



St. Mary's University
School of Graduate Studies

**Assessment of Tax audit practices and it's Effect in
Increasing Governments Revenue in Ethiopia
A case study in Ethiopian Revenue & Customs Authority
Large Tax Payers Office.**

For the fulfilment of MBA in Accounting & Finance.

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Declaration

I the undersigned declared that this senior project is my work & that all sources of materials used for the research have been dully acknowledged.

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Endorsement

This Thesis has been submitted to St Marys University, School of Graduate Studies for Examination with my Approval as a University Advisor.

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Examiners Approval Sheet

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We, the undersigned, members of the Board of Examiners of the final open defence by Abinet Lulseged have read and his thesis entitled "Assessment of tax audit practice in Ethiopia and its effect on increasing Governments Revenue: The case of Ethiopian Revenue & Customs Authority – Large Tax Payers Office", and examined the candidate. This is, therefore, to certify that the thesis has been accepted for the partial fulfilment of the requirements for the degree of Masters of Art Specialization in Accounting and Finance.

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Acronyms

<i>AA</i>	–	<i>Audit Amount</i>
<i>AAT</i>	–	<i>Amount After Audit</i>
<i>EBDSN</i>	–	<i>Ethiopian Business Development Services Network.</i>
<i>ABT</i>	–	<i>Amount Before Audit</i>
<i>EC</i>	–	<i>Ethiopian calendar</i>
<i>ECC</i>	–	<i>Ethiopian Chamber of Commerce</i>
<i>ERCA</i>	–	<i>Ethiopian Revenue & Customs Authority</i>
<i>GC</i>	–	<i>Gregorian calendar</i>
<i>LTO</i>	–	<i>Large Tax Payers Office</i>
<i>MOFED</i>	–	<i>Ministry of Finance & Economic Development</i>

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Abstract

This paper seeks to explore the effect of Tax audit in promoting tax revenues growth in Ethiopia in the broader perspective. Survey questionnaires as primary data collection instruments were distributed to selected audit officers and some management members of Ethiopian Revenue & Customs Authority equalling to 120 staff and followed by descriptive research design and Secondary data included reports from Ethiopian Revenue & Customs Authority, Large Tax Payer Office from 2002 to 2007 EC and followed by analysis of SPSS software. The results of this research work indicate that, even if the practices of Tax audit are prerequisite for growth of Governments revenue, but the case of ERCA,,LTOs relationship between Amount before audit & Amount after audit is not Statistically significant. This doesn't mean that they really don't have correlation; rather it implies that the strength of the relationship is not significant or strong. In conclusion, weaker trend in awareness raising activity for tax payers, Manual based Tax Auditing system and high turnover of experienced tax auditors due was considered as findings in the areas of the Tax Audit activity, which have direct impact on reduction of Tax revenue. The result of this research shows that further studies are needed by maximizing the population including other branches and it has also have the potential to contribute theoretically to public finance but also to the area of institutional performance.

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Chapter One

Introduction

1.1- Background of the study

Governments devise the means to generate revenue to undertake their responsibilities. Historically, this has been done through the levying of various forms of taxes. In pre-modern times, taxation was viewed as a direct exchange of bargain in which the taxing authorities on one hand, and the tax payer on the other hand, each expected to receive equal benefit in relation to what it gave out. Taxes were looked upon as the wages paid to government for its services, the chief among them being security. This concept became known as the ‘bargain theory’ (Danquah, 2007). The common view was that each one was to provide all his needs otherwise he paid the government authorities to do that for him.

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.

According to (Brown et al , 2003) 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” The primary goal of a revenue body’s compliance activity is to improve the overall compliance with their tax laws, and in the process instil confidence in the community that the tax system and its administration are fair. Instances of failure to comply with the law are inevitable whether due to taxpayers’ ignorance, carelessness, recklessness and deliberate evasion, or weaknesses in administration. To the extent that such failures occur, governments, and in turn the communities they represent, are denied the tax revenues they need to provide services to citizens (Forum on tax administration’s compliance, (2006)). At a time when tax evasion techniques have grown more sophisticated, tax agencies have simultaneously been hit with a cascade of budgetary and staffing restrictions, continually changing tax statutes and more rigorous requirements for privacy. As a result of these pressures, many tax agencies continue to rely on audits of taxpayers’ business records and financial affairs to ensure

taxpayers have computed their tax payable in accordance with current tax laws and regulations and this implies the tax revenues growth otherwise, tax agencies can lose significant revenues opportunities. (Brown et al , 2003)

When tax audit is well conducted, taxpayers understand that their returns will be quickly and scientifically analysed, voluntary compliance rates may rise which would help tax agencies avoid costs and further improve revenue collections (Brown et al, 2003). Tax audit and compliance system, a comprehensive, integrated solution designed to improve tax auditor productivity and increase tax revenues.

In Ethiopia, taxes are considered as a source for growth and development. The tax revenues audit is a critical issue to the government of Ethiopia. Tax revenues and other revenues are central to the current economic development agenda. They provide a stable flow of revenue to finance development priorities, such as strengthening physical infrastructure, and are interwoven with numerous other policy areas, from good governance and formalizing the Economy, to spurring growth (Pfister, 2009).

Tax audit will enable the government of Ethiopia to control and ensure the taxpayers' compliance with tax laws thus this will increase tax revenue collected from taxpayers. One of the functions of auditing is to detect errors and frauds, ERCA's tax audit and investigation aim at stopping the loss which comes from tax evasion, fraud and corruption. If there is a fraudulent event by taxpayers, auditing practices will enable ERCA to find out the taxpayers who had avoided paying tax and paying the tax due with penalties and fines.

Expanded domestic revenue base (especially taxation) offers a promise of greater autonomy in the future and a break from restrictive aid and loan conditionality's. With this vision, the Ethiopian government over the years has tried to improve tax systems. For instance, ERCA has evolved from the merging of Ethiopian customs Authority and Ministry of Revenue, in order to strengthen and centralize the distributed tax collection system.

In addition to an effort done in increasing the government's domestic revenue, the government introduced tax auditing into the mainstream of tax administration in July 2008, The core duty of the Tax Audit unit is, to examine financial statements of tax payer's with the view of establishing their reliability, accuracy and completeness. It is also expected to detect and counter any tax evasion and avoidance schemes, optimize the declared tax liabilities,

ensure compliance with the Tax Laws, educate tax payers and advise the ERCA on policy formulation. The unit is currently staffed with One Thousand Two Hundred (1,200) officers with Seventy (70) members being active field officers. A well-resourced Tax Audit unit can contribute far more Niu (2010).

1.2- Statement of the problem

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. Once these are in place and the right tax policy is followed, then there is taxpayer mobility and there are other sources of revenue other than tax, the revenue collected will increase. That is when there is no political interference and the season is right otherwise the revenue collected will decrease.

Obviously, a properly designed and administered taxation system is very vital in generating revenue as well as increasing the tax base to the government of developed, developing, and transitional economies. 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 favour 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 reality, under inadequate tax administration including insufficient and ineffective audit program, the potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner (Edmiston & 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.

In Ethiopia, taxation has been used for the purpose of raising governments revenue is 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 small number of tax agencies " cooperation with the business community". Tax systems are usually elaborated without proper discussion with the business community. In addition, the business owners do not have easy access to clarification on information of the tax laws. The tax agencies rarely provide advising services. As a result, taxpayers misinterpret tax rules and regulations. Moreover, they lack awareness regarding the tax type to be imposed on their doings, purpose and operation of desk audit, goods and services exempted from tax, negative upshot of contraband trade, and reporting and filing requirements of the tax law. (ECC & EBDSN, 2005.)

A successful audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue. To the greatest possible extent, tax systems should be supported by clear and straight forward laws and procedures that facilitate revenue collection, develop taxpayer's awareness, and minimize taxpayer's effort and compliance costs. The administration should be provided with appropriate enforcement tools, including conduct of effective audit. Hence, to create an effective and fair tax system, it is vital to address the administration problems that affect it.

Regarding audit staff, there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once they have given and held a particular position. Due to this reason, there is staff turnover in the tax authority, tax audit unit in particular. The authority fails to retain proficient and well-trained auditors. As a result, ERCA get in to trouble to retain experienced and proficient tax auditors. If Tax auditors are not at the required level of operational capability to conduct tax audit and professional capability they get troubled in giving appropriate services to taxpayers. The incapability of tax auditor might be due to absence of using effective pre-audit plan and inadequate audit training as well as their lack of willingness (Getaneh, 2011) .

Currently few researches have been done in this area, of which most of them are not based in Ethiopia. Their main concern is to show, the positive relationship between Tax Audit and to

that of Government revenue and Tax compliance. In addition the negative relation between Tax audit and tax evasion. In their analysis part they indicated that Tax Audit has increased Government revenue by Increasing Tax compliance and decreasing tax evasion and avoidance as well.

. Furthermore, in this regard there are no researches have been done in the Ethiopia's ERCA Large Tax Payers Office. In addition to the above tax administration problems and the presence of research gap initiates the researcher to fill the gap in this area. Besides the citizens do not understand the relationship between revenue collection and tax audit and therefore they see it as a waste of time and a bother to them. Mutarindwa and Rutikanga , (2014).

So, this study was intended to fill these gaps by establishing relationship between revenue collection and tax audit in ERCA. Furthermore, the study will also show how Tax Evasion and non Compliance affects tax revenue collection of a government.

1.3- Research Questions

In line with the problems statements, the researcher developed three specific research questions. So, the main research questions will be:

- 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?

1.4- Objectives of the Study

The main objective of the study is assessing the effect of tax audit on tax revenue growth.

Specifically, the study attempt to:

1. To analyse the effect of tax audit in increasing governments revenue by strengthening tax Administration capacity.
2. To assess the tax audit practice in minimizing tax evasion in ERCA, LTO.
3. To show the significance of tax audit leads to taxpayers' compliance with tax laws.

1.5- Hypotheses

This research is related to Tax Audit and Tax Revenues Growth. This focused on:

H1: “Tax audit contribute to tax revenues”.

H0: “Tax audit does not contributes to tax revenues growth”

1.6- Significance of the Study

This research work can give feedback to tax payers and the tax authority regarding the significance, application and practice of tax audit. The study also contributes in evaluating the prevailing tax audit practice and in making some adjustments on the existing tax audit systems. Moreover, it can provide constructive feedback about the efficiency and effectiveness of the existing tax audit practice in Ethiopian Revenue & Customs Authority (ERCA). For those who are interested to make further study on the related issue it may be used as an indication.

This project work is intended to provide immense benefit to tax administration and auditing in Ethiopia and also seeks among other things to establish the extent to which tax administration and auditing can be improved. Again, knowing the positive extent to which tax administration and auditing has helped and the purpose of which tax auditing has been introduced to help in planning the country’s economy. Mechanisms used in tax administration and auditing in Ethiopia gives clear methodologies that are of great importance to the research work.

1.7- Scope of the study

This research work assesses the tax audit practice in Ethiopia with special reference to the ERCA. While studying the tax audit practice, this study considers only the practice and its application in the ERCA LTO office, thus the scope may be somehow limited.

However, since the general guidelines, application procedures and practice are the same throughout the country; it is supposed that this study can fairly reveal the tax audit practice and its effect in increasing the revenue of the country.

1.8- Organisation of the Study

The project work is categorized into five main chapters. Chapter One focused on the background to the study, problem statement, objectives, significant of the study and Scope.

Chapter Two is devoted to systematic review of existing literature. It provides evidence regarding the tax audit practice and its role in increasing revenue of the government. The Third Chapter deals with research methodology including population, sampling techniques, methods of data collection and the research instruments employed. Chapter Four is also made up of detailed analysis of data collected and presentation of information with the aid of quantitative and statistical models. Finally the Fifth Chapter covers conclusion, findings and recommendations.

Chapter Two

Review of Literature

2.1 Introduction

This section reviews scholarly literature on taxation and tax audit practices. It provides an extensive and sufficient guide for the research and to assist other researchers who seek to replicate or delve more deeply into the thesis research topic.

2.2 Definition of Taxation

Taxation is often defined as ‘the levying of compulsory contributions by public authorities having tax jurisdiction, to defray the cost of their activities’ (Arnold and McIntyre, 2002:6). No specific reward is gained by the tax payer. The money collected is used for the common good of the citizenry – for the production of certain services, as aforesaid, which are considered to be more efficiently provided by the State rather than by individuals e.g. maintenance of law and order or security, water, electricity, transportation, etc. (Eugene,2011)

2.2.1 Purpose of Taxation

The definition of taxation given above underlines the main purpose of taxation, that is, to raise revenue to defray the cost of services provided by the State. Other purpose of taxation are to reduce inequalities arising from the distribution of wealth; to restrain certain types of consumption e.g. alcoholic beverages and cigarettes; to protect home industries and to control certain aspects of the country’s economy e.g. balance of payment, employment saving, investment and productivity. (mesfin,2008)

2.2.2 Basis for Taxation

Governments have enumerable responsibilities. Some of these include economic infrastructure (roads, legal tender, enforcement of contracts, etc.), enforcement of law and public order, and protection of property, public works, social engineering, welfare and public services (including education systems, health care systems, pension for the elderly and public transportation. Energy, water and waste management systems are also common public utilities) and the operation of government itself.

A number of revenue sources are available to a government to execute these responsibilities. Among the many sources is tax. Taxes consist of one prominent, prudent and feasible source of revenue for the government. Governments therefore tax the people in their country as they produce to earn income for themselves. Taxes form a high percentage of revenue to nations. Funds provided by taxation have been used by states and their functional equivalents throughout history to carry out many of these functions outlined above. Governments use different kinds of taxes and vary the tax rates. This is done to distribute the tax burden among individuals or classes of the population involved in taxable activities, such as businesses, or to redistribute resources among individuals or classes in the population.

Historically, the nobility were supported by taxes on the poor; modern social security systems are intended to support the poor, the disabled, or the retired by taxes on those who are still working. In addition, taxes are applied to fund foreign and military aid, to influence the macroeconomic performance of the economy (the government's strategy for doing this is called its fiscal policy), or to modify patterns of consumption or employment within an economy, by making some classes of transaction more or less expensive.

2.3- Tax Audit

An audit is the independent examination of financial statements of related financial information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon. The American Accounting Association (AAA) (2008) has provided a broader definition of audit which refers to a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. In a narrower sense, audit is an 'attestation communication' because it presents the auditor's opinion or judgment concerning the degree of correspondence between accounting information and established criteria. (Eugene,2011)

To the tax administration, tax audit refers to the examination of tax returns by concerned tax officials primarily with respect to checking as to timely arrival, inclusion of all required forms and attachments, and arithmetical accuracy. This may be called internal tax audit.

A tax audit is one of the most sensitive contacts between the taxpayer and a revenue body. The presence of an auditor in a taxpayer's private dwelling or business premises, coupled with the exploration of private and business issues and the gathering of information from

taxpayers' books and records, or just the disruption of day-to-day workflow, represents a burden on the taxpayer and may be seen by some as an unwarranted intrusion into their affairs. Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying provided information. (Eugene,2011)

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. These factors, as well as the absolute 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. (Eugene,2011)

Historically, the audit function conducted by public accountants has been associated with this activity of attesting to financial statements. Tax audit (expected to be performed by public accountants) can be thought of as an extension of this 'attest function'. For tax purpose, one assessee is liable to file a return to the concerned assessing officer with supporting documents sometimes required by tax law for simultaneous submission with the return. The assessee is sometimes called upon by the assessing officer under the tax law for producing the same. In this context, the question of tax audit may arise. And 'tax audit' means to audit an assessee's accounting and other documentary evidences to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in tax return and other required evidential statements regarding allowances and disallowance for deductions and all these are to be followed by an audit report giving the auditor's opinion about the degree of correspondence between the information content in the tax return and the regulatory provisions of the existing tax laws (AAA, 2008).

Thus, tax audit comprises the following:

Accounts and other evidences are required to comply with the 'tax basis of accounting', i.e. as per requirement of tax laws;

- Preparation of tax return, statement of computational working for items in the return and statements containing particulars of allowances and disallowance for deduction;
- Giving audit report portraying the attest function whether the tax return and statements have been fairly prepared as per the regulatory requirement of tax laws (Mukul, 2005).

When we think about who does tax audits, we first think of a public inspector, a civil servant, integrated in a public organization or agency of the government. Nevertheless, in the field of

private financial statements audit, the audit must comprise all the economic-financial operations, including the taxes-originated ones, and the auditors opinion must also include whether the taxpayer has correctly assessed tax liability. For instance, according to Kamal Gupta & Ashok Arora, in India, the Income Tax Act, provides for compulsory audit of the accounts of certain income tax assessee's (i.e. persons liable to pay income tax) whose turn over exceed the specified limits. It was also practiced for some years in India but left after the 1997 E.C. election. The objective of such audit is to assist tax authorities in making the correct income tax assessment of the assessee's concerned. The tax auditor has to specifically report on certain transactions which have an impact on the income tax liability of the assessee concerned and are, thus important to the tax authorities (Ahymed and Stern, 1991).

2.4 Scope & Extent of Governments Revenue

In recognition of the importance of an efficient revenue collection system for mobilizing the budgetary resources of the government, the need to establish revenue audit as a specialized and independent domain has been engaging the attention of the Supreme Audit Institutions for quite some time. The International Congress of International Organization of Supreme Audit Institutions (INTOSAI) held at Rio de Janeiro, Brazil in May, 1959 recommended that: Supreme Audit Institutions (SAI) ought to exercise the broadest possible supervision of revenues. (mesfine,2008)

Supervision should not be limited to the checking of collection of revenues in line with the accounts rendered by the collectors but, wherever possible, a check should be made to see whether or not tax payments were in line with legislation.

SAIs should ascertain whether there has been negligence in the matter of collections or exaggeration in the estimates. The SAIs ought to be equipped to carry out their duties, especially as regards supervision of revenues, with mechanized accounting and statistical services. (Eugene,2011)

The concept of tax audit was a sub-theme in the Third International Seminar of INTOSAI held at Bali, Indonesia in June 1988. The following guidelines were recommended in the area of tax audit.

(a) Audit mandate: SAIs should seek clear and specific legal authority for undertaking comprehensive tax audits in conformity with the relevant provisions of the Lima Declarations on Auditing Precepts.

(b) Audit of individual tax assessments: It is important that individual tax files are examined to evaluate the adequacy of the system and procedures of tax assessment and collection. As the examination of all tax files is neither feasible nor necessary, best results may be obtained while concentrating on high value and risk areas. Selective auditing of business income cases rather than salary assessment, investigations of reported evasions and use of suitable statistical sampling techniques in the review of files are preferred practices. Data and information on tax payers collected by the tax authority may be verified against other independent sources available.

(c) Interpretation of tax laws: SAIs should scrutinize the rules, regulations and notifications issued by the executive agencies under the tax statutes.

(d) Scrutiny of decisions of tax authorities: Where quasi-judicial and discretionary powers are vested in the tax officials, any decisions taken in the exercise of such powers should be scrutinized in audit.

(e) Audit methodology: Audit should be mainly system based and the objective should be to discover loopholes, lacunae and deficiencies not only in tax administration but also in tax laws. Adequate procedures for identifying and dealing with tax avoidance arising from deficiencies in laws could be considered so that remedial action including amendments to the laws could be taken promptly.

(f) Socio-Economic implication of taxation. The social and economic goals proposed to be achieved through tax concession and relief should be reviewed in audit.

(g) Reporting on the results of tax audit: Having regard to personal privacy considerations, it is imperative that confidentiality be maintained in reporting individual assessments in the audit reports.

(h) Training of tax auditors: Tax audit is a specialization which requires thorough knowledge of the relevant laws and regulations. SAIs should provide intensive and frequent training for tax auditors taking advantage of the training facilities available in their local tax department's training institutions as well as those in other SAIs.

2.5 Roles of the Taxpayer Audit Program

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. These roles are described briefly hereunder: (mesfine,2008)

- **Promote voluntary compliance:** The primary role of the audit program is to promote voluntary compliance by taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized.
- **Detect non-compliance at the individual taxpayer level:** By concentrating on major areas of risk (e.g. unreported cash income) and those individual taxpayers most likely to be evading their responsibilities, audits may bring to light significant understatements of tax liabilities, and additional tax revenue collections.
- **Gather information on the ‘health’ of the tax system (including patterns of taxpayers’ compliance behavior):** The results of normal audit activity may provide information on the general well-being of the tax system. Audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance, that over time can be used to identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on future compliance improvement strategies, to refine automated risk-based case selection processes, and even support changes to tax legislation.
- **Gather intelligence:** Audits may bring to light information on evasion and avoidance schemes involving large numbers of taxpayers that can be used to increase major counter-abuse projects.
- **Educate taxpayers:** Audits can assist clarify the application of the law for individual taxpayers and to identify improvements required to recordkeeping and thus may contribute to improved compliance by tax payers in the future.

Identify areas of the law that require clarification: Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws’ requirements and/or to better educate tax payers on what they must do to comply into the future. Given the broad range of roles to be performed a revenue body’s audit program typically entails the largest allocation of a

revenue body's total staff resources. From this perspective alone, the audit program represents a sizeable strategic investment that dictates the need for sound management policies and practices. (Eugene,2011)

2.6 Audit of Revenue of Government.

As mentioned earlier, government revenues are sourced from various tax and nontax receipts. The country papers bring out the dimensions of these two sources which in turn influence the areas of audit priority. These are tax and non-tax revenues. Government revenues are largely dependent on taxes legislated through various tax statutes. However, the spread of the two sources, viz. tax and non-tax revenues, varies from country to country. (Eugene,2011)

The scope of audit activities varies across countries, in part as a result of the system of assessment in place. There are two generally accepted systems of tax assessment applied worldwide (administrative assessment and self-assessment) In around half of OECD countries, administrative assessment is employed to varying degrees in the administration of personal income tax and corporate profits/income tax. All countries administer VAT under self-assessment principles. (mesfine, 2008)

Assessment systems operate on the principle that all tax returns should be subject to a degree of technical scrutiny before a formal assessment is sent to the taxpayer. In practice, however, much of the scrutiny previously undertaken by technical staff has been replaced in many countries by the use of automated screening techniques to identify returns requiring scrutiny before a formal assessment is issued. To the extent that there is some level of scrutiny carried out by technical officers, it ranges in practice from a very cursory examination of some tax returns to a more in-depth examination where further inquiries may be made with taxpayers (sometimes by correspondence) before a formal assessment is issued. Even countries that operate administrative assessment regimes complement these arrangements with a formal program of post-assessment audits. However, in practice such programs tend to be conducted on a smaller scale than is the case in countries only applying self-assessment principles.

In countries where self-assessment principles are applied, returns are typically accepted as filed in the first instance (with the exception of returns containing mathematical errors or clearly erroneous deductions) and, for income tax, a formal assessment/ notice confirming/advising the tax liability is sent to the taxpayer before any inquiry. A sample of returns is selected for post-assessment audit, generally applying computer-based risk selection techniques and/or manual screening processes. Large scale matching programs may

also be mounted on a post –assessment basis for the major categories of income (i.e. wages, interest, and dividends). (mesfine,2008)

Since virtually all tax returns are accepted as filed without technical scrutiny when applying self-assessment principles, it is essential for the system to be supported by a reliable automated audit case selection system using risk-based screening techniques. Typically, such systems are developed using risk-based criteria derived from analyses of completed audit cases and are regularly updated to take account of the results of audit activities and to reflect important changes in the behavioural patterns of taxpayers. Examples of risk identification models and approaches are described in the companion note ‘Audit Case Selection. As systems of administrative assessment and self-assessment have evolved over time in many countries there is something of a fine-line in practice between their features and relative efficacy. (Eugene,2011)

According to the Ethiopian Federal Inland Revenue Authority’s tax assessment and audit manual (2006), an assessment is basically an initial review by tax official of the tax declarations and information provided by tax payer and a verification of the mathematical and technical accuracy of the declared tax liability shortly after the submission of the declaration. The initial review also includes the application of various risk criteria to determine possible tax underpayments and the subsequent selection for tax audit.

An audit on the other hand, is the conduct by audit staff for appropriate verification of selected tax payers declared tax liabilities. This can include a review of tax payer’s systems, books of account and other related information. It may also include cross checks of tax payer’s records with those of tax payer’s suppliers or with other source of information such as the custom authorities or other government departments and agencies. (Eugene,2011)

2.7 Key Audit Characteristics

According to (Eugene,2011), Compliance regimes operate within the unique legal, cultural and administrative background of individual member countries. Nevertheless, there are a number of common pre-requisite features and requirements that need to be in place to ensure a good level of effectiveness and efficiency from audit activities and to support continuous improvement. They are:

- A comprehensive legal framework, including an appropriate regime of sanctions.
- Well-defined organizational and management processes, including a comprehensive performance measurement framework.
- Well-defined audit techniques and adequate support arrangements; and.

- Adequate human resource management and development programs.

2.8 Demand for Tax Audit

Four conditions tend to create the demand for the independent performance of the audit or attest function. They are as follows: (Eugene,2011)

- ✓ Conflict of interests between those who prepare accounting information reports and those who use them;
- ✓ Consequence of information to users while using them in decision-making;
- ✓ Complexity of subject matter and audit process; and
- ✓ Remoteness of users from subject matter and preparer.

When audit function is extended to tax, the above-mentioned four conditions are also required to be satisfied. Here, the preparer of income tax return and relevant information (the assessee) has the conflicting relationship in terms of financial interest with his counterpart user or evaluator of the return (the assessing officer). Because, manipulated information in the tax return may reduce the tax liability. (Eugene,2011)

Second, use of the tax return, assumed to be correct and complete, may have serious consequence on Government fiscal estimation and collection thereof. As a result, all the budgetary appropriations may stand for nothing but a baseless imagination.

Third, both financial accounting and tax accounting are recognized as a much complex discipline due to technicalities and their distinct characteristics of difficulties. Finally, between the preparer of the return and the information therein (by the assessee) and the assessing officer, there exists a wall of remoteness though the latter can call for any additional information from the former to be satisfied with the completeness and correctness of the information provided. But sometimes this may not be possible due to time and cost constraints and some other reasonable causes.

In this case, the tax authority can apply his best judgment, which may not be the expression of the reality and thus both the parties, the Government and the assessee may be affected by under- or over-charging of tax. Therefore, all the conditions creating the demand for audit with respect to tax can be found to be satisfied.

Besides, the Committee on Basic Auditing Concepts (COBAC) suggested that the subject matter of any extension of the audit function must have the following attributes:

- ❖ The subject matter has to be susceptible to the deduction of evidential assertions. Such assertions have to be both quantifiable and verifiable;

- ❖ There has to be an information system to record the actions, event or results thereof; preferably adequate internal controls have also to be in operation; and
- ❖ Consensus should exist on the established criteria against which the information prepared from the subject matter can be evaluated.

Each of the attributes stated above is essential. Two additional conditions are also needed. They are: auditor's competence and summarization of findings in a report. The COBAC of AAA has recognized that extension of the attest function to the audit of income tax return appears to satisfy all the attributes stated above. The subject matter allows the deduction of evidential assertions, which are verifiable as well as quantifiable. Tax law requires the maintenance of an 'information system' adequate for recording the actions and events, and the law also serves as a criterion for evaluating the subject matter information.

The International Federation of Accountants (IFAC) Ethics Committee, in the 'Code of Ethics for Professional Accountants' has defined 'professional service' as 'any service requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services'. Hence, an auditor must be competent first in accounting, inevitably in auditing, as well as thereafter in taxation. (Eugene,2011)

Introduction of tax audit by qualified professional accountants is indeed the esteemed recognition of their specialized competence. The real benefit from compulsory tax audit, if legally enforced, is that the audit will ensure maintenance of proper books of accounts and other records. The growing accounting habit thus developed will enable creation of a transparency of the in the middle of grey area between assumed income and reported income. Thus, tax evasion will be markedly curbed through checking the fraudulent practices concerning colluded accounts. Other arguments in favour of tax audit include: tax return with added credibility and accompanied by tax audit reports as well as necessary supporting statements can reliably be presented before the authority facilitating tax administration, relieving assessing officers from carrying out routine verifications, and attending to more important investigation aspects of assessment cases through utilization of the saved time.

2.9 Types of Tax Audits

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 (Mugume, 2006):

Full audits – The scope of a full audit is all-encompassing. It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. The objective is to determine the correct tax liability for a tax return as a whole. In some countries full audits are carried out as part of random audit programs that are used to gather data on the extent, nature and specific features of tax compliance risks, for compliance research purposes and/or the development of computerized audit selection formulae. Given their broad scope, full audits are typically costly to undertake a substantial program of full audits will require considerable resources and reduce the rate coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types.

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

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

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

Periods under examination: Audits can focus on one financial year or accounting period, or be extended to cover multiple fiscal periods. An audit can focus on specific parts of the taxpayer's activities (such as sales, goods in stock etc), specific incidents or transactions or activities (such as those carried out in a branch or subsidiary), or specific tax obligations. An audit can vary in its level of detail. Sometimes the taxpayer's affairs are examined in detail and in other situations, subject to the level of risk perceived, merely superficially (Bukanya, 1996).

2.10 Resources for the Tax Audit Function

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. In some member countries, revenue bodies have relatively limited discretion as to how staff resources are to be spread across the various areas of work, while in others broad discretion is given to senior management on how resources are to be allocated. (Eugene,2011)

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 is dealt with in the following section

1 Forum on Tax Administration's Compliance Sub-group

2 Tax Administrations in OECD and Selected Non-member Countries: Comparative Information Series (2006)

The significance of the roles played by the taxpayer audit function, as described above is evidenced in part by the relatively large proportion of staff resources devoted to this function. In many member countries, the proportion of the revenue body's overall staff resources devoted to audit and other verification activities exceeds over 30%.

2.11 Location of Audits

Tax audits can be conducted in different locations. Sometimes there is a need to carry out the audit at a taxpayer's business premises. In other situations, the books and records required to complete an audit can be collected by, or sent to, the revenue body and the audit work performed in the office. Tax audits can be categorized as 'field audits' or 'office or desk audits' on this basis. (mesfine,2008)

Given that audits can vary in terms of their scope and intensity revenue bodies should have a clear policy on the types (and numbers) of audits to be conducted, and the circumstances in which specific types of audits are to be carried out, so that audit officials (including managers) understand what is expected of them. (mesfine,2008)

2.12 Approaches & Standards of Tax Audit

In conducting a tax audit the auditor should apply the generally accepted practices of auditing as one would do in the case of other audits, e.g. an audit of a company under the companies act (Kangave, 2004). The generally accepted auditing practices are communicated in the various pronouncements of the respective country. The auditor should get the financial statements as well as the statement of particulars authenticated by the assessed before he

verifies them. The auditor can apply the technique of selective verification (statistical sampling/test-checking), depending on his evaluation of the internal control system prevalent in the entity under audit and the materiality of transactions.

In conducting the audit the auditor should keep in mind that the basic objective behind is to assist the authorities in assessing the collect income of the assessed. For conducting the tax audit effectively an auditor needs to develop an approach which is a synthesis of taxation laws and auditing principles. The nature of tax audit is such that an auditor has to rely on various legal pronouncements in the field of taxation. Tax Administration in OECD and Selected Non-member Countries: Comparative Information Series (2006).

2.13 The Efficiency and Effectiveness Tax Audit

Audit effectiveness is measured by examining the amount of evidence selected for examination in relation to the total available evidence and an optimal level of evidence. Audit efficiency is then defined as audit effectiveness per unit of time by taking the audit effectiveness measure divided by minutes spent on the task (Kangave, 2004). The key findings were that time pressure (manipulated by four levels of a time budget for the task) affected performance only at the extremes, with the highest time pressure group performing more efficiently than the auditors in the lowest time pressure group. Efficiency was also affected by audit program structure, with high structure (more detailed audit procedures listed) being associated with increased efficiency.

Apostolou *et al.* (1993) defined Audit efficiency as the ability to meet the budget and operationalize it as the percentage deviation between actual and budgeted hours. This research examined the effect of leader behaviour on audit efficiency. Two leader behaviours; (1) facilitating cooperation and teamwork and (2) administering discipline; resulted in increased audit efficiency. On the other hand, showing consideration contributed to reduced audit efficiency (Apostolou *et al.*, 1993).

In addition in an economic sense, the concept of efficiency is rooted in the ideas of minimization of inputs, absence of waste, and least cost production methods Auditing practitioners tend to define efficiency as accomplishing the audit task in less time thereby increasing profitability (McGrath and Hollingshead, 1993). The efficient and effective conduct of audit activities requires that a revenue body's audit and investigation staff have appropriate powers of access to information held by the taxpayer and other parties so that taxpayers liabilities reported in their returns can be properly verified or, in the absence of

returns, be accurately established. There should also be an appropriate regime of sanctions to punish and deter non-compliance (Moyi and Muriithi, 2003).

For these reasons, revenue bodies require a set of powers and sanctions in the legal framework supporting the conduct of tax administration activities that includes the provision of adequate powers for obtaining information and an appropriate regime of sanctions covering the various offences that may arise (Cheeseman and Griffiths, 2005). In practice, this legal framework may be set out separately in the laws governing each tax administered or, preferably for ease of legislative maintenance, in a single comprehensive law on tax administration that provides a common set of provisions covering all taxes. In the US, an official form titled 'Cost Benefit Analysis' (Review of Cost Effectiveness of Investigations) is used to measure the cost benefit of continuing an audit. The form is being prepared at a predetermined stopping point in the audit (such as when 60 hours have been expended by the auditor) (Cheeseman and Griffiths, 2005). The form calculates cost benefit by assigning dollar values for the auditor's hourly labour costs and multiplying the cost by the hours projected to complete the audit. The auditor's total labour dollar cost is matched against the projected revenue anticipated (benefit of continuance). A negative cost benefit analysis may result in the early termination of the audit.

Collectibles is another factor for possible consideration. Some countries use collectability as a pre-contact consideration and other countries reported that it could become a factor during the course of the audit if bankruptcy were imminent (Kangave, 2004). 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 (Kangave, 2004).

2.14 Importance of Tax Audit in Fighting Corruption

Simply defined, corruption is the abuse of public power for personal gain or for the benefit of a group to which one owes loyalty. It occurs at the intersection of public and private sectors, when public office is abused by an official accepting, soliciting, or obtains by threat a bribe. Klitgaard (1996) has developed a simple model to explain the dynamics of corruption:

C (Corruption) = M (Monopoly Power) + D (Discretion) – A (Accountability)

In other words, the extent of corruption depends on the amount of monopoly power and discretionary power that an official exercises. Monopoly power can be large in highly regulated economies; discretionary power is often large in developing countries and transition economies where administrative rules and regulations are often poorly defined. And finally, accountability may also be weak, either as a result of poorly defined ethical standards of public service, weak administrative and financial systems and ineffective watchdog agencies. Tax is one of the most exposed issues for corruption since it is carried out by the interaction of the tax payer and the tax auditor. (Eugene,2011)

2.15- Criteria for a Good Tax Audit

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

1. The tax auditor must be familiar with the environment in which he works. It is a condition which is highly critical that the tax inspector must be properly schooled in the political, economical, social, cultural and religious environment of the taxpayer. A good knowledge of his environment will affect the decision made by him.
2. The tax officials should be motivated to carry out tax audit, he should be properly trained and have experience in his area. The tax inspector should not be carried away by corrupt practices that render the aim of the tax audit useless.
3. The tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.
4. Specialization should be encouraged. The cases should be grouped. This will allow the tax audit staff to become specialist in specific field.
5. The manner in which the audit is being carried out should be changed. The use of computer should replace the manual process as this will go a long way in facilitating the job and helping to preserve information for a long time. This will improve the efficiency of the exercise (Ogundele, 1999).

2.16- Tax audit and investigation

According to (mesfine,2008), A number of issues are often mentioned when discussing matters relating to Tax Audit and Investigation. They are so persistent that they cannot just be ignored. A modest effort will hereby be made to address some of these contemporary issues related to Tax Audit and Investigation. Some of these are summarized below:

A. Responsibility for the result of Tax Audits

The result of a tax audit is enforced by holding the employer responsible for any tax liability arising from the tax audit of the employees. In a situation where some affected staff (local and expatriates) might have left the country by the time of the audit there is always a debate as to who should be held responsible. This debate is quite unnecessary as the law is clear on who should be held responsible. Article 90 of the Personal Income Tax Proclamation (PITP) states Penalty for Failure to Withhold Tax can be

1), A withholding agent who fails to withhold tax in accordance with this Proclamation is personally liable to pay to the tax Authority the amount of tax which has not been withheld, The withholding agent is entitled to recover this amount from the payee.

2) The tax withholding liability imposed by this Proclamation shall be treated as a tax liability for purposes of any Article providing taxpayers with the right to contest the amount of tax due or to recover tax paid. .

3) In addition to any amount for which a withholding agent is liable under Sub-Article (1), an agent who fails to withhold tax in accordance with this Proclamation shall be liable for a penalty of 1,000 Birr for each instance of failure to withhold the proper amount.

So uncollected tax from Income tax shall be recoverable as a debt due by the employer to the relevant authority". Thus it is the duty of the appointed collection agent or an employer to fully account for what it had deducted, or ought to have deducted, on behalf of the relevant tax authority.

B. Definition of Income.

Chargeable Income is defined in Section 10 of Income Tax Proclamation 286/2002 "Income" shall mean every sort of economic benefit including nonrecurring gains in cash or in kind, from whatever source derived and in whatever form paid credited or received. 3 (1) of the PITP as the income of a person "from a source inside or outside Ethiopia " and it includes any gain, profit salary, wages, fee, compensation, bonus, premium and almost all conceivable allowances but excluding some reimbursable expenses and compensation for loss of office. In some cases, only basic salary is included by the employers while other taxable allowances like bonus, appropriate portions of rent and transport allowances and leave pay are wrongly excluded from taxable income. In the oil industry where the compensation package is robust, exclusion of relevant income and allowance has the tendency of gross understating PAYE taxes and remittances to the respective state government. The normal audit approach is to re-compute the taxable income and tax there from with a view to

recovering possible underpayments, if the collection agents have previously been computing the taxable income as stipulated by the Proclamation, there would have been no need for elaborate tax audit.

C. Focus on Revenue Generation

It is often said that the customer is always right, this is however not the case in the relationship between the tax authority and the taxpayer. This is so because the major aim of tax audit and investigation is not to manage the taxpayer but a focus on generating revenue. (Ojo, 1996).

D. Artificial Transactions, Global Income, Expatriates and Deemed Income.

2.17- Effect of tax audit on revenue collection

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 tax collection.

2.18- Theories on Tax Audit & Revenue Collection

This part explains the theoretical contributions from various authors on tax audit and revenue collection. It also gives contribution of various research studies as carried out by various authors and then concludes on the general view of the various authors.

2.18.1- Specific Theories

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

2.18.2- The Policeman Theory

This theory of auditing was formulated by Awe, (2008) on assumptions that once monitoring is done on the systems at unspecified times then that is like policeman.

2.18.3- The Moderator of Claimants Theory

This theory is stated by Frey, (2003) that it is important that all vital participants in an organization continue to contribute. In order to continue these contributions, it is important that each group believes it receives a fair share of the organizations income. This is based on the assumption that when one gets a fair share then a fair share will be contributed. To the auditing theory then fairness is introduced.

2.18.4- Agency Theory

This theory is associated with conflicting interests of shareholders and management of organizations, suggesting that the less informed party will have to demand for information that monitors the behaviour of better informed manager (Akinbuli, 2010). According to Hayes et al (1999), assumptions are made that agency theory can be used to explain the supply side of the audit market. The contribution of an audit to third parties is basically determined by the probability that the auditor will detect errors in the financial statements and the auditor's willingness to report these errors. Then independence is emphasised in auditing.

2.18.5- Classical Theory of Tax Compliance

This theory of tax compliance initially formulated by Toggler, (1970) is also called the A-S models based on the deterrence theory. In the theory the taxpayer is assumed to maximize the expected utilities of the tax evasion gamble, balancing the benefits of successful tax cheating against the risky prospect of being caught and punished by tax authorities (Sandmo, 2005). Alabede et al (2011) asserted that the deterrence theory depends largely on tax audit and penalty. They further stressed that this theory of tax compliance makes taxpayers to pay tax as a result of fear and sanctions. Trivedi and Shehata (2005) says that the deterrent theories suggest that taxpayers "play the audit lottery", that is they make calculations of the economic consequences of different compliant alternative. Verboon and Dijke (2007) stated that the essence of the deterrence model of tax compliance is to chiefly examine the interaction between probabilities of detection and sanction severity that should affect non-compliance. Brook (2001) says that classical theory is only based on economic analysis but social and psychological variables are equally important in understanding the issue of noncompliance to

tax. Some of the important studies about the effects of deterrence on compliance include Hasseldine (2000), Torgler (2002) and Kirchler (2007). Elffers (2000) and Braithwaith (2003) argued that if deterrence (that is the probability of detection and sanction severity) would be the most significant variable in explaining compliance, rational individuals in most societies of the world would be non-compliant because the levels of deterrence are low. The theory has contributed to theory the fact that revenue authorities should seek audited statements or perform audits to ascertain compliance.

2.18.6- Theory of Planned Behaviour

The theory of planned behaviour states that the behaviour of individuals within the society are under the influence of definite factors, originate from certain reasons and emerge in a planned way (Erten, 2002). It was assumed that the ability to perform a particular behaviour depends on the fact that the individual has a purpose towards that behaviour. Therefore, it was asserted that the factors that determine the purpose towards that behaviour are attitude towards behaviour, subjective norms and perceived behavioural control. Ajzen (2002) says that these factors are under the influence of behavioural beliefs, normative beliefs and control beliefs. It is also asserted that sociological and psychological factors have proved to be important in understanding the high levels of tax compliance. In such analyses, concepts such as trust in authorities perceived fairness of the system moral considerations and norms are added to theory and are used to promote better understanding of tax compliance.

2.20- Empirical Studies

In this part the researcher tried to revise some researches which are done in different countries in the area of tax audit and has summarized as follows.

- Burcu Gediz Oral and Ferhan Sayin, (2015), Aiming to determine the relationship between corruption and tax auditing during the period of 1985-2011 in Turkey, the study determines the relationship between the variables using the Vector Autoregressive (VAR) Analysis. The results from VAR Granger Causality Test indicate that audit rate variable has an impact on the corruption index and also corruption index variable on the share of the tax revenues in the general budget revenues. The Variance Decomposition Analysis results used in order to determine the most effective of the variable on those in the model show that corruption variable acts as an exogenous variable in the short-term. In other words, corruption is not

affected by other variables in the short term. Changes in index of corruption are largely due to the corruption itself and audit rate in the long term. However, results of Impulse-Response Analysis to show whether the effective variable could be used as an effective policy instrument indicate that variable likely to be in audit rate could be positively effective for the mid-term while it could decrease in the long run. In other words, the tax audit reduces corruption in the long term.

- Niu (2010) in his study found, a positive association between the audit and the voluntary compliance. The finding suggests that the audit productivity may be under estimated in many studies in the literature. It reminds us that when considering the productivity of the audit work. Besides the direct audit collections, we should also take the audit impact on the voluntary compliance into consideration. For this reason, the finding may provide tax professionals and tax authorities with incentives to strengthen the audit power and to better structure their audit organization to generate more revenue for the state. Niu (2010) Historical population data of a New York State economic sector were used in this study instead of experimental data or randomly selected sample data often used in the literature. The results of both Ordinary Least Squares (OLS) and Time Series Cross Section (TSCS) autoregressive modelling methods. The results of both methods suggest that after an audit, a firm would report a higher sales growth rate.

- According to, Badara, M.S. (2012) Questionnaire distributed to forty-eight (48) respondents using descriptive statistics. The result shows that the Relevant Tax Authority (RTA) employed tax audit towards achieving target revenue, that tax audit reduce the problems of tax evasion, that tax payers do not usually cooperated with tax audit personnel during the exercise. There are several theoretical and empirical studies on tax audit and tax compliance. These studies provide mix reactions on the relationship between tax audit and tax compliance.

- J.Alm and McKee, (2006) investigates the application of experimental methods to examine the individual compliance responses to a “certain” probability of audit, and conclude that the compliance rate rises if an individual knows he will be audited and the rate falls if he knows he will not be audited. Slemrod et al, (2001) examines randomly selected taxpayers and inform them that their filling will be “closely

examined' and found evidence of taxpayers' behaviour changes in response to an increased probability of audit, although the responses are not uniform among different groups of taxpayers.

- Mittone (2006) investigates that early experience of audits in taxpayers' "tax life" is a more effective way to increase compliance than later audits. Also Kastlunger et al, (2009) study of experimental research also suggests that, although the effectiveness of audits and fines cannot be completely confirmed, early audits in taxpayers' "tax life" have a positive impact on compliance.
- According to Kleven et al (2010), 40,000 individual tax filers using experimental design and randomization test and SKAT's Business object Database with ordinary least square. Their research found that tax evasion rate is small for income subject to third party reporting, but substantial for self reported income; marginal tax rates have a positive impact on tax evasion, but that this effect is small; prior audits substantially increase self reported income and threat of audit letters also have a significant effects on self reported income, and the size of this effect depends positively on audit probability expressed in the letter. Hyun (2005) Japan & Korea using world value survey dataset and descriptive statistics and multiple regressions for analysis. Japan has the higher level of tax culture than that of Korea; and the legal system is relatively more important factor to determine the level of tax culture which eventually affects the level of compliance. Plumley et al (1996) Data set from 1991-2001 using Ordinary Least Square The result found a significant effects attributable to many tax policy and tax administration parameters; including: audits; third party information documents; the issuance of targeted non-filer notices; criminal tax convictions; marginal tax rates.
- Adediran S. A., Alade S. O and Oshode,(2013) , examines the impact of tax audit and investigations on revenue generation in Nigeria. The aim is to determine if tax audit and investigations can actually increase the revenue base of the government and if it can also stamp out the incidence of tax evasion. Data were collected through the primary sources from four hundred and ten respondents who are staff of the Federal Inland Revenue Service and Edo State Board of Internal Revenue. Hypotheses formulated were tested with Pearson Correlation Coefficient using SPSS output data. The findings are that Tax audit and investigations can increase the revenue base of

the government and can also stamp out the incidents of tax evasion in the country. It was recommended that Tax audit and investigations should be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country.

- Mutarindwa and Rutikanga ,(2014), seeks to explore the role of financial statements audit in promoting tax revenues Growth in Rwanda in the broader perspective. Survey questionnaires as primary data collection Instruments were distributed to all audit officers of Rwanda Revenue Authority equalling to 100 staff and followed both analytical research designs. Secondary data included reports from Rwanda revenue authority from 2006 to 2010. The paper also examines preliminary empirical results on the relationship between financial statements audit and tax growth , it also supports the notion that the practices of audit of final books of accounts for both small and medium enterprises at institutional level are prerequisite for growth of tax revenues in the country. In conclusion, The study found out that taxpayers ‘attitudes towards tax audit is still negative and results showed that the tax audit greatly influences the tax revenues collected by government.
- Kennedy & John Obi , (2014) , examines the impact of tax audit and other qualitative attributes on the tax compliance level of companies in Nigeria. Questionnaires were administered to staff of sampled companies in selected states of the five geo-political zones of Nigeria. Ordered Logistic Regression technique was employed to analyse the responses. The result showed that there exists a positive relationship between tax audit and tax compliance. The result also revealed that the probability of being audited, perception on government spending, penalties and enforcement, the joint effect of tax audit and penalties have a tendency to significantly influence tax compliance in Nigeria. It also recommend that the relevant authorities should seek more pragmatic and effective means of enhancing the impact of tax audits on corporate tax compliance in Nigeria in order to consolidate on government’s revenue.
- Onoja & Iwarere , (2015.) examines, The increase in tax evasion and actual tax revenue collected but not fully remitted to the government necessitated this study on tax audit. An average Nigerian has no faith in the government and will not want to entrust their resources to the government as such payment of taxes will be ranked among the least obligation they owe to the government at all levels. The study

explores the effects of tax audit on revenue generation in Federal Inland Revenue Service and to determine the relationship between the tax audit and revenue generation in Federal Inland Revenue Service. The population of the study consists of the staff of the Federal Inland Revenue Service, Abuja and Taro Yamane sampling technique was used to determine the sample size. The questionnaire was used to generate the data. The hypotheses were tested using Analysis of Variance (ANOVA). Finding revealed that: tax audit has significant effects on revenue generation in Federal Inland Revenue Service and tax audit has a positive relationship with the revenue generation in Federal Inland Revenue Service. The study recommends that there is a need for tax audit department autonomy to be able to carry-out their responsibility effectively as specified in Federal Inland Revenue Service Establishment Act 2007. Also Tax audit should be carried out on a routine basis to prevent tax evasion and extreme tax avoidance by the tax payers.

As indicated in the empirical study part above, the variables used are similar to the variables used in this research work. Since, the variables used in the both the empirical studies and this research work are the same, they have the same issues under study. So, the empirical studies can help as a supportive document for this research work in order to meet the achievement of the objectives.

2.21- The Contribution of Tax revenue in Ethiopian Economy

Table -1, The Contribution of Tax revenue in Ethiopian Economy

Budget Year (E.C)	Budget Code	Description	Budget	Percentage
2002	1100-1300	Tax Revenue	30,179,819,000	63.82%
	1400	Non Tax Revenue	9,254,765,152	19.57%
	1500	Capital Revenue	184,300,800	0.39%
	2000-2999	External Assistance	7,673,405,699	16.23%
		Total	47,292,290,650	100.00%
2003	1100-1300	Tax Revenue	41,100,000,000	59.73%
	1400	Non Tax Revenue	7,266,900,000	10.56%
	1500	Capital Revenue	474,000,000	0.69%
	2000-2999	External Assistance	15,364,093,876	22.33%
	3000-3999	External Loan	4,601,734,185	6.69%
		Total	68,806,728,061	100.00%
2004	1100-1300	Tax Revenue	70,000,000,000	65.29%
	1400	Non Tax Revenue	8,815,943,781	8.22%
	1500	Capital Revenue	345,429,704	0.32%
	2000-2999	External Assistance	21,424,874,980	19.98%
	3000-3999	External Loan	6,630,627,320	6.18%
		Total	107,216,875,785	100.00%
2005	1100-1300	Tax Revenue	87,092,800,000	70.12%
	1400	Non Tax Revenue	7,785,685,070	6.27%
	1500	Capital Revenue	170,814,930	0.14%
	2000-2999	External Assistance	16,151,791,021	13.00%
	3000-3999	External Loan	13,010,893,278	10.47%
		Total	124,211,984,299	100.00%
2006	1100-1300	Tax Revenue	100,331,600,002	72.54%
	1400	Non Tax Revenue	5,384,186,530	3.89%
	1500	Capital Revenue	203,478,868	0.15%
	2000-2999	External Assistance	15,906,435,815	11.50%
	3000-3999	External Loan	16,478,976,081	11.91%
		Total	138,304,677,296	100.00%
2007	1100-1300	Tax Revenue	115,516,153,005	73.41%
	1400	Non Tax Revenue	7,143,347,888	4.54%
	1500	Capital Revenue	393,570,000	0.25%
	2000-2999	External Assistance	16,802,617,074	10.68%
	3000-3999	External Loan	17,502,255,690	11.12%
		Total	157,357,943,657	100.00%

Source: Ministry of Finance and Economic Development.

Description	Average Percentage of Ethiopian Budget items for the 6 years
Tax Revenue	67.49%
Non Tax Revenue	8.84%
Capital Revenue	0.32%
External Assistance	15.62%
External Loan	7.73%
Total	100.00%

Source : Table 1 above

As it is stated In the above tables, Tax Revenue contributes the lion share as a source of Ethiopian Governments income, the average contribution of tax as a source of income reaches up to 67% on an annual base. This indicates, tax mainly shoulders the Governments annual budget. So, the government must be given a special attention specially designing a good tax audit system. Besides the contribution of other sources must not be ignored specially that of the external assistance, which indicates the presence a good relation with the Government of other countries and some international organizations. Furthermore the government must try to reduce the reliance on external loans and on other sources of income.

Chapter Three

Research Design & Methodology

As noted earlier, the aim of the paper is to identify the extent, efficiency and effectiveness of tax auditing in maximizing revenue generation. The focus of the paper is to obtain some qualitative and quantitative data that would facilitate a conclusion about the practice of tax audit system and its effect on revenue of the country. So in order to analyze this, the research design and methodology applied will be as follows:

3.1- Research design

Once the research project is identified and defined clearly, the next step is to design the research method, because the research design provides guidelines for data collection.

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). The design of the study will be both qualitative and quantitative. This study will adopt a descriptive approach which describes the effect of tax audit on government revenue and in ERCA.

3.2- Population and sampling

Under this study, the population was solely the ERCA's Audit division Staffs (Audit officers) and some management members. The population under this research comprises 120 ERCA's audit officers and management members who are from the Large tax payers office and the head office. The reason in which this research work based in Large tax payers office is, because as it is shown in Table -7 this office is the largest tax collection office in ERCA which contributes up to 45% of ERCA's annual tax collection (tax collection of 2005) and the office is well organized than other branches, this makes the researcher want to focus on this office.

3.3- Sample

The study used all the population stated above as a sample. Even if ERCA has 11,589 employees, but this research work is based on a single department, which is the Tax Audit department. So the distributed questionnaires are also based on the staffs of this department and some management members which have close attachment with Tax Audit functions. So,

the sample is based on 100 Tax Audit officers and 20 management members, who are assumed to have deep knowledge and experts in the area of the study.

3.4- Data collection instruments

The study used both primary and secondary data which are collected from ERCAs Tax Audit staffs and summaries of monthly and yearly tax audit and tax collection report. Based on this the main instruments used to collect data are Questionnaires. By referring standardized questionnaire formats the researcher tried to develop the questionnaires.

Data's are the basic input to conduct meaningful research. In conducting the research the data that are used are both primary and secondary data. Among the different primary data collection methods questionnaires are the most usually applied in this research paper.

The questionnaire contains some open – ended, which need further elaboration and suggestion by the respondent. Whereas, the remaining closed –ended questions about tax audit application and its efficiency and effectiveness.

3.4.1. Questionnaire Design

Questionnaire design for tax audit surveys typically helps to extract information on the characteristics of the Organization, issues of tax evasion, tax compliance, tax related malpractices by tax payers and other related issues like tax audit practices. The respondent's high educational qualification and moderate experience make the responses given more valid and reliable. i.e- as it is shown in table-2 below 95% of the respondents have BA and the rest have MA , furthermore most of the respondents have average work experience. So, experience and educational qualification can matter a lot in the reliability of the response given. Donald H & Theresa I,(2007). Besides secondary data's are collected in the form of financial data's (Amount of tax collection vs tax collection during audit) which helps to strengthen the responses given through questionnaires.

3.5- Data analysis

Collected data will be analysed through descriptive statistics then proper tools and techniques has been applied for classification and analysis of data. The main tools that can be applied for classification of data are tables, charts and graphs. Excel software helped to transform the

variables into format suitable for financial data analysis, after which SPSS software has been used for the analysis.

In addition to the above, other statistical tools such as ratios and percentage are used for the analysis (For the Questionnaires). The analysis is also based on the revenue collection performance of the ERCA.LTO compared to yields from tax audit activities in ERCA LTO.

Assumptions tests to use in T-test are ,

- ↳ Continuous dependent variables,
- ↳ dependent variables have a normal distribution
- ↳ The data must be collected from a representative, randomly selected portion of the population.
- ↳ Reasonably large sample size.
- ↳ Homogeneity (equal) of variances exists, due to the equality of SD.

So, based on the analysis stated in section 4.3.2.2 of this research work, the variables used in this research are dependent, the distribution is normal , the data's collected are representative of their population, the selected samples are reasonably large and there exists Homogeneity (equal) of variances.

Chapter Four

Results & Discussions

4.1- Background of the organization

The Ethiopian Revenues and Customs Authority (ERCA) is the body responsible for collecting revenue from customs duties and domestic taxes. In addition to raising revenue, the ERCA is responsible to protect the society from adverse effects of smuggling. It seizes and takes legal action on the people and vehicles involved in the act of smuggling while it facilitates the legitimate movement of goods and people across the border.

According to article 3 of the proclamation No .587/2008, the Authority is looked upon as "an autonomous federal agency having its own legal personality". The Authority came into existence on 14 July 2008, by the merger of the Ministry of Revenue, Ethiopian Customs Authority and The Federal Inland Revenue Authority who formerly were responsible to raise revenue for the Federal government and to prevent contraband. Reasons for the merge of the foregoing administrations into a single autonomous Authority are varied and complex.

Some of those reasons include:

- ↳ To provide the basis for modern tax and customs administrations.
- ↳ To cut through the red tape or avoid unnecessary and redundant procedures that results delay and are considered cost-inefficient etc.
- ↳ To be much more effective and efficient in keeping and utilizing information, promoting law and order, resource utilization and service delivery
- ↳ To transform the efficiency of the revenue sector to a high level.

4.1.1- Objectives, Vision, Mission and Values of ERCA

Objectives

- ✓ To establish modern revenue assessment and collection system; and provide customers with equitable, efficient and quality service,
- ✓ To cause taxpayers voluntarily discharge their tax obligations,
- ✓ To enforce tax and customs laws by preventing and controlling contraband as well as tax fraud and evasion,
- ✓ To collect timely and effectively tax revenues generated by the economy;
- ✓ To provide the necessary support to regions with a view to harmonizing federal and regional tax administration systems.

Vision

- ✓ To be a leading, fair and modern Tax and Customs Administration in Africa by 2020 that will finance Government expenditure through domestic tax revenue collection.

Mission

- ✓ ERCA will contribute to economic development and social welfare by developing a modern Tax and Customs Administration that employs professional and highly skilled staff who promote voluntary compliance amongst individuals and businesses, and take swift action against those who do not comply.

4.1.2- Organization Structure

Since the study is designed to assess the parts of key functions of the Authority (Tax Assessment process, audit and Collection), it is important to understand the organizational structure of ERCA to have meaningful image for the study. Indeed, a structure that is not well established type tax organization design results in lost efficiency opportunities, through duplication of functions for registration, accounting, audit, collection, training, information technology and human resource.

The ERCA has its headquarters in Addis Ababa. It is led by a Director General who reports to the Prime Minister and is assisted by five Deputy Director Generals, namely

- 1- Deputy D/G Domestic Tax Program, Development and Support Division;
- 2- Deputy D/G Customer Program, Development and Support Division;
- 3- Deputy D/G Enforcement Division;
- 4- A.A City Tax Program Development & Support Division ;
- 5- Deputy D/G Modernization & Corporate Division.

Both the Director General and the Deputies are appointed by the Prime Minister.

Each deputy director general oversees at least four directorates. i.e, The Domestic Tax Program, Development and Support Division consists of 7 directorates under it; among this

The Tax Audit Directorate is the one. Customer Program, Development and Support Division consist of 4 Directorates, which focuses on the Valuation of Tariff & Customers affair services. Enforcement Division consists of 7 Directorates, which focuses on Tax Intelligence and Investigation services. A.A City Tax Program Development & Support Division consists of 4 Directorates , which follows up the Function of Branches in A.A , Among these LTO is the one, And Modernization & Corporate Division consist 7 Directorates, which focuses on research & development, HR Activity and Education and communication activity.

Large Tax Payers Office is one of ERCAs branch office where the study has conducted widely to assess revenue performance of Large Tax Payers.

Apart from the foregoing directorates, the ERCA has 32 field offices, of which two of them are coordination offices located outside of Ethiopia at the port of Djibouti and at the port of Burbera, Somalia. The primary function of the foregoing coordination offices are affording/ providing transit service for the goods imported into or exported from the country. However, the latter coordination office is presently not operational. The 30 branch offices in Ethiopia comprise 22 Customs Control stations, 50 Checkpoints and 153 Tax Centers. Tax Center means a tax collection station administered under a branch office and located in the vicinity of taxpayers while Customs Control Station means a station administered under a branch office where customs formalities are complied with and collection of taxes and duties take place on imported and exported goods; checkpoint is a place where customs examination is conducted by machine and/or manually for the purpose of ascertaining that there is no variation between the goods to be imported-exported and the goods specified in the customs declaration.

Customers

According to the monthly Newspaper issued by ERCA (Gebi Lelimat Newspaer (Year7, No 86)) , Up to December 2016 GC, The total number of registered Tax Payers of ERCA in the country are 139,377. Among these 1,200 are members are Large Tax Payers. This can indicate that, when compared to the number of business men in Ethiopia there can be many un registered merchants which do not known by ERCA and not willing to pay tax.

Staffs

According to the HR Department of ERCA, Up to December 2016 GC, There are 11,589 staffs in ERCA out of these 5758 of them females and the rest 5831 of them are males. Among these 339 are members of Large Tax Payers. This can indicate ERCA hire more Males than Females.

4.2- Data Analysis

In the previous chapter, the research methodology adopted for the study to attain the objective that has been stated. This part presents the results and analysis of the data collected using different methods. The main theme of this part is to show how tax audit affects the Government revenue and how tax audit contributes in the reduction of tax evasion and non compliance in order to increase revenue through survey results and t-test analysis.

The sample size for the survey is 120 tax auditors and management members, so that 120 questionnaires were distributed. Nevertheless, the survey response was collected from only 102 survey respondents due to their workload as well as negligence. As Yesegat (2008) stated, the response rate of 71.8 percent was reasonably good in consideration of the difficulty to collect data in poor developing countries, Ethiopia in particular. For this study, the response rate is 85 percent, and it is rationally fine. The remaining discussion in this section presents the survey outcomes regarding respondents “ Characteristics of Respondents, The significance of Tax Audit on Revenue generation , Impact of Tax audit on reduction tax evasion and compliance, etc...”

4.2.1. Respondents profile

4.2.1.1- Demographic characteristics of Respondents

Table 2 shows Out of the total respondents, (65 %) are males and (35%) are females and the. And also on the same table it is also shown that, the majority of respondent (72.55%) are under the age category of between 21 to 30 years inclusive and the rest of the respondents range between the age of 31 to 50 years inclusive.

Table-2- Demographic characteristics of Respondents

	Description	Frequency	Percent	Cumulative Percent
Sex	Male	66	65%	
	Female	36	35%	
	Total	102		
Age	21-25	33	32.35%	32.35%
	26-30	41	40.20%	72.55%
	31-35	17	16.67%	89.22%
	36-40	7	6.86%	96.08%
	45-50	4	3.92%	100.00%
	Total	102		

Source :Primary data

4.2.1.2 - Socio-economic status of respondent Respondents

Work Position, Educational levels and work experience of the respondents in general are the most important variables that can affect the performance of tax audit as well as tax administration system. In line with these attempts have been made to assess the position, the educational level and work experience of the respondents. Generally the respondent's socio-economic status is presented in Table 3 below.

As it can be seen on the Table, 3 below, 8 positions are covered by the sample, among these 3 of them are management positions (Tax Audit Team Leader, Collection Division Manager and Tax Audit Process Owner) and the rest are Tax Auditors from Junior to Senior position. From the total samples, Tax Auditors covered 86.27% , Management members covered 13.73% . This indicates the respondents have deep knowledge to Tax Audit functions.

Regarding the Educational background, out of 120 sample respondents, (93%) of them have BA or BSc degree and 7%) of them have Master Degree with different field of specialization. As indicated in the above ERCA has qualified audit staff, all of the sample members of the Auditors have BA degree and above.

As indicated in the above Table 3, 71 % of the respondents have service year ranging from 0-5 year, while 26% and 3% of the respondent have service years of 6-10 & 11-5 years. This shows that above 71% of ERCAs Tax Auditors has average work experience for their current position which is 0-5 years experience. From this we can say that most of the respondents have average experience in their current position , i.e, (71%) of them have less than 5 years experience. The reason for this tax auditors turnover due to un competitive salary scale.

Table-3- Socio Economic Information of Respondents

	Description	Frequency	Percent	Cumulative Percent
Position	Junior Tax Auditor	7	6.86%	6.86%
	Tax Auditor	56	54.90%	61.76%
	Senior Tax Auditor	22	21.57%	83.33%
	Tax Audit Team Leader	11	10.78%	94.12%
	Collection Division Manager	1	0.98%	95.10%
	Tax Audit Process Owner	2	1.96%	97.06%
	Tax Investigation Auditor	2	1.96%	99.02%
	High Tax Auditor	1	0.98%	100.00%
	Total	102	100%	
Educational Status	Degree	95	93%	93%
	Masters	7	7%	100%
	Total	102	100%	
Year Of Experience	0-5	72	71%	71%
	6-10	27	26%	97%
	11-15	3	3%	100%
	Total	102	100%	

4.2.2- Analysis based on Questionnaires.

4.2.2.1- Analysis based on The Impact of Tax Audit in increasing Governments Revenue and Tax Payers compliance with the tax laws

Table-4 - Summary of responses regarding impact of Tax Audit in increasing Governments Revenue and Tax Payers compliance with the tax laws.

Questions	Answers	Frequency	Percent	Cumulative Percent
<i>Question – No,1</i> <i>Do you think that Tax Audit have a significant impact on increasing Governments Revenue?</i>	Strongly Agree	68	66.67%	66.67%
	Agree	30	29.41%	96.08%
	Nuetral	3	2.94%	99.02%
	Disagree	1	0.98%	100.00%
	Total	102	100%	
<i>Question – No,5</i> <i>Do you Agree with the function of tax audit will increase tax payer's compliance with tax law?</i>	Strongly Agree	53	51.96%	51.96%
	Agree	36	35.29%	87.25%
	Nuetral	11	10.78%	98.04%
	Disagree	2	1.96%	100.00%
	Total	120	100%	

Source :Primary data

Question No,1 - Do you think that Tax Audit have a significant impact on increasing Governments Revenue?

- ✓ The survey results showed that, out of total samples respondents 66.75% of them stated that they strongly agree that Tax Audit has a significant impact on increasing Governments Revenue, 29.41% of them stated that they agree, the rest 2.94%, 0.98% them stated that they are Neutral and Disagree .From this we can conclude that 96.08% of the respondents are in agreement with tax audit can increase Governments Revenue significantly.

Reasons given by the respondents

These responses are collected from the instruments used and synthesized summarized and categorized by the researcher as per below. Furthermore these responses are collected and summarized from the answers given to question # 2 of the questionnaire attached in the annex part.

- ❖ **Compliance**- Auditing makes tax payers to fear the tax laws and regulations & this makes them to comply with the tax laws, consequently revenue will increase.
- ❖ **Fraud** - It will reduce collision between employees and tax payers (reduce tax fraud).
- ❖ **Due Care**- It helps tax payers to take due care before declaration of their report this will reduce un-intentional mistakes done by tax payers.
- ❖ **Education** - Since some tax payers are not educated and they don't understand the purpose of paying tax, they are not committed to pay tax rather they tried to avoid. So, tax audit will teach such tax payers about the purpose of paying tax and helps to develop their bad taxpaying experience and helps them to be a good tax payer in the future. (Help to apply modern tax collection system through educational process.)
- ❖ **Timeliness**- Due to fear of criminal and administrative penalty and Interest, tax payers become pushed to pay their taxes on a timely basis.(it reverse the adverse behaviour of tax payers by levying penalty and interest,)
- ❖ **Additional Income** - Helps Government to collect additional revenue from penalty and interest.

Question No,5- Do you Agree with the function of tax audit will increase tax payer's compliance with tax law?

The survey respondents further showed that, they agreed with the function of tax audit will increase tax payer's compliance with tax law . As it is clearly indicated on table 3 above, out of the total respondents 51.96 % of them stated that they strongly agree that the function of tax audit will increase tax payer's compliance with the tax law, 35.29 % of them stated that they agree, the rest 10.78%, 1.96% stated that they are Neutral and Disagree . From this we can conclude that 87.25% of them are in agreement with the function of tax audit will increase tax payer's compliance with tax law.

This result is in agreement with the study done by Kennedy & John Obi , (2014), which examines the impact of tax audit on the tax compliance level of companies in Nigeria.

Questionnaires were administered to staff of sampled companies in selected states of the five geo-political zones of Nigeria. The result showed that there exists a positive relationship between tax audit and tax compliance. The result also revealed that the probability of being audited, perception on government spending, penalties and enforcement, the joint effect of tax audit and penalties have a tendency to significantly influence tax compliance in Nigeria. This indicates that the result of this part have similarity with the above study which is done in this area.

Reasons given by the respondents

These responses are collected from the instruments used and synthesized summarized and categorized by the researcher as per below. Furthermore these responses are collected and summarized from the answers given to question # 6 of the questionnaire attached in the annex part.

- ❖ **Awareness Creation-** One of the purposes of Auditing activity is teaching the Auditee or creating positive awareness to the tax payers. Through learning it is possible to avoid bad taxpaying experience and non compliance with tax laws, which finally helps to increase revenue.
- ❖ **Penalty & Interest** - Tax audit declares hidden taxes and over passed tax laws by tax payers, as a result penalty and interest will imposed and pushes the tax payers to incur additional costs. So, fear of criminal and administrative penalty and Interest helps tax payers to comply with tax laws.(it reverse the adverse behaviour of tax payers by levying penalty and interest,)
- ❖ **Bad Audit Experience** - Audit will help qualified tax payers to learn from their mistakes from the previous tax audit findings. This can help them to correct their previous years mistakes and make them ready for future correction, (to be compliant with the law.)

4.2.2.2- Analysis bases on The impact of Tax Audit on reduction of Tax Evasion and other fraudulent intensions.

Table-5 - Responses regarding the impact of tax Audit on Reduction of Tax Evasion and other fraudulent intensions.

Questions	Answers	Frequency	Percent	Cumulative Percent
<i>Question – No,3</i> <i>What do you think that the impact of tax Audit on Reduction of Tax Evasion and other fraudulent intensions?</i>	Very High	47	46.08%	46.08%
	High	47	46.08%	92.16%
	No Impact	3	2.94%	95.10%
	Low	5	4.90%	100.00%
	Total	102	100.00%	

Source :Primary data

Question No,3- What do you think that the impact of tax Audit on Reduction of Tax Evasion and other fraudulent intensions?

- ✓ Regarding the impact of tax Audit on Reduction of Tax Evasion and other fraudulent intensions, 46.08% of the survey respondents stated that the impact of tax payers audit in reduction of tax evasion is very high and high, 2.94% and 4.90% of the respondents stated that there is no impact and low impact. From this we can see that 92.16% of the respondents are in agreement with the impact of tax Audit on Reduction of Tax Evasion and other fraudulent intensions are high.

Reasons given by the respondents

These responses are collected from the instruments used and synthesized summarized and categorized by the researcher as per below. Furthermore these responses are collected and summarized from the answers given to question # 4 of the questionnaire attached in the annex part.

- ❖ **Fighting Corruption-** Most of the corruptions occurred on tax are through the reduction of Sales or Increasing of expense, this can happen by hiding sales receipts and adding fake receipts . This can reduce the revenue or increase the expenses of the auditee, as a result `profit and tax will be reduced. So, such fraudulent findings can be caught through the activity of tax Auditing.
- ❖ **Facilitation and Control-** Among the objective of Auditing is balancing between Facilitation and Control. Regarding this ERCA Tax Auditor follow the following sequential steps during Auditing, Educate, Service and Enforcement. So, this things contribution for reduction of Corruption and Fraudulent activities is a lot.
- ❖ **Increasing compliance** – Due to tax audit tax payers compliance with the tax laws will increase as a result fraudulent activities can reduce.
- ❖ **Experience** – Audit makes tax payers to learn from their past mistakes (fraudulent activities), help them to made corrections.
- ❖ **Fear** – Audit makes tax payers to fear & to follow tax rules in case decrease tax evasion.

4.2.2.3 – Analysis based on Tax Audit and its administration

Table-6 - Summary of responses regarding sanctions on non compliance, function and type of audit.

Question	Answer	Frequency	Percent	Cumulative Percent
Q No, 7 Is there effective sanction on non-compliance with the tax rules and regulation?	Yes	47	46%	46%
	Neutral	39	38%	84%
	No	16	16%	100%
	Total	102	100%	
Q No, 8. By whom Audit functions are performed?	Individual Auditors	17	17%	17%
	Audit Team	29	28%	45%
	Both	56	55%	100%
	Total	102	100%	
Q No, 9. By whom Audit Files are selected?	By an Auditor	4	4%	4%
	By an Audit Team	12	12%	16%
	By Audit Manager	24	24%	39%
	By one of the above	19	19%	58%
	By Tax Risk Assessment Committee	43	42%	100%
	Total	102	100%	
Q No, 10. What type of audit most usually applied in ERCA?	Full (Comprehensive) Audit	52	51%	51%
	Limited Scope Audit	2	2%	53%
	Any one of the above	48	47%	100%
	Total	102	100%	
Q No, 11. Which type of Tax Assessment practiced in ERCA?	Administrative Assessment	25	25%	25%
	Self Assessment	28	27%	52%
	Both	49	48%	100%
	Total	102	100%	

Source :Primary data

- ↳ From the responses given to Question No -7 of the above Table-6, it is shown that 46% of the respondents state that there is effective sanction on non-compliance, the rest 38% and 16% of the respondent's state that they are neutral and there is no effective sanction. *From this we can conclude that even if there are sanctions during non compliance but there are also situations in which these sanctions are not implemented.*
- ↳ When we see, the responses given for Question No 8 & 9 on Table-6 Above, The survey indicates that 17% (Q-8) of the respondents states that Audit Functions are done by a single Auditor, and 28 % (Q-9) of the respondents state that Audit Files are selected by Auditor & Audit Manager. *This can indicate that there are situations in which tax payers files are selected by individuals, which can result in collision between Auditors and Customers which finally resulted in to a case of corruption.*
- ↳ When we see, the responses given to Question No 10 on Table-6 Above, ERCA mostly focuses on a Full (Comprehensive Audit) rather than Cut-of Audit. Sometimes Limited Scope Audit will be done accordingly. *This is one of the strengths ERCAs LTO tax audit unit, in which what other branches of ERCA will have to do the same and keep up for the future .*
- ↳ From The responses of (Questions 11) on Table -6 Above, ERCA implemented both Administrative and Self-Assessment methods parallely.
- ↳ From the responses given by the respondents, to Question 12 & 13, respondents indicated that there is a no strong control of tax evasion and avoidance, there is no any reward mechanism of honest tax payers and poor training service for tax auditors. From their response this can negatively affects the tax revenue collection activity of ERCA. *So, they advice that there must be a strong control of tax evasion and avoidance through strong enforcements like penalty and interest, in order to cope up the current dynamic business environment the knowledge of tax auditors must be upgraded through competitive trainings, and there must be a reward mechanism which appreciates honest tax payers.*

4.2.3- Analysis based on Financial Data.

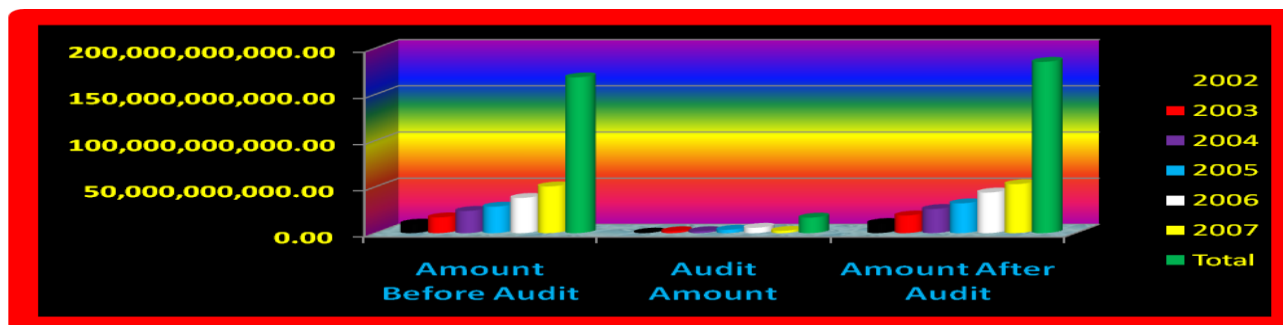
4.2.3.1- Analysis based on the performance of ERCAs LTO income from tax audit VS the performance of tax collection and ERCAs LTO tax collection VS Total tax collection of ERCA on an annual basis.

Table-7 – Comparison between ERCAs- LTOs Tax Audit and Tax Collection status from 2002 to 2007 EC on an annual base.

Year	LTO's Amount Before Audit (A=C-B)	LTO's Audit Amount (B)	LTO's Amount After Audit (C)	Percentage (D=B/C*100)	ERCAs Total tax Collection (E)	Percentage (F=C/E*100%)
2002	10,265,766,618.78	657,861,843.29	10,923,628,462.07	8.79%	35,699,590,000.00	30.60%
2003	17,017,111,050.79	2,085,132,774.01	19,102,243,824.80	23.87%	49,200,000,000.00	38.83%
2004	24,045,084,796.64	2,080,442,875.89	26,125,527,672.53	10.04%	70,649,240,000.00	36.98%
2005	28,628,084,214.64	3,607,198,850.39	32,235,283,065.03	13.88%	70,649,240,000.00	45.63%
2006	38,087,943,450.84	5,828,366,549.16	43,916,310,000.00	24.90%	106,686,800,000.00	41.16%
2007	50,541,145,167.61	2,502,528,265.64	53,043,673,433.25	5.44%	128,205,280,000.00	41.37%
Total	168,585,135,299.30	16,761,531,158.38	185,346,666,457.68	14.49%	461,090,150,000.00	40.20%

Source: Author's computation based on the Tax `Audit and Tax Collection departments of LTO data from 2002 – 2007 EC.

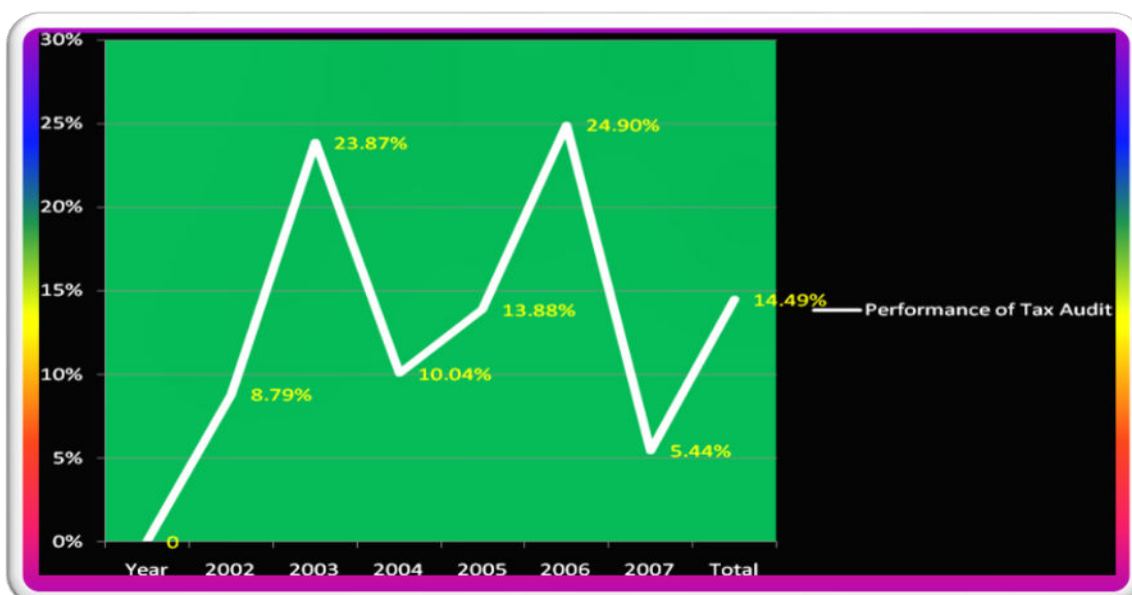
Graph-1- Comparison between ERCAs- LTOs Tax Audit and Tax Collection status from 2002 to 2007 EC on a yearly base.



↳ From the above table,7 (part C,E &F) it is shown that LTO's tax collection sometimes can reach around half of the total tax collection of ERCA (LTO's annual tax collection reached 45.63% of ERCAs total annual tax collection). And sometimes it can fall (the performance of 2006 & 2007 compared to that of 2005). From this it is understood that, even if there can be some fluctuations of performance in the annual tax collection of LTO, It is a fact that this offices tax collection income is a back bone for ERCAs as well as Governments Revenue. Because it covers the lion share of the overall tax collection. So, it must be given due attention by the government.

↳ And also on the same table, 7 (part A to D) and on the Chart below, it is shown that even if tax audit has direct impact on revenue growth of a Government but the performance of tax audit is fluctuating (sometimes go up i.e,(from the year 2002 to 2003 and from 2004 to 2006) , sometimes go down i.e,(from 2003 to 2004 and from 2006 to 2007)) in LTO, on the contrary the performance of LTOs tax collection is increasing with an increasing pace. This has a great impact on the performance LTOs tax collection and the overall Governments Revenue. This can indicate that the increasing performance of tax collection of LTO hides the fluctuating performance of tax audit. As a result the activity of tax audit can't be seen as significant as that. So, the management of ERCA has given due attention in order to upgrade the performance of LTO tax audit performance.

Chart -1 Shows the performance of LTOs Tax Audit from 2002 to 2007 EC on a yearly base.



Source: Table, 7 above

4.2.3.2- Analysis based on the relation between Tax Audit and Government Revenue on a monthly basis (based on T-Test)

Table-8 - Comparison between ERCAs, LTOs Tax Audit and Tax Collection status from July, 2002 to June, 2007 EC on a monthly base.

Month	Amount Before Audit (A)	Audit Amount (B)	Amount After Audit (C)	Percentage (D=B/A*100%)
July ,2001	476,102,734.17	40,084,749.03	516,187,483.20	8.42%
August, 2001	490,139,651.90	23,133,838.00	513,273,489.90	4.72%
September,2002	963,835,030.78	127,445,616.52	1,091,280,647.30	13.22%
October, 2002	2,806,139,045.06	39,554,671.33	2,845,693,716.39	1.41%
November, 2002	402,923,386.71	159,262,361.76	562,185,748.47	39.53%
December, 2002	867,215,629.93	40,584,637.03	907,800,266.96	4.68%
January, 2002	452,772,264.85	15,053,943.32	467,826,208.17	3.32%
February, 2002	494,129,125.35	36,694,386.27	530,823,511.62	7.43%
March, 2002	485,940,295.38	25,838,628.23	511,778,923.61	5.32%
April, 2002	1,508,377,771.02	64,084,117.70	1,572,461,888.72	4.25%
May, 2002	532,336,427.64	37,561,135.81	569,897,563.45	7.06%
June, 2002	785,855,255.99	48,563,758.29	834,419,014.28	6.18%
July ,2002	762,177,596.22	40,084,754.02	802,262,350.24	5.26%
August,2002	1,140,546,595.17	103,593,951.74	1,244,140,546.91	9.08%
September,2003	1,595,522,649.79	176,637,367.04	1,772,160,016.83	11.07%
October,2003	3,549,186,375.11	117,912,652.69	3,667,099,027.80	3.32%
November,2003	760,796,509.63	256,171,837.89	1,016,968,347.52	33.67%
December,2003	2,323,034,381.24	75,806,551.59	2,398,840,932.83	3.26%
January,2003	1,088,700,234.83	149,283,826.62	1,237,984,061.45	13.71%
February,2003	371,125,831.15	626,695,087.26	997,820,918.41	168.86%
March,2003	1,339,244,301.97	93,800,127.22	1,433,044,429.19	7.00%
April,2003	1,529,066,599.18	284,266,133.02	1,813,332,732.20	18.59%
May,2003	1,251,341,731.69	97,646,908.94	1,348,988,640.63	7.80%
June,2003	1,306,368,244.81	63,233,575.98	1,369,601,820.79	4.84%
July ,2003	2,324,966,146.52	286,515,532.76	2,611,481,679.28	12.32%
August,2003	1,702,111,423.50	139,893,498.91	1,842,004,922.41	8.22%
September,2004	1,778,164,722.16	157,220,860.46	1,935,385,582.62	8.84%
October,2004	4,271,975,325.48	100,861,920.00	4,372,837,245.48	2.36%
November,2004	1,377,102,346.98	69,902,100.35	1,447,004,447.33	5.08%
December,2004	1,213,350,688.97	57,446,277.42	1,270,796,966.39	4.73%
January,2004	1,957,061,276.46	75,487,123.78	2,032,548,400.24	3.86%

February,2004	1,561,139,703.11	152,859,512.54	1,713,999,215.65	9.79%
March,2004	1,494,166,501.78	672,671,459.81	2,166,837,961.59	45.02%
April,2004	2,069,144,642.84	35,923,216.83	2,105,067,859.67	1.74%
May,2004	1,589,269,468.98	242,484,617.55	1,831,754,086.53	15.26%
June,2004	2,706,632,549.86	89,176,755.48	2,795,809,305.34	3.29%
July ,2004	3,324,771,043.63	146,056,969.46	3,470,828,013.09	4.39%
August,2004	3,184,581,377.06	1,110,286,190.62	4,294,867,567.68	34.86%
September,2005	1,811,335,572.91	34,861,027.46	1,846,196,600.37	1.92%
October,2005	1,936,188,416.11	186,638,984.47	2,122,827,400.58	9.64%
November,2005	3,894,382,305.88	597,859,194.60	4,492,241,500.48	15.35%
December,2005	1,342,544,952.07	678,791,554.60	2,021,336,506.67	50.56%
January,2005	1,640,053,388.38	91,522,051.26	1,731,575,439.64	5.58%
February,2005	2,148,173,429.39	41,913,487.61	2,190,086,917.00	1.95%
March,2005	2,246,357,379.54	29,054,858.29	2,275,412,237.83	1.29%
April,2005	2,948,892,088.38	2,018,383.20	2,950,910,471.58	0.07%
May,2005	1,665,421,853.36	666,198,393.74	2,331,620,247.10	40.00%
June,2005	2,485,382,407.93	21,997,755.08	2,507,380,163.01	0.89%
July ,2005	3,033,042,743.27	73,137,256.73	3,106,180,000.00	2.41%
August,2005	3,627,472,026.29	119,157,973.71	3,746,630,000.00	3.28%
September,2006	1,700,319,501.33	1,799,290,498.67	3,499,610,000.00	105.82%
October,2006	6,343,523,446.54	357,476,553.46	6,701,000,000.00	5.64%
November, 2006	2,310,159,400.52	50,510,599.48	2,360,670,000.00	2.19%
December, 2006	3,180,879,818.54	88,750,181.46	3,269,630,000.00	2.79%
January, 2006	3,649,074,729.91	121,015,270.09	3,770,090,000.00	3.32%
February, 2006	3,009,255,705.26	83,474,294.74	3,092,730,000.00	2.77%
March, 2006	3,606,831,731.84	78,948,268.16	3,685,780,000.00	2.19%
April, 2006	2,469,575,462.01	1,412,544,537.99	3,882,120,000.00	57.20%
May, 2006	1,427,047,339.24	1,552,052,660.76	2,979,100,000.00	108.76%
June, 2006	3,730,761,546.09	92,008,453.91	3,822,770,000.00	2.47%
July , 2006	4,494,146,833.81	96,101,897.03	4,590,248,730.84	2.14%
August, 2006	5,142,768,943.48	3,937,146.94	5,146,706,090.42	0.08%
September,2007	4,586,457,352.33	21,954,770.62	4,608,412,122.95	0.48%
October,2007	6,742,815,535.81	288,161,793.95	7,030,977,329.76	4.27%
November,2007	2,890,168,558.95	77,030,983.00	2,967,199,541.95	2.67%
December,2007	3,257,527,453.74	404,187,154.77	3,661,714,608.51	12.41%
January,2007	4,303,022,180.62	73,075,453.84	4,376,097,634.46	1.70%
February,2007	3,778,363,045.80	2,312,146.26	3,780,675,192.06	0.06%
March,2007	4,017,142,780.98	141,135,215.80	4,158,277,996.78	3.51%
April,2007	3,879,460,859.39	875,929,402.00	4,755,390,261.39	22.58%
May,2007	3,272,588,484.46	455,998,102.53	3,728,586,586.99	13.93%
June,2007	4,176,683,138.24	62,704,198.90	4,239,387,337.14	1.50%
Total	168,585,135,299.3	16,761,531,158.38	185,346,666,457.68	14.49%

Source: Author's computation based on the Tax `Audit and Tax Collection departments of LTO data from July 1,2002 – June 30,2007 EC.

4.2.3.3 - Descriptive Statistics

Table-9– Analysis base on Descriptive Statistics

Description	N	Minimum	Maximum	Mean	Std. Deviation
Amount Before Audit	72	371,125,831.15	6,742,815,535.81	2,341,460,212.49	1,426,945,273.59
Audit Amount	72	2,018,383.20	1,799,290,498.67	232,799,043.87	359,225,470.88
Amount After Audit	72	467,826,208.17	7,030,977,329.76	2,574,398,145.25	1,473,539,523.58

Source: SPSS Result of table 8 above

From the above table-8 it is indicated that, the minimum amount of Tax Audit is 2,018,383.20 and the maximum is 1,799,290,498.67. This indicates the performance of Tax Audit become the lowest (April 2005 E.C) which is 0.07% of the tax before audit and maximum is during September, 2006 which is 105.82% of the ABT. The mean score of the Tax before Audit for the 72 months is 2.34 Billion, while the tax paid during the audit is 232 million and that of the after audit amount is 2.57 Billion. This indicates that the average collection made during the Audit (for the 72 month or the 6 years) is 9.94% ($(232,799,043.87 \div 2,341,460,212.49) * 100\%$) of the before tax amount. When we compare this result with the LTOs maximum tax audit performance (105.82%) which is stated in the above Table-8, we can say, the average performance of Tax Auditing in LTO is lower. Based on this, the standard deviation depicts a variation in the tax paid before, during and after audit from the mean is, 1.426 billion, 359.22million and 1.473 billion. High standard deviation indicates the data points can spread far from the mean and smaller standard deviation depicts that they are clustered closely around the mean. From this we can s that they that the standard deviation of the AA is smaller than that of the ABA & AAA.

4.2.3.4 – Analysis based on Group Statistics

Table-10 – Summary based on Group Statistics

Group	N	Mean	Std. Deviation
Tax	ABA	2,341,460,212.49	1,426,945,273.59
	AAA	2,574,398,145.25	1,473,539,523.58

Source: SPSS Result of table 8 above

Sample Size

- From the above Table-11 above we can see that the total sample size of both ABA and that of AAA is equal to 72, which is greater than the minimum sample size requirement, 30.

Mean

- From Table 11, The mean value of the ABA is 2,341,460,212.49 and that of AAA is 2,574,398,145.25, and the mean difference between the two mean is the mean amount of tax collection during tax audit of the 72 months, 232,799,043.87. The question is , does this mean statistically significant or not? This can be prove in the Independent Sample T-Test section (4.3.2.3).

Standard Deviation

- From Table 12, The Standard Deviation of ABA and AAA is 1,426,945,273.59 and 1,473,539,523.58. This indicates that, even if the standard deviation of ABA & AAA has some differences, but it is not statistically significant from each other.

Skewness and Curtosis

- The sampling distribution of statistics will follow a normal distribution, Skewness and Kurtosis helped to measure the normality of the distribution. In order to get the Normal distribution the value of Skewness and Kurtosis must be between 1 and -1. So, based the data on the table below the total result of Skewness and Kurtosis of AAB and AAA is 0.716 and 0.290. This can indicate that the sampling distribution of the data is Normal.

Group	Skewness	Kurtosis
AAB	.787	.434
AAA	.664	.281
Total	.716	.290

Source: SPSS Result of table 8 above

4.2.3.5– Analysis based on Independent Sample T-Test

Table-11 – Summary based on Independent Sample T-Test

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	Df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
Tax	Equal variances assumed	0.109	0.742	-0.964	142	0.34	-232,937,932.75	241,738,252.08	-710,808,767.05	244,932,901.54
	Equal variances not assumed			-0.964	141.85	0.34	-232,937,932.75	241,738,252.08	-710,813,004.17	244,937,138.66

Leven’s Test for Equality of Variances

- One of the assumptions of Independent Group T-Test is, having equal variances within the groups in the population, and this can be revealed with the Leven’s Test of Independent T-Test.
 - ✓ The desired outcome for this test is to retain the null hypothesis, which demonstrates equality of variances. In order to retain the null hypothesis the value of Significance associated with ‘F’ must be above 0.05.
 - ✓ Based on table-12 of above, the value of Significance associated with ‘F’ is 0.742, which is greater than 0.05. So, the requirement for retaining the null hypothesis is satisfied, so this indicates the fulfilment of the requirement of equality of variances.

T-Test for Equality of Means

➤ Assumptions for Sig. (2-tailed)

- ✓ Significance level $\alpha=0.05$ at 95% level of confidence
- ✓ Rejection region if p value > 0.05

From the table above the value of Significance level (p -value) associated with 't' is 0.34, and it becomes 0.17 when we divided it by 2 for a one tailed test. This indicates that the value of 'p' is greater than 0.05, which implies statistically there is no significance of tax collection after Tax Audit. But this doesn't mean that, there is no relationship between ABA & AAA, rather it shows that their relationship is not statistically significant. According to the studies done in different countries, the contribution of tax audit for Governments revenue is great, but when we see the case of ERCA,LTO the contribution is very less or insignificant. Lack of highly experienced tax auditors, low level of awareness raising activity to tax payers and manual tax auditing system and low level tax audit performance can be raised as a core reason for this result.

4.3- Number of Audited Tax Payers

Table 12- The number of files audited (Source - Tax Audit department of LTO)

Month	2002	2003	2004	2005	2006	2007
July	6	8	15	10	7	9
August	5	13	13	12	9	11
September	6	8	19	6	8	5
October	9	20	17	15	12	16
November	13	17	17	10	9	5
December	6	11	17	11	10	9
January	10	10	13	13	15	11
February	19	21	19	12	14	3
March	20	17	19	13	11	10
April	18	19	15	NA	12	10
May	13	20	14	8	13	20
June	13	15	9	13	11	18
Total # of file audited per year	138	179	187	123	131	127
Number of Large Tax payers	1,000	1,000	1,000	1,000	1,000	1,200
Percentage	13.80%	17.90%	18.70%	12.30%	13.10%	10.58%

From the above table the maximum number of files audited during the 72 months is 21 and the minimum is 5 file per month. In addition the maximum performance of tax audit done per year is 187 tax payers (18.7%) and the minimum is 127 tax payers (10.58%).

Chapter Five

Conclusion, Findings & Recommendations.

This chapter provides concluding remarks of tax audit practices of ERCA, LTO and how it can help improve revenue mobilization. The conclusions are supported by a summary of the results from the analysis on prevailing tax audit practice and tax performance. The chapter also contains a couple of recommendations aimed at improving the performance of LTO and overall revenue mobilization of ERCA.

5.1- Conclusion

The result of the survey indicates that, the majority of respondents are in agreement with the function of tax audit can increase tax payer's compliance with tax law. Awareness Creation, Penalty & Interest and Bad Audit Experience are issues which are raised as results of tax audit which can increase of tax payer's compliance with the law.

Regarding the impact of tax Audit on reduction of Tax Evasion and other fraudulent intensions, the survey indicated that the respondents are in agreement with the impact of tax Audit on reduction of Tax Evasion and other fraudulent intensions are high. Facilitation and Control, Increasing compliance, Bad auditing experience and Fear of Audit are issues which are raised as a result of tax audit which helps to reduce tax evasion.

Furthermore, the results of the survey indicates that , even if there are sanctions during non compliance but there are also situations in which these sanctions are not implemented. There are also situations in which tax payers files are selected by individual tax auditors, which can be a cause for collision between Auditors and Tax payers can finally resulted in a case of corruption.

Besides, Full (Comprehensive Audit) is the type of audit mostly performed by ERCA, LTOs tax audit unit than Cut-off Audit, and Limited Scope Audit will also be performed accordingly. This is one of the strengths of ERCAs LTO tax audit unit, which contribute a lot in more tax revenue collection. Regarding the assessment methods, Even though, self assessment method can lead to collision between Auditors and tax payers for adjustment to be done, but in the survey it is indicated that ERCA, LTO performs both Administrative and Self-Assessment methods parallelely.

An indication of absence of strong control on tax evasion and avoidance, absence of any reward mechanism to honest tax payers and poor training service for tax auditors are issues raised by the respondents, which needs to be focused by ERCA. Furthermore, it is stated that, these issues have their own contribution in the reduction of the tax revenue collection activity of ERCA.

From the previous studies done, it is shown that Tax audit actually has an effect on increasing Governments revenue, but as per the results of the secondary data collected from ERCA, LTO and analyzed using the independent T – tests, implied that, there is statistically no significance correlation between tax collected before the audit and to that of after the audit. This clearly indicates the effort done in Tax Audit in ERCA, LTO is not enough, Lack of highly experienced tax auditors, low level of awareness raising activity to tax payers and manual tax auditing system can be raised as a core reason for this result.

5.2- Findings

Even if the major aim of this research is to show the effect of tax audit on Governments Revenue, but there are situations which affect and hinder the Tax collections process and the Tax Audit activity as well. So, the major findings are the following:

- ❖ *Insufficient number of Tax Auditors:* Even if Tax Audit has a great impact on increasing Governments Revenue, But this is not the case of ERCA, LTO one of the reasons for this is, the number of Tax Auditors done do not match with that of the number of Tax payers (100 tax Auditors to 1200 tax payers), This indicates that for 12 tax payers there is one auditor, which resulted in to a maximum of 18% audit coverage per year, which is a lower audit coverage status. Smaller audit coverage, resulted in lower tax revenue collection from tax audit functions.
- ❖ *Manual Tax Audit System:* The Tax Audit system is not supported by Computer Assisted Audit software is not supported by technology like Computer Aided Audit Tool (CAAT). Rather the Audit work is done manually.
- ❖ *Uncompetitive salary payment scale:* This can force experienced tax auditors to resign and to be substituted by new un experienced auditors. Finally it can lead to poor Tax Audit performance.

- ❖ *Poor Awareness Raising and customer relation Activity:* The presence of weak Tax Payers awareness raising activity can lead tax payers to submit lower amount tax unknowingly. This consequently reduces government's revenue.
- ❖ *Tax Payers Complain :* High customer complains to pay tax due to system problem and miss-match between the number of tax collection staffs and number of tax payers this takes the tax payers two or three days to pay his tax. Which resulted in customer complain.
- ❖ *Insufficient Training Service:* In order to cope up with the current dynamic business environment training to auditors is vital, which helps them to upgrade and refresh their knowledge and to give a better reliable service and be competitive. But the trend of ERCAs, LTOs training service for tax auditors is not sufficient. Trainings are given once or twice a year which is not timely and sufficient in the current ever changing business environment.
- ❖ *Absence of strong control of tax evasion and avoidance mechanism*
- ❖ *Weaker tax payers reward mechanism*

Therefore the researcher concludes that, the above findings are a base for non compliance And tax avoidance, which have a negative impact in decreasing Governments revenue.

5.3 - Recommendations

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. Based on the tax administration and in the context of tax audit practice with a special reference to the LTO of ERCA and based on the findings obtained the following recommendations are made:

- 1- *Increasing the number of Tax Auditors:* Since the office of LTO is the largest tax collection office of ERCA, it has to be given higher attention than other offices. The higher the tax collection the higher the corruption and risk of miss-statement of financial reports. So, in order to protect such mischievous activities, the contribution

of tax audit is higher. In order to have strong tax audit system, there must be qualified auditors with enough number. When we see the current number of Auditors of LTO they are 100 for 1,200 tax payers, which indicate for 12 tax payers there is one tax auditor. This does not mean that for each tax payer there must be an auditor, rather the current number of tax auditors cannot bring a significant result in.

- 2- *Better Training service:* In order to cope up with the ever changing dynamic business environment, ERCA must update tax auditors through trainings thoroughly. Even if it is costly, it is very vital to auditors, which helps them to upgrade their knowledge and to give a better reliable service. So, it is better for ERCA, LTO if off Job trainings are given on a quarterly basis, otherwise tax payers can deceive tax auditors easily.
- 3- *Computer Aided Audit Tools (CAATs) :-* Relevant higher officials and tax auditors and should have full knowledge of modern audit tools like, Computer Aided Audit Tools (CAATs) to enhance performance and maximum tax revenue generation. The importance of tax revenue to the government cannot be over emphasized especially now that government over dependence on Agricultural products is falling due to global drop in prices. All relevant authority should encourage tax audit for increase in tax revenue, in order for government to keep up with its obligation to his citizen.
- 4- *Continuous education :* Awareness rising should be provided to the tax payers by the ERCA in order to create awareness about their rights and obligations so as to build and develop a better partnership with them and also to create citizens who have better understanding of taxation which will engender honest and voluntary compliance.
- 5- *Strong Control:* To have a successful revenue collection, there is the need to have a strong control not only on the tax evasion but also on tax avoidance by applying effective and efficient tax audit based on reliable evidences and documents.
- 6- *Strong Reward and Penalty mechanism:* The tax collection system should be designed in such a way that not only the tax evasion but also the tax avoidance becomes very expensive for the taxpayer and compliance very rewarding.

- 7- *Establishing Good Relationship with Tax payers:* Increased accountability and an open and honest relationship with taxpayers are crucial for maintaining public trust and confidence in the performance of tax administration. Taxpayers must be able to expect a high degree of certainty in their dealings with revenue agencies. This can only be achieved when tax laws, regulations, procedures, and administrative guidelines are made public, easily accessible, and applied in a consistent manner by avoiding unstable tax laws which creates confusion not only for tax payers but also for tax auditors.

- 8- *Optional Payment Mechanism:* Since there are customers who have complains in the area of tax collection due to system failure, ERCA has to think about other cash collection mechanisms as an option. i.e, manual tax collection mechanism.

- 9- *System Designing:* Most tax payers of any country generally 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 end tax audit is one of the most powerful revenue administration tools that can ensure that tax payers pay their tax liability with very little room for evasion. Therefore, the tax audit function should be strengthened to minimize both deliberate and innocence tax evasion made by many tax payers. Again appropriate expertise and the necessary resources should be allocated for this tax administration function.

- 10- *Better Salary payment Scale:* In order to retain experienced tax auditors and reduce corruption, ERCA has to think about for improvements in the current salary payment scale.

5.3- Suggested area for further study

This study has based in ERCA,LTO, which is one of the 30 tax collection offices ERCA has. Even if the contribution of LTO is high in the activity of tax collection, but this can somewhat narrow the scope of this research. So, by taking larger population further study must be needed in order to arrive at a better result.

The issue of importance of Tax Audit practice in increasing Governments revenue in ERCA is not much enough in the area that was covered in this study. Therefore, undertaking further studies in relation to this is a paramount importance. Thus the researcher recommends the following topics for further study.

- The impact of tax Audit practice in increasing Governments revenue in ERCA.
- The impact of tax evasion and tax avoidance in reduction of Government revenue.
- The significance of tax payer's compliance in increasing of Government revenue.

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Appendices

**St Marry University
School of Post Graduate Studies
Questionnaire**

Dear Respondent:

This questionnaire has been prepared in view of assessing the objectives of research titled “Assessment of Tax audit practices and its effect increasing Government’s Revenue in Ethiopia a case in ERCA.” The purpose of the study is to analyze the prevailing tax audit practice and its significance in tax revenue generation. The primary objective of the questionnaire is to collect data, information & opinion for the conduct of a Senior Thesis for partial fulfilment of the requirement for award of Master of Business Administration specialization in Accounting & Finance.

Participation in this project is completely voluntary. Survey results will be recorded anonymously, and strict confidentiality will be maintained. Individual responses will not be identified in the Researcher’s MBA thesis.

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

Thanking you in advance for your valued time & cooperation, the researcher believes that your genuine response, opinions & views are used only for academic purpose.

Abinet Lulseged.

The Researcher.

N.B please give your answer on the space provided & put tick a mark In the box corresponding to your response.

Personal Information

↪ Sex Male Female

↪ Age _____

↪ Educational background _____

↪ Position of respondent _____

↪ Number of years of experience _____

Instruction:

Please use a tick (✓) mark for your thought and where appropriate give your opinion for the open ended questions.

1. Do you Agree that Tax Audit have a significant impact on increasing Governments Revenue?

- Strongly Agree
- Agree
- Neutral
- Disagree
- Strongly Disagree

2. If your answer is 'Strongly Agree or Agree' please explain.

3. What do you think that the impact of tax Audit on Reduction of Tax Evasion and other fraudulent intensions?

- Very High
- High
- No Impact
- Low
- Very Low
- Don't Know

4. If your answer is 'Very High or High' please explain.

5. Do you Agree with the function of tax audit will increase tax payer's compliance with tax law?

- Strongly Agree
- Agree
- Neutral
- Disagree
- Strongly Disagree

6. If your answer is 'Strongly Agree or Agree' how? please explain.

7. Is there effective sanction on non-compliance with the tax rules and regulation?

- Yes
- Neutral
- No

8. By whom Audit functions are performed?

- Individual Auditor
- Audit Team
- Both

9. By whom Audit Files are selected?

- By an Auditor
- By an Audit Team
- By Audit Manager
- By one of the Above

10. What type of audit most usually applied in ERCA?

- Full audit
- Limited scope audit
- Single issue audit
- Any of the three as appropriate depends on the risk identified

11. Which type of assessment most usually applied in ERCA?

- Administrative assessment
- Self-assessment
- Both

12. What has to be done by ERCA to reduce noncompliance, Evasion and corruption in order to increase tax revenue?

13. Do you have any ideas, opinions and suggestions that have not been included in the aforementioned questions?



Figure - Organization Structure of ERCA

