



SCHOOL OF POSTGRADUATE STUDIES

Accounting and Finance Program

Assessment of tax audit practices and its effect

(A case study in Ministry of Revenues

Large taxpayers' Branch Office)

By: Hanna Ali

Addis Ababa University

Addis Ababa, Ethiopia

March, 2023



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Assessment of tax audit practices and its effect

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**A Thesis is submitted to the school of postgraduate studies presented in
partial fulfillment of the requirements for the Degree of Masters of in
Accounting and Finance**

Addis Ababa University

Addis Ababa, Ethiopia

February, 2023

DECLARATION

I, *Hanna Ali*, the under signed, declare that this thesis entitled: “*Assessment of Tax audit practices and its Effect case study in Ministry of Revenues Large Taxpayers’ Branch Office*” is my original work. I have undertaken the research work independently with the guidance and support of the research supervisor. This study has not been submitted for any degree or diploma program in this or any other institutions and that all sources of materials used for the thesis has been duly acknowledged.

Hanna Ali
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Signature

Date

This is to certify that the thesis entitled: **Assessment of Tax Audit Practices and its case study in Ministry of Revenues Large Taxpayers’ Branch Office** submitted in partial fulfillment of the requirements for the degree of Masters of **Accounting and Finance** of the Postgraduate Studies, Addis Ababa University and is a record of original research carried out by **Hanna Ali, ID. No GSD/3068/11**, under my supervision, and no part of the thesis has been submitted for any other degree or diploma. The assistance and help received during the course of this investigation have been duly acknowledged. Therefore, I recommend it to be accepted as fulfilling the thesis requirements.

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Certificate of Approval

This is to certify that the thesis prepared by *Hanna Ali* entitled “Assessment of Tax audit practices and its Effect case study in Ministry of Revenues Large Taxpayers’ Branch Office” and submitted in partial fulfillment of the requirements for the Degree of Masters of Arts in MSc in Accounting and Finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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ACKNOWLEDGEMENTS

First of all, I would like to thank my almighty GOD and WELADITE AMLAK for enabling me to finish this research work. Secondly, I would like to express my deepest gratitude to my advisor Dr. Habtamu Birhanu for his valuable guidance advice during the course of the study. I am also indebted to the respondents for their willingness to provide me with the necessary data. I am greatly indebted to my colleagues at the Ministry of Revenues Large Taxpayers' Branch Office for their support

I am very thankful for your unconditional support and unreserved effort in providing all the required assistance.

Last but not the least; I want to express my deepest gratitude to my husband, Dr. Girma Gezahegn, and my daughter, Hawi Girma, and also my brother, Sisay Haile who encouraged me throughout the course of my study.

Abbreviations and Acronyms

- IT - Information Technology
- GDP - Gross Domestic Product
- LTO - Large Taxpayers' Branch Office
- MOR - Ministry of Revenues
- OECD - Organization for Economic Cooperation and Development
- SIGTAS - Standard Integrated Government Tax Administration System
- TOT - Turn over Tax
- VAT - Value Added Tax

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ABSTRACT

One of the main objectives of the Ethiopian Ministry of Revenues is to generate adequate tax revenues towards finance ever increasing public expenditure on poverty alleviation and development projects; this would be achieved through streamlining of the tax administration. The failure to collect all potential revenue could be linked to poorly administered tax system. Tax audit can play a major role in improving tax administration and overall taxpayer compliance by impacting on taxpayer behavior; hence the purpose of this study was to assess the tax audit practice of large taxpayers' Branch Office of the Ministry of Revenues of Ethiopia regarding Audit Selection methods, Types of Tax Audit, Examination techniques and audit workforce capabilities. The techniques used in the study include survey with tax auditors, senior tax auditors I & II and team leaders, in-depth interviews with the section head of tax audit and department of risk management besides document analysis of the annual report of large taxpayers' Branch office were taken and those collected data were analyzed using descriptive analysis. Finally the study reveal that among the factors that affect the collection of tax revenue of a country, tax audit effectiveness plays a vital role on the side of tax authority of LTO which minimize tax avoidance and evasion besides enhance and maximize revenue generation.

Key words: *tax evasion, tax compliance, effective tax audit*

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the study

Government revenue includes all amounts of money (i.e. taxes and/or fees) received from sources outside the government entity. Collecting taxes and fees is a fundamental way for countries to generate public revenues that make it possible to finance investments in human capital, infrastructure and the provision of services for citizens and businesses. Tax is the charge levied by the government of a country upon its habitants for its support or for the purpose of facilitating the service delivery in a country (Amir, Qayyum, Nasir, Hussain, Khan and Butt, 2011). It is an enforced payment to the government. Though the major aim of revenue collection for most governments is to motivate and guide the economic and social development of the country, there are several determinants for an effective realization of the exercise.

Taxation is meant to meet two major objectives: first to raise revenue that is sufficient for public spending without the government having to borrow heavily in order to finance its activities and secondly to mobilize revenue in equitable manner that is able to minimize its disincentive effects on economic activities (Moyi and Ronge, 2006). For most developing countries, taxation goes hand in-hand with economic growth and taxes are lifeblood for governments to deliver essential services and to make long-term investments in public goods (OECD, 2010; Paepe & Dickinson, 2014). Very low tax to gross domestic product (GDP) ratio is a common characteristic of most of the developing countries (Ter-Minassian, 2012).

It has become increasingly demanding for governments all over the globe to devise appropriate means of generating adequate revenue to finance their expenditure which continue to soar as a result of growth in population with its attendant demand for infrastructure and other social and economic investment. It is for this reason that taxation has become legally accepted all over the world as one of the most suitable means of generating revenue. For most developing countries, taxation goes hand in-hand with economic growth and taxes are lifeblood for governments to deliver essential services and to make long-term investments in public goods (OECD, 2010; Paepe & Dickinson, 2014).

Low tax to GDP has been linked to poorly administered tax system characterized by low tax audits, complicated tax system and thereby discouraging compliance and contributes to difficulties in raising tax revenues in Latin American region (Aggrey, 2011; Ter-Minassian, 2012). The failure to collect all potential revenue, could be linked to Tax Administration system characterized by lack of proper tracking of registered taxpayers, failure to verify majority of declarations and to follow up taxpayers who had not filed their returns or remained inactive since the time of their tax registration; capacity challenges in tax audits endeavors leading to low tax audit coverage and many contested audit results which resulted in reduction in amounts of tax assessed and weak revenue protection system which is highly dependent on informers instead of generating and reviewing exceptional reports from existing systems to provide more preventive revenue protection strategies (Abiola & Asiweh, 2012; Dube, 2014).

Kircher (2008) stated that 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. He further reported that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return. Ola (2001) stated that the process of tax audit involves tax returns that are selected for audit using some selection criteria. Thereafter, the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed. Tax audit is important because it assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance of tax payers and to ensure that the amount due is collected and remitted to government.

Okezie (2003) states that a tax is a burden which every citizens must bear in order to sustain his or her government thus enabling that government perform certain basic functions to the benefit of those its' governance. Thus, it is evident that a good tax structure plays a multiple role in the process of economic development of any nation, of which Ethiopia is not an exception. The government of Ethiopia has several options to finance its public expenditures and pursue its fiscal policy. These options include imposing of taxes on businesses and persons, and non-tax revenues such as service fees, money prints, loans (both domestic and foreign institutions), property and investment income, privatization of public enterprises, and

domestic and foreign grants. Among others, tax along with customs collections is an important source of revenue for every government, and is a heart to a country's wellbeing (Damme et al. 2008).

The responsibility to collect revenue for the Ethiopian federal government rests with Ministry of Revenue (MOR). Currently MOR at federal level has 5 branches in which Large Taxpayer Office is among them which is expected to collect the highest revenue from domestic tax; thus accurately designed and administered taxation system is very important in generating revenue as well as increasing the tax base to the government. 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 for that matter 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 assessed tax audit practice and identifies the main problems of tax audit program performed in LTO and the effect on government revenue.

1.2. Statement of the problem

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). 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 fraud typically 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). As a matter of fact, under inadequate tax administration including insufficient and ineffective audit program the potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner (Edmiston & Bird, 2004).

Further, weak tax administration may make the tax system unfair in that honest taxpayers would bear heavier and disproportional burden. It, in turn, may have impact on the efficiency of tax operation, and also may encourage businesses to work in the illegal economy. Apparently, a properly designed and administered taxation system is very vital in generating revenue as well as increasing the tax base to the government of developed, developing, and transitional economies. As Bird (2008) noted, it is unquestionable to ensure that the revenue collected from tax should be raised in efficient and effective manner although it is difficult without fear or favor in countries that are politically fragile. However, the tax base of developing countries adversely affected by administration problems including poorly conceived tax policies and lack of certainty regarding future policy changes. In addition, tax administrations can also create problems for the tax payers as they impose onerous (difficult) reporting and record keeping requirements, perform excessive inspections and audits, fail to deal with their corrupt employees, and failure to provide transparency in the operations of tax administration (Baurer, 2005).

In Ethiopia, taxation has been used for the purpose of raising government's revenue as much as possible to meet the ever-expanding public expenditure needs of the government. It is also a mechanism for reduction of inequalities in income distribution, promotion of capital investment and trade, encouraging and/or discouraging certain industries depending on how suitable for country's economic development program. However, it is not often the case to collect the potential tax revenue in the country due to lack of awareness of taxpayers as well as weak tax administration. To this view tax audit is one of the most powerful revenue administration tool that enforces taxpayers to pay their tax liability without evasion; 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. 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 (Gebeyehu, 2008)

It is widely believed that the governments of many low-income countries, and especially the relatively poor performers like Ethiopia should be aiming to increase the proportion of GDP they raise in tax revenue. There are risks in emphasizing increasing revenue at the expense of other objectives; Governments also need to be concerned with questions of

equity, efficiency, trust and reciprocity, among others. However, the question of how governments can further increase revenue is a central part of that broader story, it is a big question. Nevertheless this study tries to assess the possibilities of increasing revenue through generally improving tax administration; which is limited to the issues regarding tax audit.

1.3. Research Questions

In line with statement of the problems, the researcher developed three specific research questions.

- How does Tax audit contribute to the tax revenue growth?
- How does Tax audit help to identify the tax evasion and other fraudulent intention?
- How does tax audit lead to the taxpayers' compliance with tax laws?
- What are the main weaknesses and strengths of the tax audit program performed as compared to international standards?

1.4 .Objectives of the Study

❖ General objective

The main objective of the study is assessing the tax audit practice in the Ministry Of Revenue at LTO branch and the effect on the tax revenue growth.

❖ Specific objectives

Specifically, the study attempt to:

1. To assess the tax audit practice in minimizing tax evasion in MOR, LTO.
2. To examine the effect of tax audit in increasing voluntary compliance
3. To analyze the effect of tax audit in increasing governments revenue by strengthening tax administration capacity.
4. To identify the main weakness and strength of the tax audit program performed and provide feedback

1.5. Significance of the Study

Taxes are the main revenue for the government and thus the concerned agency should ensure they are collected the right way. The system must be monitored to avoid evasion and wrong submissions. This study is all about tax audit practices and its effect in

increasing government revenue. Tax audit is enabling the tax administration to control and ensure the taxpayers' compliance with tax laws thus this is increase tax revenue collected from taxpayers. Basically more tax collection results in empowering government provided it has set the right administrative tools. So once the right administrative tools are employed the tax revenue would be dependent on the tax structure. Since government assertive revenue is tax, identifying the gap in the tax administration it helps both the tax authority as well as the government. Taxation not only pays for public goods and services it is also a key ingredient in the social contract between citizens and the economy. Holding governments accountable encourages the effective administration of tax revenues and more widely, good public financial management. Academically this study is contribute to 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 examine the existing tax audit practice and identifying the main weakness and strength of the tax audit program performed in LTO and tries to assess the possibilities of increasing revenue through generally improving tax administration which is limited to the issues regarding tax audit practice. As mentioned before the highest revenue from domestic tax expected to collect by LTO, the study specifically focuses on audit department of LTO, which exclude other branches of MOR as well as other departments of LTO except the risk department. The results of the study may suffer from some limitation, since the question of how governments can further increase revenue is a big question plus the Ministry Of Revenue has different structural units and branches which contribute to government revenue, there is absence of incorporating the audit practice of other branches of MOR. Despite the probable limitation, the researcher is 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 one 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 Scope of the study. The review of related literature and different researches dealing with the assessment of Tax Audit practice and its effect in revenue will be 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 will be presented. Consequently, the results and analysis of the study findings will be discussed in the fourth chapter. Finally, the conclusion and recommendations based on findings will be presented in the fifth chapter.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

2.1. Introduction

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 and government revenue. The review has three parts; the first part presents the theoretical under-pinning related to government revenue generation and concepts of tax audits and its practices. This is followed by the review of empirical studies regarding tax audit practice and its effect on government revenue and related issues. Finally, conclusions on the literature review and identification of the knowledge gap are presented in the last part.

2.2. Theoretical review

2.2.1. Taxation and Economic Growth

As Alqadi M, Ismail S (2019) stated, the impact of government interventions on economic growth through fiscal policy instruments such as government spending, taxation, and public debt remains a significant economic policy issue in the global economy. The tax revenues finance public services and goods, such as infrastructure, education, health care, and so on, which innovators and businesses get the benefits from and rely on. Therefore, tax increases are desirable if they support public goods that raise the revenues of entrepreneurs. Also, this line of thought suggests that higher tax and redistribution lead to increase investment opportunities in an economy. Moreover, Romer CD, Romer DH (2010) argue that taxation (1) sustains and the economic growth and strengthens the global competitiveness, (2) provides stable and predictable fiscal circumstances; consequently, helps to accumulate funds to finance the social and physical infrastructural needs, (3) reduces the long-run dependence on aid, and (4) ensures good governance through strengthening the accountability of governments.

2.2.2. Government Revenue Generation

Revenue is defined as all totals of money received by a government from outside sources, for example those creating from “outside the government” net of refunds and other improving transactions, proceeds from issuance of debt, the sale of investments, agency or private trust transactions and intra-governmental transfers (Ahmed, 2010). The development of any nation depends on the amount of revenue generated and applied by the government on public

infrastructure for the benefits of members of that society. No economy can grow without adequate resources for infrastructural development and provision of power and public utilities and services (McKerchar and Evans, 2009). All governments thus, undertake huge community expenditure on behalf of their inhabitants for the provision of basic facilities and other social services. To meet up with these responsibilities, governments thus want plenty amount of funds and taxes are the most significant and greatest reliable funding much more than any other sources (Kennedy and John, 2014). For example, as a percent to Gross Domestic Product (GDP), statistics indicate that tax contributes 15% for low- income African countries, 22.5% for medium income and over 29% for high-income countries (Okonjo-Iweala, 2013).

Rittenberg and Schwieger (2005) defined revenue as the enhancements or inflows of assets of a firm or payments of its liabilities during a period from delivery or producing goods, rendering service or other activities that constitutes the entity's ongoing major operations. Financial resources of government constitute the bulk of its revenue and this relate to monies generated in the economy (Obiechina, 2010). Olotu (2012) mentioned that today, taxation is already sowing seed of transformation in many developing countries, more and more states across the country are now turning to taxation to shore up their revenue to finance critical infrastructural projects". Tax revenue is defined as the revenues composed from taxes on income and profits, social security contributions, taxes levied on goods and services, payroll taxes, taxes on the possession and handover of property, and other taxes. Money received by the State thanks to taxation. It is the leading income for the state, funding public expenditure and other items, tangibly expressing the common efforts of the public (Mutarindwa & Rutikanga, 2014).

Taxes, and tax systems, are fundamental components of any attempts to build nations, and this is particularly the case in developing or transitional nations; in line with this, taxes build capacity (to provide security, meet basic needs or foster economic development) and they build legitimacy and consent (helping to create consensual, accountable and representative government) (McKerchar and Evans, 2009). As Brautigam (2008) stated that taxes underwrite the capacity of states to carry out their goals; they form one of the central arenas for the conduct of state-society relations, and they shape the balance between accumulation and redistribution that gives states their social character. In addition, Azubike (2009) noted that a tax system is an opportunity for the government to collect additional revenue needed in discharging its present obligations.

2.2.3. Concept of Tax Revenue

Tax systems are primarily aimed at financing public expenditures. Tax systems are also used to promote other objectives, such as equity, and to address social and economic concerns. They need to be set up to minimize taxpayers' compliance costs and government's administrative cost, while also discouraging tax avoidance and evasion. But taxes also affect the decisions of households to save, supply labor and invest in human capital, the decisions of firms to produce, create jobs, invest and innovate, as well as the choice of savings channels and assets by investors. What matters for these decisions is not only the level of taxes but also the way in which different tax instruments are designed and combined to generate revenues. (Åsa Johansson, 2008). Taxation is the raising of revenue for the daily running of government activities. Government activities involve creating funds and using same to provide security, social amenities, infrastructural facilities, etc. for the residents of the country. Based on this, it is worthy of note that the objective of taxation is in favor with the functions of government (Akhori, 2014). A tax is "a compulsory charge imposed by the Government without any expectation of direct return in benefit ". Or "an involuntary fee or more precisely, "unrequited payment", paid by individuals or businesses to a government (central or local)". Hence, "taxation should not be like killing the goose that lays golden eggs".

For most developing countries, taxation goes hand-in-hand with economic growth and taxes are lifeblood for governments to deliver essential services and to make long-term investments in public goods (OECD, 2010; Paepe & Dickinson, 2014). Some of the countries in Latin America region that are on a fiscally sustainable path, revenues appear inadequate to fund a socially sustainable level of provision of public services (Ter-Minassian, 2012). The United Nations considers that achieving the Millennium Development Goals (MDGs) requires developing countries to raise at least 20% of their gross domestic product (GDP) in taxes. Several Asian and Latin American countries and some of sub-Saharan African countries still mobilize less than 17% of their GDP in tax revenues hence making it difficult to finance public projects (Paepe & Dickinson, 2014). Very low tax to gross domestic product (GDP) ratio is a common characteristic of most of the developing countries (Ter-Minassian, 2012). For example, over the past few years, lower than projected tax revenue has forced the government of Tanzania to cut its ambitious plans which reduced its capacity to finance public projects. Similarly, Despite the fast economic growth of Uganda, its tax to GDP ratio is still low (11% in 1997 to 13% now) (Mwenda M., 2015); and even Kenya the leading

country in East-Africa, the tax to GDP ratio is still lower than the East African region ratio target of about 25% (African Economic Outlook, 2015).

As Damme et al. (2008), stated developing countries are in struggle to collect taxes efficiently, because of many serious challenges they face as to tax design and administration. According to Ittner et al (2003) study, effective internal control for revenue generation and preservation involves; applicable laws and regulations, regular a review of the reliability and reliability of financial and operating information, a review of the controls employed to safeguard assets, assessment of workers' compliance with management policies, an evaluation of the efficiency and effectiveness with which management achieves its organizational objectives. Internal control has a much wider purpose such that the organization level of control problems associated with lower revenues, which explore relations between disclosure of material weakness and fake, earnings management or restatements (Doyle et al., 2005).

Many countries Specially Developing countries across the world typically suffer from insufficient supply of internal resources. Despite much effort, many countries fail to raise sufficient revenues to finance the government budgets and to support the development needs of the country. This incapability is a major hindrance for the government's regular operations and for the capacity to accelerate economic growth initiatives (Haque, 2012). Low tax to GDP has been linked to poorly administered tax system characterized by low tax audits, complicated tax system and thereby discouraging compliance and contributes to difficulties in raising tax revenues in Latin American region (Aggrey, 2011; Ter-Minassian, 2012). Those working in informal sector do not find the need of paying tax whereas it is the largest and growing component in economy and this leads to the revenue loss (Abiola & Asiweh, 2012; Dube, 2014).

According to the report by Rwanda Auditor general's (2015), the failure to collect all potential revenue, could be linked to Tax Administration system characterized by lack of proper tracking of registered taxpayers for domestic taxes and gaps in existing databases of taxpayers; failure to register some taxpayers, failure to verify majority of declarations and to follow up taxpayers who had not filed their returns or remained inactive since the time of their tax registration; capacity challenges in tax audits leading to low tax audit coverage and many contested audit results which resulted in reduction in amounts of tax assessed and weak revenue protection system which is highly dependent on informers instead of generating and

reviewing exceptional reports from existing systems to provide more preventive revenue protection strategies.

According to Ogbonna (2011), the tax system is a prospect for the administration to raise additional revenue separately from other sources of income, required to transfer out its responsibilities. Thus, in order to meet their mission in general and revenue collection in specific, every organization in the nation should sort their internal governor including tax audit more vigorous that assume incessant changes that this world is fronting today.

2.2.4. Tax Gap and Compliance

❖ Tax gap

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). The tax gap 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).

❖ Tax compliance

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). 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.

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).

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. Brown and Mazur (2005) noted tax compliance as a multi-faceted measure and theoretically, it can be defined by considering three distinct types of compliance such as payment compliance (timely payment of all obligations), filing compliance (the timely filing of any required return), and reporting compliance (the accurate reporting of income and of tax liability).

The Organization for Economic Cooperation and Development (2001) divided compliance into administrative compliance and technical compliance. Administrative compliance refers to complying with administrative rules of lodging and paying. This compliance can also be called reporting compliance or regulatory compliance. The technical compliance refers to complying with technical requirements of tax laws.

According to Sarker (2003), Tax compliance can be achieved through the application of public relations, tax education, tax consultation & guidance and examination.

Tax Public Relation: The purpose of public relations is to build a tax conscious environment not only among taxpayers but also among the public including latent taxpayers, and can be categorized as the need to enhance tax compliance; diffuse and enhance public knowledge of taxation; improve mutual understanding and trust between taxpayers and tax authorities and obtain the understanding and cooperation from mass-media for tax administration Tax education is one of the strategies used by the relevant tax authorities to ensure tax compliance. According to Ola (2001), the Board is cognizant of the fact that taxpayers cannot comply with the laws unless they know and understand what is expected of them. To this end, the Board provides assistance and publications to help taxpayers to fill their returns.

Tax Counseling: The objective of tax counseling is to assist taxpayers in matters related to tax and encourage the voluntary submission of accurate tax returns and payment of taxes. Generally, tax counseling offices provide advice on the interpretation and application of tax laws, procedures for filing returns and applications, etc. (Sarker, 2003).

Tax Guidance and Examination: In order to enhance taxpayer compliance so that they voluntarily file tax returns and pay taxes appropriately, the tax administration provides individuals and groups with guidance on how to improve bookkeeping standards and tax returns. Besides the tax administration will examine whether a taxpayer has correctly assessed and reported their tax liability and fulfilled their obligations.

Tax Recognition and Prizes: This is also a very important strategy that can be used to achieve tax compliance. Tax officials and taxpayers should be recognized and rewarded to ensure that they work very hard as tax officials and comply to with tax laws as taxpayers.

2.2.5. Overview of tax audit

Tax audit is a review of a taxpayer's business registers and financial concerns to guarantee that the amount of tax described and paid are in harmony with tax laws and regulations. This is an additional audit to the statutory audit and is supported out by tax officials from a relevant tax authority (Bitrus, 2014, Okonkwo 2014, Oyedokun 2014). According to Jennings, A.R. & Thomson a Kircher (2008), Tax audit is the checkup of an individual or organization's tax report by the significant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. Tax audit exercise as concluded by

Okonkwo (2014) is a very important compliance tool in most tax jurisdictions all over the world. It has subsidized immensely in building awareness amongst stakeholders, strengthening of the self- assessment tax system, bringing of more taxpayers into the tax net, increased generation of tax revenue and checking of numerous abuses in the tax system.

Kircher (2008) stated that 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. He further reported that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return. Tax audit have different objective. Among others, it manages and imposes the tax programs in an impartial manner, determines correct reporting of the taxpayers audited, stimulates correctness in self-assessments of taxes by educating taxpayers in the application of tax statutes and regulations of taxpayers through "visibility" of audit presence (Audit & Compliance Division of the New Mexico Taxation and Revenue Department, 2009).

The process of tax audit involves tax returns that are selected for audit using some selection criteria. Thereafter, the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed. Tax audit is important because it assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government. In more formal usage, revenue is a calculation or estimation of periodic income based on a particular standard accounting practice or the rules established by a government or government agency (Ola, 2001).

Tax audit affects revenue collection in that it promotes voluntary compliance of taxpayers which increases revenue. It also determines the accuracy of returns so as to ensure the right taxes are submitted. With tax audit tax liability can be easily declared and matters that need adjustment are identified. It also helps in collecting tax interests and penalties which thereby increase revenue collection. Tax audit also helps to implement changes to eradicate evasion. Thus, tax audit is positively related to Revenue collection (Kagarama, 2013).

2.2.6. Purpose and scope of tax audit

Purpose of tax audits

The OECD (2006) attributes six grounds to taxpayer audits. These are:

- Promotion of voluntary compliance
- Detection of non-compliance at the taxpayer level
- Gathering information on the “health” of the tax system (including patterns of taxpayer’s compliance behavior)
- Gathering intelligence information
- Educating the taxpayer
- Identifying areas of the law that require clarification or amendment

i. Promotion of voluntary compliance

Promotion of voluntary compliance by the taxpayers with the tax laws is envisaged as the primary role of the audit program. This is achieved by:

- Reminding the taxpayers of the risks associated with non-compliance that serious abuses of the tax law will be detected and appropriately penalized.
- Taxpayer education provided by the auditors during the audit creates awareness among the taxpayers of their obligations.

ii. Detection of non- compliance at the taxpayer level

This is achieved by concentrating on major areas of risk relevant to taxpayers likely to be evading their responsibilities. This may bring to light significant understatements of tax liabilities and additional tax revenue collections.

iii. Gathering information on the “health” of the tax system (including patterns of taxpayers’ compliance behavior)

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

iv. Gathering intelligence information

Audits may bring to light information on evasion and avoidance schemes involving large number of taxpayers that can be used to mount major counter abuse projects.

v. Educating the taxpayers

The tax audit process is expected to play its role to continuously engage in awareness creation programs that target on creating compliant taxpayers during the course of the audit. In addition, tax audit is very essential to minimizing the degree of tax avoidance and evasion, and thereby to increase voluntary compliance through providing input for taxpayer education programs of the Ministry.

vi. Identifying areas of the law that require clarification/ amendment

Audits may bring to light areas of the tax law that are grey and problematic to taxpayers and thus require further efforts by the revenue body to clarify the law requirements and to better educate taxpayers on what they must do to comply into the future.

Scope of tax audit

The scope of tax audit is determined by:

- i. Risk level of the individual taxpayer
- ii. Legal framework

i. Risk level of the taxpayer

Where the risk parameters indicate that the taxpayer is risky across the different tax types (Corporate, VAT and Excise duty), it is expected that the scope will be **(Comprehensive audit)**. However, it is apparent that comprehensive audits are costly since they require a lot of investment in person audit hours and may require extensive tax and specific industry knowledge that the tax authorities may not possess. Where the risk parameters point to an isolated aspect of the taxpayer's tax account, then it would be naturally expected that the tax audit focuses on that **(single issue audit)**. These audits are usually information based, take relatively little time to complete compared to comprehensive audits.

ii. Legal framework

The Federal Tax Administration Proclamation (article 28(2) and article 26(1) read together) determine the scope or period of audit as follows:

In case of fraud, or gross or willful neglect by, or on behalf of the taxpayer and where the taxpayer fails to file a tax declaration at any time. This implies that audit coverage is not limited in terms of scope (period). For instance, a taxpayer who is found to have committed fraud 10(ten) years back, will have their declarations audited for the same period (10 years). In any other case, within 5 (five) years of the date that the self-assessment taxpayer filed the self-assessment declaration to which the self-assessment relates or within 5 (five) years from the date on which the Ministry served the notice of the assessment on the taxpayer in the circumstances where the auditor failed to submit their declaration. This implies that for the category of taxpayers who are not found to be fraudulent, negligent or failed to make their declaration, the audit scope is restricted to a five-year period. Audit activity and assessments that span over 5 years for this category of taxpayers are a nullity and cannot be enforced in law. It is important audits especially at the national planning level (national audit plan) adhere to the statutory time lines to avoid incidences where audit activity may be time barred.

2.2.7. Nature of tax audit

Tax audit like any other audit is a compliance check. The difference is that it seeks to confirm whether the taxpayer has complied with tax legislation and the obligations provided thereof. Accordingly, audit procedures must be planned in a manner that seeks to assess the level of taxpayer compliance with the tax laws. Tax law sits on an accounting framework which is what taxpayers use to provide the financial position of their enterprises. Accordingly, tax audit envisages an in-depth understanding of the taxpayer's accounting system in order to determine whether the tax account fully complies with the provisions of tax law since any adjustments during audit will be made on the basis of the taxpayer's declaration MOR (2019).

2.2.8. Types of Tax Audit

According to MOR (2019) types of tax audits are defined by three major factors; the audit scope and intensity, the period(s) under examination and the location of the audit activity. The major types of audit are described below:

Comprehensive Audit: A comprehensive audit is all-encompassing in scope and entails an in-depth examination of all information relevant to the calculation of a taxpayer's tax liability for all tax types for a given period. Given the broad scope, comprehensive audit is typically costly to undertake in terms of time and resources, and thus reduces the rate coverage of taxpayers that could otherwise be audited. Comprehensive audit is classified into Very Complex, Complex and simple. This classification will depend on a number of factors ranging from size, group, trade or

profession, volume of records or transactions, nature of business to location. In practice, the scope and nature of any comprehensive audit activity to be undertaken will depend on the available evidence pointing to the likely risks of non-compliance and a taxpayer's history. An audit may also be classified and justified as complex or very complex because of the taxpayer's financial and/or business activities which are unusually complex. In order for an audit to be classified as Comprehensive, the following factors must be considered, The audit must be detailed and involve an in-depth inquiry into all aspects of compliance; The audit must cover all tax types to which the taxpayer is liable; The audit must cover a period of at least one accounting year; The audit process involving all procedures outlined under Pre-engagement activities, Planning and Evaluation activities, Execution or Performance of the audit activities, and Audit conclusion activities; The relevant documentation in respect of the audit assignment i.e. from initiation to conclusion must be kept in an Audit Box File.

Desk Audit: A Desk audit is used as a preliminary examination of declarations analyzing accuracy, completeness, ratios and crosschecking information to determine if further audit or investigation is warranted. By implication, returns which are stated on certain level of risk. According to Adediran, Alade and Oshode, 2010, and audit takes place within the confines of the office of the tax officials. In this situation the tax official may simply request the taxpayers to provide some additional documents to his office to enable him clear some issues in the returns submitted. In this type of audit, no official notice is given to the taxpayer of the impending desk audit exercise. He only gets to know when letters are written to him requesting for certain documents or explanations. The essence is to ensure some level of compliance with tax laws, rules and regulations as well as performing the administrative checks on returns submitted. Basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination.

Issue Audit: This is a limited scope audit that may be confined to specific issues in a tax return and/or a particular tax type. The objective here is to examine key potential risk areas of non-compliance. This type of audit is recommended because it consumes relatively fewer resources than comprehensive audits and allows for an increased coverage of the taxpayer population. The audit will normally focus on a single tax type, period or item. Where an issue audit is escalated into a comprehensive audit, the team coordinator's concurrence must be sought and the procedures prescribed for comprehensive audits adhered to.

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

Field Issue Audit: This is the escalation of a desk issue audit into a field activity or exercise. It is important to remember that the audit is limited to key issues of compliance or to a tax type or period. Field issue audit is commonly used in examining whether a taxpayer has met his/her obligations in respect of PAYE, VAT/TOT and Excise tax, Withholding Tax or Income Tax normally for a specified tax period. Care should always be taken to guard against being derails and thus progressing field issue audits into comprehensive audits. The objective of the field issue audit is to focus on a shorter period for a single tax item for a faster and effective outcome. This audit type should therefore be the commonest and most effective audit type to be utilized for faster results. A Field Issue audit will ordinarily emanate from a desk review of returns and disclosures made by the taxpayer in financial statements, together with any privileged third party information; will normally target an issue in a particular tax head and cover a specified period, depending on the tax head under review; A specific issue(s) must be identified and the field activity must be sanctioned by the Team coordinator; must involve a review of the taxpayer's primary records relating to the identified subject matter at the taxpayer's premises or in the tax office, as the case may be; Documentation in respect of the specific review must be kept in a separate file folder; The Standard Audit Working Papers must be used to report the specific review activity. Additional reporting on the field assignment may be provided where the case warrants.

Special Audit Projects: Audits can be organized as a separate project for a targeted or specific group of taxpayers in a given period to verify compliance in the sector. These audit projects may cover an industry, trade, profession or a line of businesses. They will consist of specific checks and are used to address a particular risk or to establish the degree of non-compliance in a particular sector, industry or trade. For this audit type to be effective, all taxpayers in the targeted sector must be considered and handled within the shortest time possible.

Advisory Visit Audits: All registered taxpayers or businesses need to be visited with the aim of offering advice on tax obligations and the taxpayer's rights, and any other developments pertinent to the tax system and administration. It is highly recommended that auditors carry out

these audits to keep abreast with compliance trends of their taxpayers and offer timely advice so as to improve compliance. These audits are expected to be spontaneous and hence should not take more than a day. According to IMF, 2010 advisory audit visit to newly established businesses advising obligations in terms of tax types, filing of returns, payment of amounts due, records to be maintained. It is very appropriate when introducing new laws.

Refund Audits: This is the verification of a taxpayer's claim for a tax refund prior to processing the refund. The predominant claim for refund is VAT and/or WHT which is submitted monthly. The details are specified in the Refund Guidelines.

Investigation Audit: Involve the most serious cases of non-compliance with Criminal implications. Require special skills in investigation and evidentiary requirements as they often involve seizure of records, taking testimonies from witnesses and preparing briefs for courts. Require special skills in investigation and evidentiary requirements.

De-Registration Audits: In order to establish outstanding obligations or liabilities, a de-registration audit will be conducted for all reported cases of cessation of business, winding up or uncertainty. The audit will focus on determining taxes due and any other pertinent issues. The objective of de-registration audit is to ensure orderly exit from the tax register with the attendant obligations and liabilities sorted out.

Field Audit: by the nature and scope of their work, regular assessing officers can only carry out limited desk audit through examination of accounts and returns. It is in a bid to check this handicap as well as to improve on tax compliance that tax authorities carry out field audit exercise on taxpayers by physically conducting the exercise in the office of the taxpayer. The taxpayers are however formally notified of the arrival of the auditor prior to the commencement of the audit and the requirements of the auditors in terms of documents to be audited will also be requested for in advance. Field audit involves physical verification of documentary evidence and materials at the premises of a taxpayer so as to confirm the facts and figures of the tax returns filed by corporate taxpayers (Adediran, Alade and Oshode 2010).

2.2.9. 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 (Verboon and Dijke 2007).

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. Therefore, planning an adequate audit strategy is a key success factor in post-fraud detection (where audits are intended to detect tax evasion and fraudulent claims) as well as proactively preventing tax frauds and evasions (Gupta and Nagadevara n.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.

2.2.10. 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).

The standards for selecting cases for tax audit include persistent losses, zero tax returns, refund cases, no submission of returns, low tax yield, suspicion of tax avoidance, fraud or evasion, transfer mispricing, thin capitalization and most often when the taxpayers request for tax clearance certificate among others (Bitrus, 2014, Okonkwo 2014, Oyedokun 2014). Accordingly, the first key to successful audit is the case selection methodology. It is critical to select audit candidates consistent with program objectives. Whatever the audit objectives have, the ability to narrow the pasture of potential audit candidates is necessary to achieve program objectives and optimal use of audit resources. Regardless of how automated and efficient the audit process, audit effectiveness would not be realized under the selection of inappropriate audit candidates (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 nonproductive 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. 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).

2.2.11. Sector based auditing

Tax audit just like financial audit involves the collecting of material and treating it for determining the level of compliance of an organization with tax laws of the territory. For an effective audit, it is necessary that the auditor categorizes his work in such a way that the assignment is accomplished completely and efficiently (Adediran, Alade & Oshode, 2013).

As stated by MOR (2019), Sector based auditing directs tax audit activity to specialized sectors; this inevitably requires auditors to develop capacity and skill to direct audit activity with precision. Sound knowledge of the sector dynamics in which the taxpayer operates and the legal framework (Accounting/IFRS and Tax law) that regulates financial and tax compliance of the specific sector are a basic requirement for an auditor undertaking review of a specialized nature (sector based auditing). This considers tax audit of seven (7) specialized sectors - Construction, Manufacturing, Finance (banking), Insurance, Import/export, Mining and Agriculture.

Construction sector

This sector incorporates establishments primarily engaged in the construction buildings, roads and other public infrastructure. Construction activities may include new projects, additions, alterations, reconstruction, installation, maintenance and repairs. Also included are demolition activities, clearing of sites and sale of materials from demolished structures, blasting, drilling, land fill or leveling, earth moving, excavation, draining and other land

preparation. Activities of these establishments are generally managed at a fixed place of business, but construction activities are normally performed at multiple project sites with responsibilities specified in contracts with the owners of the construction projects for prime contracts with other construction establishments for sub-contracts.

Manufacturing sector

The manufacturing sector features the following;

- The manufacturing sector includes businesses engaged in the mechanical, physical, or chemical transformation of materials, substances, or components into new products and are usually described as plants, factories or mills. They characteristically use power driven material handling equipment.
- Materials, substances or components transformed by manufacturing establishments are raw materials that are products of agriculture, forestry, mining, or quarrying, as well as products of other manufacturing establishments.
- Materials used in the manufacturing may be purchased directly from producers, obtained through normal trade/market channels or secured by transferring the product from one establishment or another under the same ownership.
- The products of a manufacturing entity may be finished in the sense that it is ready for utilization or consumption, or it may be semi-finished so as to become an input for another establishment engaged in further manufacturing.
- As a general rule, establishments in the manufacturing sector are engaged in the transformation of materials into new products. Their output is a new product.

Finance

This sector comprises establishments of firms which primarily engage in financial transactions involving the creation, liquidation or change in ownership of financial assets; and / or in facilitating or monitoring financial transactions.

Import and Export

This sector involves the importation of finished commercial goods for resale on the local market in Ethiopia and the export of finished; semi processed or unprocessed raw items.

Insurance services

This involves pooling of risk by underwriting insurance and annuities. These firms collect fees, insurance premiums or annuity considerations; build up reserves; invest those reserves; and make contractual payments.

Agriculture

This sector involves the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets. The two elements that form part of, or result from, agricultural activity can be defined. Biological assets: living animals and plants with an innate capacity of biological transformation which are dependent upon a combination of natural resources (sunlight, water, etc.) and Agricultural produce: harvested produce of the entity's biological assets, at the point of harvest.

Mining and mineral

Generally mining can be defined as the extraction of valuable minerals or other geological materials from the earth, usually from an ore body, vein or (coal) seam. Materials recovered by mining include base metals, precious metals, iron, uranium, coal, diamonds, limestone, oil shale, rock salt and potash. Any material that cannot be grown through agricultural processes, or created artificially in a laboratory or factory, is usually mined. Mining in a wider sense comprises extraction of any non-renewable resource (e.g., petroleum, natural gas, or even water).

Mining operations are easily recognizable. By nature of what mining means –digging, removing soil and overburden, and separating out ores and non-metal minerals –these operations leave behind environmental “footprints”. Such ”footprints” can have a number of different effects –at worst seriously limiting the ability of surrounding communities to earn and sustain their livelihood, particularly in areas where communities rely on their natural environment to provide food, shelter, transport, and other opportunities.

By its inherent nature, mining impacts on land, water and air which are the essential components of the environment. Among the Environmental issues associated with mining can includes erosion, formation of sinkholes, loss of biodiversity, and contamination of ground water and surface water by chemicals from the mining process, contamination of the areas surrounding the mines due to the various chemicals used in the mining process as well

as damaging compounds and metal removed from the ground with ores, water produced from mine drainage, mine cooling, aqueous extraction and other mining process increase the potential for these chemicals to contaminate the ground and surface water

2.2.12. Examination techniques

A revenue audit is a checkup of the information and figures revealed by a taxpayer in their tax returns in contradiction of those shown in their business records. Therefore, the auditor needs to see all books and records in relation to the tax for the period being audited and these should be available on the first day of the audit Olotu (2012). A tax auditor applies various techniques to examine the books and records behind a return. The techniques to be used depend on the taxpayer and the tax regime concerned. As Biber (2010) noted, an effective case plan can be cognizant of a range of investigative and analytical approaches that may vary depending upon the area of risk and the circumstances of the particular taxpayer. The decision regarding the type of tests to be undertaken as well as the records needed by the auditor to address specific issues is influenced by the nature of the taxpayer's operations, adequacy of books and records, and materiality of potential adjustments. According to OECD (2006a), the techniques used for audit examination purposes include analytical review, investigative approach, field examination, record examination, and counterpart examination.

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

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

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

through physical checks of original transaction records and vouchers, assets and liabilities and other aspects of the business.

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

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

2.2.13. 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.

2.3. Empirical studies

(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.

Bortey (2011) in a study found that Tax Audit is a key component in any attempt to enhance revenue generation and has a major part to play in tax administration, it has become even more important under the current dispensation of tax administration which is gearing more towards self- assessment by tax payers rather than administrative or provisional assessment of taxpayers by tax officers. The self-assessment regime requires for a very efficient and effective tax audit to maximize tax collection and eliminate tax avoidance and evasion. It is recommended that the tax audit unit be expanded to cover the whole nation and tax auditors be aided to be abreast with the tax law and their skills be enhanced through training, refresher courses and attachment to well established tax audits units of revenue collecting agencies of friendly nations.

Mirera (2014) investigates that Tax audit actually has an effect to revenue collection as according to the t – tests there is significance in the correlation between tax collected before the audit and after the audit. This clearly indicates that tax audit increases revenue collection. That in essence means that the more the tax audit conducted the more revenue is collected. Thus it is right to say that tax audit is directly related to revenue collection. All the tax audits are important because they add something to revenue and thus should be encouraged as it assists the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

The 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.

Ayalew (2014) found that perceived adequacy or inadequacy of both organizational independence and audit quality extends noticeable influence on perception of tax audit effectiveness. The influence of organizational independence on tax audit effectiveness may be attributed to the audit quality. Tax audit effectiveness and their perception come from the independence; tax auditors' positive attitude towards various components and their professional proficiency. The research examines the taxpayers' cooperation with the tax systems and auditors during auditing. Findings of the research indicated that majority of the respondents replied that, most taxpayers may not cooperate to the tax system and the tax auditors without knowledge of sufficient tax laws and regulations, according to this perception, auditors penalize taxpayers instead of educating them, low level encourage honest taxpayers, and also deliberately some taxpayers do not support the tax auditors during the audit. It can be concluded that most taxpayers are noncompliance as result they impeded the tax audit effectiveness.

Mihret (2011) investigated that the problems in tax audit practice in Ethiopia (the case of the federal government). The study was conducted to investigate the tax audit practice, and to identify the main problems of the tax audit program performed that affects tax revenue collection and taxpayers' voluntary compliance in the Ethiopian tax system. The study adopted both quantitative and qualitative approaches. Specifically, the techniques used in the study include survey with tax auditors and investigators, in-depth interviews with tax officials and taxpayers, and documentary analysis. 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 utilizes its enforcement powers in addressing tax revenue in arrears and evasion challenges, and makes its power visible to the community to encourage noncompliant taxpayers to comply. However, tax audit practice in ERCA is a toddler tool in improving voluntary compliance through helping taxpayers to understand their tax and customs obligations that could generate the right tax revenue at the right time. Currently, segmentation approach is adopted and would provide one spot customer service that might result customer satisfaction, and minimizes both taxpayer compliance costs and tax administrative costs. However, tax audit program is mainly directed to specific segments and sectors those have large tax potential with less emphasis to medium and small category of taxpayers" community. In addition, the audit coverage is unsatisfactory that might be due to inappropriate audit type adopted and resource constraint.

Summary and Knowledge Gap

Tax audit is important because it assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by taxpayers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

From the empirical literature studied 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. Moreover, the tax audit function minimize both deliberate and innocence tax evasion made by many tax payers with appropriate expertise and the necessary resources in the tax administration function. Furthermore, it can be noted that tax audit has significant effects on revenue generation in Government Revenue; in which tax audit ensures arithmetic accuracy

of all figures in account and computation in taxpayer's records, compliance with tax laws, rules and regulations by the taxpayers. An increase in tax audit increases revenue generation and reduce tax fraud in the tax system which leads to voluntary compliance. Tax audit that carried out on a routine basis ensure actual revenue collected and prevents tax evasion by the tax evaders and avoiders by enhancing effectiveness of tax audit.

Therefore, this study also aims to assess tax audit practices that will increase government revenue in case of Ministry Of revenue Large Tax Payers Branch Office. The research intended to fill the gap identified in some researchers done by some few scholars so far literatures (Iwarere and Henry, 2015) The effects of tax audit on revenue generation in Federal Inland Revenue Service, Abuja experience, (Bortey, 2011) Improving Revenue Collection through Tax Audit Practice: The Case of Ghana Revenue Authority, (Mirera, 2014) The Effects of Tax Audit on Revenue Collection: Case of Kenya Revenue Authority, Gebeyehu (2008) the significance and role of tax audit in increasing tax revenue and in strengthening tax administration capacity, (Mihret, 2011) Tax Audit Practice in Ethiopia: The Case of The Federal Government and (Ayalew, 2014) Factors Affecting Tax Audit Effectiveness a Study on Category 'A' Taxpayers in Bahir Dar City Administration Revenue Office.

2.4. Conceptual framework

The major objective of this study is to assess the tax audit practice and its effect in increasing government revenue. A very efficient and effective tax audit is a major part to play in tax administration; among the factors that affect the collection of tax revenue of a country, tax audit effectiveness plays a vital role on the side of tax authority of LTO which minimize tax avoidance and evasion besides enhance and maximize revenue generation. Thus this study tries to explain the relationship between the independent variables of the tax audit practices (Audit Selection methods, Types of tax audit, Examination techniques and audit workforce capabilities) of the Ethiopian ministry of revenues of large taxpayers' branch office and the dependent variables of government revenue.

CHAPTER THREE

3. RESEARCH DESIGN & METHODOLOGY

This chapter outlines and explains the methodology employed to achieve the research objective; which embraces the research methodology adopted, research approaches, actual data collection tools, data presentation & analysis techniques used in the study.

3.1. Research Design

A research design is a plan for collecting and utilizing data so that desired information can be obtained as defined by Paul et al (2009). For this study, the researcher was applied descriptive analysis using the fact that explanatory research design 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. In this study descriptive survey method focus on assessing the status, practice and problem related to tax audit of LTO branch at federal level and its effect in increasing government revenue.

3.2. Research Approach

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, these approaches are different in terms of their philosophical assumptions as well as techniques used in data collection, analysis and interpretation, and be discussed in the subsequent paragraphs. 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

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 (Creswell, 2007).

Quantitative research approach

Quantitative research approach generates statistical data through the use of large scale survey research, using methods such as close-ended questionnaires and/or structured interviews. This approach is based upon an empirical cycle that has a deductive nature Jonker and Pennink (2010).

Mixed research approach

Mixed research 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). Therefore this study used mixed research approach for the aforementioned reason; by distributing questioners for tax auditors and by conducting interview with the tax audit section head and risk department management.

3.3. Research methods used

Research methods are the techniques used to collect data. In this study, the researcher adopt mixed methods approach, as discussed in the previous section, which will 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 put on quantitative (survey) and qualitative (in-depth interview & document analysis), and are discussed in the following sub-sections; to examine tax audit operations in the Ministry of Revenue (LTO).

3.3.1. 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 method of quantitative approach is appropriate and will be 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). This study used questionnaire, which is a widely used and useful instrument for collecting survey information. The researcher can select several types of questionnaire, from highly structured (closed ended) to unstructured (open ended). 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). Hence in this result the researcher apply semi-structured questionnaire.

❖ **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.

3.3.2. Qualitative aspect:

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 collected through in-depth interview and document analysis. In-depth 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). 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 (Patton, 2003).

3.4. Population and sampling

According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. MOR is responsible for the administration of tax programs, as well as the delivery of economic and social benefits; LTO is one of MOR branches at the federal level that stand to achieve the revenue authority vision and mission. LTO has a total number of 320 employees in which 82 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 risk department manager of LTO. The study take all the population of the study without using sampling technique; as a result questioner distributed for all tax auditors and team leaders as well interview conduct with managers.

3.5. Document analysis

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). In addition to the data obtained through other methods, the study employ a descriptive analysis of documents such as tax audit manuals, periodical tax audit reports and annual report of MOR large taxpayer office.

Overall, in order to achieve the research questions stated in the previous section, the researcher used both qualitative and quantitative approach (mixed approach) in collecting and analyzing data. Besides in-depth interview, questioner and document review conducted as method of data collection method; and those collected data analyzed using descriptive analysis.

CHAPTER FOUR

4. FINDINGS AND DISCUSSION

The purpose of this study is to assess tax audit practices and the effect of tax audit on revenue collection of Ethiopian government within the scope of large tax payers of MOR. This chapter presents the result of survey, in-depth interview, documentary analysis and discussion of results. The analysis addresses the tax audit practice in LTO with respect to different audit activities and its effect on government revenue. The survey was conducted with 71 tax auditors and 11 team leaders so that 82 questionnaires were distributed. However, the survey response was collected from only 71 survey respondents. Hence, the response rate was 86.5 percent, and it is rationally fine. Since this will assure the survey result can be generalized to the population and reduces the likelihood of response bias further, the interview was conducted with the tax audit section head and risk management department.

4.1. The Demographic Profile of Respondents

Table.4.1. Demographic Profile of Respondents

Variables	N = 71	Count	Percent
Gender	Male	43	61%
	Female	28	39%
Age	Less than 25 year	-	-
	25 – 35 years	59	83%
	36 – 45 years	12	17%
	46 – 55 years	-	-
	Above 55 years	-	-
Highest level of education achieved	Certificate	-	-
	Diploma	-	-
	BSc/BA	52	73%
	MSc/MA and above	19	27%
Field of study	Accounting and Finance	47	66%
	Management	12	17%
	Economics	2	3%
	Business administration	10	14%
	Other	-	-

Out of the total respondents, 61 per cent were male and 39 per cent were female, among them 59 per cent were under the age range of 25 to 35 years, 17 per cent were between 36 to 45 years. Regarding educational level, the majority of the respondents have a good level of educational qualification that is 73 percent of respondents were BA degree holder, and 27 per cent of the respondents attended MSc/MA, this figure shows that the tax auditors' and team leaders' educational qualification is seem to be adequate to perform audit tasks. As audit standards majority of auditors should have a university and college graduated, therefore it can be concluded that educational qualification is important to understand the tax laws and regulation and other international auditing standards, as a result of this LTO will achieve its audit objective; not only this but also auditors should have more professionalism to do best audit practices, activities and responsibilities in order to enhance audit efficiency, gain audit effectiveness, receive audit performance, and audit success. 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 66 per cent and the remaining 17 per cent management, 3 percent Economics and 3 percent studied business administration. According to OECD, 2006 the international audit standard requires an auditor to have the knowledge of accounting, investigation and management, it can be concluded that the auditors have the required knowledge; this enables the study that respondents are appropriate in providing answers to the research questions.

4.2 Purpose and benefit of tax audit

Table: - 4.2. Purpose & benefits of tax audit performed in LTO

What is the purpose of tax audit performed at LTO	frequency	percentage
Promoting voluntary compliance	65	92%
To check tax evasion and Detect non-compliance	67	94%
For assessment and collection of additional tax revenue	58	82%
Educating the taxpayer	44	62%
What is the benefit of tax audit	frequency	percentage
It ensures arithmetic accuracy of all figures of tax payers' records	58	82%
Solves the problems of tax evasion avoidance and other irregularities	94	94%
Identify areas of the law that require clarification or amendment	44	62%
Can gather information regarding taxpayers' compliance behavior	32	45%

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). According to the survey result (table 4.2) 94 per cent of respondents believe that the primary purpose of tax audit is to check tax evasion and detect non-compliance, promoting voluntary compliance (92 percent of the respondents) and 82 and 62 percent of respondents agreed that tax audit performed in LTO is for assessment & collection of additional tax revenue and also educating the taxpayer respectively. Besides the issue regarding benefits of tax audit 82 percent of respondents believe that benefit of tax audit is to ensures arithmetic accuracy of all figures of tax payers' records, to solve the problems of tax evasion avoidance and other irregularities (94 percent of respondents response); 62 and 45 percent of the respondent agreed that Identifying areas of the law that require clarification or amendment and gathering information regarding taxpayers' compliance behavior can be adopted through tax audit. The tax audit function plays a critical role in the administration of tax laws in all countries. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the 'public face' of a revenue body (Eugene, 2011). The in-depth interview with tax audit section head, also showed that LTO conduct a tax audit as a financial tool for collecting a state tax revenue by assessing the level of tax compliance accordance with tax laws; thus the main purpose of tax audit is to reduce tax evasion, to ensure the accuracy and completeness of the tax returns, to establish effective tax administration moreover to offer the government with appropriate tax revenues to finance its budget and sustain economic growth as well as financial sustainability. Furthermore to encounter those purposes tax audit has different benefits that assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic & financial order and stability by carry out intensive examinations of taxpayers' books and records, detecting & deterring noncompliance and interpreting complex laws. Tax audit helps revenue authority achieving its objectives, and ensuring the fiscal health by means of indirectly driving voluntary compliance and directly generate additional tax collections, both of which help tax authorities to reduce the tax gap between the tax due and tax collected (OECD, 2006). The survey result shows that tax audit is more than

verifying taxpayers books of account in which tax audit is a very crucial way in minimizing the degree of tax avoidance and evasion, audits may bring to light areas of the tax law that are grey and problematic to taxpayers and thus require further efforts by the revenue authority to clarify the law requirements and to better educate taxpayers on what they must do to comply into the future. Promotion of voluntary compliance by the taxpayers with the tax laws is envisaged as the main purpose of the audit program this is achieved by concentrating on major areas of risk relevant to taxpayers likely to be evading their responsibilities. Furthermore, audit results may provide information on the general well-being of the tax system; audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance. Therefore the tax authority (LTO) should promote voluntary compliance by making its endeavors more than the examination of tax returns.

4.3 The role of tax audit

Table: - 4.3. Role of tax audit performed in LTO

Do you think the existing role of tax audit is significance to treat the compliance risk available in LTO and increase revenue base?	Frequency	Percentage
Yes	65	83%
Neutral	-	-
No	12	17%

83 percent of respondents believe that the existing role of tax audit is significance to treat the compliance risk available in LTO and increase revenue base which is Promotion of voluntary compliance, detection of non-compliance at the taxpayer level, gathering information on the “health” of the tax system (including patterns of taxpayer’s compliance behavior), Gathering intelligence information, Educating the taxpayer, Identifying areas of the law that require clarification or amendment. However 17 percent of respondents believe that even if the stated role of tax audit in LTO is significance to treat compliance risk and increase revenue base, due to different reasons somehow those stated roles doesn’t go to the ground or seen practically. For instance identifying the laws that require clarification or amendment may not be recommended by auditors, even if they are the one who intensely engage on the audit work. Audits can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance, that over time can be used to

identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on future compliance improvement strategies. As the survey result shows, as a strategy even if the tax audit program at LTO plays many roles, coming to the ground some roles are not in practice; consequently a well-structured audit program plays an important part in improving the effectiveness of other parts of the administration, as well as detecting and addressing non-compliance and can provide valuable support like assisting in clarifying the application of the law for taxpayers and bringing light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus this requires further efforts by the revenue body to clarify the laws' requirements and/or to better educate tax payers on what they must do to comply into the future. Moreover the tax audit program of LTO should be effectively carried out and should make a significant contribution to improve administration of the tax system.

4.4. Types of Tax Audit performed in LTO

Table:- 4.4. Types of tax audit performed in LTO

Types of audit performed at LTO	Frequency	percentage
Desk Audit	58	82%
De-registration Audit	9	13%
Fraud investigation	-	-
Issue Audit	32	45%
Comprehensive Audit	71	100%
Refund Audit	65	92%
Field Audit	27	38%

Audits can vary in their scope and the level of intensity to which they are conducted. For this reason, various terminologies have evolved to describe different types of audit activity. The survey results showed all respondents respond that LTO predominantly conducts comprehensive audit in which taxpayers selected by risk criteria and third party information and those need to dispose over 50 per cent of their business fixed assets or close the business; to check whether taxpayers filed and paid the appropriate tax returns in line with the tax law and accounting principles. Likewise, according to 82 percent of respondents' desk audit is conducted for data cleaning purpose to confirm whether the data submitted by the taxpayers is genuine or not. Refund audit also conducted at LTO for verification of a taxpayer's claim for a tax refund prior to processing the refund as 92 percent of respondent's response. a de-

registration audit will be conducted to ensure orderly exit from the tax register with the attendant obligations and liabilities sorted out, for all reported cases of cessation of business, winding up or uncertainty (13 percent of respondents). And as 45 percent of respondent issue audit is confined to specific issues in a tax return and/or a particular tax type to examine key potential risk areas of non-compliance. Based on the information that comes from various sources with evidence regarding the deliberate evasion or serious fraud is conducted at head office (fraud investigation audit). As 38 percent of respondents' field audit conducted through physical verification of documentary evidence and materials at the premises of a taxpayer so as to confirm the facts and figures of the tax returns filed by corporate taxpayers; however, in LTO this type of tax audit is conducted if taxpayers files are large in number. The reason behind this was if tax auditors are at field audit they may not engage in the audit work properly and efficiently due to less control by the team leader furthermore it is assumed that it may be exposed for corruption or may create collision between taxpayers and tax official since tax auditors contact the taxpayers frequently.

The scope and nature of any comprehensive audit activity to be undertaken will depend on the available evidence pointing to the likely risks of non-compliance and a taxpayer's history; the audit must be detailed and involve an in-depth inquiry into all aspects of compliance, must cover all tax types to which the taxpayer is liable and the audit must cover a period of at least three accounting year. As a result 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 LTO might consume audit resources improperly with exertion of much work force, on mass of transactions and intensive records even on reliable tax returns due to its concentration merely on comprehensive examination of five-year period documentation. 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; the tax authority might suffer low audit coverage that minimizes tax revenue and overall voluntary compliance. On the whole, the results of the study revealed that tax audit program remains undeveloped in LTO with an emphasis mainly on comprehensive, desk audit, and refund with the exclusion of other audit methodologies such as advisory audit (especially to newly established businesses) and other types of audit have not yet in place and that concerns the tax system with respect to potential

loss of tax revenue due to evasion or fraud and other noncompliance activities. The results of the study revealed that tax audit program remains undeveloped in LTO with an emphasis on comprehensive, refund and desk audit with the exclusion of other audit methodologies, this 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 such type of audit operation might result low audit coverage (rate), took a lot of time and auditors' error may occur in such enormous examination and this may affects the overall tax audit practice and future tax revenue. In addition this may not convey the desired aftermath of the tax administration conspiracy; hence the limited audit resources should be allocated towards the noncompliant to detect compliance risk, and to support those taxpayers who want to be complaint. The audit program of LTO should be with vigorous range of audit types directed to a wide range of taxpayers and tax types. As stated by different authors the appropriate selection of tax audit types depends on the compliance risk needs to be addressed, the desired audit rate (coverage), audit quality, and the overall deterrent effect that needs to be accomplished. The level of taxpayers' awareness is relatively poor, and taxpayers are incapable to understand the stated tax rules and regulations as well as the forms and instructions provided by the tax authority besides 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 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.

4.5. Compliance and non-compliance behavior of taxpayers in LTO

Table: - 4.5. Compliance and non-compliance behavior of taxpayers in LTO

Do taxpayers of LTO comply with the tax system in Ethiopia?	Frequency	Percentage
Yes	9	13%
Sometimes	13	18%
Neutral	6	8%
No	43	61%
Compliance behavior of LTO taxpayers	Frequency	Percentage
Comply with the existing rules and regulation	13	18%
Non-filing tax returns	29	41%
Underreporting of income	59	83%
Fail to registered when required	-	-
Non-payment of tax return on time	43	61%
Reasons for the noncompliance behavior of the taxpayers	Frequency	Percentage
Taxpayers' carelessness	45	64%
Taxpayers' deliberate action	58	82%
Taxpayers' lack of awareness	65	92%
Weakness in tax administration itself	62	87%

Tax compliance is a major concern for all governments and analytical investigation of tax evasion. According to table 4.5 61 per cent of respondents stated that taxpayers do not comply with the tax system in which 8 per cent and 18 per cent of respondents agree taxpayers' compliance with the tax system and sometimes taxpayers might comply with the tax system respectively; 13 percent of the respondents were neutral. As 92 per cent of respondents showed, the above compliance risks arise mainly due to taxpayers' lack of awareness, taxpayers' deliberate action as responded by 82 percent; it may also arise due to weakness in tax administration (87 percent) and taxpayers' carelessness (64 percent). Besides, compliance with the tax law typically means true reporting of the tax base, correct computation of the liability, timely filing of the return, and timely payment of the amounts due. The taxpayers' compliance risk in LTO is characterized by underreporting income (59 per cent), nonpayment of tax returns when due (43 percent), and non-filing tax returns (41 per

cent). Tax audit can play a major role in improving tax administration and overall taxpayer compliance by impacting on taxpayer behavior (Agumas.A, 2016). The role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Tax audit may increase tax revenue in two ways: directly through assessment of additional taxes, and indirectly by improving taxpayer compliance with the tax laws and regulations (Biber, 2010). Therefore, for taxation to be effective in achieving both short and long term goals in any economy, the level of tax compliance must be improved for efficient tax administration. Hence, one measure that can be used to improve the level of tax compliance is tax audit because tax audit is one of the most effective policies to prevent tax evasion behavior and it helps to improve voluntary compliance by detecting and bringing into account those who do not abide by the law. Creating taxpayers awareness might be necessary to increase voluntary compliance and to mitigate future compliance risks in LTO. Even if most taxpayers have knowledge about 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; nevertheless, according to the survey taxpayers lack awareness in which they 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. So that LTO 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 due to the absence of advising and law interpretation services through reasonable physical contacts with taxpayers. 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.

4.6. Self-assessment of tax

Table: - 4.6. Self-assessment of tax

Does self-assessment exposed to the risk of tax evasion?	Frequency	Percentage
Yes	23	32%
Sometimes	36	51%
Neutral	2	3%
No	10	14%
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?	Frequency	percentage
Yes	55	77%
Neutral	6	8%
No	10	14%

Many countries have adopted the self-assessment system (SAS) in order to simplify the tax assessment system and encourage voluntary compliance. Self-assessment system helps to encourage voluntary compliance, reduce tax evasion and make taxpayers more responsible. Under this system, taxpayers are expected to render tax returns based on their income, determine their tax liabilities and pay within the time stipulated by law (Abiy.B, 2020). According to the survey result 32 percent of respondents stated that self-assessment exposed to the risk of tax evasion, 51 percent of respondents agree that sometimes self-assessment may exposed to the risk of tax evasion whereas 14 percent of respondents disagree with this and 3 percent of the respondents were impartial. According to Biber (2010) if taxpayers believe that the tax authorities have the capabilities to find out any misleading reports or frauds during the audit process and the consequence creates penalties and interests based on the underreporting or non-reporting amount, mostly they will report the accurate tax liabilities by fearing the penalties and interests. Thus tax revenue of a country can be increased through tax auditing by direct assessment of additional taxes and indirectly discouraging underreporting of liabilities of taxpayers.

Ethiopian tax policy is based on taxpayers' voluntary compliance i.e. self-assessment (MOR, 2019). 77 percent of respondents reply taxpayers may believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit. According to Biber (2010) if taxpayers believe that the tax authorities have the capabilities to find out any misleading reports or frauds during the audit process and the consequence creates penalties and interests based on the underreporting or non-reporting amount, mostly they will report the accurate tax liabilities by fearing the penalties and interests. Thus tax revenue of a country can be increased through tax auditing by direct assessment of additional taxes and indirectly discouraging underreporting of liabilities of taxpayers. In order to sustain the credibility of self-assessment system (SAS) taxpayers are subject to verification by the relevant tax authorities during this enforcement activities, in particular tax audit is regarded as the primary strategy taken in ensuring a high level of tax compliance (Ojonta, 2011). As the result of the study many taxpayers believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit. Hereafter self-assessment is completing a tax return each year to report income and calculate whether the tax due or refund; this is considered the most economical and efficient way to collect taxes and increase government revenue, thus this system is not easy as it seems since it is being rest fully to the tax payer to meet the law taxation and may exposed to the risk of tax evasion. 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. 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. Through audit, LTO 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, noncompliant taxpayers that have been considered as a big fish are subject to penalty, and will be enforced to pay the evaded tax with such penalty and interest so as to maximize their future compliance as well as to educate others to comply by publicizing such enforcement. Planning an adequate audit strategy therefore, is a key success factor in a posteriori fraud detection (where audits are intended to detect tax evasion and fraudulent claims) as well as proactively preventing frauds and tax evasions; this will assist 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.

4.7. The cooperation of taxpayers during audit

Table: - 4.7. Cooperation of taxpayers during audit

Do taxpayers cooperate to give essential information necessary for performing an audit?	frequency	percentage
Yes	12	17%
Sometimes	51	72%
Neutral	-	-
No	8	11%
If taxpayers do not provide the required document, how tax auditors can audit the taxpayer business?	frequency	percentage
By reviewing the previous case histories of taxpayers	32	45%
Using information from third parties	54	76%
Using related business sector profile	43	61%

As 72 per cent of survey respondents replied, taxpayers sometimes cooperate to give essential information necessary for performing an audit. If taxpayers do not provide the required document tax auditors can audit the taxpayer business by reviewing the previous case histories of taxpayers (as 45 per cent of respondents), using information from third parties and related business sector profile (as 76 percent and 61 percent of respondents) Revenue bodies are encouraged to examine the tax payers' books of records and the related companion documents to identify new approaches and opportunities for strengthening their tax audit activities (OECD, 2006). Adediran et al. (2013) addressed that, the tax audit just like financial audit involves the gathering of information and processing it for determining the level of compliance of an organization with tax laws of the country. As the study revealed sometimes taxpayers may not cooperate with the tax administration when audit is going to be executed. Therefore for a successful audit it is necessary that the assignment is accomplished, completely and efficiently; to meet those accomplishment taxpayers' complaisant is important. LTO can influence its taxpayer's compliance behavior directly through direct interventions targeting specific groups of taxpayers or indirectly by changing the context in which the taxpayer operates. It can change the context by changing the way it operates itself or by influencing the context through others, for example by investing in enhanced relationships with 3rd parties, for instance tax intermediaries, industry associations or other governmental bodies.

4.8. The legal framework of tax audit

Table: - 4.8. Legal framework of tax audit

Is there audit manual to perform the audit work?	Frequency	Percentage
Yes	71	100%
Neutral	-	-
No	-	-
How do you evaluate the audit manual	Frequency	Percentage
It is clear and workable	22	31%
It lacks some clarity	49	69%
It is completely unclear	-	-

All of the survey respondents replied there is a tax audit manual which is a guide for Auditors conducting audits of taxpayers. Besides it outlines the procedures to be followed, provides a framework for planning, preparation, carrying out an audit and preparing reports; it is particularly important in that it sets out a different and more professional approach to audit since it describes many of the standard techniques used to check or assess the correctness of a tax payer's liability to direct & indirect tax. As 31 percent of survey respondents replied the audit manual is clear and workable however 69 percent of survey respondents replied the manual lacks some clarity. Aiming the result of the study, legal frameworks are essential to provide integrity in the way tax administrations carry out audits and to ensure that taxpayers' rights are properly protected. As such, in many jurisdictions the taxpayer may request a review of any proposed assessments or an explanation of the audits techniques used and adjustments being proposed. Techniques used in tax audit department of LTO can often vary but the results should usually be very similar, for that matter auditor need a sound understanding of tax law and the audit procedures. The standard techniques used to check or assess the correctness of a tax payer's liability and the procedures to be followed by Auditors in conducting audits of taxpayers should be clear, more understandable and concrete, which provides a framework for planning, preparation, carrying out an audit and preparing reports. It is particularly important in that it sets out a different and more professional approach to audit furthermore auditors should give their valuable suggestions based on their experience which will help to make further improvement of this manual.

4.9. Audit standards

Table: - 4.9. Audit standards

Description	Yes		Neutral		No	
	Frequency	%	frequency	%	frequency	%
Does GASP (General Auditing Standard Procedure) used during the audit	17	24%	13	18%	41	58%
Is there any standard that requires the audit work to be started and completed within a predetermined timeframe?	58	82%	13	18%	-	-
Are taxpayers aware for the standard?	11	15%	20	28%	40	56%

The tax authority doesn't run-through General Auditing Standard Procedure (GASP) during the audit (as 58 percent of respondents), 18 percent of respondents were impartial and 24 percent of respondents agreed about the subject matter. National revenue bodies face a varied environment within which to administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture; as such, a standard approach to tax administration may be neither practical nor desirable in a particular instance (OECD, 2009). According to OECD (2006) 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. In respect of the audit timeframe, 82 per cent of respondents responded LTO has a rule that requires audit activities to be started and completed within a predetermined timeframe as well 15 percent of respondents also believe that taxpayers are aware of the audit time frame but 56 percent of the respondent disagree with this. The tax audit section head further stated LTO 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 10 days, comprehensive audit expected to be started and completed within 40 days. There are pre-audit factors that need to be recognized in an efficient audit management structure one of them is 'Audit cycle' or 'enquiry window' which establishes regulations to require that all audits must be started or completed within a

predetermined timeframe. This gives certainty to taxpayers that after some period of time the danger of audit will pass. It needs to be supported however by powers of discovery to overturn the enquiry window where substantial tax fraud is found. This is supported in most administrations by a statute of limitations to give the taxpayer some closure with regard to the particular tax year (OECD, 2006). 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. Moreover, since taxpayers are not aware about the predetermined time frame work they may not pool resources in providing essential information or necessary documents for audit on time. Although 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.

4.10. Repetitive audit of a taxpayer

Table: - 4.10. Repetitive audit of a taxpayer

Does LTO of MRO repetitively audit the same taxpayer in consecutive period?	frequency	Percentage
Yes	38	54%
Sometimes	25	35%
Neutral	-	-
No	8	11%
When and in what condition those taxpayers are audited?	frequency	Percentage
When serious tax fraud case is found	64	90%
When taxpayers have large tax potential	61	86%
When taxpayers reported tax returns less than previous period return	33	46%

As 54 percent and 35 per cent of respondents argued that LTO may repetitively audit the same taxpayer in consecutive period, which is taxpayers that were audited in the previous period may be selected for audit. In addition 86 percent of respondents, repetitive audit is performed when taxpayers have large tax potential, 90 and 46 percent 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. As of the in-depth interview sometimes 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. 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 OECD (2006a). As a result of the study it might be appropriate to conduct audit on the same taxpayers repetitively when serious tax fraud is found regardless of the taxpayers' compliant history; a taxpayer that is audited for the current year, and the audit results with no additional taxes owed should be granted relief from audit. Though, 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, LTO 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.

4.11. Selection of taxpayers for audit

Table: - 4.11. Selection of taxpayer for audit

What are the possible techniques used by the LTO in selecting taxpayers to be audited	frequency	Percentage
Taxpayers are simply selected randomly	6	8%
Data mining that identifies patterns of noncompliance in the past and current	14	20%
Statistical techniques using prior tax audit results in conjunction with taxpayer data	44	62%
Rule base and automated risk scoring system that identifies risk of noncompliance	62	87%
Are those selected taxpayers for audit notified in advance	frequency	Percentage
Yes	71	100%
Sometimes	-	-
Neutral	-	-
No	-	-

Every year, a large number of taxpayers fail to declare their tax liabilities correctly, and the Tax Administration is forced to tackle a tough task – to detect them (and enforce compliance from them) without increasing the compliance costs of the tax compliant taxpayers. It is not possible to identify the likely tax-evaders by simple query and reporting tools. Tax departments have access to enormous amounts of taxpayer data. However, it is impossible to ascertain the legitimacy of and intention behind a claim or a declaration in the tax return by simply looking at the return or a profile of a taxpayer (Gupta and Nagadevara, n.d). Hence interview and the survey results shows that 87 percent and 62 of respondents believe that LTO mainly uses rule base and automated risk scoring system and statistical techniques using prior tax audit results in conjunction with taxpayer data that identifies risk of noncompliance respectively. Furthermore, selected taxpayers for audit notified in advance (all respondents) in which this may have impact on the audit outcome since the taxpayers know they are being selected they may try to contact and induce with the higher tax officials not to be audited or may have time to evade or avoid taxes by correcting their books of record. Audit of all taxpayers is unattainable having inadequate audit resources and large noncompliant taxpayers 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).

Audit case has been selected through risk management department of LTO; as the interview with risk department manager revealed, taxpayers have been selected based on their associated compliance risk (compliance risk indicators) for audit purpose; 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. Any audit selection strategy cannot hope to, and cannot practically catch all the tax-evaders, besides it may be immaterial whether it is able to catch all the under-declarers/ evaders. In selecting a taxpayer, one can compromise on the performance efficiency in quest for a better strike rate in increasing the tax revenues with the returns. An audit selection strategy based on data-mining technique can meet the conflicting issues of audit planning, viz., tradeoff between maximizing audit benefits and minimizing

audit costs (Gupta and Nagadevara, n.d). 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). The computerized systems in LTO that is used for in selecting taxpayers for audit is SIGTAS; however, it has not been fully utilized for risk assessment and it 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 the tax administrator uses risk-based approach. The risk selection criteria include the business sector type, 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, MOR LTO branch 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). As a result the tax administration of LTO should use computerized system in the selection process that will help in maximizing government revenue and minimizing not only audit selection costs but also saving the intake of time in performing the audit work on non or less evaders.

4.12. Sector based audit

Table: - 4.12. Sector based auditing

Which business sectors are most usually selected for tax audit	frequency	Percentage
Manufacturing enterprises	58	82%
Service enterprises	26	37%
Merchandising enterprises	44	62%
Construction and real estate sectors	67	94%
Financial sectors	19	27%
What is the reason behind for the selection of those taxpayers	frequency	Percentage
Taxpayers have higher compliance risk	52	73%
Taxpayers have large tax potential at risk	58	82%
Taxpayers have no effective record or bookkeeping	-	-
It is difficult to tax taxpayers	-	-

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 and it may be based on either reported tax amounts or the industry type (Barreca and Ramachandran 2004). As the survey result MOR LTO branch mostly select manufacturing and construction sectors for audit (82 and 94 percent of respondents) for the reason taxpayers of those sectors have higher compliance risk and large tax potential at risk (as 73 and 82 percent of respondents response). As well merchandising enterprise (44 percent of respondents), service and financial sectors (26 and 19 percent of respondents) will also selected for audit using different criteria of risk based approach. As (MOR, 2016) with sector based auditing directs tax audit activity to specialized sectors this inevitably requires auditors to develop capacity and skill to direct audit activity with precision. Sound knowledge of the sector dynamics in which the taxpayer operates and the legal framework (Accounting/IFRS and Tax law) that regulates financial and tax compliance of the specific sector are a basic requirement for an auditor undertaking review of a specialized nature (sector based auditing). The interview with the tax audit section head disclose that currently the ministry of revenue segments specialized business sectors for the purpose of audit which are: Construction, Manufacturing, Finance (banking & Insurance), Import/export, Mining and Agriculture. The

tax authority rely on that earmarking the business based on sector will enable to identify the highest risk, to know capable taxpayers and also to strength tax auditors capability by specializing their experience with one sector. Nevertheless, the issue that auditors may specialize has a point may leave the tax authority in question that if those who specialized in one sector leave the tax office it will have negative impact on the engagement of audit work as well as for the tax authority. As a result of the survey, segmentation along specialized sectors enables greater understanding of the taxpayer’s operations and provides better insights into the nature of audit procedures relevant to a given audit assignment. Auditors should maintain a certain level of professional skepticism in order to exercise professional judgments and draw conclusions. Therefore, business sector analysis has a large shadow economy and might be a valuable policy tool for increasing government revenue.

4.13. Rotation of tax auditors

Table: - 4.13. Rotation of auditors

Description	Yes		Sometimes		Neutral		No	
	frequency	%	frequency	%	frequency	%	frequency	%
Do you think rotation of tax auditors in auditing a variety of organizations and different sectors has an impact on audit effectiveness?	45	64%	6	9%	-	-	19	27%

Revenue bodies should consider creating career paths for their auditors to reflect increases in work complexity and leadership roles (OECD, 2006). According to 64 percent of respondents believe that rotation of tax auditors in auditing a variety of organizations and different sectors has an impact on audit effectiveness. Hence Job rotation and/or placement programs provide auditors and other staff with new opportunities, experiences and challenges. Such processes help to: achieve workforce shifts, provide development opportunities, prevent inappropriate relationships with clients developing, develop the breadth and depth across the audit workforce, share knowledge and ideas across the organization, raise staff morale, and encourage staff to improve their abilities. Job rotation and/or placement programs can be formal structured processes or operate on an ad-hoc or

needs basis. The variety and range of audit work necessary in any large revenue body will inevitably lead to an established grade structure and movement between these grades, or promotion to them.

4.14. Type of audit tests conducted at LTO

Table: - 4.14. Type of tests conducted at LTO

Which type of tests is conducted at LTO to check the accuracy of tax returns?	frequency	Percentage
Review of financial statements and returns	65	92%
Examination of information from third party	32	45%
Examination of taxpayer's record such as books and documents	65	92%
Physical checks of current transactions, vouchers, assets and other aspects	54	76%

According to Drogalas et al. (2015), auditing of taxpayers is defined as the activities conducted by the tax authorities in order to detect whether there is under reporting of tax basis. Tax audit is as a process of assessing the level of taxpayers that have produced financial statements in compliance with the sated tax rules and regulations and whether the taxpayers have accordingly declared the tax payables as per the tax legislations. The accuracy of the declared tax documents should be assessed and the tax auditors confirm the amount of tax liabilities that will be paid by taxpayers. Audit is an independent examination of an entity by an auditor, who delivers reports about facts observed to the best of her/his knowledge and which is exercised to hold an organization accountable for their deeds. In addition, it is the process of examining financial statements of an organization independently and passes opinions on the findings in accordance with the auditors' terms of engagement and compliance with statutory regulation and professional requirements. An auditor will apply various techniques to examine the books and records behind a return, these will vary with the customer and the tax regime concerned. As 65 percent of respondents the accuracy of tax returns have been tested through Review of financial statements and returns, examination of taxpayer's record such as books and documents and field examination (physical checks of taxpayers' assets and other aspects). The survey result further showed that examination of information from third party is the other way of examining the accuracy of taxpayers returns(32 per cent of respondents) which is mainly used when taxpayer doesn't

provide their book keepings or if more investigative approach is needed whether the taxpayer try to evade taxes. However due to auditors different levels of capability those examination techniques may not be conducted correspondingly this is a challenge for LTO to establish completeness, accuracy, credibility and validity of audit techniques. As the survey result since taxpayer’s operations, adequacy of books and records and capabilities of auditors are different the decision regarding the type of tests to be undertaken will depend on auditors approach. Hence In order to analyze the taxpayers’ financial statements for the purpose of identification of key tax risks and design of appropriate audit procedures, it is necessary for the auditor to imagine how the taxpayer could have developed and presented the financial statements in a manner that reduces their tax exposure. The auditor is expected to exercise a degree of professional skepticism that the taxpayer could have manipulated financial statements in order to under declare taxable income.

4.15. Efficiency of tax audit

Table: - 4.15. Measurement of tax audit efficiency

How does the efficiency of tax audit is measured?	frequency	Percentage
By productivity and yield of audit	15	21%
By volume of the audit performed	19	27%
Both by volumes of audit performed and productivity & yield of audit	37	52%

Adediran et al. (2013) addressed that, the tax audit just like financial audit involves the gathering of information and processing it for determining the level of compliance of an organization with tax laws of the country. For a successful audit, it is necessary that the assignment is accomplished, completely and efficiently. Audit effectiveness is measured by examining the amount of evidences selected for examination in relation to the total availability evidence and an optimal level of evidence. Audit efficiency is then defined as audit effectiveness per unit of time by taking the audit effectiveness measure divide by minutes spent on the task (Kangave, 2005). According to the survey result 52 percent of respondent, efficiency of tax audit was measured both by volumes of audit performed and productivity & yield of audit and 21 percent of respondents believe that productivity & yield of audit and 27 percent of respondents states the efficiency of tax audit in LTO measured by the volume of audit conducted. Furthermore, most of the respondents believe that likewise effectiveness of tax audit is evaluated based on productivity and yield of audit which is

defined by the additional revenue gained by tax audit. To collect the necessary tax revenue from the taxpayers, countries should design different mechanisms of tax collection; effective tax audit is one of the mechanisms that help to collect the estimated governments' revenue from tax. Among the factors that affect the collection of tax revenue of a country, tax audit effectiveness plays a vital role on the side of tax authority. Wherein the information system, tax legislation, education, experience and training of auditors, audit quality, organizational setting, top management support, audit attributes and organizational independence are the factors that affect tax audit effectiveness (Drogalas et al., 2015; Elias, 2014).

The success of any audit program has a direct relationship with the quality of the individual audits that comprise that program. In order to deliver quality outcomes, auditors need access to approved procedures, policies and tools. Obviously, such products vary considerably with the variety and complexity of the regimes administered by individual tax administrations. Nevertheless it is possible to identify certain pre-requisites that must be in place if auditors are to be able to carry out their work efficiently (OECD, 2006). Effective tax auditing minimizes tax evasion and fraud beside on this also 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). As a result the effectiveness of tax audit should be measured by reduction of tax evasion, reduction of tax avoidance, encouraging voluntary compliance and finally to generate tax revenue to support government expenditure.

4.16. Audit Workforce and capabilities

Table 4.16 Current job occupation and work experience

Variables		Count	Percent
Current job occupation	Tax auditor	21	30%
	Senior Tax auditor 1	23	32%
	Senior Tax auditor 2	16	23%
	Tax audit team leader	11	15%
Work experience	Less than 3 years	-	-
	3- 6 years	44	62%
	7-10 years	27	38%
	Above 10 years	-	-

Tax auditors' competency is considered as one of the major determinants of tax audit effectiveness. An audit requires a professional staff that collectively has the necessary education, training, experience and professional qualifications to conduct the full range of audits required by its mandate (Elizabeth & Diane, 2014). Tax audit with educated, experienced and trained auditors is able to enhance tax audit effectiveness. Thus, it is crucial for an auditor to be competent enough to handle audit cases efficiently and furnish himself with technical knowledge, audit skills and analytical thinking. According to the survey result of current job occupation, 30 percent of respondents were tax auditors, 32 percent senior tax auditor I, 23 percent senior tax auditor II and 15 percent of the respondents were tax audit team leaders. Moreover, 62 percent of respondents hold 3 to 6 years of work experience and the remaining 38 percent respondents' works for 7 up to 10 years. As it can be seen from the above the current job occupation and work experience has positive implication in improving the tax administration, since well experienced tax auditors/officials can tackle tax avoidance and evasions committed by non-compliant taxpayers in a better way. As Wangraj, Ussahawanitchakit, & Muenthaisong (2007) tax audit effectiveness is less achieved if the tax auditors lack adequate knowledge, professional skills, expertise, ethics, proper education and work experience. Accordingly the survey result of the study shows that LTO tax audit work force has well experienced tax auditors/officials that can tackle tax avoidance and evasions committed by non-compliant taxpayers in a better way experience of audit greater than three years. The majority workforce of LTO have a good level of educational qualification which are studied the field related to business with a BA degree and attended MSc/MA, Trying to meet the tax administration objectives the main activities of tax auditors in LTO during their audit work tax auditors' educational qualification seems to be adequate to perform audit tasks and understand the implementation of taxes and related issues.

4.17. Activities of auditor

Table 4.17 Main activities tax auditors expected to do

What are the main activities that tax auditors expected to perform during an audit period?	frequency	Percentage
Educating taxpayers	65	91%
Search for unregistered taxpayers	-	-
Detecting noncompliance behavior of individual taxpayer	71	100%
Interpreting complex tax rules and regulations for taxpayers	52	73%
Identify areas of tax law that require clarification and amendment	52	73%

Are there enough audit staff resources to perform comprehensive crosschecking of invoices or transactions and onsite audits on all taxpayers?	frequency	Percentage
Yes	11	15%
Neutral	16	23%
No	44	62%

According to 89 percent of respondents the main activities of auditors and during their audit work is detecting noncompliance behavior of individual taxpayer, Educating taxpayers (52 percent) Interpreting complex tax rules and regulations for taxpayers (34 percent) and Identifying areas of tax law that require clarification and amendment (24 percent). However as most respondents respond the current audit staff resources is not enough to perform comprehensive crosschecking of invoices or transactions and onsite audits of all taxpayers (62 percent of respondents). As OECD (2006a) stated the taxpayer audit function plays a critical role in the administration of tax laws in all member countries. In addition to their primary role of detecting and deterring non-compliance, tax auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the "public face" of a revenue body. These factors, as well as the sheer size of the audit function in most revenues bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function and, in particular, to the strategies and methods used for recruiting, developing and managing individual audit staff. 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.

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, the cultural environment of MOR doesn't appreciate tax auditors to give advising services because of the fear that there will be unnecessary communication between the auditors and the taxpayers which may leads to corruption. Moreover, tax auditors lack willingness in clarifying financial and law issues to the taxpayers rather they simply intimidate them by raising the consequence of not being

compliant. Through declaring the consequence of being noncompliant, LTO 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 LTO 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.

4.18. Audit coverage by auditors

Table 4.18 Audit coverage by auditors

How many audit cases on average an individual (auditor, senior 1 or 2) has expected to complete in a year?	Frequency	percentage
2 to 4 cases	26	36%
5 to 7 cases	45	64%
Greater than 7 cases	-	-

Revenue bodies typically have at their disposal a finite level of resources to conduct the day to day business of revenue administration. Given the many tasks to be performed and the inevitable decisions that must be made on priorities, a process is required to determine how those resources are to be allocated. Given the importance of tax audits and the specialized skills they involve, all revenue bodies in member countries include one or more specialized departments that are responsible for all activities relating to audits of SMEs, large businesses, and other taxpayers (OECD, 2006). As interview with the tax audit section head, tax auditors are assigned to audit with in each audit teams having their own team coordinators. Under each audit team, there are three levels of auditors: auditor, senior auditor I and senior auditor II. 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 combination will be either 1 auditor with senior auditor I or with senior auditor II for any selected cases. However if very complex cases are selected for audit senior auditor I and senior auditor II are

assigned for that case. Regarding auditors’ operational capability, 26 percent of respondents replied an individual (auditor) has expected to complete 2 to 4 audit cases on average in a year and 5-7 cases as 45 percent of respondents’ response. As a plan LTO expects 2 auditors to audit 5 taxpayers, which is approximately expected 175 taxpayers in a year; but comparing with the number of taxpayers in LTO this is a small number which is averagely 14% of LTO taxpayers. Regardless of how the overall budget of resources for audit work is arrived at, a key issue for the audit function is how those resources will be spread over the various segments of taxpayers; determining how resources might best be allocated is a key element of a revenue body’s strategy for compliance improvement and maximizing government revenue. Revenue bodies with effective tax audit programs pay close attention to the way tax audit operation is organized, resourced, and managed.

4.19. Improving tax auditors’ performance

Table 4.19 improving tax auditors’ performance

Description	Yes		Sometimes		Neutral		No	
	frequency	%	frequency	%	frequency	%	frequency	%
Does LTO provide training regarding tax audit issues and any special training before and during tax audit activities?	12	17%	23	32%	-	-	36	51%
Does LTO perform a continuous assessment to improve the capability or competency of auditors?	18	25%	-	-	15	21%	38	54%

Given the relatively large amounts of staff resources available for audit work and the important roles that audits can play, audits are a key element of a revenue body’s overall strategy for achieving improved compliance with the laws. For this reason alone, the delivery of audit activities justifies a high degree of planning, monitoring and evaluation to ensure that they are contributing in an optimal way to the revenue body’s goal of improved overall

compliance with the laws (OECD, 2006). Tax audit staffs were asked whether they have taken any special training or tax audit issues and the responses shows that 51 percent of them agreed that the tax authority (LTO) doesn't provide adequate training. Furthermore, as 54 percent of respondents the tax authority doesn't perform an assessment to improve the capability or competency of auditors. Continuous improvement and lifelong learning will lead to high quality audit report and sustainable audit performance thereby increasing taxpayers' confidence on tax auditors.

Competency of tax auditors and tax audit effectiveness is toward the argument that tax audit work will be effective when tax auditors are competent enough to carry out their duties and responsibilities in a proper manner (i.e. as the competence of tax auditors increases, tax audit effectiveness will also increase and vice versa) Hannimitkulchai & Ussahawanitchakit (2016). In addition in-depth interview with tax audit section head convey that auditors and team leaders are taken different trainings like preparation of audit findings, audit examining techniques and other types of training the international audit standards like (IFRS). Competency assessments are commonly performed every six month of the budget year (an annual or bi-annual basis) for those staff maintaining current positions and this assessment processes are typically performed by the staff member and their team leader; the assessments are mainly on the audit outcome as well as behavior of auditors. The audit outcomes are irrespective of number of cases performed and the amount of tax identified by audit, this also used for promoting a tax auditor during competition of the audit workforce. It is important that capability gaps are identified and acted upon. Feedback and observations regarding capability gaps are typically gathered from the following sources, considered at a corporate level, and used to improve training and development activities and competency improvement programs: quality management system results, performance system interviews and appraisals, client professionalism, satisfaction and other similar surveys, and training program evaluations (OECD, 2006). 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. As a result the tax administration of LTO should pay close attention to the overall management of the tax audit function and in particular developing and managing individual audit staff by regularly trained about the rules and regulation of the country, international standard of audits, the legal frame work or audit manual and other related tax audit issue in order to strengthen the large taxpayer office capacity.

4.20. Tax audit effect on government revenue

Table 4.20. Tax audit effect on government revenue

Do you think tax audit has an effect on the tax revenue growth?	Frequency	percentage
Yes	66	93%
Neutral	5	7%
No	-	-

According to the survey result 93 percent of respondents' believe that tax audit has an effect on the tax revenue growth. Since the tax audit program of a revenue body performs a number of important roles that effectively carried out and can make a significant contribution to improved administration of the tax system as well as increase government revenue. Also the in-depth interview with the tax audit section head enlighten that the principle purpose for tax audits is the enhancement of voluntary compliance of the taxpayers which is achieved by reminding taxpayers of the risks of non-compliance and by signaling the broader community that serious abuses of the tax law will detected and appropriately penalized. Audit activity improves taxpayer compliance and is a means for revenue generation. Through tax audit practice the tax office assesses the auditor's ability to generate revenue through audit. While this is not the main reason for tax audits, maintaining a keen eye on revenue collected directly from audits ensures that auditors plan their audits in a manner that generates additional tax revenue. It is expected that an audit program anchored on a robust risk assessment guarantees high tax returns.

Determining the score card depends on the potential revenue yield (projected tax revenue) for a particular sector/ taxpayer and growth trends in the economy. It is also important to consider the contribution to GDP of various sectors and the growth trends in order to project expected tax revenues for a particular sector. Most taxpayers do not want to pay taxes unless obligated by a situation where they are left with no option other than to pay the taxes; thus for better tax compliance and collect additional tax revenue tax audit is one of the most powerful revenue administration tool that enforces tax payers to pay their tax liability without evasion. A very efficient and effective tax audit is a major part to play in tax administration of LTO which minimize tax avoidance and evasion; it has become even more important under the current dispensation of tax administration which is gearing more towards self-assessment by tax payers, besides it is a key component in any attempt to enhance and maximize revenue generation.

To sum up the survey result of auditors response and interview with tax audit section head about the tax audit practice and its effect in increasing government revenue; the purpose of tax audit is to determine a true and fair view of the business records for tax purposes. The tax audit officer is responsible to ensure that the reported amount is correct and that the amount of tax paid is correct accordance with tax laws and regulations. Besides, tax audit aim to achieve the voluntary compliance with the tax laws and regulations and that a higher tax compliance rate is achieved. In order to achieve those objectives large taxpayers office face some challenges while exercising tax audit practices which are Poor/lack of record keeping and lack of co-operation by taxpayers and agents, lack of audit skills by some Tax auditors. Moreover, the audit workforce performs all the processes manually; this seriously hampers accountability and transparency in the tax system, as well as the effectiveness and efficiency of the audit practice and tax collection. It also impairs supervision and access to many sources of information.

Document analysis

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). One of the main objectives of the Ethiopian tax reforms was to generate adequate tax revenues to finance ever increasing public expenditure on poverty alleviation and development projects. This would be achieved through streamlining of the tax system to mobilize tax revenues from national economic growth. In Ethiopia, the responsibility for the administration of tax programs, as well as the delivery of economic and social benefits rests with the Ministry of Revenue (MOR), who formerly responsible to raise revenue for the Federal government and to prevent contraband. 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".

Ethiopian tax policy is based on taxpayers' voluntary compliance i.e. self-assessment; in which MOR has the mission for accomplishment of these policy objectives: "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". Currently MOR at federal level has 5 branches in which Large Taxpayer Office is among them which is expected to collect the highest revenue which is 70 percent (70%) the total domestic tax revenue and over 45percent (45%) of national tax revenue.

4.21. LTO annual report of tax audit performance

Table 4.21 LTO annual report of Tax audit performance

Budget year	number of tax payer in LTO	number of tax payer selected for audit based on risk	number of audited taxpayer for the period	percentage of audited taxpayers from the total number of total LTO taxpayers	declared tax by a taxpayer those selected for audit	Amount Planned to be collected by tax audit	additional tax assessed by tax audited	percentage
2008	1,116	205	130	12%	495.36 million	4.17 billion	3.26 billion	78%
2009	1,152	156	85	7%	559.39 million	3.15 billion	3.94 billion	125%
2010	1,145	227	133	12%	5.90 billion	5.06 billion	4.65 billion	92%
2011	1,056	272	157	15%	14,31 billion	4.41 billion	11 billion	249%
2012	754	169	134	18%	990.67 million	9.21 billion	21.16 billion	230%

(Source:- LTO annual report of 2008-2012)

Data analysis result of the annual report shows that there is under reporting of income by taxpayers, small amount of taxpayers are selected for audit when compared to the total taxpayers of LTO. Moreover those selected for audit are not entirely audited (low audit coverage) in which as the five years annual report of large taxpayers' office the percentage of audited taxpayers from the total number of total taxpayers is less than twenty percent (20%). Accordingly, the national audit plan the tax authority expected to audit twenty percent (20%)

of the taxpayer register annually to safeguard against being locked out on account of statutory time limits, the twenty percent or another percentage, as appropriate, would then constitute the upper limit. According to MOR (2019), audit coverage considers the proportion of the taxpayer register audited during a given period (financial/fiscal year and month). In order to cause the desired level of compliance through audit activity, and based on the level of risk indicators, it is imperative that the audit coverage is considered a key performance indicator. Consequently, as we have seen the percentage completion on the annual report of the five consecutive periods when the audit coverage increase the amount of tax assessed will increase which directly affect the revenue generation.

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. 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 (Gebeyehu, 2008).

The aforementioned result of the data analysis hence can be linked to non-compliance behavior of taxpayers and a gap in the tax audit practice with respect to audit Selection methods, types of tax audit performed, examination techniques and audit workforce capabilities of LTO. Tax stands as a major source of government revenue which guides national development and used to finance a substantial part of government operations including provision of public social services. According to the result of data analysis comparing the amount of tax collected from declared tax by certain taxpayers and after the assessment of tax (audit) it is clear that after the audit the taxpayers paid more tax. Therefore, the existence of effective tax audit in large taxpayers' branch office should give attention to increase the audit coverage and risk based audit to gain additional revenue from the audit activity. With tax audit tax liability can be easily declared and matters that need adjustment

are identified. It also helps in collecting tax interests and penalties which thereby increase revenue collection. Tax audit also helps to implement changes to eradicate evasion. Thus, tax audit is positively related to tax collection low tax to GDP can be linked to failure to collect all potential revenue because of poorly administered tax system characterized by low tax audits, gaps in existing databases of taxpayers, failure to verify majority of declarations and to follow up taxpayers who had not filed their returns or remained inactive since the time of their tax registration, capacity challenges in tax audits leading to low tax audit coverage and many contested audit results which resulted in reduction in amounts of tax assessed and weak revenue protection system which is highly dependent on informers instead of generating and reviewing exceptional reports from existing systems to provide more preventive revenue protection strategies. As we had seen tax audit determines the accuracy of returns so as to ensure the right taxes are submitted and matters that need adjustment are identified. It also helps in collecting tax interests and penalties which thereby increase revenue collection.

Tax policy and tax laws create the potential for raising tax revenues, the actual amount of taxes flowing into the government coffers, to a large extent, depends on the efficiency and effectiveness of the revenue administration. Weaknesses in revenue administration lead to inadequate tax collections; financing of the resulting budget deficit through borrowing or monetary expansion can cause an unsustainable increase in public debt and inflation, respectively (Eugene, 2011). Based on the findings of this study tax audit should be carried out more often and as thoroughly as possible so as to bring down the rate evasion and avoidance of tax to the minimum, The tax payers should be educated and enlightened as to importance and benefits of taxes to them and the economy at large, the work force/auditors should be well trained & motivated and tax collected by the government should be properly used. This will go a long way in encouraging tax payers to be more faithful. Tax audit performed at LTO should be embraced as it has a dual purpose or benefit: On the part of the taxpayer, it serves as a check on the proffers guiding tax administration and also helps in strengthening the activities of the taxpayer. To the authorities, it maximizes the collection of revenue which enables the government addresses developmental projects that will benefit its citizenry. Since audit is critical to causing the tax payer to be on their toes it should be serving as a reminder to all parties that it does not pay to engage in deliberate tax evasion this is particularly true for the taxpayer who is marginally complying and can easily be moved to the realm of tax evaders. According to the data analysis tax audit actually has an effect on

revenue collection that in essence means the more the tax audit conducted the more revenue is collected; thus it is right to say that tax audit is directly related to revenue collections. As a result it should be encouraged as it assists the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

CHAPTER FIVE

5. SUMMARY, CONCLUSION AND RECOMMENDATION

The previous chapter presented the results and analysis of the study. This chapter provides the summary, conclusions and recommendations in line with the findings of the study; it is structured in three sections. The first section deals with summary whereas the second section presents conclusions and some recommendations suggested as a solution to problems that have been identified in the study.

5.1. Summary on Findings

Since well experienced tax auditors/officials can tackle tax avoidance and evasions committed by non-compliant taxpayers in a better way LTO tax audit work force has experience of audit greater than three years. The majority of the tax auditors, senior tax auditor I & II and team leaders have a good level of educational qualification which are studied the field related to business with a BA degree and attended MSc/MA, this shows that the tax auditors' educational qualification is seem to be adequate to perform audit tasks and understand the implementation of taxes and related issues. Trying to meet the tax administration objectives the main activities of tax auditors in LTO during their audit work is detecting noncompliance behavior of individual taxpayer, Educating taxpayers, Interpreting complex tax rules and regulations for taxpayers and Identifying areas of tax law that require clarification and amendment. However 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. Even if those teething troubles are encountered the tax administration of LTO doesn't provide adequate training. Given the many tasks to be performed and the inevitable decisions that must made on priorities tax auditors are assigned to audit, with in each audit teams having their own team coordinators. In which an individual auditor expected to complete 2 to 6 audit cases on average in a year but a small coverage (14%) comparing with the total number of taxpayers in LTO. Even though the tax authority perform a competency assessments of auditors, it only evaluate the audit outcome (audit yield & coverage) and manners of auditors though it doesn't perform an assessment to improve the capability or competency of auditors tax audit which is indispensable for the tax audit effectiveness.

Based on accurate and timely taxpayer data audit case are selected for audit purpose through risk management department of LTO based on their associated compliance risk (compliance risk indicators) with presupposes certain clue of noncompliance. Currently the tax administrator mainly uses risk-based approach with the criteria of the business sector type, showing abnormal and repetitive loss report, underreporting income, reporting exaggeratedly deviated margin from the sector, potentially over claimed deductions and unusual credit and refund claim. MOR LTO branch mostly select manufacturing and construction sectors for the reason that taxpayers of those sectors have higher compliance risk and large tax potential at risk. Within the scope and the level of intensity depending up on the available evidence pointing to the likely risks of non-compliance and a taxpayer's history LTO predominantly conducts comprehensive audit to check whether taxpayers filed and paid the appropriate tax returns in line with the tax law and accounting principles. Likewise desk and refund audits are conducted for confirming whether the data submitted by the taxpayers is genuine or not and for verification of a taxpayer's claim for a tax refund respectively, other types of audit (de-registration audit, issue audit and advisory) rarely used in the tax administration; whereas fraud investigation audit conducted at head office of MOR. The accuracy of tax returns tested through review of financial statements and returns, examination of taxpayer's record such as books and documents, physical checks of taxpayers' assets and other aspects).

Taxpayers are expected to render tax returns based on their income, determine their tax liabilities and pay within the time stipulated by law however self-assessment. They may perhaps believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit. Even if the tax policy of Ethiopia is based on taxpayers' voluntary compliance (i.e. self-assessment) it is mainly exposed to the risk of tax evasion. The taxpayers' compliance risk in LTO is characterized by underreporting of income, nonpayment of tax returns when due and non-filing tax returns which is mainly arise due to taxpayers' lack of awareness, taxpayers' deliberate action and due to weakness in tax administration. Tax audit performed in LTO ensures arithmetic accuracy of all figures of tax payers' records, help to solve the problems of tax evasion/ avoidance and other irregularities; meanwhile the primary purpose of tax audit performed in the branch is to checking tax evasion, promoting voluntary compliance, assessing & collecting of additional tax revenue and also educating the taxpayer as a result tax audit can play a major role in treating the compliance risk available in LTO and increase revenue base.

For a successful audit, it is necessary that the assignment is accomplished, completely and efficiently to meet those accomplishment taxpayers' complaisant is important, nonetheless taxpayers of LTO sometimes don't cooperate to give essential information and documents necessary for performing an audit; in this sense auditors try to examine the taxpayer business by reviewing the previous case histories of taxpayers, using information from third parties and related business sector profile. Regardless of the type of audit performed LTO has a standard that requires audit activities to be started and completed within a predetermined timeframe however it doesn't take in to account the complexity and the size of the taxpayers business. Also repetitively audit (taxpayers that were audited in the previous period may be selected again for audit) for the reason that those taxpayers have large tax potential, serious tax fraud is found and taxpayers report less tax return than the previous period. Furthermore the tax authority doesn't run-through General Auditing Standard Procedure (GASP).

A very efficient and effective tax audit is a major part to play in tax administration. Among the factors that affect the collection of tax revenue of a country, tax audit effectiveness plays a vital role on the side of tax authority of LTO which minimize tax avoidance and evasion besides enhance and maximize revenue generation. However at MOR large taxpayers' office effective tax audit is assessed based on the audit coverage and productivity/yield of audit which is defined by the additional revenue gained by tax audit. Tax policy and tax laws create the potential for raising tax revenues, the actual amount of taxes flowing into the government coffers to a large extent, depends on the efficiency and effectiveness of the revenue administration. The branch has some weakness that a computerized system has not been fully utilized due to absence of well-organized and clean data, poor organizational setting, lack top management support, inadequate trainings for auditors. Weaknesses in revenue administration lead to inadequate tax collections; financing of the resulting budget deficit through borrowing or monetary expansion can cause an unsustainable increase in public debt and inflation, respectively.

5.2. Conclusion

Since the tax policy of Ethiopia is based on taxpayers' voluntary compliance (i.e. self-assessment) it is mainly exposed to the risk of tax evasion. Using risk-based approach with the criteria of the business sector type and other risk criteria's LTO predominantly conducts comprehensive audit for the sectors that have higher compliance risk and large tax potential

at risk; to check whether they filed and paid the appropriate tax returns in line with the tax law and accounting principles. Meanwhile the primary purpose of tax audit performed in the branch is to checking tax evasion, promoting voluntary compliance, assessing & collecting of additional tax revenue and also educating the taxpayer. As a result tax audit can play a major role in treating the compliance risk available in LTO and increase revenue base.

The taxpayers' compliance risk in LTO is characterized by underreporting of income, nonpayment of tax returns when due and non-filing tax returns which is mainly arise due to taxpayers' lack of awareness, taxpayers' deliberate action and due to weakness in tax administration. Tax audit performed in LTO ensures arithmetic accuracy of all figures of tax payers' records, help to solve the problems of tax evasion/ avoidance, and other irregularities. Even if taxpayers don't cooperate to give essential information the tax administration assess taxpayer business by reviewing the previous case histories of taxpayers, using information from third parties and related business sector profile; thus particular taxpayers may believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit.

A very efficient and effective tax audit is a major part to play in tax administration. Among the factors that affect the collection of tax revenue of a country, tax audit effectiveness plays a vital role on the side of tax authority of LTO which minimize tax avoidance and evasion, enhance and maximize revenue generation. Tax policy and tax laws create the potential for raising tax revenues, the actual amount of taxes flowing into the government coffers to a large extent, depends on the efficiency and effectiveness of the revenue administration.

Trying to meet the tax administration objectives the main activities of tax auditors in LTO during their audit work is detecting noncompliance behavior of individual taxpayer, Educating taxpayers, Interpreting complex tax rules and regulations for taxpayers and Identifying areas of tax law that require clarification and amendment. As a result educational qualification is seem to be adequate to perform audit tasks and understand the implementation of taxes and related issues. LTO tax audit work force has well experienced tax auditors/officials and have a good level of educational qualification which are studied the field related to business that can tackle tax avoidance and evasions committed by non-compliant taxpayers in a better way. However 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. Even if those teething troubles are encountered the tax administration of LTO doesn't provide adequate training and doesn't perform an assessment to improve the capability or competency of tax auditors which is indispensable for the tax audit effectiveness.

Weaknesses in revenue administration lead to inadequate tax collections; financing of the resulting budget deficit through borrowing or monetary expansion can cause an unsustainable increase in public debt and inflation, respectively. MOR large taxpayers' office has several weaknesses that a computerized system has not been fully utilized due to absence of well-organized and clean data, poor organizational setting, lack top management support, inadequate trainings for auditors, repetitively audit, low audit coverage's and the legal framework doesn't take in to account the complexity and the size of the taxpayers business.

5.3. Recommendations

To increase the audit coverage and voluntary compliance having inadequate staff resources, LTO should adopt a wide range of audit methodologies rather than use of full comprehensive audit. The issue audit should be widely applied to increase the audit coverage, and education type audits (advisory audit) that are not yet in place should be implemented to improve taxpayers' awareness and voluntary compliance. Furthermore, all taxpayers should feel that their underreporting and other noncompliance activities have a good chance of being detected due to high probability of being audited for this reason the tax administration of LTO should give emphasis for sectors of taxpayer to improve overall taxpayers' voluntary compliance that may affect future tax revenue.

Audit of all taxpayers is unattainable having inadequate audit resources and large noncompliant taxpayers both unknowingly and intentionally. For a better strike rate in increasing the tax revenues with the returns an audit selection strategy based on data-mining technique can meet the conflicting issues of audit planning tradeoff between maximizing audit benefits and minimizing audit costs, though it requires hi-tech (computerized) system which enables the branch to have effective tax audit that plays a vital role in enhancing and maximize revenue generation.

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. As a result the tax administration should pay close attention to the overall management of the tax audit function and in particular developing and managing individual audit staff by regularly trained about the rules and regulation of the country, international standard of audits, the legal frame work or audit manual and other related tax audit issue in order to strengthen the large taxpayer office capacity. Furthermore It is important that capability gaps are identified and acted upon, because as the competence of tax auditors increases, tax audit effectiveness will also increase and vice versa.

To ensure that tax automation adoption leads to an increase in government revenue performance, the MOR should implement an effective ICT infrastructure in the tax authority of large taxpayers' office in order to support effective implementation of tax audit practices. In addition the tax administration should improve the organizational setting, the top management should support the tax audit workforce, should avoid repetitive audit of a taxpayer and should increase the audit quality and coverage's by taking in account the complexity and the size of the taxpayers business during selecting and conducting of an audit. The study finally suggested further studies to be carried out regarding effective tax audit practices, audit workforce capabilities performance and other tax audit practices.

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Addis Ababa University
School of Business and Economics
Department of Accounting and Finance (MSc)
Research Questionnaire

Dear respondent,

I am a postgraduate student of the Addis Ababa University in Accounting and Finance Department. As part of the requirement of the program, I am required to undertake a research project in my area of study. My research topic is on “*Assessment of Tax audit practices and its Effect in Increasing Government’s Revenue in Ethiopia the case of ministry of revenues Large Taxpayers’ Branch Office*”. Therefore, the audit staffs of LTO have been selected as a respondent in this project. Your sincere and correct answers will be important in attaining this goal. All information will be treated with utmost confidentiality for learning purpose only.

Note: - You can give your opinion in Amharic language.

Thank you in advance for your cooperation!

Hanna Ali

Email – hanna.ali6842@gmail.com

Mobile – 0911-68-42-13

Appendix-1

Part I: Background information

1. Gender:

Male 1 Female 2

2. Age:

Less than 25 1 25-35 years 2

36-45 years 3 Above 55 years 4

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 Administration 4

Others 5, please specify _____.

Part II: Questions regarding Purpose and type of audit

5. What is the purpose of tax audits performed at LTO? (multiple answers are possible)

Promoting voluntary compliance 1

To check tax evasion and detect non-compliance 2

For assessment and collection of additional tax revenue 3

Educating the taxpayer 4

Others 5, please specify _____

6. What is the benefit of tax audit? (multiple answers are possible)

It ensures arithmetic accuracy of all figures of tax payers' records 1

Solves the problems of tax evasion avoidance and other irregularities 2

Identify areas of the law that require clarification or amendment 3

Can gather information regarding taxpayers' compliance behavior 4

Others 5, please specify _____

7. Do you think the existing role of tax audit is significance to treat the compliance risk available in LTO and increase revenue base?

Yes 1 Neutral 2 No 3

8. If your answer question #7 is No what do you think the reason is?

9. What types of Audit are usually performed in LTO? (Multiple answers are possible)

Desk Audit 1 Registration Audit 2 Fraud investigation 3

Issue Audit 4 Refund Audit 5 Comprehensive Audit 6

Field Audit 7

Other 8, please Specify _____

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

Part III: Questions regarding Compliance

11. Do taxpayers of LTO comply with the tax system in Ethiopia?

Yes 1 Sometimes 2 Neutral 3 No 4

12. How the compliance behavior of taxpayers does characterize in LTO? (Multiple answers are possible)

Comply with the existing rules and regulation 1

Non-filing tax returns 2

Underreporting of income 3

Fail to registered when required 4

Non-payment of tax return on time 5

Others 6, please specify _____

13. 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 action 2

Taxpayers' lack of awareness 3

Weakness in tax administration itself 4

Others 5, please specify _____

14. Does self-assessment exposed to the risk of tax evasion?

Yes 1 Sometimes 2 Neutral 3 No 4

15. 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?

Yes 1 Neutral 2 No 3

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

Yes 1 Neutral 2 No 3

17. 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 1

Using information from third parties 2

Using related business sector profile 3

Others 4, please specify _____

Questions regarding legal framework of tax audit

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

Yes 1 Neutral 2 No 3

19. If you have the manual how do you evaluate it?

It is clear and workable 1 It lacks some clarity 2

It is completely unclear 3

Other 4, please specify _____

20. Does GASP (General Auditing Standard Procedure) used during the audit?

Yes 1 Neutral 2 No 3

21. Is there any standard that requires the audit work to be started and completed within a predetermined timeframe?

Yes 1 Neutral 2 No 3

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

Yes 1 Neutral 2 No 3

23. Does LTO of MRO repetitively audit the same taxpayer in consecutive period?

Yes 1 Neutral 2 No 3

24. If your answer for question No. 23 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 _____

Questions regarding Effective Tax Audit Program:

25. What are the possible techniques used by the LTO in selecting taxpayers to be audited (multiple answers are possible)

Taxpayers are simply selected randomly 1

Data mining that identifies patterns of noncompliance in the past and current 2

Statistical techniques using prior tax audit results in conjunction with taxpayer data 3

Rule base and automated risk scoring system that identifies risk of noncompliance 4

Others 5, please specify _____

26. Are those selected taxpayers for audit notified in advance?

Yes 1 Neutral 2 No 3

27. If your answer for #26 is yes, does the advance notification have an impact? How?

28. Which business sectors are most usually selected for tax audit (multiple answers are possible)?

Manufacturing enterprises 1

Service enterprises like (professional services, hotel and hospitality etc.) 2

Merchandising enterprises 3

Construction and real estate sectors 4

Financial sectors 5

Others 6 please specify _____

29. What is the reason behind for the selection of the taxpayers that you have selected in Q #28?

Taxpayers have higher compliance risk 1

Taxpayers have large tax potential at risk 2

Taxpayers have no effective record or bookkeeping 3

It is difficult to tax taxpayers 4

Others 5, please specify _____

30. Do you think rotation of tax auditors in auditing a variety of organizations and different sectors has an impact on audit effectiveness?

Yes 1 sometimes 2 Neutral 3 No 4

31. If your answer for #30 is yes, what impact does it has?

32. Which type of tests is conducted at LTO to check the accuracy of tax returns?

(Multiple answers are possible)

Review of financial statements and returns 1

Examination of information from third party 2

Examination of taxpayer's record such as books and documents 3

Physical checks of current transactions, vouchers, assets and other aspects 4

Other 5, please specify _____

33. When and in what conditions the tests that you have selected in question #32 are conducted?

34. How does the efficiency 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 _____

35. How do you weigh the effectiveness of audit performed in LTO?

36. 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 _____

Questions regarding Audit Workforce and capabilities

37. Current job occupation:

- Tax auditor 1 Senior Tax auditor I 2
Senior Tax auditor 3 Tax audit team leader 4

38. For how long did you work with your current job occupation in MRO LTO branch?

- Less than 3 years 1 3- 6 years 2
7-10 years 3 above 10 years 4

39. 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 _____

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

Yes 1 No 2

41. How many audit cases on average an individual (auditor, senior auditor 1 or 2) has expected to complete in a year?

2 to 4 cases 1 5 to 7 cases 2 Greater than 7 cases 3

42. Does LTO provide training regarding tax audit issues any special training before during tax audit activities?

Yes 1 Sometimes 2 Neutral 3 No 4

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

Yes 1 Sometimes 2 Neutral 3 No 4

44. Do you think tax audit has an effect on the tax revenue growth? How?

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

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

Thank you!

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

1. What is the primary purpose of conducting an audit?
2. What are the possible measures to eliminate or reduce tax evasion in LTO?
3. Is there a responsible unit at LTO for the investigation of serious fraud or evasion?
4. Do you believe the current risk-based tax audit system optimizes tax collection and risk department is effective to select the taxpayers based on risks? If yes, how is it achieved? If not could you tell the reason and how it should be improved?
5. Which sectors are usually selected for audit? What would be the reason behind the selection?
6. Does LTO gather information regarding the taxpayers' compliance behavior and areas of weaknesses in the tax law through tax audit program performed?
7. Are taxpayers' of LTO aware of rules, regulations and other information regarding taxes? If they are not aware, how LTO plans to do regarding awareness creation and compliance improvement?
8. Does the tax audit program performed by the LTO makes its power visible to the community and encourages noncompliant taxpayers to comply?
9. Does the large taxpayers' branch office obligates the taxpayers for properly using books of accounts, whole accounting software modules and provides information to the tax auditor?
10. Is there adequate man power in numbers, knowledge and experience to conduct tax audit?
11. Do the management of LTO gives close attention for the tax audit by assigning appropriate and skilled persons allocating sufficient resources and support the audit workforce?
12. What are the required capabilities of a tax auditor, team leaders and section heads to participate in tax audit activities of LTO?
13. Are there any exam, tutor, and training to evaluate an auditor? If so, when and how the trainings and exams are provided? And do you believe encouragement of the tax officials could promote productivity.
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 and by what criteria audit cases are assigned to senior and junior auditors?
16. How many audit cases on average an auditor has expected to complete in a year?
17. How do you evaluate the strength of tax audit staff with respect to tax audit effectiveness?
18. Do you believe that LTO has currently collecting the potential amount of tax revenue? If yes, how is it achieved? If not, could you tell me the reason behind?
19. Do you have any ideas, opinions and suggestions on the effectiveness of tax audit on revenue generation and other issues that have not been included in the aforementioned questions?
20. How does Tax audit contribute to the tax revenue growth, lead to the taxpayers' compliance with tax laws?
21. What are the main weaknesses and strengths of the tax audit program performed in LTO as compared to international standards?

Thank you for your cooperation!

Appendix 3 – Risk management department in-depth interview instrument

1. Who perform the selection of taxpayers for audit?
2. How audit cases are selected and what are the bases considered or criteria used for selecting the audit case?
3. What are the possible techniques used by the LTO in selecting taxpayers to be audited (simple random sampling, data mining, statistical techniques, rule base or automated risk-scoring system)?
In what condition does it use those methods?
4. Does LTO Apply standard risk identification criteria for identify highly risky business? If yes would you please mention the criteria and procedures used to identify the highest risk taxpayers?
5. Does taxpayers of LTO that were audited in the previous audit period and found no tax liabilities owed during an audit are selected for audit in the current audit period?
6. Does the Case Selection method consider the availability of resource for tax audit
7. Are taxpayer's high tax potential and series evasion & fraud basis for selection?
8. Does the risk department timely available accurate and comprehensive data from the system, taxpayers and third parties?
9. Do you have any ideas, opinions and suggestions that have not been included in the aforementioned questions
10. Does the risk management staffs in numbers and the availability of relevant knowledge and skills to updating audit case selection process are enough on the level of the branch?

Thank you for your cooperation!