

The majority of the respondent has tax audit work experience in ERCA A/K/S/C Less than 2 years (57.14 percent), 2- 4 years (28.57 percent), 5-7 years (8.57 percent) and 8-10 years (5.71 percent). Regarding auditors' previous audit work experience, the survey result showed that 82.86 per cent of respondents have no any audit experience before they have been employed in ERCA. In addition, 31.43 percent of respondents' works in ERCA A/K/S/C other than tax audit in which 8.57 percent of respondents work for 2-4 years, 5-7 years (2.86 percent) and 8-10 years (5.71 percent) (Table 4.10.2). The in-depth interview with the section head of tax audit revealed that most of the current tax auditors have an experience of less than two years. This might be due to higher staff turnover in the tax authority, tax audit team in particular. Therefore, mere classification of auditors as junior and senior auditor might not be effective in the absence of having experienced and capable tax auditors though the classification is momentous to deal with a range of complexity of audit cases. The assignment of audit cases based on experience and capability of auditors and complexity of cases might increase audit quality. However, in ERCA, such classification might not be achieve due to lack of capable and experienced audit staff resources especially for the conduct of complex audit cases. The authority fails to retain proficient and well-trained auditors, as employees become more experienced, it is expected that they might become effective and need safe working environments. Hence, most tax auditors resign themselves from their position after two to four years of experience that might be due to workload without additional benefits, unsafe atmosphere in work environment, absence of satisfactory allowance for fieldwork and uneven compensation payment for similar field activities, and absence of performance based promotion.

Table 4.10.2 Work experience of auditors

Work experience	Audit In ERCA		Audit in other organization	
	Frequency	Percentage	Frequency	Percentage
Less than 2 years	20	57.14	-	-
2- 4 years	10	28.57	3	8.57
5-7 years	3	8.57	1	2.86
8-10 years	2	5.71	2	5.71
Above 10 years	-	-	-	-

Source: Survey outcomes and own computations

4.11. Main activities of tax auditors

According to 80 percent of respondents the main activities of auditors andduring their audit work is detecting noncompliance behavior of individual taxpayer, Educating taxpayers (28.57 percent) Interpreting complex tax rules and regulations for taxpayers (25.71 percent) and Identifying areas of tax law that require clarification and amendment (8.57 percent) (Table 4.11). as OECD (2006a) stated, tax auditors are often required to make effective decisions under the law, effectively communicate and interpret complex tax laws, and conduct intensive examination of taxpayers' books and records in addition to their primary role of detecting and deterring noncompliance. However, in ERCA, the in-depth interview with the section head of tax audit most of the tax auditors have no standardized knowledge regarding clarification of unclear tax rules and regulations, and are incoherent in giving information regarding tax issues. In addition, tax auditors lack willingness to give advising services to taxpayers rather they simply intimidate them by raising the consequence of not being compliant.

Through declaring the consequence of being noncompliant, ERCA might bring deliberate evaders (taxpayers' those not comply intentionally) to the tax system. However, compliant taxpayers could not comply with whatever sanction declared unless their tax awareness improved and be acquainted with their tax obligations through appropriate services including interpretation of complex tax rules and providing essential information for tax matters. Sometimes the tax officials, auditors in particular, may fail to keep properly taxpayers' data that have been already submitted by taxpayers, and they unnecessarily request taxpayers to submit the report yet again. Such unreasonable request might create negative image about ERCA on the eyes of compliant taxpayers that affects the smooth operation of the tax system as well as increase taxpayers" burden and compliance costs so that they might hesitate to comply with the tax system in their future tax periods.

Table 4.11Main activities of tax auditors

Main activities of tax auditors	Frequency	Percentage
Educating taxpayers	10	28.57
Search for unregistered taxpayers	-	-
Detecting noncompliance behavior of individual taxpayer	28	80
Interpreting complex tax rules and regulations for taxpayers	9	25.71
Identify areas of tax law that require clarification and amendment	3	8.57

Source: Survey outcomes and own computations (multiple answers were possible)

4.12. Tax auditor's operational capabilities

Tax auditors are categorized in to audit teams having their own team coordinators. Under each audit team, there are two levels of auditors: junior auditor and senior auditor. The tax audit team coordinators assign audit cases to their own team members based on the auditors' experience and capability as well as the complexity of cases. The simple and medium cases are expected to be performed by junior auditors, whereas very complex cases are assigned to senior auditors. Regarding auditors' operational capability, 34.29 percent of respondents replied that both junior and senior auditors are expected to complete less than 4-7 cases per month. Whereas 65.71 per cent of survey respondents showed both junior and senior auditors are expected to complete less than 4 cases per month. As (Tait 1988) stated, having proper audit planning, it is reasonable to expect an office auditor to complete an average of 10 to 20 cases a month, and for field auditor to complete an average of 4 to 6 cases a month. An experienced junior tax auditor is also expected to complete about 200 cases a year. However, in ERCA, a junior and senior auditor performs less than 4 cases on average per month on the contrary auditors perform less than 48 cases on average per year (Table 4.12). The tax audit section head further stated that most tax auditors usually conduct their audit work without preparing pre-audit plan.

Table 4.12 Tax auditor's operational capabilities

audit case coverage per month	Junior auditors		senior auditors	
	Frequency	Percentage	Frequency	Percentage
Less than 4 cases	23	65.71	23	65.71
4 to 7 cases	12	65.71	12	65.71
7 to 10 cases	-	-	-	-
above 10 cases	-	-	-	-

Source: Survey outcomes and own computations

4.13. Tax auditors training and competency assessment

ERCA provides training regarding tax law and tax audit issues at the time of recruitment, before engaged in tax audit activities, as stated by 48.57 per cent of respondents. 20 per cent of respondents replied that sometimes ERCA provide training, 31.43 percent of the respondents do not agree with this. As stated by the tax audit section head, at the time of recruitment A/K/S/C provides training regarding tax law and tax audit issues at the time of recruitment before engaged in tax audit activities. Besides all candidate employees are expected to attend training regarding government policies and strategies, overall objectives and structure of ERCA, tax rules and regulations, and one week basic audit training (for candidate tax auditors). ERCA sometimes provides training after recruitment and once the auditors held their required position In addition if the candidate employees are recruited from the head office to A/K/S/C, after the completion of the training all the trainees are expected to take the exam (in-house tests) based on the training they attended for assessment purpose. Such assessment might help ERCA to confirm whether the trained auditors reach the required level of competency, but should consistently undertake by branch offices. Further, training is not enough only during recruitment. Rather, it is essential before, during, and after recruitment based on appropriate need assessment and gap identification. As noted in the literature, competency improvements should be integrated in to normal business activities, and auditors should have been given continuous training so that their skills are kept up-to-date and relevant (OECD 2006a). However, ERCA provides inadequate training after recruitment and once the auditors held their required position.

According to 62.86 per cent of respondents, ERCA A/K/S/C does not perform a continuous assessment. 17.14 And 20 per cent of respondents replied that sometimes ERCA A/K/S/C does perform a continuous assessment to improve the capability or competency of auditors which engaged in the tax audit activities. , and 31.43 percent of the respondents do not agree with this. The interview with tax audit section head revealed that there is no a well-established model to make a continuous competency assessment. The in-depth interview also confirmed there is a balanced scorecard to evaluate employee's achievement, though there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once the employees have given and held a particular position, as a result, ERCA does not have experienced and proficient tax auditors.

Table 4.13 Tax auditors training and competency assessment

ERCA provide training for tax auditors	frequency	Percent
Yes	17	48.57
Sometimes	7	20
Neutral	-	-
No	11	31.43
A continuous assessment to improve the capability or competency of auditors		
Yes	6	17.14
Sometimes	7	20
Neutral	-	-
No	22	62.86

Source: Survey outcomes and own computations

4.14. Examination techniques used

The accuracy of tax returns have been tested through Review of financial statements and returns (82.86 per cent), Examination of information from third party (37.14 percent), Observing, discussing and reviewing documents of taxpayers (62.86 percent) and Examination of taxpayer's record such as books and documents (71.43 per cent). The survey result further showed that field examination (physical checks of taxpayers' assets and other aspects) is mainly used when a particular taxpayer needs to sell its business fixed assets or close the business (57.14 per cent) (Table 4.14). As OECD (2006a), effective auditing requires more than verifying that a taxpayer has correctly included a particular transaction in his books of account along with the adoption of investigative approach. However, the application of investigation approach is not as such in ERCA. The accuracy of taxpayers" tax liability is determined mainly through analytical review of financial statements and returns. Thus, ERCA may not be able to determine what wealth the taxpayers have accumulated but not documented or recorded in their books of accounts and financial reports without the conduct of appropriate investigation. It may not be also possible to ERCA to establish the completeness, accuracy, credibility and validity of a taxpayer's declarations, disclosures and other financial arrangement.

4.14 Table Examination techniques used

Examination techniques used	frequency	percent
Review of financial statements and returns	27	77.14
Examination of information from third party	10	28.57
Observing, discussing and reviewing documents of taxpayers	19	54.29
Examination of taxpayer's record such as books and documents	23	65.71
Physical checks of current transactions, vouchers, assets and other aspects	18	51.43

Source: Survey outcomes and own computations (multiple answers were possible)

4.15. Audit case selection methods

Another aspect of tax audit practice is use of appropriate audit case selection methods to select taxpayers for audit. In A/K/S/C, audit of all taxpayers is unattainable having inadequate audit resources and large noncompliant taxpayers (especially small and medium enterprises) both unknowingly and intentionally. Taxpayers might underreport their income, not pay tax returns when due, fail to register when required by the tax law, and fail to file their tax returns. As noted in the literature, the selection of appropriate audit candidates in line with program objectives is a key to the effectiveness of tax audit program (Barreca and Ramachandran 2004). According to the interview with tax audit section head audit case has been rarely selected through risk management department of ERCA A/K/S/C office case review. As stated by (OECD 2004a) In effective translation of strategic priorities for risk treatments in to individual case selections for action (1) Accurate & timely data and information relevant to the compliance risks to be addressed, and (2) knowledge management and analysis techniques to analyze the base data and facilitate feedback in to the compliance risk management process.

The essential information to case selection comes from previous case histories of the taxpayer concerned, information from third parties such as banks and informants (whistle-blowers), and intelligence team, which can confirm the details shown on the tax return, and more generic taxpayer (business sector profile). As the interview revealed the case, selection decision is based on accurate and timely taxpayer data; the information used for tax audit might be from case histories of taxpayers, third parties, and business sector profile. The criteria or information based selection system presupposes certain clue of noncompliance, which might be a sign of other things such as change in economic conditions in such particular sector or taxpayer type.

As the interview result revealed, taxpayers have been selected based on their associated compliance risk (compliance risk indicators) for audit purpose. A/K/S/C has partially implemented data mining and statistical analysis techniques to identify patterns of noncompliance in the past and those characteristics in the current population. Data mining requires significant investments in IT both hardware and software, and it may be difficult to acquire accurate data on which IT programs can operate (OECD 2004a). However, in ERCA A/K/S/C SIGTAS has not been fully utilized for risk assessment and the use of SIGTAS does not provide reliable decision to assure appropriate risk selection due to absence of well-organized and clean data. This condition results the audit work to be mainly depend on external sources, and the unorganized and insufficient audit information from internal sources might hinder the audit operation from being performed on time and as scheduled.

Currently A/K/S/C uses both random selection system and risk-based approach concurrently. The risk selection criteria include the trend of delay in tax payment, non-filing tax returns, nil tax declaration, showing abnormal and repetitive loss report, showing profit significantly deviated from previous periods (underreporting income), reporting exaggeratedly deviated margin from the sector, potentially over claimed deductions, unusual credit and refund claim, and past case histories of the target taxpayer. In the risk-based approach the data is reviewed against a set of risk indicators and the results be ranked in terms of the risk of noncompliance identified. Such system is an essential tool in facilitating the exclusion of bulk of returns with no or very low identified risks and allowing the resources for risk identification to concentrate their efforts only on those cases with significant identified risks (OECD 2004a). As (Vellutini 2010) stated, with random case selection system, ERCA might fight corruption at the expense of not focusing on highest risks, and treat both compliant and noncompliant taxpayers equally regardless of their associated risk. However, simple random selection has a major drawback that both honest and dishonest taxpayers are equally treated since probability selection give equal chance of being selected for both (Gupta and Nagadevara, n.d)

Chapter 5: Conclusions and Recommendations

The previous chapter presented the results and analysis of the study. The basic intent of this chapter is to present the overall overviews of the research by summing the main findings of the analysis part and give future research directions. The chapter is structured in two sections; accordingly the chapter starts its discussion by briefly sum up the overviews of the study and its main findings. In section two based on the study finding the researcher highlight some recommendations suggested as a solution to problems that have been identified in the study.

5.1. Conclusions

Taxation is key source of revenue for the government of Ethiopia followed by external loan grants and assistances. In addition, taxation is used to allocate economic resources for government's priority by directing economic agents to the development goals foreseen by the government through the incentive schemes embedded within the prevailing tax laws. The responsibility to collect revenue in Ethiopia rests with the Ethiopian Revenue and Customs Authority (ERCA); in which one of the branches is Addis Ketema Sub City. Nevertheless, the performance of tax revenue is relatively poor that shows, the Revenue Authority of A/K/S/C collects less revenue compared with the plan, which is caused by lack of voluntary compliance mainly due to paucity of taxpayers' awareness and the weakness in the tax administration itself, ineffective audit program in particular. A well-structured tax audit program is vital to achieve revenue objectives and sustain the health of the tax system by reducing tax gap through voluntary compliance improvement and additional tax collections. Further, it might provide valuable support in identifying areas of the tax law that require clarification or addressing deficiencies in the law, and to influence compliance of taxpayer at all levels.

Thus, the study examined the problems in tax audit practice in Ethiopian Revenue and Customs Authority (the case of the A/K/S/C). 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. The study adopted both quantitative and qualitative approaches. Specifically, the techniques used in the study include survey with tax auditors, in-depth interviews with tax audit section head and risk management department and documentary analysis. The findings from the discussions are concluded in the subsequent paragraphs.

Tax audit program remains undeveloped with an emphasis on comprehensive and desk audit with the exclusion of other audit methodologies. There is 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 could detect noncompliance behavior of individual taxpayers, and used as a compliance enforcement tool to collect unpaid or evaded tax return and to ensure the deterrent effect. Through audit, ERCA A/K/S/C 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 A/K/S/C 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.

Currently, segmentation approach (categorization of tax payers) 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 5 days period regardless of the complexity of audit cases and the size of the taxpayers. Taxpayers might be repetitively audited if there is an indication of serious tax fraud. As a result, there is unreasonably consumption of audit resources as well as increase the hardship associated with repetitive audits for fully compliant taxpayers; corruption might also arise due to repetitive contact between the same auditors and taxpayers.

The potential amount of tax revenue that might be found with the target taxpayer and the possibility of collecting evaded tax return, is the secondary objective of tax administration, have been also considered for conducting audit. Moreover, the case selection decision is based the information from SIGTAS, past case histories of taxpayers, third parties such as banks and informants, and intelligence team. However, the use of SIGTAS does not provide reliable decision to assure appropriate risk selection due to absence of well-organized and clean data.

Once the data is collected, audit cases have been selected using both the previous case selection system (random selection) and automated risk-scoring system concurrently. Data mining and statistical analysis techniques is partially implemented which requires significant investments in IT both hardware and software. However, the audit functionality of SIGTAS in A/K/S/C is not being fully utilized for risk assessment and the use of SIGTAS does not provide reliable decision to assure appropriate risk selection due to absence of well-organized and clean data.

To check the accuracy 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 analytical review of financial statements and returns. 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 staff, there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once they have given and held a particular position. There is also higher staff turnover in the tax authority, tax audit team in particular. The authority fails to retain proficient and well-trained auditors. As a result, 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. The incapability of tax auditor might be due to absence of using effective pre-audit plan and inadequate audit training.

5.2. Recommendations

This section provides some recommendations that are suggested as a solution to mitigate the operational problems of tax audit program so that to improve voluntary compliance and to meet the revenue needs of the ERCA. Therefore, based on the findings of the research the following recommendations are provided:

- To increase the audit coverage and voluntary compliance having inadequate staff resources, the A/K/S/C should adopt a wide range of audit methodologies in addition to full comprehensive audit. 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 audit staff to investigation audit.

- ERCA should give emphasis for all levels of taxpayer segments to improve future overall taxpayers' voluntary compliance that may affect future tax revenue, and to be capable to sustain confidence in the tax system and its administrations. All levels of taxpayer community should feel that their underreporting and other noncompliance activities have a good chance of being detected due to high probability of being audited.

- ERCA should revise the stated 5 days 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.

- To avoid unnecessary resource consumption and minimize compliant taxpayers' burden, ERCA should consider the inherent factors in a specific sector and economic conditions before conducting audit in consecutive audit periods on the same taxpayers that have been audited and show less tax return in the current period. In addition, the authority should give attention and preclude tax auditors from auditing the same taxpayers in different audit periods to alleviate the risk of corruption. The authority should also give priority to the detection of compliance risk rather than considering the collectability of the evaded tax return, which should be a secondary objective.

- 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.

- The ERCA should use full risk-based audit selection strategy that rewards taxpayer compliance with a light touch approach and openly demonstrates that valuable taxpayer resource is being deployed against the non-compliant. The tax audit program that properly identify risks and focus on customers who are not complying should be implemented. Taxpayers who are complying should benefit by not being subjected to harassment and unnecessary audit activity that in turn minimizes costs of administration and reduces taxpayer compliance costs.

- 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 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 a taxpayer's declarations, disclosures, and other financial arrangements.
- 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. There should be appropriate need assessment and employees should have been given training based on the gap identified.

- Auditors should have been given continuous training so that their skills are kept up-to-date and relevant. Further, the authority should supply sufficient computers and other necessary audit resources for auditors. The authority should also found a mechanism to retain the qualified tax auditors. Besides, the reason why staff resources of ERCA, tax audit team in particular resign themselves from their position after some years of experience might need a detail investigation and can be a researchable topic in the future.

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APPENDIX

ST' MARY UNIVERSITY

DEPARTMENT OF BUSINESS ADMINISTRATION

2014/2015 ACADEMIC YEAR

Appendix 1

I. Tax auditors survey instrument

Dear Participant

The purpose of this questionnaire is to gather relevant data that will be used in undertaking a study on the topic ***"Tax audit practice in Ethiopian Revenue and Customs Authority: The case of Addis Ketema Sub city"*** as a partial fulfillments of the requirements for the Masters of Business Administration. The investigator is Kidist Tsegaye who is currently an MSc (in General Business Administration (MBA)) student at St' Mary university.

Purpose of the paper is to examine tax audit operation of Ethiopian Revenue and Customs Authority in the case of Addis Ketema Subcity. Accordingly, this questionnaire designed to collect data on the perceptions that you have, towards the tax audit practices. Participation in this paper is voluntary and strict confidential; your cooperation in filling out the questionnaire carefully and genuinely, apart from contributing towards the successful completion of the study is essential input towards the creation of a levelheaded knowledge regarding the previously mentioned issue.

Instruction: Put (X) sign on the box of your choice; multiple answers are possible if it is necessary

For further information, please contact Kidist Tsegaye by the following address:

Tel.: +251937442510

E-mail: kidisttsegaye5@gmail.com

Part I: Questions regarding background information

1. Gender: Male ☐ Female ☐ 2
2. Age: Less than 25 year ☐ 1 25-35 years ☐ 2

   36-45 years ☐ 3 46-55 years ☐ 4

   Above 55 years ☐ 5

3. Highest level of education achieved:

   Certificate ☐ 1 Diploma ☐ 2

   BSc/BA ☐ 3 MSc/MA and above ☐ 4

4. Field of study:

   Accounting and Finance 1☐ Management 2☐

   Economics 3 Business☐nistration 4 ☐

   Others 5, please specify ____

5. Current job occupation:

   Junior Tax auditor ☐ 1 Senior Tax auditor ☐ 2

   Tax audit team leader ☐ 3 Tax audit section head ☐ 4

Part II: Questions regarding tax audit practice:

6. What is the primary purpose of tax audit performed in the ERCA?**(**multiple answers are possible)

   To check the evasion of tax 1 ☐

   To create awareness to taxpayers ☐ 2

   To ensure compliance in accordance with tax law ☐ 3

   For assessment and collection of additional tax revenue ☐ 4

   Others 6, please specify_______________________________________

7. Which category of taxpayers is most usually audited?**(**multiple answers are possible)

   Category A1 ☐ Category B 2 ☐

   Category C ☐ All of them 4 ☐

8. What types of Audit are usually performed in Addis Ketema sub city? **(**multiple answers are possible)

   Desk Audit ☐ 1 Registration Audit ☐ 2 Fraud investigation ☐ 3

   Issue audit ☐ 4 Refund Audit ☐ Comprehensive audit ☐

   Field Audit ☐ 7 Advisory audit ☐

   Others 6, please specify_______________________________________

9. When and in what condition the audit type that you have selected in question No.8 would be conducted, and for how longdoesthe audit cases expected to complete?

   ____

   ____

   ____

   ____

   ____

10. Does a tax auditor have good access to information held by the taxpayers and others?

Yes ☐ 1 No ☐ 2

11. Do taxpayers cooperate to give essential information necessary for performing an audit?

Yes ☐ 1 No ☐ 2

12. If taxpayers do not provide the required document, how tax auditors can audit the taxpayer business?(multiple answers are possible)

By reviewing the previous case histories of taxpayers concerned1 ☐

Using information from third parties such as financial institutions ☐

Using business sector profile ☐

Others 4, please specify ____

13. Does ERCA A/K/S/C repetitively audit the same taxpayer in consecutive period?

Yes1 ☐ etimes2Neutral 3 N ☐ ☐ ☐

14. If your answer for question No. 13 is yes, when and in what condition those taxpayers are audited?(multiple answers are possible)

When serious tax fraud case is found ☐ 1

When taxpayers have large tax potential ☐ 2

When taxpayers reported tax returns less than previous period return ☐ 3

Other 4, please specify ____

15. Do you think taxpayers of ERCA A/K/S/C comply with the tax system in Ethiopia?

Yes1 ☐ etimes2Neutral 3 N ☐ ☐ ☐

16. If your answer for question No. 15 is sometimes or no, how the noncompliance behavior of taxpayers is characterized? (multiple answers are possible)

Non-filing tax returns ☐ 1

Underreporting of income ☐ 2

Fail to registered when required ☐ 3

Registering of ineligible taxpayers ☐ 4

Non-payment of tax return on time ☐ 5

Others 6, please specify ____

17. What do you think the main reasons for the noncompliance behavior of the taxpayers to arise? (multiple answers are possible)

Taxpayers' carelessness 1 ☐

Taxpayers' deliberate action2 ☐

Taxpayers' lack of awareness 3 ☐

Weakness in tax administration itself ☐

Others 5, please specify ____

18. Do you think taxpayers may believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit?

Yes1 ☐ Neutral2 ☐ No3 ☐

19. Do you think a tax audit is a sole treatment for compliance risk available in ERCA A/K/S/C?

Yes1 ☐ Neutral 2 ☐ No 3 ☐

20. Is there audit manual to perform the audit work?

Yes1 ☐ Neutral2 ☐ No3 ☐

21. Is there any standard in ERCA A/K/S/C that requires the audit work to be started and completed within a predetermined timeframe?

Yes1 ☐ Neutral2 ☐ No3 ☐

22. If your answer for question No. 21 is yes, are taxpayers aware for this standard?

Yes1 ☐ utral2 No3 ☐ ☐

23. How does the effectiveness of tax audit is measured?

By productivity and yield of audit ☐ 1

By volume of the audit performed ☐ 2

Both by volumes of audit & productivity ☐ 3

Others 4, please specify ____

24. How and by what criteria the position that currently you hold is provided to you?

Based on education level achieved ☐

Based on your field of study completed2 ☐

Based on exam and training attended ☐

Based on your past work experience related to your position ☐

Others 5, please specify ____

25. For how long did you work with your current job occupation in ERCA?

Less than 2 years ☐ 1 2- 4 years ☐ 2

5-7 years ☐ 3 8-10 years ☐ 4

Above 10 years ☐ 5

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

Yes ☐ 1 No ☐ 2

27. If your answer in question No. 26 is yes, how long did you work as an auditor?

Less than 2 years ☐ 1 2- 4 years ☐ 2

5-7 years ☐ 3 8-10 years ☐ 4

Above 10 years ☐ 5

28. What are the main activities that tax auditors expected to perform during an audit period? (multiple answers are possible)

Educating taxpayers ☐ 1

Search for unregistered taxpayers ☐ 2

Detecting noncompliance behavior of individual taxpayer ☐ 3

Interpreting complex tax rules and regulations for taxpayers ☐ 4

Identify areas of tax law that require clarification and amendment ☐ 5

Others 6, please specify ____

29. Are there enough audit staff resources to perform comprehensive crosschecking of invoices or transactions and onsite audits on all taxpayers?

Yes ☐ 1 No ☐ 2

30. How many audit cases on average an individual (junior auditor) has expected to complete in a month at Addis Ketema sub city?

Less than 4 cases1 ☐ 4 to 7 cases2 ☐

7 to 10 cases 3 ☐ e 10 cases4 ☐

31. How many audit cases on average an individual (senior auditor) has expected to complete in a month at Addis Ketema sub city?

Less than 4 cases1 ☐ 4 to 7 cases2 ☐

7 to 10 cases 3 ☐ e 10 cases4 ☐

32. Does ERCA provide training regarding tax law and tax audit issues before you engage in tax audit activities?

Yes1 ☐ etimes2Neutral 3 N ☐ ☐ ☐

33. Does ERCA perform a continuous assessment to improve the capability or competency of auditors engaged in the tax audit activities?

Yes1 ☐ etimes2Neutral 3 N ☐ ☐ ☐

34. Which type of tests is conducted at ERCA to check the accuracy of tax returns? (multiple answers are possible)

Review of financial statements and returns ☐

Examination of information from third party ☐ 2

Observing, discussing and reviewing documents of taxpayers ☐ 3

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

Physical checks of current transactions, vouchers, assets and other aspects ☐ 5

Other 6, please specify ____

35. When and in what conditions the tests that you have selected in question No. 34 are conducted?

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36. What are the challenges of tax administration related with the tax audit? Besides, what do you suggest for the improvement of Tax administration and tax audit program?

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37. Do you have any ideas, opinions and suggestions that have not been included in the aforementioned questions, regarding tax audit practice?

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Thank you for your cooperation!

Appendix 2 - Tax audit section head in-depth interview instrument

1. What is the primary purpose of conducting an audit?
2. Is there a responsible unit at ERCA for the investigation of serious fraud or evasion? If yes, how those responsible units decide about the need to investigate a certain taxpayer? When and how an investigation on a selected taxpayer is conducted?
3. What type of audit is mostly performedin ERCA A/K/S/C? How and in what condition does those types of tax audit performed?
4. Which category of taxpayers and business sectors are usually selected for tax audit? What would be the reason behind this selection?
5. Does ERCA A/K/S/C gather information regarding the taxpayers' compliance behavior and areas of weaknesses in the tax law through tax audit program performed?
6. Are taxpayers' of ERCA A/K/S/C aware of rules, regulations and other information regarding taxes? If they are not aware, what A/K/S/C plans to do regarding awareness creation and compliance improvement?
7. Does the tax audit program performed by the ERCA makes its power visible to the community and encourages noncompliant taxpayers to comply?
8. Does ERCA consider the amount and collectability of tax returns assessed for conducting an audit work?
9. What are the primary criteria and preconditions to employ individuals as a tax auditor, team leaders and section heads to participate in tax audit activities?
10. What are the required capabilities of auditors, investigators and audit managers in ERCA?
11. Are there any exam, tutor, and training to hire an auditor? If so, when and how the trainings and exams are provided?
12. Are there enough audit staff resources to perform comprehensive crosschecking of invoices or transactions and onsite audits on all taxpayers? How and by what criteria audit cases are assigned to senior and junior auditors?
13. How many audit cases on average an individual field auditor has expected to complete in a month at the ERCA?
14. Is there any continuous assessment on competency and knowledge upgrading processes of tax audit staff? If yes, who performs the assessment? When and how these assessments are conducted?

15. How the rank of junior and senior auditors is categorized? When and how do the junior auditors promote to the position of senior auditors?
16. How many audit cases on average an individual experienced junior and senior tax auditor has completed during the year 2007 E.C at Addis Ketema sub city?
17. How long an individual tax audit employee stays on average in ERCA? Is there a possibility of tax auditors resign themselves from their position in ERCA? What do you think the reason behind this?
18. Do you believe that ERCA has currently collecting the potential amount of tax revenue? If yes, how is it achieved? If not, could you tell me the reason behind, and on what audit cases should ERCA concentrate in its audit work?
19. Do you have any ideas, opinions and suggestions that have not been included in the aforementioned questions?

Thank you for your cooperation!

Appendix 3 – Risk management department in-depth interview instrument

1. How audit cases are selected? What are the bases considered for selecting the audit case?
2. What are the possible techniques used by the ERCA A/K/S/C in selecting taxpayers to be audited?
3. Does ERCA A/K/S/C select taxpayers' for audit using simple random sampling, data mining, statistical techniques, rule base or automated risk-scoring system? In what condition does it use those methods?
4. Does ERCA A/K/S/C Apply standard risk identification criteria for identify highly risky business for audit
5. Would you please mention the criteria and procedures used to identify the highest risk taxpayers?
6. Does taxpayers selected based on their associated compliance risk?
7. Does a taxpayer select for audit in consecutive period repetitively? What is the reason behind for the selection of those taxpayers?
8. Does the Case Selection method consider the availability of resource for tax audit
9. Are taxpayer's high tax potential and series evasion & fraud basis for selection?
10. Do you have any ideas, opinions and suggestions that have not been included in the aforementioned questions

Thank you for your cooperation!