



**ST. MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES**

**ASSESSMENT OF TAX AUDIT PRACTICE  
THE CASE OF ETHIOPIAN REVENUES & CUSTOMS  
AUTHORITY EAST ADDIS DISTRICT**

**BY  
TIRSIT BEKELE  
ID No. MBAAF/0237/2006A**

**JANUARY/ 2017  
ADDIS ABABA, ETHIOPIA**

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**A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY,  
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IN ACCOUNTING AND FINANCE**

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## **ENDORSEMENT**

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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## **DECLARATION**

I, the under signed, declare that this thesis is my original work, prepared under the guidance of Assmamaw Getie (Asst. Prof.), my thesis advisor. All sources of materials used for the thesis have been properly acknowledged, I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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Tirsit Bekele  
St Mary's University, Addis Ababa

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Signature & Date

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## **Abbreviations/Acronyms**

ASYCUDA	Automated System for Custom Data Management
CD	Compact Disk
EC	European Commission
ECC	Ethiopian Chamber of Commerce
ERCA	Ethiopian Revenue and Customs Authority
ETR	Electronic Tax Register Machine (Cash Register Machine)
IT	Information Technology
OECD	Organization for Economic Cooperation and Development
SIGTAS	Standard Integrated Government Tax Administration System
SMEs	Small and Medium Enterprises
SPSS	Statistical Packages for Social Science
TIN	Taxpayer Identification Number
TOT	Turn over Tax
VAT	Value Added Tax

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## ***Abstract***

*This study assesses tax audit practice in Ethiopian Revenues and Customs Authority (ERCA)-Eastern Addis District. The study aims to assess tax audit practice: to investigate the tax audit looks like the experience and capability of auditors participated in tax audit practices as required by international standards. To conduct the study, the researcher used both primary and secondary data sources through questionnaire, interview and documentary review from target population of tax auditors. The study has employed descriptive types of research; both qualitative and quantitative research design has used in order to make the study meaningful. The researcher takes the entire target population (census) in order to achieve the research objectives and to answer research questions. Specifically, the techniques used in the study include survey with tax auditors and investigators, in-depth interviews with tax officials, and documentary analysis. The findings shows that poor working condition, poor remuneration and lack of motivational incentives, lack of training, insufficient public awareness, continuously high turnover, lack of follow-up, ineffective utilization of IT and unclear data in SIGTAS, were expressed as the major problems of tax audit activities. The study recommends that ERCA-East Addis District to give more attention for the tax auditor continuous training should be provided, working condition should be improved and good salary structure should be set for tax officials. Also, need to employ positive relationship among tax audit quality, organizational independence, tax audit effectiveness, competent and qualified staff with background knowledge of accounting and tax discipline. The study suggests that Auditors need to audit smarter which can be accomplished by the need for auditors to be more aware in context which the audit occurs and the fact that the nature and concentration of fraud varies by industry and auditors should be aware of the development of their profession.*

*Keywords: Tax, Taxation, Tax Audit*

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago. It becomes an issue of worldwide concern, from the time of its inception. This is due, in great part, to effects on the life of virtually every human being. Taxation has gained importance not only as a tool for raising revenue but also help to meet the administrative costs of governance, the provision of public services such as medical care, education, infrastructure, security and maintenance of law and order. Also as a tool available to planners, policy makers and implementers aiming to regulate the economy in order to bring about desired economic development (Laymer and Oat, 2009).

Tax administration is a complex and dynamic responsibility. On a regular basis, leaders have faced with new issues, conflicting priorities, taxpayer compliance and emerging commitments Thomson (2008). As Berhan and Jenkins (2005) noted, governments of developing countries are eager to create modern tax systems although settled with weak tax administrations, and sometimes have experimented with tax administration mechanisms that inflict higher compliance costs on the private sector.

Tax is an ingredient of development in all parts of the world. In the last decade or so, government's scholars, economists, and international organizations have emphasized the need for improved tax 'administration to increase the contribution of tax revenue towards financing development activities. Developed countries have largely, been able to enjoy the benefits of improved tax administration, and developing countries seem to be following suit. The latter, however, still encounter various constraints. Some of these problems included corruption, restraint in administrative recourses and tax evasion to

mention only a few. These problems, and many others, have contributed to poor tax revenue and consequently affected economic growth and development (Bird, 2004).

Tax involves every aspects of income generating activities and consumption items, and requires not only administrative capacity of revenue authority but also the involvement of private sectors through proper accounting and reporting (Tadros, 2009).

Tax audit is an extension of the normal audit generally conducted for expressing an opinion as to the fairness of the accounts examined by the auditor, and the certification of financial statements for tax purposes. It is meaningful if based on the knowledge of tax laws, similarities and dissimilarities between commercial accounting and tax accounting and reporting to the tax department, recognizing their requirements to enable the latter to compute taxable income. It includes what a tax official can look for when aiming to complete an assessment of tax. It covers also the disclosure of all significant accounting practices employed in the organization, a report on the financial accounts, i.e. the balance sheet, profit and loss account and other related accounts and schedules, which are part of the financial reports. Furthermore, information is required to compute the assessable income as well as to ensure that the compliance of the tax laws and regulations is proper. On the other hand, tax audit is not a very welcome procedure for both the taxpayers and the economy. Conducting audits involves costs to the tax department as well as to the taxpayer. Tax administration agencies should therefore, use their scant resources very judiciously to achieve maximal taxpayer compliance, and minimal intrusion and costs. Among others, having effective tax audit program is a key success factor for cost minimization and detection of tax evasion and fraud as well as proactively preventing tax frauds (Gupta and Nagadevara, 2010).

An effective audit program will have significantly wider impacts than just raising revenue directly from audit activities. By selecting the highest risk cases, efficiently detecting non-compliance, applying appropriate sanctions, and publicizing results of audit activity

(either generally or specifically), taxpayers are put on notice that attempting to avoid tax will result in a high likelihood of detection and imposition of significant sanctions. Thereby, a well-planned audit program can provide the administration with significant advantage across the community rather than only affecting the taxpayer selected for audit and collecting the tax that should have been paid in the first place (Biber, 2010).

Tax audit is a detailed exploration into the activities of a taxpayer to determine whether he/she has been correctly declaring the tax liabilities. The inspection of the taxpayer's activities indirectly drives voluntary tax compliance, and directly generates additional tax revenue collections. As a result, both (compliance by the taxpayers and the additional tax revenue collected) help tax agencies to reduce the tax gap between the amount due and collected (Barreca & Ramachandran, 2004).

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 revenue bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function. Tax audit (expected to be performed by public accountants) can be thought of as an extension of this "attest function". For tax purpose, one assessed 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 assessing officer sometimes calls for the assessed under the tax law for producing the same. In this context, the question of tax audit may arise. In addition, tax audit means to audit an assessor'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. Other required evidential statements regarding

allowances and disallowance for deductions and all these have 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 (Gebye, 2008).

## **1.2 Statement of the Problem**

Tax audit is a critical and significant component of the compliance activities of tax administration by means of proper use of enforcing tax laws; it is the conduct by audit staff of appropriate verification of selected taxpayers, whether he/she has been correctly declaring the tax liabilities including a review of taxpayer's systems, books of account and other related information. It may include cross checks of taxpayer's records with those of taxpayer's suppliers or with other government departments and agencies, source of information and lack of sufficient timely and reliable information, inefficient or misutilization of resources in the organization. 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 lack of tax agencies cooperation with the business community (OECD, 2006).

Tax systems are usually elaborate without proper discussion with the business community. In addition, the business owners do not have easy access to and clarification on information of the tax laws. The tax agencies do not also provide advising services. As a result, taxpayers misinterpret tax rules and regulations. Moreover, they lack awareness regarding the tax type to impose 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 (McKinley and Kyrili 2009).

Among other things are problems in achieving of the Authority objectives as well as Customer satisfaction. Therefore, the study identifies the problems related with the tax audit practice. To mitigate such and so fraud problems, therefore, a successful audit

program should be implemented which is capable to investigate, detect and prevent loss of tax revenue. To the greatest possible extent, clear and straightforward laws should support tax systems and procedures that facilitate revenue collection, develop taxpayer's awareness and minimize taxpayer's effort and compliance costs (Getaneh, 2011).

The research gaps and aims are despite of the public's negative perceptions, scholars have given little attention to ERA auditors' behavior, particularly their enforcement regulatory styles. Strict approaches might fail to deal with different compliance behavior and tax administration complexity. Further, a bureaucratic and rigid application of procedures, regardless of circumstances, can lead to inefficiencies and taxpayer resistance. They should treat taxpayers respectfully and courteously, work to achieve favorable outcomes and remain neutral in decision making to ensure they are fair and promote future compliance (Mann, 2005). However, there is no published study on ERCA auditors' enforcement regulatory styles. Studies on tax auditors' enforcement regulatory styles are extremely important to deal with any disputes over tax liability fairly, efficiently and quickly and to ascertain if an assessment is correct and practicable.

Finally, to solve the above problem effective tax auditing is so vital. Effective tax audit could assist in that direction to monitor tax payers in complying with tax procedures so as to reduce tax evasion and then to increase the revenue generation through tax by creating good tax administration and collection system (Harrison and Krelove 2005). Hence, this study was focus on assessing Tax Audit practice performance and tax auditors' enforcement regulatory styles of ERCA- East Addis District.

### **1.3 Research Questions**

The researcher formulates the following research questions:

1. Does tax audit are frequently performed in the ERCA-East Addis District?
2. Does audit case selection methods and audit techniques used appropriately?



3. What are the main weaknesses and strengths of the tax audit program performed as compared to international standards?
4. What are the experiences and capability of auditors participated in tax audit practices as required by international standards?

## **1.4 Objectives of the Study**

The study has both general and specific objectives.

### **1.4.1 General Objective**

The general objective of this study was to assess Tax audit practice of ERCA-East Addis District.

### **1.4.2 Specific Objectives**

The specific objectives of the study were:

1. To assess the types of tax audit frequently performed in the ERCA-East Addis District.
2. To assess whether or not the audit case selection methods and audit techniques have been use appropriately?
3. To examine the main weaknesses and strengths of the tax audit program performed as compared to international standards.
4. To investigate the experience and capability of auditors participated in tax audit practices as required by international standards.

## **1.5 Definition of Key Terms**

**Tax** is define as a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return. One of the main reasons why the government imposes taxes is to generate income to manage the economy and redistribute resources (Lymer and Oats, 2009).

**Taxation** is one of the important elements in managing national income, in both developed and developing countries (FIRS, 2012).

**Tax audit** is a systematic examination of a business' relevant commercial system to determine whether a taxpayer's declaration states the tax liability correctly and complying with the provisions of the tax laws and related subsidiary legislations. Auditing involves examination of the financial statements, books of accounts and vouchers of a taxpayer by Tax Auditors to ascertain whether the taxpayer has accurately considered revenues and expenses when determining the taxes shown in the declarations as per the requirements of the tax laws (Biber, 2010).

## **1.6 Significance of the Study**

The study has different benefits. In the first place, ERCA- East Addis District understands the existing Tax Audit performance, evaluating Tax Audit practice to make some adjustment in the procedure and strengthens the weakness of Tax Audit practice. In addition, it helps the Authority office tax auditors to know their role in the tax system. Moreover, it may serve as a source of reference and give some highlights for others who would like to know more about the issue and interested in undertaking further and detail studies in tax audit effectiveness as a research title. It is believed that the study adds something to the existing literature and it will serve as a reference material for those who will conduct further study in the area.

## **1.7 Scope of the Study**

This study has covered the practice of tax auditing in ERCA- East Addis District. Therefore, it does not include other districts and outside Addis. The geographical coverage of the study is ERCA– East Addis District only in Addis Ababa because of time and financial constraints.

## **1.8 Limitations of the Study**

Every research has its own challenges. Notwithstanding, this research had its own limitations. During data collection, most of the workers were on site so it was quite difficult getting in touch with them. The researcher also did have limited time, but these limitations did not affect the validity of the study. To minimize all of these challenges the researcher tried best with a lot of patience. Finally, the research has concluded in well-organized manner keeping the limitations.

## **1.9 Organization of the Study**

The study has organized in to five chapters; with the scope of the study as mentioned above and systematically to deal the fact in the most comprehensive manner. Chapter one has incorporated background of the study, statement of the problems, basic research questions, objective, significance and scope of the study. The Second chapter is concerned with the review of different researches and related literature dealing with the assessment of Tax Audit. Third chapter presents methodologies used in conducting the study and description of the study area, research design, data sources, target populations, data collection instruments, data collection procedures and methods of data analysis. Chapter Four includes the result and discussion of the study the data collected and analyzed using the data analysis tools. Finally, the last chapter shows the summary, conclusion and recommendation.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

This chapter presents the review of related literature. The chapter has organized in three major sections. The First section reviews theoretical studies on tax audit in a tax administration system while the second section presents the empirical facts about tax audits and related issues. The third section provides concluding remark on the review of the literature and identifies the knowledge gap that has addressed in the study.

#### **2.1 Theoretical Studies of Tax and Tax Audit**

Tax is define as a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return. However, not all payments to government are considering tax payments: for example, charges, and other levies have paid to obtain a specific service and are not strictly tax payments. One of the main reasons why the government imposes taxes is to generate income to manage the economy and redistribute resources (Lymer & Oats, 2009).

Taxation is one of the important elements in managing national income, in both developed and developing countries. Thus, taxation can be broadly and comprehensive defined as a compulsory collection of money by government; it is a payment extracted by the government from people and organizations to fund public expenditures, transfers resources from private to public consumption and are involuntary levies without a quid pro quo (Misrak, 2008).

Tax audit defined as “an examination of an individual or organisation’s tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state”. He further said that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return. Tax compliance can be defined as “an ability of a tax liable body to submit accurate, complete and satisfactory returns in conformity with tax laws and regulations of the state to the authority for the purpose of tax assessment” (Kircher, 2008).

Frank (2010) concludes that, the designed tax authorities audit policy can have important effects on production decision by firms. The nature of such effects depends on whether firms compete or collude. Accordingly, an appropriate designed audit policy may not only achieve greater compliance and higher net revenue for given output and resources spend on audit but may also have other effects that normally considered desirable in a wider economic context. By a smart design of audit policy, the authorities can create information externalities that partially offset the informational advantages of industry insider. Since decision in the product market is in the light of the eventual outcome of net after tax expected profits, the audit policy can create a linkage to Output decisions.

Tax audit just like financial audit involves the gathering of information and processing it for determining the level of compliance of an organization with tax laws of the territory. For a successful audit, it is necessary that the auditor organize his work in such a way that the assignment was accomplishes completely and efficiently. More importantly however, a professional tax auditor or investigator must possess sound accounting and taxation knowledge, he must be sharp in interpreting the tax laws, tactical and must display high intelligence in applying tax laws, and he must have sound knowledge of investigation techniques. Apart from technical skills, he must be alert and open minded with good communication Skills. These are necessary personal prerequisite for any tax auditor or investigator to be successful for tax audit assignments. A tax as we already know is a

charge imposed by governmental authority upon property, individual or organization to raise money for public purpose. An audit on the other hand can be seen as the examination of the records underlying a financial statement as will enable the auditors to report authoritatively, whether in his opinion, the statement gives a true and fair view (Izedonmi, 2000; Okoye, 2006)

A tax audit is a systematic examination of a business' relevant commercial system to determine whether a taxpayer's declaration states the tax liability correctly and complying with the provisions of the tax laws and related subsidiary legislations. Auditing involves examination of the financial statements, books of accounts and vouchers of a taxpayer by Tax Auditors to ascertain whether the taxpayer has accurately considered revenues and expenses when determining the taxes shown in the declarations as per the requirements of the tax laws. It also involves other approaches such as observation of premises, direct monitoring of receipts in cash businesses, use of mark-up techniques and analysis of key ratios (ERCA Tax Audit Manual 2014). However, a tax audit is an investigation made by the tax authority in order to verify the accuracy of tax returns and attempt to detect non-compliance behavior and activities (Kirchler, 2007).

Thus, tax audit results in increased tax revenue in two ways: (1) directly through assessment of additional taxes; and (2) indirectly by discouraging underreporting of liabilities by all taxpayers. The purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations. The tax audit in a tax administration system that includes purpose of tax audit, types of tax audit to performed, effective audit program, audit case selection methods, examination techniques to be apply for tax audit and required capabilities of effective tax auditors (Barreca & Ramachandran, 2004).

### **2.1.1 Purpose of Tax Audit**

The primary purpose of tax audit performed in tax administrations is to ensure compliance with tax law and the submission of accurate and current returns for proper computation of tax liability. For tax audit to take place effectively, tax payers must perform their duties toward the submission of accurate and current returns of their operations. The purpose of tax audit is to examine the accounting records from which the income tax return has been compiled in order to determine the correct tax liability. The audit program of a revenue body performs a number of important roles to improve tax revenue collection. Promoting voluntary compliance by taxpayers with the tax laws is one among other purposes. 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 have been detected and appropriately penalized (Adesina, 2005).

### **2.1.2 Types of Tax Audit**

Tax audits can vary in their scope and the level of intensity to which they have been performed. A field audit, which is conducted at the taxpayer's place of business, involves third party contacts with suppliers or other government entities to obtain information to validate the accuracy of books and records. Therefore, it is inappropriate to carry out all audits based on comprehensive examination of documentation across all tax obligations and all periods that could be open for amendment. Such an approach wastes resources targeting compliant taxpayers and limits the number of audits that can be undertaken. Therefore, revenue bodies should aim to achieve a balanced program of audits that considers audit coverage, audit quality, and overall deterrent considerations (Biber, 2010).

As Ebrill et al. (2001), Grandcolas (2005); Harrison & Krelove (2005), OECD (2006) and Biber (2010) noted, tax audit program in a function based administration includes desk audit or verification, field audit, registration check, advisory audit, record keeping audit, refund audit, issue-oriented audit, comprehensive or full audit and fraud investigation. The following briefly reviews these tax audit types:

**Desk audit or verification:** This type of audit usually carried out annually and primarily based on: (1) a review of income tax and VAT returns, or basic ratios comparing with previous periods or other taxpayers in similar industries, and (2) the cross checking of information included in the taxpayer files. It involves basic checks conducted at the tax office when the auditor is confident that all necessary information would ascertain through in-office examination.

**Field Audit:** According to OECD (2006), field audit is types of audit focuses on detailed examination of taxpayers' books and records to determine whether the correct amounts have reported on the tax returns. The auditor may also obtain information from other sources such as banks, creditors and suppliers, to confirm items on returns. The audit has conducted at taxpayers' place of business, home, or at the office of their accountant, attorney, or other person who may represent them. The auditor tries to select the place that is most appropriate under the circumstances and most convenient for them.

**Registration check:** This takes the form of unannounced visits to taxpayer's premises for new enterprises (mainly small and medium sized) to detect businesses operating outside the tax system. As Ebrill et al. (2001) stated, during this visit, the tax officer ensures that the taxpayer: (1) has a basic understanding of their obligations; (2) keeps appropriate records (book keeping review should be mandatory in case of voluntary compliance when the turnover of the taxpayer is below the registration threshold); and (3) issues proper invoices when required by law. This type of visit is a quick check on businesses to establish that they are correctly registered. It should not take more than half a day.



**Advisory audits:** It involves the auditor's visit to newly established businesses. They advise them regarding tax types, filing of returns, payment of amounts due, record keeping to be maintained, refund claims, risk of audit and sanctions of noncompliance. These visits are very appropriate when introducing new tax laws.

**Record keeping audit:** It is unannounced visits to the taxpayers' business premises to check whether the appropriate records have kept and VAT invoices issued. The visit points out the obligations of the taxpayer regarding the keeping of records and follow up with penalties if the taxpayer continues to disregard record keeping requirements (OECD, 2006).

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

**Issue-oriented audit:** It has directed at verifying items for which errors has been detected in the returns typical ratios. It should focus on a single tax type and covers no more than one or two reporting periods. Single-issue audits are limited to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single-issue audits typically take less time to conduct and can be use to review large numbers of taxpayers involved in similar schemes to conceal noncompliance (Biber, 2010).

**Comprehensive or full audit:** It has comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. This audit may cover all tax obligations over a number of tax periods, or extended to several years up to the limit provided for in the law. All cases where serious underreporting or evasion has

detected under any of other audits must be forwarded to a unit responsible for undertaking comprehensive audits of all tax liabilities (Ebrill, 2001).

**Fraud investigation:** Fraud investigation is a type of tax audit that investigates criminal, which arises from where the most serious cases of noncompliance. It helps to detect fraud, evasion, and criminal activity (Harrison & Krelove, 2005).

### **2.1.3 Audit Quality**

Audit quality, which is demonstrated by the office's capability to provide useful audit findings and recommendations, is one of the most prominent factors on which audit effectiveness is anchored. The office's ability to properly plan, perform and communicate the results of audits is a proxy for audit quality. Therefore, audit quality is arguably a function of extensive staff expertise; reasonableness of the scope of service; and effective planning, execution and communication of audits (Getaneh & Yismaw, 2007; Aaron & Gabriel, 2010).

Audit quality and management support strongly affect audit effectiveness. Better audit effectiveness, in turn, has a positive bearing on these two factors. If tax audit enhances quality to the extent it elicits management's interest, management support would be a natural return of favor because the management would realize the contribution of tax audit to the achievement of organizational goals. To achieve effective audit work, the auditors are required to have full and unrestricted access to all activities, records and properties, and provided with cooperation from the auditee.

Some common principles of good practice around the conduct of individual tax audits, and attempts to give a broad overview of the elements required within an effective and improving audit regime (OECD, 2006). Following these principles have not intended to

take away or limit the authorities granted through legal or procedural guidelines. Rather they are descriptive of the manner in which an audit should conduct:

- **Accurate** - They identify non-compliance, entail a correct interpretation of the law, and lead to a correct assessment of liability.
- **Efficient** - They minimize the compliance burden on the taxpayer and minimize the use of the revenue body's resources in terms of the outcome delivered.
- **Objective** - All decisions made has based on facts.
- **Transparent** - As issues are developed and fully documented in the work papers, these developments generally discussed with the taxpayer during the course of the audit.
- **Fair** - Technically accurate and procedurally correct in accordance with domestic laws and policies.
- **Complete** - The audit has a defined start and end and the taxpayer knows when the audit process is complete.
- **Defensible** - The decisions made in the audit and the actual audit process can stand up to external scrutiny.
- **Consistent** - The same taxpayer circumstances should produce the same result regardless of which auditor undertakes the audit.

#### **2.1.4 The Effective Tax Audit Program**

The tax audit program provides visibility to the compliance and enforcement arm of the tax administration (Thomson, 2008). The auditing and spot-checking of records, coupled with a system of adequate penalties for detected cases of fraud, is the universal method for tax control and the prevention of tax evasion. It derives voluntary compliance and generates additional tax collections, both of which help tax agencies to reduce the tax gap between the taxes due and the amount collected (Barreca & Ramachandran, 2004).

The development of an effective tax audit program typically addresses coverage (percentage of taxpayers to be audited), selection of audit cases, methods (types of audits to be performed, duration of audit, approaches taken by auditors), staffing and training (staff resources needed to implement the audit program and the training provided for them), and monitoring activities. When an audit program is ineffective, it may result in the deterioration of tax compliance and a loss of credibility of the tax administration. Prevent taxpayer's might from minimizing their tax liabilities if they believe that there is a little chance of being audit. There are several reasons for ineffective audit programs that are evident in varying degrees in several potential (Ebrill et al., 2001).

Most taxpayers lack sufficient knowledge of tax assessment and collection procedures. Thus, most of taxpayers do not know why they are paying taxes; what types of taxes has expected from them; and the applicable rules and regulations. Due to this and other factors mentioned in the analysis of this study, negligence, delay in tax payment and evasion has taken by taxpayers as solution to escape from payment of taxes (Assamenew, 2011).

### **2.1.5 Tax Audit Performance**

According to OECD (2006), audit operation constitute a critical program of the work of national revenue bodies in all OECD countries, given their direct relationship to the achievement of improved taxpayers' compliance, budget revenue targets, and the significant level of staff resources involved. If thus follows that these operation should be under planned by sound management practices including the development and implementation of a comprehensive set of performance measures/indicators (both output and outcomes-focused) and with close monitoring of the results and quality of operations achieved in practice.

### **2.1.6 Audit Case Selection Methods**

The primary goal of revenue authorities is to manage and improve overall compliance with the tax laws, and in the process sustain confidence in the tax system and its administration. Tax audit is a sole treatment for compliance risk available to administrations that allows exercising effective sanctions (imprisonment and penalties and/or interest). It acts as a public sanction making the extent of the administration's enforcement powers visible within the community and encouraging others to comply. Compliance risk is the failure to comply with the tax law by taxpayers whether due to their ignorance, carelessness, recklessness, deliberate evasion, or weaknesses in tax administration itself, and has addressed only by enforcement through an audit-based approach. Tax administration, with limited resources and relatively large numbers of taxpayers to administer (especially in the small and medium enterprises), must design the audit program to deploy audit resources in a risk-based way with a view to achieve the most possible compliance and revenue objective (Thomson, 2008).

Case selection with risk management techniques is necessary to ensure that the audit program is fully in line with the administrations compliance strategy, and to set up the necessary audit trails to show why cases have, and have not, been made the subject of an audit. The most effective systems utilize taxpayer profiles and criteria to identify the highest risks for the revenue. These systems were frequently base on the crosschecking of internal information (Ebrill et al., 2001).

Apart from the above pre-audit case management factors, there are two key elements necessary in effective translation of strategic priorities for risk treatments in to individual case selections for action:

- (1) Accurate and timely data and information relevant to the compliance risks to be addressed, and

- (2) Knowledge management and analysis techniques to analyze the base data and facilitate feedback in to the compliance risk management process. Here, the main requirement is access to the data contained within individual tax returns.

**Random selection:** It has no bias in audit case selection, and useful to fight corruption. These methods have perceived as fair by taxpayers. However, it clearly not focused on highest risks, may have high opportunity cost if used as sole case selection method. Simple random selection has a major drawback in that both honest and dishonest taxpayers has equally treated since probability selection give equal chance of being selected for both (Vellutini, 2010).

**Screening or case review by auditors** It is the traditional method by which audit cases have been selected, and dates from the time when there was little or no IT support, the data available was in any case limited, and the compliance risk management techniques at a strategic level less well developed.

**Rule base and automated risk scoring systems** It allows for the bulk processing and risk assessment of returns data. The data is reviewed against a set of risk indicators and the results be ranked in terms of the risk of noncompliance identified. Such system is an essential tool in facilitating the exclusion of bulk of returns with no or very low identified risks and allowing the resources for risk identification to concentrate their efforts only on those cases with significant identified risks (OECD, 2004).

**Data mining and statistical analysis** It is becoming increasingly common to base case selection methodologies on the results from statistical analysis. Data mining is the exploration and analysis of large quantities of data in order to discover meaningful patterns and rules (Barreca & Ramachandran, 2004)

## **2.1.7 Tax Audit Examination Techniques**

Biber (2010) noted that, there are different approaches to investigate and review the organization record depending on up on the area of risk, nature of the taxpayers operation and the taxpayers' condition. The decision regarding the type of tests to be undertaken as well as the records needed by the auditor to address specific issues is influenced by the nature of the taxpayer's operations, adequacy of books and records and materiality of potential adjustments.

Kircher (2008) stated that, tax audit is the examination of an individual or organization's tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. There are different techniques used for tax audit examination:

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

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

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

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

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

- Financial institutions and public companies information on interest and dividends matched with what taxpayers report in their tax return;

### **2.1.8 Audit Workforce Capabilities**

As ISA (2009) stated that, revenue bodies must manage and develop their audit workforce to deliver their planned outcomes through increasingly designing and implementing capability or competency models. Capability or competency model refers to a formal specification of the skills, knowledge and attributes of staff that are required to perform a specific job in an efficient and effective manner. It is typically supported by training, exams, and educational requirements to ensure and build capability. Different capabilities are required for work performed in different market segments, or on clients exhibiting different behaviors towards tax compliance:

**Required capability** the required capabilities of auditors were generally identified by analyzing the activities required to perform particular audit tasks, and through practice and experience. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex tax laws and conduct intensive examinations of taxpayers' books and records. Thus, tax auditors should have a capability to: conduct investigations, determine compliance, tax accounting and financial analysis, conduct research and analysis, make effective decisions under the law, effective communication, apply work processes and procedures, and manage own work and relationships.



**Competency assessment** it is important for tax administrations to assess and evaluate the competencies of their staff. The direct manager commonly performs competency assessments during recruitment and promotional processes on an annual or semiannual basis for those staff maintaining current positions.

**Improving competency and addressing capability gaps** responsibility and accountability for improving auditors, audit managers and audit directors commonly lies with the staff member in question and their direct manager and/or local management team. Competency improvement should be integrated (not be seen as extra task) into normal business activities. Revenue bodies may develop staff and address capability gaps through recruitment processes and the use of programs such as training and development programs, mentoring and coaching programs, job rotation and/or placement programs, career paths, knowledge sharing initiatives and knowledge tests. Capability gaps are typically gather from various sources including quality management system results, performance system interviews and appraisals, client professionalism, satisfaction and other similar surveys, and training program evaluations.

### **2.1.9 Legal Framework**

An audit program needs to be supported by a legislative framework that: (1) requires taxpayers to maintain appropriate books and records; (2) provides the administration with adequate powers to conduct wide ranging enquiries; (3) allows delegation of the powers to staff conducting audits; (4) allows reconstruction of income and reassessments of tax using a range of methods and techniques within a generous timeframe; (5) give taxpayers a right of appeal; (6) places a burden of proof on the taxpayer; and, (7) applies sufficient penalties to deter non compliance. Management needs to monitor the audits to ascertain if the legislation is deficient, not understood, or inconsistently applied, in any of these areas, and develop plans to address such deficiencies. Plans may include: proposing amendments to existing laws or developing a tax procedure code; testing the law and establishing precedent before the courts; clarifying the law through interpretive rulings and education; and improving the training of auditors (Edmund Biber, 2010).

### **2.1.10 Tax Auditors Capacity Improvements**

Responsibility and accountability for improving auditors appears has influenced by the Organization Structure. Human resource departments often have joint responsibility and/or are significant contributors to this process, together with tax auditing/training departments (Pentland, B.T., Carlile, P., 1996).

### **2.1.11 Organizational Policies and Procedures**

In order to make tax audit effective, there should exist clear policies and procedures against which organizational practices has engaged. In addition, the results of the tax audit services help improve those policies and procedures (Bahl, 2008). The policies and procedures for the organizational practices in the institution studied are those applying to

the public sector organizations in Ethiopia, this component of the organizational setting factor rates fairly in terms of its influence on audit effectiveness (ERCA, 2010).

## **2.2 Empirical Studies**

A number of empirical studies examined tax administration in both developed and developing countries, tax audit program in particular. For instance, Chan & Mo (2000); Sen & Bala (2002); Tuerck et al. (2007); Arachi & Santoro (2007); Yesegat (2008); Gebeyehu (2008); Assamenew (2011); Appelgren (2008), have been taken. All the aforementioned studies with the exception of Tuerck et al. (2007) examined tax audit. A brief review of each of these studies is present in the following discussions.

In China, Chan & Mo (2000) studied that, the effect of tax-holidays (exemption and reduction) on foreign investors' tax noncompliance behavior in the China developing economy. The empirical results of the study by Chan & Mo (2000) indicated that, a company's tax-holiday position affects noncompliance. Companies are least compliant during the pre-holiday period whereas most compliant during the tax exemption period.

Appelgren (2008) studied that, the effect of information regarding different audit strategies on taxpayers' compliance behavior in Sweden. The study is conduct with the intent of examining whether the taxpayers in reality behave as expected by theory of tax audit. Experimental design is use to test the effect of information regarding different audit strategies on taxpayers' compliance behavior. The results of the study indicate strongly that information concerning the use of rational audit strategies is superior to information concerning random audits, and that audit information, in general, is superior to no information. The information concerning the rational audit strategy reduces tax fraud compared to no information.

The study by Gebeyehu (2008) was an attempt to trace out, the basic concepts of tax audit, and analyze the significance and role of tax audit in increasing tax revenue and in

strengthening tax administration capacity. The methods adopted include questionnaires (both open and close-ended), personal interviews, and document analysis by using documents such as published materials, annual reports, magazines and internet. In general, the study mainly focused on the issues of personal income tax and business profit tax.

The study by Assamenew (2011) also studied the most taxpayers lack sufficient knowledge of tax assessment and collection procedures. Thus, most of taxpayers do not know why they are paying taxes; what types of taxes have expected from them; and the applicable rules and regulations. The factors mentioned in the analysis of this study, negligence, delay in tax payment and evasions have taken by taxpayers as solution to escape from payment of taxes.

Getaneh (2011) also studied, tax audit practice in ERCA. The study adopts mixed research approach. In the study, questionnaires for the tax auditors and investigators, an in-depth interview with tax officials and taxpayers, and documentary analysis used to collect relevant data. The results of the study indicated that, in Ethiopia the key source of revenue for the government of Ethiopia is tax followed by external loan grants and assistances. However, the potential tax revenue are not collected due to absence of taxpayer's compliance with the tax law both deliberately and unknowingly. In addition, the level of taxpayer's awareness is relatively poor, and taxpayers are incapable to understand the stated tax rules and regulations as well as the forms and instructions provided by revenue authority.

Regarding audit staff, the study revealed that 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. Based on taxpayer data, audit case has selected in ERCA using the statistical techniques using prior tax audit results and rule-based audit, case selection strategy, scarcity of audit resources, tax auditors in particular and absence of proficient and experienced tax auditors.

### **2.3 Summary of the Literature Review and Knowledge Gap**

Tax audit practice is a current issue for both developing and developed countries. Tax audits, audit rates and prior audit experience have been ambiguously discussed in relation to tax compliance. Some studies declared that audits have a positive impact on tax evasion (Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004: cited in Palil and Mustapha, 2011). These findings suggest that in self-determinants systems, tax audits can play an important role and their central role is to increase voluntary compliance. There is no sufficient theory regarding tax audit activities. In the theoretical review, to the knowledge of the researcher, there is no standard as to the percentage of audit methodologies to be conducted in a given tax authority. In addition, there is no adequate literature regarding the appropriate audit examination techniques used for checking the accuracy of tax returns in line with the level of economy and technological advancement, developing countries in particular.

The empirical studies that have been reviewed in the preceding section focused on the different audit strategies that affect tax compliance behavior, income tax in particular, and the use of sampling tax audit strategy for improving the tax audit coverage. In addition, most prior studies regarding tax audit issues tried to examine the possible audit strategies including the use of audit information for the purpose of compliance improvement and fraud detection, and the impact of component reporting requirements on taxpayer incentives to misstate the tax liability.

However, to the knowledge of the researcher, it is possible to conclude that although there have been a number of studies on tax audit related issues both in developed and developing countries, Ethiopia in particular, there are not enough studies that exhaustively examine the tax audit practice. In Ethiopia, different types tax audit issues. Some of those studies are Yesegat (2008), Gebeyehu (2008) and Getaneh (2011) which has reviewed in the preceding section. Even these studies did not assess exhaustively all tax audit activities in Ethiopia.

The study by Yesegat (2008) was specific to VAT, and mainly focused on administrative capability issues. The study by Gebeyehu (2008) was specific to income tax in Addis Ababa City administration, and mainly focused on the way of increasing government revenue. The study of Getaneh (2011) was specific to practice of tax audit assessment in ERCA. These studies did not comprehensively examine issues regarding tax audit practice. Its effect on tax revenue growth and compliance improvement by considering issues such as tax fraud investigations, types of audit performed and its suitability, appropriate case selection approaches, frequency of audit for other tax types, educational level and experience of tax auditors and practice of tax audit assessment in Ethiopia.

Based on these gaps in the following grand research question is established. “How is the tax audit practice in Ethiopia Revenue and Custom Authority- East Addis District in respect of the type of audit performed and its suitability, appropriate case selection methods used, audit techniques applied, the frequency or rate of audit performed, tax audit fairness and the experience and quality of audit staff resources?” With this end, the next chapter discusses the research design and specific research methods that are applied for the study along with proper justification for the selection of appropriate research methods.

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **3.1 Research Design**

A research design is the arrangement of condition and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (Kothari, 2004). The researcher applied descriptive analysis using the fact that a descriptive research design used to describe the data and characteristic about what was been studied. Descriptive survey also enables to obtain the current information. It was also use in fact finding studies and helps to formulate certain principles and give solutions to the problems concerning local or national issues. Descriptive survey method focuses on investigating the status, practice and problem related to tax audit of ERCA-East District.

#### **3.2 Research Method Adopted**

This study incorporated both quantitative and qualitative research approaches (used mixed method) in order to generate the advantage of both approaches like; to address different objectives of the study, which cannot be achieved by a single method and to enable one approach to inform another approach, either in design or in interpretation. These approaches are different in terms of their philosophical assumptions as well as techniques used to data collection; analysis and interpretation have discussed in the subsequent paragraphs (Corbin, 2008).

Qualitative research approach explores attitudes, behaviors and experiences through methods such as in-depth interview and/or focus group discussion. The second approach, quantitative research, generates statistical data using large-scale survey research, using methods such as close-ended questionnaires and/or structured interviews (Dawson 2002). Quantitative approach employee's strategies of inquiry such as experiments and surveys, and collect data on predetermined instruments that yield numeric data that can be analyze

using statistical procedures. It is a means for testing objective theories through examining the relationship among variables. On the other hand, mixed methods approaches will combine both qualitative and quantitative approaches. It employees strategies of inquiry that involves collecting data either simultaneously or sequentially to best understand the research problem. Mixed approach characterized by its time-intensive nature of analyzing both numeric and text data (Creswell, 2009).

Research methods are the techniques used to collect data. In this study, the researcher adopted mixed methods approach (qualitative and quantitative method), as discussed in the previous section, which has employed concurrently in collecting and analyzing data.

### **3.3 Source of Data**

The data used in this study consists of both primary and secondary data. The primary data were collect through questionnaire and interview. The questionnaire comprised of both closed and open-ended questions. Closed ended questions are quicker and easier for both respondents and researcher. Most of the closed ended questions are designed on an ordinal level of measurement basis, and others are designed as multiple choice, some of the closed ended questions were a five scored likert scales (Kothari, 2004) to provide respondents a wider range of alternatives with end points where the statement strongly agree to the statement refer to strongly disagree. Adding open-ended questions allows respondents to offer an answer that the researcher did not include in the questions. In addition, interviews were use for those most related tax officials. Secondary source of data are Journal articles, textbooks, periodical collections, newspapers, ERCA annual reports and other scholarly write up.



### **3.4 Population and Sampling Technique**

#### **Target Population**

The targeted population, which directly related to the purpose of this study, was 70 tax auditors in ERCA-East Addis District. The survey population was 70 tax auditors and investigators, so that 70 questionnaires were distributed. Nevertheless, the survey response has collected from only 61 respondents, the other respondents due to their workload as well as negligence do not reply.

The remaining discussion in this section presents the survey outcomes regarding respondents background information, types of tax audits performed, characteristics of audit program, audit case selection methods applied, examination techniques used, and audit resources, the capability and experience of tax auditors in particular.

In addition to Questionnaire, attention given for the interview and observation because of reducing biased and the possibility of getting unreliable answer. Finally, to come up with sound, concrete and credible research findings, interviews used for concerned person in the area of the tax audit Sub-process Head. Observation and visiting also done in the area of tax audit office, getting more practical knowledge about Structures, Design and outlay of the office and helpful for the findings of research.

### **3.5 Types of Data and Tools/Instruments of Data Collection**

Data are the basic input to conduct meaningful research. In conducting the research, the data that are going to be used are both primary and secondary data. The primary data sources and data collect by using both questionnaires and interview from tax auditors. These sources of data helped to get first-hand information and secondary data collected from related study and working papers, books, written materials, organizational records,

official publications and reports tax proclamations, regulations and directives, tax audit manuals, published and unpublished documents, journal articles, broacher, internet. Also assist in strengthening of the primary source of data and important secondary data sources helped to collect data through documentary analysis and other internet sources.

There are different tools available to the researcher to collect the required data including questionnaires, observation, interview, and document analysis. For this study, the researcher applied qualitative (in-depth interview and document analysis), and are discussed in the following sub-sections. This indicates that the paper is semi-conceptual in nature, therefore, findings conclusion and recommendation based on concept and issues raise and discussed. After completing of these tools, the collected data would be organized and interpreted.

### **3.6 Procedures of Data Collection**

In order to gather data the researcher used both interview (structured and unstructured) and questionnaires mixed type (closed-end and open-end) because to get extra information and explanation rather from limiting/fixing of the respondents. In the same way for the interview the researcher used both structured/planned and unstructured interview (asking another question based on what the interviewee says/responds) because it strengthen the answer.

### **3.7 Methods of Data Analysis**

The analysis was conducting a clear analysis about the tax audit practice. The method of data analysis both primary and secondary sources of data are analyzed using descriptive analysis, and the rationale for choosing this method of data analysis is that it allows in describing, summarizing and presenting the qualitative data and quantitative methods.

After completion of data, an appropriate data analysis has discussed to achieve the research objectives, and the required data has been collected through survey questionnaire and in-depth interview. The link of research questions and research methods adopted in this particular study has also presented with proper justification in method selection in line with the strength and weakness of each research method. Therefore, the data has analyzed through descriptive statistics using Statistical Packages for Social Scientists (SPSS), Data collected using questionnaire was table's, frequency distribution and percentage, graphs used to present the data. With this end, the next chapter presents the results and analysis of the study.

## CHAPTER FOUR

### RESULTS AND DISCUSSIONS

#### 4.1 RESULTS/ FINDINGS OF THE STUDY

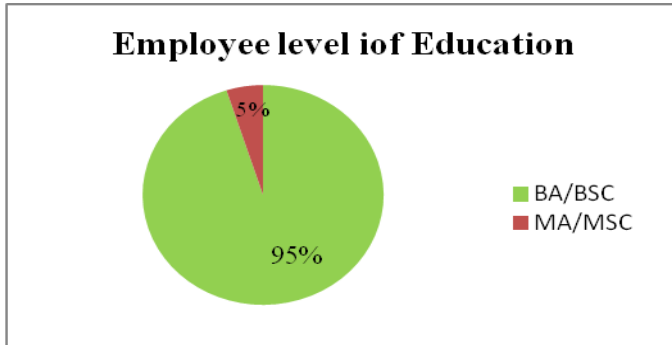
The researcher identified in this section presents the survey outcomes regarding respondents background information, types of tax audits performed, effectiveness of audit program in terms of educating taxpayers and the appropriateness of case selection methods, examination techniques, capability of tax auditors, audit resources, audit qualities, and the overall deferent effect that needs to be accomplished.

**Table 4.1 – Background information of respondents Profile**

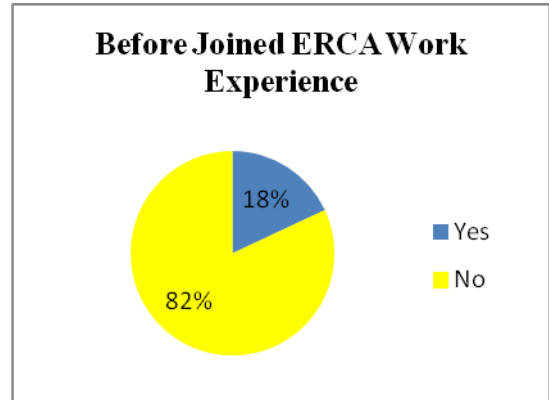
Variable		Frequency	Percentage
Sex for both respondents	Male	39	62.5
	Female	22	37.5
Employees Level of education	BA/BSC	58	95.1
	MA/MSC	3	4.9
Field of Study	Accounting	44	72.1
	Economics	7	11.5
	Management	10	16.4
Employees Work experience as an Auditor	Less than 2 years	9	14.8
	2-4 years	22	36.1
	4-6 years	14	23.0
	6-10 years	13	21.3
	above 10 years	3	4.9
Before joined ERCA Work experience of tax audit	Yes	11	18.0
	No	50	82.0
Work experience in current occupation	Less than 2 years	4	6.6
	2-4 years	4	6.6
	4-6 years	1	1.6
	6-10 years	2	3.3%
	Above 10 years	-	-

*Source: Compiled from survey data Dec., 2016*

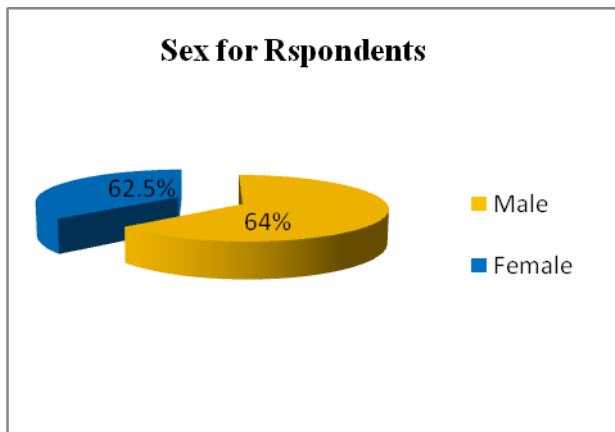
**Figure 1: Background information of respondents Profile**



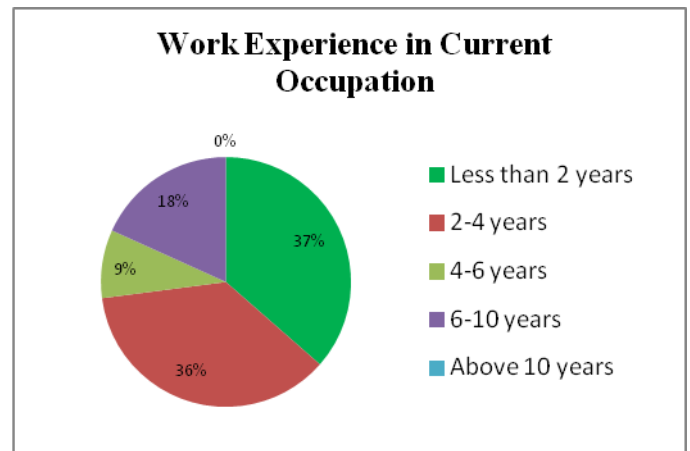
Source: Table 4.1 Compiled from survey data Dec., 2016



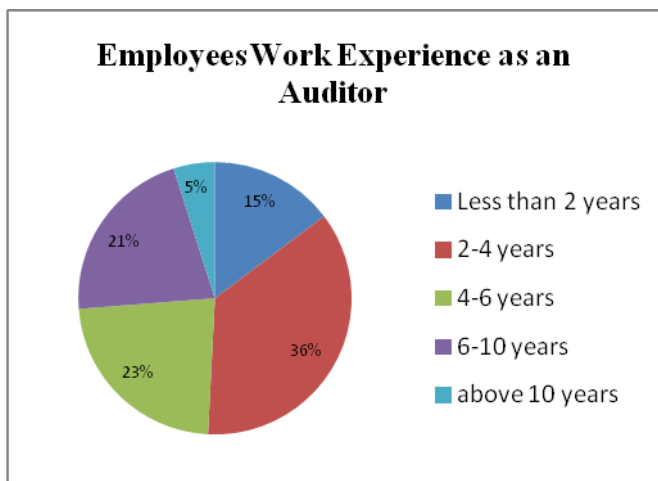
Source: Table 4.1 Compiled from survey data Dec., 2016



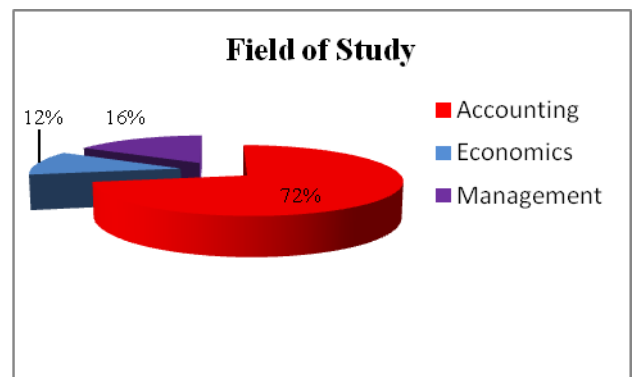
Source: Table 4.1 Compiled from survey data Dec., 2016



Source: Table 4.1 Compiled from survey data Dec., 2016



Source: Table 4.1 Compiled from survey data Dec., 2016



Source: Table 4.1 Compiled from survey data Dec., 2016

The result shows that majority of the respondents participated in the study 61 out of this male represented 39(62.5%). The female respondents were participated in the study 22(37.5%), as compared to male respondents the female is less than 50%, which is that the involvement of women is minimal in the organization.

In order to get more information from all categories of people, those that have attained BA/BSc, MA/Msc level of education. These educational levels, 58(95.1%) respondents were BA degree holder, 3(4.9%) attended MA/MSC. This table indicate that a small number of respondents were highly educated shown by the 3(4.9%) of respondents who had postgraduate Degrees, however 58(95.1%) of the respondents were Degree holders, In this regard, the greatest number of respondents with filled the questioner higher level of educational status.

The educational qualification are fundamental, it should be support with the appropriate experience in order to be more effective with in a relatively shorter period. Hence, tax auditors with more experience tend to perform best audit practices, achieve superior audit outcomes, and gain outstanding audit success.

Based on this, 44(72.1%) of the respondents are having accounting field of study, 10(16.4%) are having management field of study and the remaining 7(11.5%) has Economics field of study. Most of them are accounting and management graduated, to be an auditor a person has deep knowledge of accounting and management theory and principles therefore, the findings indicated that an organization audit staff almost might have sufficient knowledge of their field of study. Then the researcher concluded that educational level attainment of respondents is excellent and which could be relate to their profession.

The interview result also revealed that educational qualification and work experience affect the quality of tax audit. According to their response, ERCA-East Addis District prefers to recruit Tax Auditors who have no experience than experienced auditors to minimize corruption. Tax rules, regulation and directives are complex to understand easily and interpret. Additionally, it takes time for less experienced auditors to adopt with the system and perform the audit works in efficient manner because Audit needs additional skills like statistical knowledge, communication approach, Economic as well as marketing knowledge and research and analysis. Then concluded that ERCA-East Addis District office auditors' experiences may have a good positions and audit experience is a positive effect on audit.

Then it concluded that the audit staffs do not satisfied with their current salary the experienced auditors might be turnover increased and them towards illegal activities such as corruption, finally it might have a negative impact on audit effectiveness of an organization.

**Table 4.2 – Types of Tax Audit Performed in Eastern Branch of ERCA**

<b>Types of Tax Audit Performed</b>	<b>Frequency</b>	<b>Percentage</b>
Desk (office) audit	6	9.8
Field audit	8	13.1
Comprehensive audit	42	68.9
Refund audit	2	3.3
Advisory audit	1	1.6
Issue audit	-	-
Registration check	-	-
Fraud investigation	2	3.3

*Source: Compiled from survey data Dec., 2016*

The survey results showed that ERCA-East Addis District exhaustively conducts comprehensive audit 42(68.9%) of respondents followed by desk audit 6(9.8%) of respondents. ERCA-East Addis District also conducts refund audit 2(3.3%), field audit 8(13.1%), fraud investigation 2(3.3%) and advisory audit 1(1.6%).

The survey respondents further stated that comprehensive audit were conducted using five-year taxpayer information to check whether taxpayers filed and paid the appropriate tax returns in line with the tax law and accounting principles. In ERCA, comprehensive audit conducted to ensure compliance on the taxpayers selected by risk criteria and third party information, and on taxpayers, those need to dispose over 50 per cent of their business fixed assets or close the business. ERCA performed desk audit for data cleaning purpose to confirm whether the data submitted by the taxpayers is genuine.

**Table 4.3 - Which Business Sector are mostly selected for tax audit**

<b>Which business sectors are mostly selected for tax audit</b>	<b>Frequency</b>	<b>Percentage</b>
Manufacturing Enterprise	14	23.0
Service Enterprise (Professional Services, Hotel and Hospitality etc.)	7	11.5
Merchandising Enterprise	8	13.1
Construction Enterprise	8	13.1
Financial Sectors	2	3.3
All	22	36.1

*Source: Compiled from survey data Dec., 2016*

As indicated in the above table out of 14(23%) the respondent of manufacturing sector, 8(13.1%) Merchandising Enterprises, and 8(13.1%) Construction of Enterprise



respondents showed that ERCA-East Addis District has selected, for tax audit purpose. The rest two sectors selected for audit are Service enterprise and financial institutions as replied by 7(11.5%) and 2(3.3%) of respondents respectively.

Regarding sectors selected for audit, ERCA-Eastern Branch conducts audit usually on merchandising, manufacturing, and construction and real estate sectors due to their large tax revenue at risk. Besides, as the in-depth interview with tax officials showed, construction industry is highly developing and increasing at present time in Ethiopia. However, construction sectors contribute relatively inadequate tax revenue to ERCA-Eastern Branch, and have high risk due to their complex transactions that might be difficult to identify for audit purpose. The service delivery sectors excluding financial service sectors are also risky taxpayers that have been usually select for audit purpose.

**Table 4.4 - Purpose of Tax Audit**

Purpose of Tax Audit	No. of resp.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
The primary purpose of tax audit performed in tax administrations is to ensure compliance with tax law		52.5	32.8	8.2	-	6.6	100
Tax auditors, investigators assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer		24.6	50.8	13.1	4.9	6.6	100
Tax Audit improve the level of compliance		32.8	59.0	8.2	-	-	100
Tax audit solves the problem of tax evasion, avoidance and other irregularities		34.4	26.2	34.4	4.9	-	100

*Source: Compiled from survey data Dec., 2016*

According to table 4.4, 52.5% of the respondent tax auditors replied strongly agreed. The study reveals that 34.4% of the respondents strongly agreed that the tax audit reduce the problems of tax evasion, avoidance and irregularities in tax matters. Tax audit can be

effective if its design is such as to eliminate the problems of tax evasion, tax avoidance and other tax irregularities.

The primary purpose of tax audit performed in tax administrations is to ensure compliance with tax law and the submission of accurate and current returns for proper computation of tax liability. For tax audit to take place effectively, tax payers must perform their duties toward the submission of accurate and current returns of their operations. In this study, all the respondents agreed that the primary purpose of tax audit is to maintain the confidence in the integrity of the self-assessment system. It helps to improve voluntary compliance by detecting and bringing to book those who do not pay the correct amount of tax.

The in-depth interview with tax officials also showed that the purpose of tax audit is primarily to assess unreported income and additional revenue for the Government. The interview respondents further stated that the duty of taxpayers' awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. As a result, ERCA-Eastern Branch provides training and exam regarding tax law and tax audit issues at the time of recruitment before engaged in tax audit activities.

**Table 4.5– Effective of tax audit program**

Effective of tax audit program	No. of resp.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
The ERCA- East Addis District gather information regarding the taxpayer’s compliance behavior and areas of weaknesses in the tax law through tax audit program performed.		16.4	27.9	39.3	13.1	3.3	
Tax registered traders can easily understand and be aware of the rules, forms and instructions or information provided by the ERCA- East Addis District.		9.8	29.5	39.3	16.4	4.9	
Taxpayers believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit.		11.5	32.8	32.8	23.0	-	
Tax audit program performed by the ERCA-East Addis District makes its power visible to the community and encourages noncompliant taxpayers to comply.		11.5	44.3	31.1	11.5	1.6	
Effectiveness of tax audit is measured by volume of the audit performed		14.8	32.8	32.8	13.1	6.6	
Effectiveness of tax audit is measured by productivity and yield of audit		14.8	44.3	24.6	14.8	1.6	
Continuous and sufficient trainings for tax auditors		14.8	21.3	32.8	16.4	14.8	
Tax auditors and investigators have good access to information held by the taxpayers and others		14.8	29.5	34.4	11.5	9.8	
Apply standard risk identification criteria for identify highly risky business for audit		19.7	27.9	36.1	13.1	3.3	
A continuous assessment to improve the capability or competency of staff resources, auditors and investigators		26.2	29.5	21.3	11.5	11.5	

*Source: Compiled from survey data Dec., 2016*

As can be observed from table 4.5, though the majority respondents agreed that tax auditors get information from third party, Tax Auditor effectiveness is dependent on auditor's capability and efficiency to perform audit activities, resources allocated and tax administration system.

Tax Auditors access to get information held by taxpayers and others 39.3% of respondent tax auditors replied. 34.4% of respondent tax auditors reported that the audit works performed by tax auditors that tax auditors and investigators have good access to information held by taxpayers and others. 44.3% of respondent replied effectiveness of tax audit has measured by productivity and yield of audit, 29.5% of the respondents agreed that the tax audit improves a continuous assessment of the capability or competency of staff resources, auditors and investigators.

The role of an audit program in a modern tax administration goes beyond verifying a taxpayer has reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. The effective tax audit program has desire to attain a tax audit department, which, indicates that still there is a gap between tax auditors and managements. This means the tax auditors to the questions implying high independency and to those questions, which referred to as the tax auditors are free from other influence. From this, it is clear that the audit quality and organizational independence had the highest effect on tax audit effectiveness with comparing audited attributes, organizational setting and top management support constructs.

**Table 4.6 – Tax Auditor is aware tax rules and regulations**

Tax Auditor are aware tax rules and regulations	No. of resp.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
Loopholes Tax rules and regulation that initiates taxpayers to evade tax		23.0	36.1	31.1	8.2	1.6	100
Tax payers are happy in tax audit process		4.9	13.1	47.5	19.7	14.8	100
The tax authority penalized those who do not obey the tax law		24.6	55.7	11.5	8.2	-	100
Your offices equally penalize tax payers who do not follows tax regulations		18.0	47.5	23.0	8.2	3.3	100
You take corrective measure to those who use the gap of tax law		18.0	45.9	32.8	3.3	-	100
Auditors give sufficient education to the taxpayers about the tax laws and regulations during auditing.		21.3	27.9	45.9	4.9	-	100

*Source: Compiled from survey data Dec., 2016*

As shown the above table 4.6, majority of the respondents 45.9% replied that the taxpayers have adequate of knowledge towards the tax laws and regulations. This is due to the adequacy of education gives to the taxpayers by the organization; on the other hand, a few 19.7% respondent replied as taxpayers are happy in tax audit process and have knowledge about their duties and responsibilities.

The findings indicated that, the taxpayers’ knowledge toward the tax rule and regulations is somehow good. The researcher concluded that the ERCA-East Addis District office was providing education to the taxpayers using both printed and electronic media, newspapers, magazines, brochures, radios, televisions, conferences and exhibitions and it is easily understand by registered taxpayers.

**Table 4.7 – Frequency of Tax Audit**

Frequency of Tax Audit	No. of resp.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
Every business audited once a year		3.3	4.9	11.5	41.0	39.3	
Tax auditor or investigator usually performs the audit work repetitively		13.1	23.0	31.1	19.7	13.1	
Taxpayers that were audited in the previous audit period and found no tax liability during an audit is not selected for the next audit		6.6	19.7	29.5	32.8	11.5	
The Authority tax audit frequently performs field Audit & comprehensive or full audit, refund audit and fraud investigation		19.7	37.7	29.5	9.8	3.3	

*Source: Compiled from survey data Dec., 2016*

Regarding audit frequency as show in table 4.7, The frequency of tax audited once a year reply out of 61 respondents 41% respondent Disagree, Tax auditor or investigator usually performs the audit work repetitively 31.1% respondent reply moderate agree, The Authority tax audit frequently performs field Audit & comprehensive or full audit, refund audit and fraud investigation 37.7 % respondent agreed. Therefore, auditors do not perform audit periodically.

**Table 4.8 – Examination Techniques**

<b>Examination Techniques used</b>	<b>Frequency</b>	<b>Percentage</b>
Review of financial statements and returns	4	6.6
Observing, discussing and reviewing documents of taxpayers	5	8.2
Physical checks of current transactions, vouchers, assets and other aspects	6	9.8
Examination of taxpayers record such as books and documents	28	45.9
Examination of information in third parties	1	1.6
All test to be checked	17	27.9

*Source: Compiled from survey data Dec., 2016*

In table 4.8, the survey result showed that, field examination (physical checks of taxpayers, assets and other aspects) has mainly used when a particular taxpayer needs to sell its business fixed assets or close the business. Examination of taxpayer’s record such as books and documents 28(45.9%); Physical checks of businesses, current operation including transactions, assets and other aspects 6(9.8%). Observing, discussing and reviewing documents of taxpayers 5(8.2%). The accuracy of tax returns have been tested through review of financial statements and returns 4(6.6%); examination of information in third parties such as financial institutions 1(1.6%).

Regarding examination techniques, various types of information might be reviewed namely tax returns, financial statements, accounting records, customs declaration and other source documents in ERCA. The techniques used to test the accuracy of tax returns include; examination of information from third parties banks and informants; analytical review of financial statements and returns; examination of taxpayers’ records such as books and documents. Investigations through observing, discussing and reviewing documents of taxpayers on sight survey of the taxpayers’. Current business conditions

through physical checks of current transactions, assets and other aspects. Field examinations, on sight survey of business condition have applied when a particular taxpayer needs to sell its business fixed assets or close the business.

Furthermore, with respect to the examination techniques are effective in detecting fraud and determine the accurate tax liability. The analysis of the response indicates that the existing examination techniques may be effective proportionality in detecting fraud and determine the accurate tax liability.

**Table 4.9 - Techniques of Checking Taxpayers Liability**

Techniques of Checking Taxpayers Liability	No. of resp.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
The audit manual procedure identifies the tax liability of non-compliance.		21.3	37.7	29.5	8.2	3.3	
Review of financial statements and returns type of tests are conducted to check the accuracy of tax returns.		16.4	55.7	21.3	6.6	-	
Observing, discussing and reviewing documents of taxpayer's are conducted to check the accuracy of tax returns		21.3	44.3	27.9	6.6	-	
Physical checks of current transactions, vouchers, assets and other aspects type of tests were conducted to check the accuracy of tax returns.		18.0	52.5	23.0	3.3	3.3	

*Source: Compiled from survey data Dec., 2016*

In table 4.9, 55.7% of the respondents agreed that review of financial statements and returns type of tests were to checked in the accuracy of tax returns, 44.3% of tax auditors replied that observe, discussed and reviewed documents of taxpayers, 52.5% of



respondent agreed physical checks of current transactions, assets and other aspects of tests.

The techniques used to test the accuracy of tax returns includes: examination of information from third parties banks and informants; analytical review of financial statements and returns; examination of taxpayers records; investigation through observing, discussing and reviewing documents of taxpayers; and on sight survey of the taxpayers current business condition through physical checks of current transactions, assets and other aspects. Field examination (on sight survey of business condition) applied when a particular taxpayer needs to sell its business fixed assets or close the business.

The accuracy of taxpayer's tax liability is determined mainly through analytical review of financial statements and returns. Thus, ERCA may not be able to determine what wealth the taxpayers have accumulated but not documented or recorded in their books of accounts and financial reports without the conduct of appropriate investigation. It may not be also possible to ERCA to establish the completeness, accuracy, credibility, and validity of a taxpayer's declaration, disclosures and other financial arrangement.

**Table 4.10 – Tax Audit Resources**

Tax Audit Resources	No. of rep.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
The ERCA- East Addis District has enough audit staff resources to perform onsite audits on all taxpayers or comprehensive cross checking of invoices or transactions.		6.6	16.4	16.4	44.3	16.4	
Qualified audit staff/well experienced staff are available		4.9	19.7	36.1	24.6	14.8	
Well organized structure and suitable office		8.2	11.5	24.6	24.6	31.1	
Continuous and sufficient trainings for tax auditors		6.6	13.1	27.9	23.0	29.5	
Lack of training and shortage of manpower is one of the cause for tax audit inefficiency		49.2	23.0	19.7	4.9	3.3	
The authority uses advanced and automated technology in the process		13.1	11.5	14.8	16.4	44.3	

*Source: Compiled from survey data Dec., 2016*

In table 4.10 stated that, 44.3% of the respondents disagreed that, the office has enough audit staff resources and to perform onsite audits on all taxpayers or comprehensive cross checking of invoices or transactions, 49.2% of respondents strongly agreed that lack of training and shortage of manpower has one of the causes of tax audit inefficiency training, where as 36.1% of the respondents moderately agreed, qualified audit staff/well experienced staff are available, and the rest 31.1% of respondent strongly disagree well organized structure and suitable office and the rest 44.3% of respondent replied strongly disagreed that the office uses advanced and automated technology in the process.

Regarding staff resources, from the interview made with tax officers, the decision-making process within the core process show that it is not participatory. This may force the tax auditors not to take part in the core process activities and lack of willingness to implement decision. It also creates conflict within the core process, which hinders the effectiveness of the core process. The organization also gives less attention on tax auditors training and personal development. There exist lack of identification of documents and shortage of strict assessment system. This failure has an impact on collection tax revenue.

There is also a higher employee turnover, audit staff in particular, in ERCA-East Addis District, and there is shortage of computers, network cables, and sockets. There is also absence of separate workroom to keep the information that might use for conducting investigation audit. Even the existing computers are detected by viruses and do not accept flash and CD to enter the softcopy information that comes from different sources. Moreover, the tax auditors have no access for the SIGTAS, and are not even familiar with the system due to absence of adequate training. For the effective and efficient tax audit not only the skill and qualification of tax auditor's but also adequate number of tax auditors, materials and equipment necessary for audit have greater impact.

The new technologies revolutionize the work of auditors. Not only because of the access to better source of information, which will also better planning of activities, but also because during the audits, specific software products will guide you interactively in the realization of the field work. The information you obtain and with which you feed the systems will be the best element to guarantee the effectiveness of their activities and will allow measurements of performance.

**Table 4.11 –Audit Case Selection Methods**

Audit Case Selection Method	No. of resp.	Percentage of Respondents					Total
		Strongly Agree	Agree	Moderate Agree	Disagree	Strongly Disagree	
Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment		3.3	18.0	27.9	26.2	24.6	
Tax payers selected for audit is through screening and case review		9.8	36.1	39.3	8.2	6.6	
Tax auditors select audit cases randomly without any analysis		4.9	13.1	19.7	41.0	21.3	
Taxpayers cooperate to give essential information necessary for performing an audit.		11.5	24.6	45.9	14.8	3.3	
Taxpayers (audited) has selected based on their associated compliance risk.		11.5	36.1	36.1	11.5	4.9	
Tax audit is a sole treatment for compliance risk available to ERCA-East Addis District		13.1	24.6	31.1	21.3	9.8	

*Source: Compiled from survey data Dec., 2016*

The above table 4.11, clearly reflects 27.9% of the respondents replied, auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment, 39.3% of the respondent replied taxpayers selected for audit is through screening and case review, 36.1% of respondents that replied taxpayers has selected based on their associated compliance risk. The sole mechanism to treat taxpayer’s compliance risk might be tax audit with 24.6% as responded. As 41% of survey respondents strongly disagree replied, tax auditors select audit cases randomly without any analysis. Generally, tax auditors selects cases based on associated risk, and commitment of tax fraud and evasion.

Audit Case selection has through the computer system based on risk analysis criteria. However, the selection of audit cases has not confined to the selection by the computerized system only, as cases can also be selected based on information received from various sources. Audit cases has selected in the following manner: Selection based on risk analysis; Information received from third party; Selection based on specific industries; Selection based on specific issues for a certain group of taxpayers; and Selection based on location.

**Table 4.12 – The possible techniques used selecting taxpayers audited by the ERCA-East Addis District**

Possible Techniques used	Frequency	Percentage
Taxpayers are simply selected randomly	4	6.6
Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment	5	8.2
Data mining that identifies patterns of noncompliance in the past and current	5	8.2
Statistical techniques using prior tax audit results in conjunction with taxpayer data	5	8.2
Rule base and automated risk scoring system that identifies risk of noncompliance	41	67.2
All	1	1.6

*Source: Compiled from survey data Dec., 2016*

The survey results showed that in table 4.12, the techniques used selecting taxpayers audited, 41(67.2%) of respondent replied that taxpayers to be audited have been usually

selected uses rule based and automated risk-scoring system. On the other hand, 5(8.2%) of respondent data mining and 5(8.2%) of respondent statistical techniques used prior tax audit results. 5(8.2%) of tax auditors select audit cases manually based on their own knowledge of taxpayer's behavior and environment. As 4(6.6%) taxpayers were simply select randomly and 1(1.6%) of respondent selected all audit case selection methods. This implies that taxpayer's select for audit were with standard rule base and automated risk identification system.

As indicated in table 4.12, tax auditors were not selecting any item of business frequently. Construction Company and real estate were not usually selecting for tax audit. The case selection systems were not focus on any business type. It focuses only on associated risk and the Revenue authority has no strategy to segment the business based on similar character or riskiness of the business. Risk identification based on riskiness of individual business rather than business in different segment. The finding revealed that no specific business are selected for tax audit and tax auditors were not given priority to select Construction Company.

## **CHAPTER FIVE**

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Conclusions**

The researcher has raised several questions to tax auditors and Tax Supervisors as well in depth interview help to reach at some finding and conclusions as follows.

- ◆ There is no enough staff for tax assessment and collection through the entire state.
- ◆ There is insufficient public awareness on the important and benefit of paying taxes.
- ◆ Lack of proper training and knowledge of computer among the staff
- ◆ Poor working condition and un conducive atmosphere for effective tax collection
- ◆ Poor remuneration scale for tax officials
- ◆ Lack of incentive and motivation reward for hard working
- ◆ Very frequent employee turnover
- ◆ Electric power failure

In the above problems explain that, ERCA-East Addis District has no suitable offices to perform Audit work as well as to put taxpayers' document in a safe way. The office is also not safe to discuss with taxpayers and other people on tax related issues. Therefore, ERCA-East Addis District has no enough audit staffs, no enough materials needed for audit and not have suitable offices. Then it concluded that the audit staffs do not satisfied with their current salary the experienced auditors might be turnover increased and them towards illegal activities such as corruption, finally it might have a negative impact on audit effectiveness of an organization.

As a result, there is unreasonably consumption of audit resources as well as increase the hardship associated with repetitive audits for fully compliant taxpayers. Corruption might also arise due to repetitive contact between the same taxpayers. ERCA-East Addis District did not adopt segmentation approach this result in low customer satisfaction, and increases both taxpayer compliance costs and tax administrative costs.

In addition, the audit coverage is unsatisfactory that might be due to inappropriate audit type adopted and resource constraint. Case selections only based on associated compliance risk. The ERCA-East Addis District not fully used automated risk score system and previous case selection system (random selection). Regarding tax audit staff, there is no competency assessment model, and less emphasis has been give for continuous upgrading the capability and knowledge of staff resources once they have given and held a particular position.

Furthermore, the office does not produce report for separate annual plan of tax audit program. The results of the in-depth interview carried out showed that the ERCA-East Addis District tax office has faced different financial, operational and administrative problems and challenges to handle the taxpayers. It might be consider as the implemented tax collection and assessment system is not successful. That is, there exists inefficient and insufficient number of tax auditors in the ERCA-East Addis District.

## **5.2 Recommendations**

Based on the results of the survey study the tax audit practice of the ERCA-East Addis District office is not performing well at required level though there are improvements. Therefore, the following feasible recommendations are suggest.

- ERCA-East Addis District improve the overall tax administration and audit quality absence of frequent discussion concerning various problems encountered in the tax audit office,



Electric power failure. Strength service delivery to create strong enforcement, make clear and accountable of work environment must be created.

- ERCA-East Addis District should create awareness, schedule weekly/monthly meeting with taxpayers, provide information through Radio and TV on local areas language, magazines, workshops, brushers, newspapers, house-to-house impressively and openly discusses with taxpayers to reduce tax evaders and corruption.
- Make the ERCA-East Addis District office free from management influence and audit quality by paying attention to the needs and desires of tax auditor, reducing the corruption, the management attention to audit findings (since they are important assets owned by every organization) to perform their tax audit work effectively and efficiently.
- ERCA-East Addis District gives recognize model taxpayers as well as tax officials, adjusting rules and regulation based on taxpayer's feedback, monitor and evaluate the tax employees, creating tax day celebration, strengthen strong political commitment, penalty does not teach taxpayers.
- ERCA-East Addis District should create a good work environment by encouraging relationship among tax auditors and taxpayers, with colleagues, and immediate supervisors so that they are motivated in performing tasks/activities in the office.
- The ERCA-East Addis District office should consider on the convenient tax audit system as well as making brief tax law, policies, rules and regulations in the office.
- To make effective audit the ERCA-East Addis District audit should increase number and capability of audit staffs through appropriate need assessment and employees and identified gap. Auditors should have taken continuous training so that their skills keep up-to-date and relevant. Further, the authority should supply sufficient computers and other necessary audit resources for auditors.
- The authority should make SIGTAS accessible to tax auditors, and should fully utilize it for risk assessment purpose. There must be also a specified time range within which the taxpayers have expected to present their report or information, to

enforce especially non-volunteer taxpayers, and to get the necessary information as required for audit activities.

- ERCA-East Addis District Qualified, well-trained and motivated tax auditors are crucial for the collection of taxes and the performance of tax administration bodies as a whole. In order to motivate tax auditors to work in accordance with the interests of the government and to reduce their vulnerability to corruption, attention has given to wages and other incentives.

It recommends that a joint effort should made by the tax auditors, taxpayers and all concerned bodies of the Government to bring about a spirit of teamwork, so that sustainable growth and development will be ensured in the nearest future.

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**ST. MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES  
MBA PROGRAM IN ACCOUNTING AND FINANCE**

**Questionnaires to be filled by Tax Auditors of ERCA-East Addis  
District**

**Dear respondent:**

You are being kindly requested to participate in a survey that intends to assess Tax Audit Practice in ERCA-East Addis District. The purposes of the study are to: assess and describe the practice of Tax Audit in ERCA-East Addis District, identify the inductive factors and assure the Tax Audit practices, implementation and recommended solutions to help the program implemented successfully.

The questionnaire has two parts: **Part -I** Background Information. **Part-II** is the overall questions about Tax audit practice. Please read each item carefully and give your honest response to each item and your response will be highly confidential.

Thank you in advance for your kind cooperation.

**Part I: Background Information**

1. Gender:

1. Male

2. Female



2. Age:
1. Less than 30 years                       2. 30-40 years
3. 40-50 years                                       4. Above 50 years
3. Level of education achieved:
1. Certificate       2. Diploma                       3. BSc/BA
4. MSc/MA and above       5. Others  , please specify \_\_\_\_\_
4. Field of study (multiple answers are possible):
1. Accounting                       2. Economics                       3. Management
4. Others
5. How long have you been in this organization?
1. Less than 2 years                       2. 2-4 years                       3. 4-6 years
4. 6-10 years                       5. Above 10 years
6. Current Job Occupation:
1. Tax auditor                       2. Tax investigator                       3. Tax Audit Coordinator
4. Tax Audit Director                       5. Tax assessors                       6. Others
7. Did you have any audit experience before you joined the ERCA-East Addis District?
1. Yes                                      2. No
8. If your answer in Question "7 is yes, how long did you work as an auditor?
1. Less than 2 years                       2. 2-4 years                       3. 4-6 years
4. 6-10 years                       5. Above 10 years

**Part II: The following items are related to Tax Audit Practice;**

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

- 1. Manufacturing Enterprise
- 2. Service Enterprise (Professional Services, Hotel and Hospitality etc.)
- 3. Merchandising Enterprise
- 4. Construction Enterprise
- 5. Financial Sectors
- 6. Others

10. What is the selection behind for the taxpayers that you have selected in Q"9?

- 1. Taxpayers have higher compliance risk
- 2. Taxpayers have large tax potential at risk
- 3. Taxpayers have no effective record or bookkeeping
- 4. It is difficult to tax taxpayer
- 5. Others

11. What types of audits are usually performed by the ERCA- East Addis District (multiple answers are possible)?

- |                        |                          |                           |                          |
|------------------------|--------------------------|---------------------------|--------------------------|
| 1. Desk (office) audit | <input type="checkbox"/> | 6. Issue audit            | <input type="checkbox"/> |
| 2. Field audit         | <input type="checkbox"/> | 7. Registration check     | <input type="checkbox"/> |
| 3. Comprehensive audit | <input type="checkbox"/> | 8. Fraud investigation    | <input type="checkbox"/> |
| 4. Refund audit        | <input type="checkbox"/> | 9. Others, please specify |                          |
| <hr/>                  |                          |                           |                          |
| 5. Advisory audit      | <input type="checkbox"/> |                           |                          |

12. What are the possible techniques used by the ERCA in selecting taxpayers to be audited (multiple answers are possible)?

1. Taxpayers are simply selected randomly
2. Auditors select audit cases manually based on their own knowledge of taxpayers' behavior and environment
3. Data mining that identifies patterns of noncompliance in the past and current
4. Statistical techniques using prior tax audit results in conjunction with taxpayer data
5. Rule base and automated risk scoring system that identifies risk of noncompliance
6. All

13. Is there a responsible unit at the ERCA- East Addis District for the investigation of serious fraud or evasion?

1. Yes

2. No

14. What are the challenges of tax audit? What do you suggest for the improvement of Tax audit and tax audit program? \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

15. Which type of tests are conducted at ERCA-East Addis District to check the accuracy of tax returns (multiple answers are possible)?

1. Review of financial statements and returns
1. Observing, discussing and reviewing documents of taxpayers
2. Physical checks of current transactions, vouchers, assets and other aspects
3. Examination of taxpayers record such as books and documents
4. Examination of taxpayers record such as books and documents

Put a “√” mark in one of the columns provided for each possible indicator. Use the scales:- the rates are strongly Agree (SA), Agree (A), Moderately Agree (MA), Disagree (DA), and Strongly Disagree (SDA).

Items	SA	A	MA	DA	SDA
<b>Questions regarding the Purpose of Tax Audit</b>					
The primary purpose of tax audit performed in tax administrations is to ensure compliance with tax law					
Tax auditors, investigators assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer					
Tax Audit improve the level of compliance					
Tax audit solves the problem of tax evasion, avoidance and other irregularities					
<b>Questions regarding the effectiveness of tax audit program</b>					
The ERCA- East Addis District gather information regarding the taxpayers compliance behavior and areas of weaknesses in the tax law through tax audit program performed.					
Tax registered traders can easily understand and be aware of the rules forms and instructions or information provided by the ERCA- East Addis District.					
Taxpayers believe that there is a good chance of being seized in their underreporting and other noncompliance activities during an audit.					
Tax audit program performed by the ERCA- East Addis District makes its power visible to the community and encourages noncompliant taxpayers to comply.					
Effectiveness of tax audit is measured by volume of the audit performed					
Effectiveness of tax audit is measured by productivity and yield of audit					
Continuous and sufficient trainings for tax auditors					
Tax auditors and investigators have good access to information held by the taxpayers and others					
Apply standard risk identification criteria for identify highly risky business for audit					

A continuous assessment to improve the capability or competency of staff resources, auditors and investigators					
<b>Tax Auditors are aware about tax rules and regulations</b>					
Loopholes Tax rules and regulation that initiates taxpayers to evade tax					
Tax payers are happy in tax audit process					
The tax authority penalized those who do not obey the tax law					
Your offices equally penalize tax payers who do not follows tax regulations					
You take corrective measure to those who use the gap of tax law					
Auditors give sufficient education to the taxpayers about the tax laws and regulations during auditing.					
<b>Questions regarding frequency of tax audit</b>					
Every business audited once a year					
Tax auditor or investigator usually performs the audit work repetitively					
Taxpayers that were audited in the previous audit period and found no tax liability during an audit is not selected for the next audit					
The Authority tax audit frequently performs field Audit & comprehensive or full audit, refund audit and fraud investigation					
<b>Questions regarding techniques of checking tax payers liability</b>					
The audit manual procedure identifies the tax liability of non compliance.					
Review of financial statements and returns type of tests are conducted to check the accuracy of tax returns.					
Observing, discussing and reviewing documents of taxpayer's are conducted to check the accuracy of tax returns					
Physical checks of current transactions, vouchers, assets and other aspects type of tests are conducted to check the accuracy of tax returns.					
<b>Questions regarding tax audit resources</b>					

The ERCA- East Addis District has enough audit staff resources to perform onsite audits on all taxpayers or comprehensive crosschecking of invoices or transactions.					
Qualified audit staff/well experienced staff are available					
Well organized structure and suitable office					
Continuous and sufficient trainings for tax auditors					
Lack of training and shortage of manpower is one of the cause for tax audit inefficiency					
The authority uses advanced and automated technology in the process					
<b>Questions regarding audit case selection methods</b>					
Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment					
Tax payers selected for audit is through screening and case review					
Tax auditors select audit cases randomly without any analysis					
Taxpayers cooperate to give essential information necessary for performing an audit.					
Taxpayers (auditee) are selected based on their associated compliance risk.					
Tax audit is a sole treatment for compliance risk available to ERCA- East Addis District					

Please, do you have any ideas, opinions and suggestions that have not been included in the aforementioned questions?

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## **Tax administrator's in-depth interview instrument**

1. What is the primary purpose of conducting an audit? Does ERCA provide awareness creation for taxpayers? How?
2. Is there any Audit Manual to perform tax audit activities?
3. Are you aware of about the tax rules and regulations of ERCA? Have you been informed by tax administrators about the new rules and regulations in the Ethiopian tax system?
4. Could you tell me about the auditor's capability to clarify unclear rules and regulation, willingness to advise taxpayers and decision giving procedure of tax auditors?
5. Do you get clear instruction, understandable forms, assistance and information as necessary from ERCA-East Addis District?
6. Are there any exam, tutor, and training to hire an auditor or investigator? If so, when and how the trainings and exams are provided?
7. How and in what condition desk audit, field audit, comprehensive audit, single audit, advisory audit, registration audit, record keeping audit, refund audit, and fraud investigation are performed in ERCA-East Addis District. Which audit types are mostly performed? Why could it be?
8. Which category of taxpayers and sectors are usually selected for tax audit? What would be the reason behind this selection?
9. How audit cases are selected? What are the bases considered for selecting the audit case?
10. Have you been audited in consecutive audit periods? If so, how do you think the reason behind this?
11. Do you believe that illegal traders come to the system through tax audit and investigation?

