



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

**MBA in ACCOUNTING & FINANCE**

**ASSESSMENT OF TAX AUDIT PRACTICE AND IT'S CHALLENGES:**

**THE CASE OF ADAMA REVENUES AND CUSTOMS OFFICE**

**BY:**

**BELAY TAFESSE**

**ID No. SGS/0129/2009B**

**DECEMBER, 2018**

**ADDIS ABABA, ETHIOPIA**

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**A THESIS SUBMITTED TO ST.MARY'S UNIVERSSSITY COLLAGE SCHOOL  
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**DECEMBER, 2018  
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## DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of **Assmamaw Getie (Ass. Prof.)**. All sources of material used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institutions for the purpose of earning any degree.

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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.

**Assmamaw Getie (Ass.Professor)**

**Advisor**

**St. Mary's University,**

**Addis Ababa,**

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**Signature**

**December, 2018**

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## **List of Acronyms and Abbreviations**

ARCO	Adama Revenues and Customs Office
ERCA	Ethiopian Revenue and Customs Authority
GDP	Gross Domestic Product
OECD	Organization for Economic Cooperation and Development
NBR	National Board of Revenue
SME	Small and Medium Enterprises
TOT	Turn over Tax
UNDP	United Nations Development Program
VAT	Value Added Tax
WB	World Bank

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## ***Abstract***

*This study tried to assess the practices and the challenges of tax audit in case of selected Revenue and Customs Authority, The Adama Revenue and Customs Office. For this end, with the intention of getting the relevant information, this study considered only audit department staff of office as population of the study. Since the number of population is small, this study considered the whole staff members of the audit departments. As the sources of data, the current study used both primary and secondary sources. And, to collect the necessary data survey questionnaires were used as the methods of data collection. The questionnaires were rated at Five Points Likert Scale Rate. To analyze the collected data descriptive statistics such as mean, standard deviation and percentages were applied. From the data analysis, it was revealed that comprehensive tax audit was repetitively performed tax audit type. There was well established role of tax audit. The tax audit practice of the office has weakness in selecting those taxpayers with high tax potential and in business wise. The department also not applied statistical techniques and automatic risk scoring system for its audit selection case. The primary purpose of the tax audit in the office was not ensuring the tax compliance behavior but increasing tax revenue collection. There was problem in supply of audit resources such as skilled and experienced tax auditors and organized and suitable office structure. There was no taxpayer segmentation of taxpayers for tax audit and risk based tax audit strategy. In addition, inadequate number of auditors, lack of skilled and qualified auditors and unwillingness of taxpayers to present necessary records were some challenges of tax audit in the office. Based on these findings, it was recommended that the office should have skilled and qualified tax auditors through training and retaining the experienced auditors, focus on ensuring tax compliance behavior, shall practice statistical techniques for case selection, to follow risk based tax audit strategy, to segment taxpayers and apply different tax audit types. Lastly, it is suggested that the office must have continuous assessment of auditor's efficiency and level of tax compliance behavior enhanced every time.*

*Keywords: Audit, Tax Audit, Comprehensive Audit, Taxpayer*

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# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the Study

The term tax audit is an examination of whether a taxpayer has correctly assessed and reported their tax liability and fulfilled other obligations (OECD, 2006). It is also independent examination of the books and accounts of an organization by a duly appointed employee to enable that employee gives an opinion as to whether the accounts give a true and fair view and comply with relevant statutory guidelines( Awe, 2008). According to Biber (2010), the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. This means that effective audit program extends beyond raising the government revenues. Thus, tax audit is needed to increase tax revenue and taxpayer compliance.

Any tax in a tax system is vulnerable for evasion and fraud, which has become the concern of many countries. Tax fraud is an intentional reduction of the tax liability stemming from real transactions. As Baurer (2005) noted, it is a deliberate misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. It typically includes underreporting profits and turnover, overstating deductions, underreporting employee wages, failure to register or file tax declarations, hiding of taxable receipts coming from the production and distribution of real products and services, overvaluing of VAT spent on inputs and abuse of tax return through fictitious transactions and trades.

According to ERCA Annual Report (2017), the contribution of total tax revenue to GDP for the country is still very low. This low tax to GDP ratio may be explained by less efficient and ineffective efforts and measures taken by the tax administrations. It could also be explained by the low level of tax compliance behavior. In addition, there is not effective tax audit program in the Ethiopian Revenues and Customs Authority.

All these facts call to the evaluation of tax audit practice and performance in the Adama Revenues and Customs Office in enhancing revenue collection and voluntary tax compliance level. Thus, this study endeavored to assess the tax audit practice and its challenges in Adama Revenues and Customs Office.

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## 1.2. Statement of the Problem

Taxation is a way by which governments finance their expenditure by imposing taxes on both citizens and their business entities. In any countries, one of the main purposes of taxation is the raising of as much revenue as possible to meet the ever-expanding public expenditure for the supply of public goods and services (which are not provided by the market). Particularly, nowadays, in developing countries with the increasing task of the government, the role of taxation in economic development has become more significant (ECC, 2005). Even though the government has several ways to raise revenue for its expenditure, revenue through taxation is the main tool for government expenditure. Thus, most governments have used taxation as the tool by which to enhance most of its fiscal requirements. This means that tax is the most viable source of government revenue (Netsanet, 2014).

The central aim of taxation in Ethiopia is to collect revenue to finance the administrative structures of the government as well as to finance the fulfillment of basic infrastructures. In addition, taxation has the goals of maintaining and expanding adequate social services, the decreasing of unnecessary consumption of luxury items, the maintaining of economic stability (Baurer, 2005). To this end, the Ethiopian government has been experiencing many tax reforms (for example; introducing self-assessment, merging Inland Revenue Authority and Customs Authority into one tax administration and etc.) for many times through different government regimes.

However, the potential amount of tax revenue in the country has not been collected in an efficient and equitable manner. The functional self-assessment system has not been working effectively. Still there is the problem of underperformance in tax revenue collection (ERCA Annual Report, 2017). Also, the tax administrations have confusion on the relationship in both revenue collection & tax audit and tax compliance & tax audit and therefore they didn't develop effective tax audit programs in their tax administrations so far (Mirera, 2011). Therefore, it is imperative to determine whether tax audit can actually increase the revenue of the government or tax compliance or both in Ethiopian tax administration.

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According to the study by Alemayehu (2010), there is the problem of tax non-compliance behavior by taxpayers in providing information on credit, nil and non-filer filings. This study result indicated that taxpayers' compliance problems were continuously manifested by deliberate evasion and unlawfulness, and weak audit and enforcement capacity of the tax administration. This means that the audit practice is not effective and not creates a deterrent effect.

The tax audit practice and challenges for developing countries are different from the developed countries (Agumas, 2016). For example, according to Bird (2003), respect of both tax administration and taxpayer compliance developed countries experienced a considerable previous literature and much best tax knowledge and experience. However, the reality is that much of these literature, knowledge and experience experienced in the developed countries are directly applied to the developing countries. This reflected that decision makers and revenue authorities in developing economies in general and in Ethiopian case in particular face quite different challenges and constraints.

In general the empirical review of this study indicated that different studies has been carried out by different researchers on the practices of tax audit and its contribution to tax revenue collection and tax compliance behavior of tax payers.

The empirical results of these studies particularly conducted by the Ethiopian researchers indicated that tax audit program of Ethiopian federal government remains undeveloped with an emphasis on comprehensive and desk audit with the exclusion of other tax audit types which are known in empirical world but it didn't show the reasons why entirely. In addition, even though the audit program performed in federal government of Ethiopia could detect non-compliance behavior of individual taxpayers, and used as a compliance enforcement tool to collect unpaid or evaded tax return and to ensure the deterrent effect, its tax audit practice is still a weak tool in improving voluntary compliance through helping taxpayers to understand their tax and customs obligations that could generate the right tax revenue at the right time. However, major challenges and resultant solutions were not addressed exhaustively.



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Taking these gaps into consideration together with the fact that tax audit is one of the most important aspects of tax administration functions, this study tried to assess the tax audit practices and its challenges in the case of Adama Revenues and Customs Office.

### **1.3. Research Questions**

1. How effective tax audit program and which tax audit type mostly practiced in Adama Revenues and Customs Office (ARCO)?
2. What are the tax audit challenges in ARCO?
3. What is the tax audit practice and performance in Adama Revenues and Customs Office?

### **1.4. Objectives of the Study**

#### **1.4.1 The General Objective**

The general objective of this study was assessing tax audit practice and its challenges in the case of Adama Revenues and Customs Office.

#### **1.4.2. Specific Objectives**

1. To examine effectiveness of tax audit program and effective tax audit type in Adama Revenues and Customs Office (ARCO);
2. To identify challenges of tax audit performance in ARCO and
3. To evaluate the tax audit practice and current audit performance in ARCO.

### **1.5. Significance of the Study**

The outcomes of this research work have some purposes. One important purpose of the study is providing the relevant recommendations which help as an inputs for Adama Revenues and Customs Office(ARCO) to re-examine the practice of tax audit in the office and performance of its tax auditors so that to take corrective action for the future. It also serves as an empirical source of data for those who want to conduct further investigation in this area.

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## **1.6. Scope of the Study**

The study limited on the data which was obtained from Adama Revenues and Customs Office. This study assessed the practice and its challenges of tax audit in the case of Adama Revenues and Customs Office for the last three years.

## **1.7. Limitations of the Study**

Like many studies in empirical world, this study also faced some biased reactions from the selected respondents. Thus, the researcher has taken care of it ahead.

## **1.8. Organization of the Study**

This study is sectioned into five chapters. The first chapter is all about introduction, background, problem statement, objectives, significance, scope, and limitations of the study. The review of the related literatures is revealed in chapter two. The third chapter talks about research methodology. Chapter four presented results, discussions and interpretation of the analysis. The last chapter comes with conclusions and recommendations.

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## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

This study mainly focused on assessing the tax audit practice and its challenges in the case of Adama Revenues and Customs Office. In relation to this, in the study some research questions have been raised and thereby objectives were targeted. With this view, the purpose of the current chapter mainly was to review the related literatures in taxation, tax audit and its challenges in the case of Adama Revenues and Customs Office. This review of the related literatures established the framework for the study and help in clearly identifying the gap in the literatures.

*“No one likes taxes. People do not like to pay them. Governments do not like to impose them. But taxes are necessary both to finance desired public spending in a non-inflationary way and also to ensure that the burden of paying for such spending is fairly distributed. While necessary, taxes impose real costs on society. Good tax policy seeks to minimize those costs.”*

*Richard Bird, 2003.*

#### **2.1. Theoretical Literature**

The current chapter has two major parts such as theoretical literatures review and empirical literatures review. So, the first section focused on some theoretical aspects of tax audit and other related issues.

##### **2.1.1. Tax Audit**

Kircher (2008) defined 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 relevant tax laws and regulations of the given country. The author also stated that tax audit is a process where the Inland Revenue authority tries to confirm the numbers that the selected organization has put on its tax return. Tax audit is the overall concept of tax inspection and treatment carried out by the revenue authority by law on the conditions of tax payment and

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withholding performance of the taxpayers and withholding agents. It includes daily audit and investigation, audit and investigation on special cases.

According to Ola (2001), the process of tax audit involves tax returns that are selected for audit using some selection criteria. This means that the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed. As the author, tax audit is important because it assist the government in collecting appropriate tax revenue so that to ensure that satisfactory returns are submitted by the tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government. Therefore, fundamental tasks of tax audit are implementing the national tax laws, investigation and penalizing tax offences, ensuring the national revenue, safeguarding the tax regulations, promoting compliance and guaranteeing the right implementation of the tax laws.

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD, 2006). According to Biber (2010), the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declarations and supporting documents. Barreca and Ramachandran (2004) noted that the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations.

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

In this section the researcher reviewed the different tax audit types. Based on the evidence from OECD (2006), the tax audit can vary in their scope and the level of intensity to which they are performed. The nature of audits conducted should reflect the risks to be addressed and desired audit coverage of the taxpayer population. For instance; spot (issue) audit provides a high level of audit coverage but at the expense of audit quality, tax revenue, and missed opportunities to properly detect taxpayers' noncompliance behavior.

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The tax audit activities with an excessive number of in-depth examinations reduce the numbers of audits that might be conducted, possibly leading also to less overall deterrent effect (OECD, 2006). Therefore, it is inappropriate to carry out all audits on the basis of comprehensive examination of documentation across all tax obligations and all periods that could be open for amendment. Such approach waste resources targeting compliant taxpayers and limit the number of audits that can be undertaken. Thus, revenue bodies should aim to achieve a balanced program of audits that considers audit coverage, audit quality, and overall deterrent considerations (Biber, 2010).

#### **2.1.2.1. Comprehensive Audit**

A comprehensive audit is a 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 (Ebrill, 2011) as cited by Mekonnen(2017).

A comprehensive audit is all-encompassing in scope and entails an in-depth examination of all information relevant to the calculation of a taxpayer's tax liability for all tax types for a given period. It is classified into very complex, complex and simple (ERCA Tax Audit Manual, 2017).

This classification depends on a number of factors ranging from size, group, trade or profession, volume of records or transactions, nature of business and location.

In practice, the scope and nature of any comprehensive audit activity to be undertaken depended on the available evidence pointing to the likely risks of non-compliance and a taxpayer's history.

An audit may also be classified and justified as complex or very complex because of the taxpayer's financial and/or business activities which are unusually complex. Given the broad scope, in terms of time and resources comprehensive audit is typically costly to undertake and thus it is better to reduce the rate coverage of taxpayers that could otherwise be audited.

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#### **2.1.2.2. Issue Audit**

This is a limited scope audit that may be confined to specific issues in a tax return and/or a particular tax type. According to Grandcolas (2005), it focuses on a single tax type and covers no more than one or two reporting periods. The objective here is to examine key potential risk areas of non-compliance. This type of audit is recommended because it consumes relatively fewer resources than comprehensive audits and allows for an increased coverage of the taxpayer population. The audit normally focused on a single tax type, period or item. Where a field issue audit escalate the case into a comprehensive audit, the team coordinator`s concurrence must be sought and the procedures prescribed for comprehensive audits adhered to. Issue audits may be conducted either on the desk or in the field.

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

**Field Issue Audit** is the escalation of a desk issue audit into a field activity or exercise. It is important to remember that the audit is limited to key issues of compliance or to a tax type or period. Field issue audit is commonly used in examining whether a taxpayer has met his/her obligations in respect of payee, VAT/TOT and excise tax, withholding tax or income tax normally for a specified tax period.

#### **Distinction between Comprehensive and Field Issue audits**

According to ERCA the tax audit manual, in order for an audit to be classified as **comprehensive audit**, the following factors must be evidenced:

- 1) The audit must be detailed and involve an in-depth inquiry into all aspects of compliance, (2) the audit must cover all tax types to which the taxpayer is liable; (3) the audit must cover a period of at least one accounting year;

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(4) the audit process involving all procedures outlined under Pre-engagement activities, Planning and Evaluation activities, Execution or Performance of the audit activities, and Audit conclusion activities and (5) the relevant documentation in respect of the audit assignment i.e. from initiation to conclusion must be kept in an Audit Box File;

On the other hand, in the case of **field-issue audits**, the requirements are as follows: (1) A Field-Issue audit ordinarily emanated from a desk review of returns and disclosures made by the taxpayer in financial statements, together with any privileged third party information; (2) A Field-Issue audit normally targeted an issue in a particular tax head and cover a specified period, depending on the tax head under review; (3) A specific issue(s) must be identified and the field activity must be sanctioned by the team coordinator; (4) A Field-Issue audit must involve a review of the taxpayer's primary records relating to the identified subject matter at the taxpayer's premises or in the tax office; (5) Documentation in respect of the specific review must be kept in a separate file folder; (6) The Standard Audit Working Papers must be used to report the specific review activity. Additional reporting on the field assignment may be provided where the case warrants.

#### **2.1.2.3. Desk Audit**

A Desk audit is used as a preliminary examination of declarations analyzing accuracy, completeness, ratios and cross-checking information to determine if further audit or investigation is warranted. It involves basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination. Information technology (IT) systems should provide strong support for these verifications (Ebrill, 2011) as cited by Mekonnen(2017).

#### **2.1.2.4. Advisory Visit Audits**

It involves the auditors visit to newly established businesses (Netsenet, 2014). All registered taxpayers or businesses need to be visited with the aim of offering advice on tax obligations and the taxpayer's rights, and any other developments pertinent to the tax system and administration.

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It is highly recommended that auditors carry out these audits to keep abreast with compliance trends of their taxpayers and offer timely advice so as to improve compliance. These audits are expected to be spontaneous and hence should not take more than a day. These visits are very appropriate when introducing new tax laws.

#### **2.1.2.5. Refund Audits**

This is the verification of a taxpayer's claim for a tax refund prior to processing the refund. It should focus only on the period covered by the claim. A pre-refund audit should be undertaken to verify the taxpayer's entitlement to a refund prior to processing a first refund claim particularly for new registrants. It is also carried out where the refund claim varies significantly from established patterns and trends. Audits of further claims should be carried out selectively Grandcolas (2005). According to the ERCA Audit Manual (2017), the predominant claim for refund is VAT and/or withholding tax in which their returns are submitted monthly.

#### **2.1.2.6. Investigation Audit**

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

#### **2.1.2.7. Registration Check**

Registration check is a form of unannounced visits to taxpayer's premises for new enterprises (mainly small and medium sized) to detect businesses operating outside the tax system and a quick check on businesses to establish that they are correctly registered. It should not take more than half a day (OECD, 2006). According to Ebrill, *et al.* (2001), in this audit check 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.



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#### **2.1.2.8. De-Registration Audits**

In order to establish outstanding obligations or liabilities, a de-registration audit conducted for all reported cases of cessation of business, winding up or uncertainty. The audit focused on determining taxes due and any other pertinent issues.

The objective of de-registration audit is to ensure orderly exit from the tax register with the attendant obligations and liabilities sorted out.

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

#### **2.1.3. The Effective Tax Audit Program**

Tax auditing program is a key for tax administration. 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.

According to Barreca and Ramachandran (2004), effective tax auditing 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. Furthermore, a well-structured tax audit program can provide valuable support in gathering information on the health of the tax system (including patterns of taxpayers' compliance behavior), educating taxpayers (improving future compliance), and identifying areas of the tax law that require clarification or addressing deficiencies in the law (OECD, 2006).

Accurate and timely self-assessment and compliance with tax by taxpayers is achieved only through highly visible and effective audit programs, including the consistent application of strong sanctions where noncompliance is encountered. Taxpayers must feel that there is a good chance that unreported liabilities and other forms of non-compliance have been detected during an audit.

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Although the frequency of audit is a contentious issue, the judgment is always a delicate balance between the treat of audit to check the temptation to evade and the cost. Where the tax system is fairly well established, audits of 15 percent to 20 percent of registered traders a year are sufficient (Biber, 2010).

Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance (EC, 2006). Tax compliance can be facilitated through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary.

The international standards as to the total staff assigned to audit should be close to 40 percent of the total staff of the tax administrations (Biber, 2010). Thus, the actual number of audits planned should depend on the audit resources available to the program. With proper audit planning, strong supervision, good facilitation, and competent audit performance the tax audit program could be effective.

#### **2.1.4. Audit Case Selection Methods**

Compliance risk is the failure to comply with the tax law by taxpayers whether due to their ignorance, carelessness, recklessness, deliberate evasion, or weaknesses in tax administration itself, and have been addressed only by enforcement through an audit-based approach (OECD, 2004). However, tax administrations do not have sufficient resources to perform thorough on-site audits of the activities of all taxpayers or comprehensive crosschecking of all invoices or transactions. Tax administration, with limited resources and relatively large numbers of taxpayers to administer (especially in the small and medium enterprises), must design the audit program to deploy audit resources in a risk-based way with a view to achieve the most possible compliance and revenue objective (Thomson, 2008 & OECD, 2004).

Regardless of how automated and efficient the audit process, audit effectiveness would not be realized under the selection of inappropriate audit candidates. Hence, managing an effective auditing program involves decisions as to the selection of best audit case strategy or combination of strategies. The selection strategies may vary by tax type. It may be based on either reported tax amounts or the industry type (Barreca and Ramachandran, 2004).

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Case selection through the use of risk management techniques is necessary to ensure that the audit program is fully in line with the administration's compliance strategy, and to set up the necessary audit trails to show why cases have, and have not, been made the subject of an audit (OECD, 2006).

Ebrill, *et al.* (2001) noted that the most effective systems utilize taxpayer profiles and criteria to identify the highest risks for the revenue. These systems are frequently based on the crosschecking of internal information. In tax administration, a risk is anything that can negatively affect the administration's ability to achieve its compliance and revenue objectives. Risk management is a formalized and systematic approach, based on sound analysis, designed to set the best course of action under the uncertainty of risk.

The technique involves identifying, assessing, understanding and acting on risks that impinge on the organization's ability to achieve its objectives (Thomson, 2008).

## **2.2. Empirical Literature**

Nyakamba Daniel Mirera (2011) has carried out the research study on the effects of tax audit on revenue collection in case of Kenya revenue authority and found that tax audit is directly related to revenue collection. He suggested that all the tax audit types are important to extra revenue collection in the Kenyan revenue authority. According to the researcher finding, practicing of more tax audits should be encouraged as it assists the government in collecting appropriate tax revenue necessary for the government expenditure.

The study by Getaneh (2011) has been carried out on the problems of tax audit practice and its effect on tax collection and voluntary tax compliance behavior by the tax payers in Ethiopian tax system.

The findings of this study indicated that tax audit program of Ethiopian federal government remains undeveloped with an emphasis on comprehensive and desk audit with the exclusion of other tax audit types which are known in empirical world.

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In addition, even though the audit program performed in federal government of Ethiopia could detect non-compliance behavior of individual taxpayers, and used as a compliance enforcement tool to collect unpaid or evaded tax return and to ensure the deterrent effect, its tax audit practice is still a weak tool in improving voluntary compliance through helping taxpayers to understand their tax and customs obligations that could generate the right tax revenue at the right time.

The study by Netsanet (2014) has attempted to analyze the existing tax audit practice and its performance in the Hawassa City Revenue Authority. According to this study, the revenue authority audit department has been applying comprehensive audit intensively and there is less flexible tax audit program. The authority has not used different types of audit options in relation to simplicity and complexity of the audit cases. The study also identified that there is unreasonably consumption of audit resources as well as increase the hardship associated with repetitive audits for fully compliant taxpayers.

The empirical results of the study by Chan and 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. The study further indicated that domestic market oriented companies, service companies, and joint ventures are less compliant than export oriented companies, manufacturing companies, and wholly foreign-owned enterprises, respectively.

Sen and Bala (2002) studied income tax audit operation in Bangladesh. The intent of the study was to conceptualize the term tax audit conducted by professional chartered accountants, and to give an overview of the prevailing tax scenario and the operations of income tax audit. The methods adopted were experience survey and personal interview with tax officials in National Board of Revenue (NBR), and documentary analysis using documents such as Government statistical yearbooks and/or annual reports, and publications of the World Bank (WB) and the United Nations Development Program (UNDP).

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The main finding of the study by Arachi and Santoro (2007) was that tax enforcement for SMEs is always challenging since they usually operate on the border between the formal and the shadow economy. The study further showed that the distribution of firm size affects the optimal tax enforcement policy in two ways.

First, there can be a relationship between firm size and the propensity to evade or to avoid taxes. Small traders may underreport the tax base, exploit loopholes in the tax system, choose an organizational form with preferential tax treatment, or operate outside the formal economy. Second, the costs and returns of tax auditing may depend on firm size. The study also argued that business sector analysis might be a valuable policy tool for developing countries, which have a large shadow economy and a high share of microenterprises.

Collins and Plumlee (1991) studied the effect of tax audit schemes on the taxpayer's labor and reporting decision. The study also examined the impact of alternative tax rates and penalty levels on earned and underreported income. Experimental design was adopted, and laboratory labor setting was used to test the effects of audit schemes, tax rates, and penalty levels on underreported income and work effort.

The three independent variables that were manipulated include; tax rate, audit scheme (the decision rule the taxing authority followed in determining reports to be audit), and penalty for underreporting. The audit scheme took on three levels that differ principally in the information used by the taxing authority to determine self-reports to be audited: random (no information), cut-off (reported income information), and conditional (both reported income and an estimate of true income).

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## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

This chapter presented the research methodology to be employed for data gathering as well as the relevant statistical analytical tools that employed for analyzing the survey results. The purpose of this section is to provide a description of research design, the study population, sample size and sampling techniques, data sources and data collection instruments and analysis.

#### **3.1. Research Design**

A research design is the process that guides researchers on how to collect, analyze and interpret observations. From different types of research designs, descriptive research design employed as research design for this study so that to achieve the intended objectives. The reason behind using descriptive research design is because the study is interested in describing the existing situation under the topic in the research area. In addition, here the researcher employed qualitative research approach for this study. This is because the researcher used qualitative data. This means that the qualitative data use one way of data collecting approach.

In addition, this study also employed a survey research design. Survey design is a research method that provides a quantitative or numeric description of trends, attitudes, or opinions of participants with the intent of generalizing from a sample to a population (Creswell, 2009). Under survey research design, data is gathered at a particular point in time with the intention of describing the nature of existing conditions, or identifying standards against which existing conditions can be compared, or determining the relationships existed between specific events (Cohen *et al.* 2000). Therefore, since the main objective of the study is describing the aptness of audit in its different aspects, the study applied both descriptive and survey research designs.

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## **3.2. Sources of Data**

### **3.2.1. Primary Source of Data**

Field survey is the central and important source of collecting the primary data. Since only secondary data rarely solves a given research problem, it is important to have additional information from primary sources such as primary data. In this study, primary data collected from the employees and tax audit team leaders through questionnaires and interviews.

### **3.2.2. Secondary Source of Data**

Secondary data are data which have been collected by individuals or agencies for their purposes other than the particular research study. Since the primary data is not enough to address the research problem, the researcher also focuses on secondary data in the process of data collection as additional information. In this study, the authority's tax related directives, tax audit manuals, published journals, and other published researches reviewed as secondary data source.

## **3.3. Tools of Data Collection**

### **3.3.1. Questionnaires**

This method of data collection is used to collect necessary information from the sample respondents. To do this, both open-ended and closed ended questionnaires prepared and distributed to both employees and leaders of the respondents. Questionnaires are prepared by English version. However, if there is any confusion in the question during the data collection, the researcher gave more explanation to the question in person.

### **3.3.2. Interviews**

To extract as much information as possible that helps the researcher in addressing the specific objectives of the study, structured interview carried out through face-to-face contact with tax audit team leaders and process owner of the office so that to address the problem of the study.

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### 3.4. Sample Size and Sampling Techniques

#### Population

According to the definition by Eboh (2009) population is all items in any field of enquiry or study. It is any group the researcher has focused his attention to and has been chosen as the approved subject of study. Thus, the population of this study was auditors, audit team leaders and audit process owner of Adama Revenues and Customs Office. There is a rule of thumb that says when the number of the target population of the given study area is less than one hundred, it is more appropriate to take the whole population as a sample size for the study (Yount, 2006). In the current case since the number of auditors and the team leaders are less than one hundred; this study considered all auditors as its respondents. In addition, the Adama Revenues and Customs Office is selected based on the interest of the researcher and the width of the revealed problem. The given office also collects the considerable amount of government revenues from domestic tax sources. The researcher gives special attention for audit practices and its challenges in the office. Thus, the total research population to this study was 35 employees of Adama Revenues and Customs Office.

Table 3.1: Details of the Sample and Sample Size

Auditors	Junior Auditors	Auditor	Senior Auditor	Team Leaders	Process Owner
Quantity	4	12	15	3	1
Percentage	11%	34%	43%	9%	3%

*Source: Adama Branch Office, 2018*

### 3.5. Method of Data Analysis and Presentation

Both primary and secondary data presented and analyzed using statistical tools like mean, standard deviation and percentage. More over tables and charts were employed to facilitate the interpretation of the result of the data analyzed. In this study the qualitative data analyzed against various theories that help in providing reasonable and acceptable explanations thereby enhancing the ability of generalizing the research result to the wider population of interest.



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In addition, the quantitative data is the data that has been collected and put in to numeric form, so that they can be counted. Analyzing quantitative data involves the use of descriptive statistics such as tables and percentages. This is done after the collected data is fed into SPSS version 20 to make the data ready for processing through figures and tables.

In general, the analyzing instruments in this study were statistical tools such as mean, standard deviation and percentages. In addition to these tools tables, charts, documentary analysis and trend analysis of the tax audit performance in the office were employed.

### **3.6. Ethical considerations**

In this study, privacy, confidentiality, data protection, and voluntary nature of participation considered the significant ethical issues. Every effort made to minimize the risk or discomfort to the participants arising from these issues. Prior to the interviews and questionnaires, the researcher asked for organizational permission to conduct the research with staffs and officials, including permission for the interview.

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## CHAPTER FOUR

### RESULTS, ANALYSIS AND INTERPRETATION

This study tried to assess the tax audit practices and its challenges in Adama Revenue and Customs Office found in Adama city. The survey results were presented and discussed in the current chapter.

#### 4.1. Analysis and Discussions of Survey Results

In this section, the survey results collected from distributed copies of questionnaires were analyzed. Therefore, those distributed and properly returned copies of the questions analyzed, discussed and interpreted under this section. The discussions included evaluations of the tax programs, practices and challenges of the tax audit in Adama Revenues and Customs Office. For this, the responses from employees of the office were collected through yes or no questions and using lickert scale measurement. In case of lickert scale measurement, 1 represents strongly disagree, 2 disagree, 3 neutral, 4 agree and 5 strongly agree. Therefore, the collected responses from the employee were analyzed and discussed in the subsequent figures and tables.

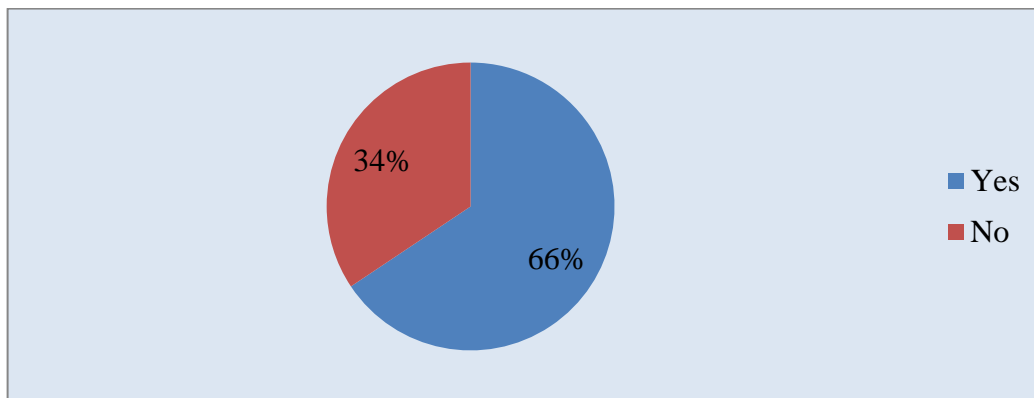


Figure 4.1: Role of the Tax Audit

The figure 4.1 above is all about the established role of the tax audit in Adama Revenues and Customs Office. To get appropriate information the auditors were asked whether the role of the audit was well established in the office or not.

As it was shown in the figure above, 21(66%) of respondents replied the positive response and they said as the role of the tax audit was well established in the office. Therefore, it can be conclude that the role of tax audit was established in the office.

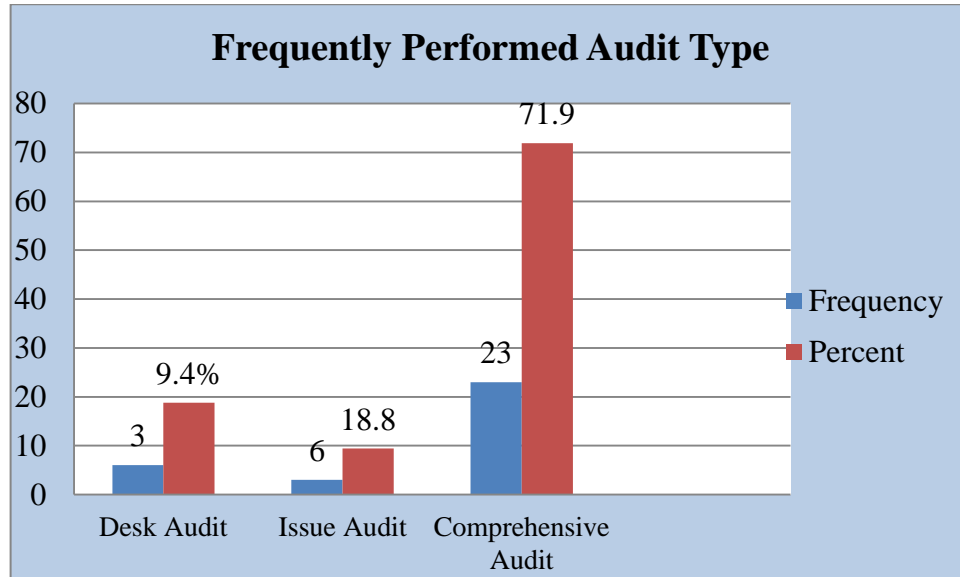


Figure 4.2: Frequently Performed Audit Type

As revealed in the figure 4.2 above 23(71.9%) of the respondents replied comprehensive audit type was frequently performed audit type in the office. Therefore, from the majority result it can be concluded that comprehensive audit type was frequently performed audit type in the selected office. The table 4.1 below shows the hierarchy of the audit type frequently performed in the office.

Table 4.1: Rank of Frequently Performed Audit Type

Audit type	Rank
Comprehensive audit	1
Issue audit	2
Desk audit	3

Source: Field Survey, 2018

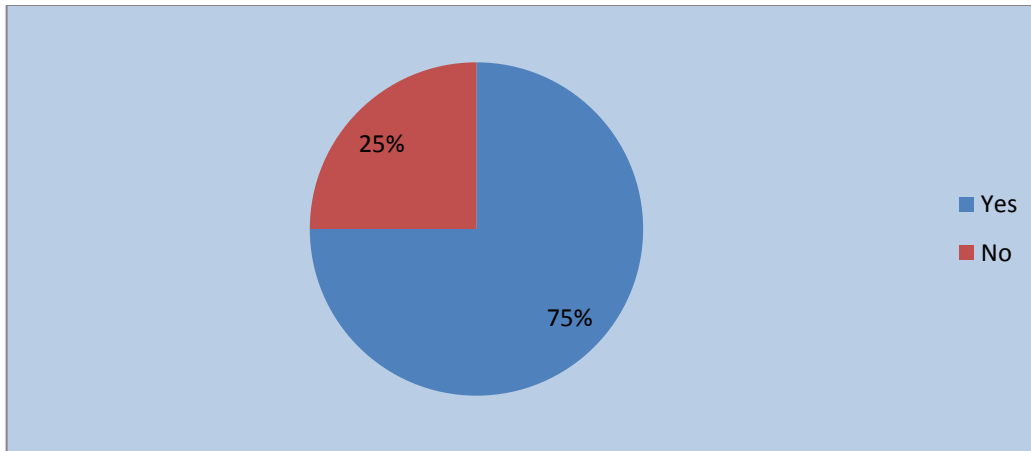


Figure 4.3: Frequency of the Tax Audit on the same Premises

In relation to frequency of the tax audit on the same taxpayer, to know the fact the respondents were asked whether there was a situation that the office can repetitively audits the same taxpayer in a fixed period or not. As 75% of the respondents replied there was a situation that the office can repetitively audits the same taxpayer in a fixed period. In addition, as the information from interview survey, there were repetitively audited taxpayers while considering the existence of relevant reasons to audit the same taxpayer in the fixed period. Furthermore, as explained by the auditors the audit laws also supported the audit task to be undertaken whenever, there were reliable reasons to audit the selected taxpayers repetitively. According to the responses from the auditors the reasons might be the discrepancy of monthly reported tax returns, tax potential of the taxpayer, investigated repetitive tax frauds and higher frequency of nil and credit filing by taxpayers for the selected tax administration. Therefore, from this survey result it can be concluded that there were situations to audit a given taxpayer repetitively.

On the other hand, the figure 4.4 below presented the survey information about the intelligence input and its support for effective audit work in the selected office. This is because for effective audit task there must be intelligence input towards identifying high risk taxpayer.

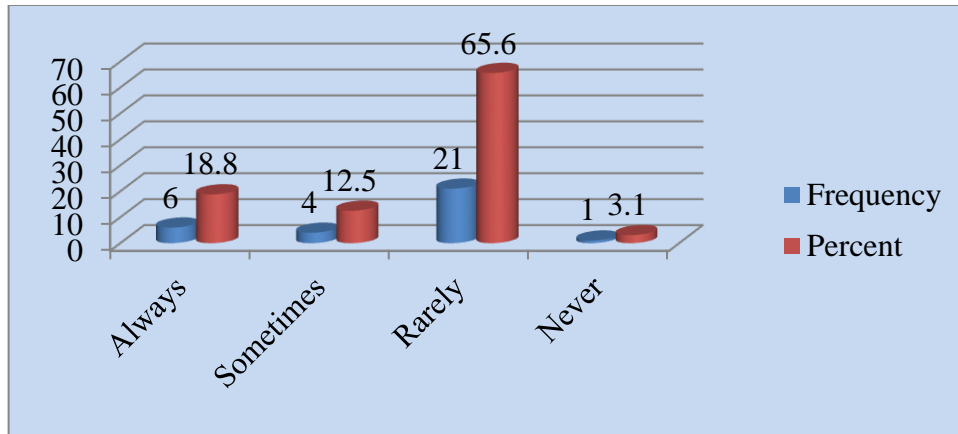


Figure 4.4: Intelligence Input for Tax Audit

As the survey result presented in the figure 4.4 above, the audit works undertaken by the office has rarely been supported by the intelligence input. As the respondents indicated the intelligence team was incapable enough to provide relevant and reliable information to the audit department that can help the auditors to perform the audit task most effectively.

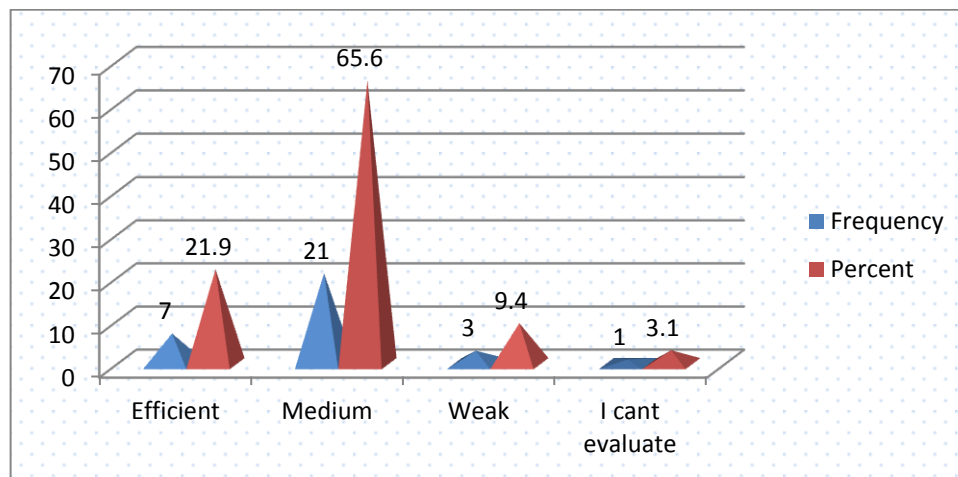


Figure 4.5: Effectiveness of the Tax Audit

As revealed in the figure 4.5 above, 21(66%) of the respondents confirmed that the audit tasks in the office had medium effectiveness in its performance. Therefore, from the majority result (66%), it can be concluded that there was inefficient tax audit performance.

The table below shows the hierarchy of the reasons for noncompliance behavior by taxpayers in the office.

Table 4.2: Rank of Reasons for noncompliance behavior by Taxpayers

Reasons for non-compliance	Rank
Deliberate Action of Taxpayers	1
Weakness in Tax Administration	2
Lack of awareness by taxpayers	3
Taxpayers carelessness	4

*Source: Field Survey, 2018*

The results presented in the table 4.2 above show hierarchies of reasons for noncompliance behavior by taxpayers in the Adama Revenues and Customs Office. According to the survey result presented in table 4.2, the number one reason was deliberate action of taxpayers followed by the weakness in tax administration. Then, these two reasons were followed by lack of awareness by taxpayers and their carelessness towards the tax laws.

Table 4.3: Constructs of Legal Framework

Questions	Disagree	Neutral	Agree	Strongly Agree	M	SD
Taxpayers can easily understand and be aware of the tax rules, the tax audit forms	18 (56.3%)	6 (18.7%)	8 (25%)	-	2.69	0.86
Legal framework empowers auditors to have access to taxpayers' records and third party information	5 (15.7%)	6 (18.7%)	21 (65.6%)	-	3.50	0.93
Taxpayers obligated to keep books and records	7 (21.9%)	6 (18.7)	17 (53.1%)	2 (6.3%)	3.44	0.91
There is a sanction or penalty for non-compliant tax payers	6 (18.7%)	5 (15.7%)	16 (50%)	5 (15.7%)	3.62	0.98
Statements of taxpayers' rights and obligations are presented in the tax laws	6 (18.7%)	7 (21.9%)	15 (46.9%)	4 (12.5%)	3.53	0.95
<b>overall mean and standard deviation</b>					<b><u>3.36</u></b>	<b><u>0.89</u></b>

*Source: Survey Result, 2018*

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As revealed in the table 4.3 above, the majority result indicated that the tax laws and other legal issues were not easily understandable by the taxpayers; the tax laws empower the auditors to access the taxpayers' information for the audit work in the office, the taxpayers have an obligation to keep audit books and records for the next five years as necessary audit documents, the existence of penalty for non-compliant taxpayers by the office and the tax laws defined the right and obligations of taxpayers clearly in its framework.

However, the overall mean value is for the questions related with the legal framework is 3.36 and the standard deviation is 0.89. This higher overall mean value indicated the existence of better tax legal framework for the audit tasks in the office in general.

In relation to audit selection, the table 4.4 below explains the detail survey result of 10 items. According to this survey result, it can be concluded that there was no cooperation between taxpayers and the tax audit department while selecting the premises or taxpayers to be audited, the reasons to select the taxpayer for tax audit were the risks associated with the non-compliance behavior by the taxpayers, the availability of resources, high tax potential, tax evasion and frauds.

On the other hand, the respondents revealed that the office has not used statistical techniques for selection using prior tax audit results; the audit case selection was not based on automated risk scoring system and business sector, the audited taxpayer but found no tax liability was selected for the next audit, unless there was enough reason to undertake the audit work, any business can't be selected in the same period for audit work by the office, the audit department didn't select audit cases manually based on their own knowledge about taxpayers' behavior and environment.

The overall mean value for questions related with audit selection case is 2.81 and the standard deviation for the questions is 0.82. This means that the audit department of the office was not applied the audit case selection criteria exhaustively.

Table 4.4: Constructs of Audit Selection Case

Questions	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	M	SD
Audit case selection is done with cooperation of taxpayers	-	17 (53.1%)	6 (18.8%)	9 (28.1%)	-	2.75	0.88
Taxpayers are selected based on associated compliance risk	-	11 (34.4%)	6 (18.8%)	15 (46.9%)	-	3.13	0.91
Audit case selection is based on the availability of resources	-	7 (21.9%)	5 (15.6)	20 (62.5%)	-	3.41	0.84
Selection is based on taxpayers' high tax potential		9 (28.1%)	5 (15.6%)	16 (50%)	2 (6.3%)	2.72	0.89
Serious evasion and fraud are basis for selection	-	7 (21.9%)	4 (12.5%)	15 (46.9%)	6 (18.8%)	3.44	0.84
using Statistical techniques for selection using prior tax audit results	4 (12.5%)	15 (46.9%)	6 (18.8%)	5 (15.6%)	2 (6.3%)	2.50	0.76
Automated risk scoring system that identifies risk of noncompliance is the possible techniques in selecting	3 (9.4%)	16 (50%)	6 (18.8%)	7 (21.9%)	-	2.66	0.83
Audit case selection based on the business sector	4 (12.5%)	17 (53.1%)	4 (12.5)	7 (21.9%)	-	2.56	0.84
The tax audit department has selected audit cases randomly	4 (12.5%)	19 (59.4%)	7 (21.9%)	4 (12.5%)	-	2.47	0.72
Auditors select audit cases manually based on their own knowledge about taxpayers behavior and environment	11 (34.4%)	14 (43.8%)	4 (12.5%)	3 (9.4%)	-	2.44	0.67
<b>overall mean and standard deviation</b>						<b><u>2.81</u></b>	<b><u>0.82</u></b>

Source: Survey Result, 2018



Table 4.5: Constructs of Purpose, Resources and Frequency of Audits

Questions	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	M	SD
The primary purpose of tax audit performed is to ensure tax compliance with tax law.	2 (6.3%)	14 (43.8%)	8 (25%)	6 (18.8%)	2 (6.3%)	2.75	1.05
The primary purpose of tax audit performed is collecting additional tax revenue.	1 (3.1%)	6 (18.8%)	5 (15.6%)	16 (50%)	4 (12.5%)	3.50	1.05
The main purpose of tax audit performed is to educate taxpayers.	3 (9.4%)	14 (43.8%)	3 (9.4)	10 (31.3%)	2 (6.3%)	2.81	1.18
Tax audit is for reducing tax evasion and tax fraud	4 (12.5%)	8 (25%)	3 (9.4%)	15 (46.9%)	2 (6.3%)	3.10	1.23
<b>overall mean and standard deviation</b>						<b><u>3.04</u></b>	<b><u>1.13</u></b>
<b>Questions Related With Audit Resources Provisions</b>							
There is enough audit staffs for all tax audit types	-	16 (50%)	6 (18.8%)	6 (18.8%)	4 (12.5%)	2.94	1.11
Enough materials and equipment for audit program	1 (3.1%)	9 (28.1%)	5 (15.6%)	15 (46.9%)	2 (6.3%)	3.25	1.05
Qualified and experienced tax audit staffs	6 (18.8%)	17 (53.1%)	4 (12.5)	5 (15.6%)	-	2.25	0.95
Well organized structure and suitable office	6 (18.8%)	18 (56.3%)	3 (9.4%)	5 (15.6%)	-	2.22	0.94
<b>overall mean and standard deviation</b>						<b><u>2.68</u></b>	<b><u>1.01</u></b>

Questions Related With Frequency Of The Tax Audit								
Questions	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	M	SD	
Every businesses audited once a year	3 (9.4%)	22 (68.8%)	3 (9.4%)	4 (12.5%)	-	2.25	0.80	
The tax work has been performed repetitively	-	20 (62.5%)	3 (9.4)	9 (28.1%)	-	3.44	0.84	
The audited taxpayer but found no tax liability is not selected for the next audit	-	7 (21.9%)	4 (12.5%)	21 (65.6%)	-	2.66	0.90	
<b>overall mean and standard deviation</b>						<b><u>2.78</u></b>	<b><u>0.85</u></b>	

*Source: Survey Result*

As shown in the table 4.5 above, the survey result indicated that the primary purpose of tax audit performed in the office was not to ensure tax compliance with tax law and to educate tax payers. Improving revenue collection and reducing tax evasion and tax fraud were taken as the primary purpose of tax audit by the office.

The table 4.5 above also holds the survey results related with supply of audit resources for the tax audit work in the selected office. According to this survey result although the office has enough materials and equipment for audit program, it faced the problem in shortage of enough skilled and experienced tax auditors, well-organized structure and suitable office.

Related with frequency of the tax audit as revealed in this table above, the survey result indicated majority of the respondents replied that every business was not audited once in a given year. As it was added by the audit department, the reason was inadequate number of auditors. On the other hand, 20(62.5%) of the respondents replied that the tax work has not been performed repetitively unless there is enough reason for audit.

Table 4.6: Constructs of Tax Audit Program

Questions	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	M	SD
Use taxpayers segmentation for tax audit	4 (12.5%)	17 (53.1%)	3 (9.4%)	6 (18.8%)	2 (6.3%)	2.53	1.14
Audit is performed based on audit manual	-	4 (12.5%)	4 (12.5%)	15 (46.9%)	9 (28.1%)	3.91	0.96
Effectiveness of tax audit is measured by volume of the audit performed	5 (15.6%)	17 (53.1%)	3 (9.4)	7 (21.9%)	-	2.38	1.01
Effectiveness is measured by enhanced tax compliance and revenue collection	-	4 (12.5%)	4 (12.5%)	18 (56.3%)	6 (18.8%)	3.81	0.89
Continuous and sufficient trainings for tax auditors	-	5 (15.6%)	6 (18.8%)	21 (65.6%)	-	3.5	0.76
Apply standard risk identification criteria to identify highly risky business	5 (15.6%)	17 (53.1%)	4 (12.5%)	6 (18.8%)	-	2.34	0.98
A continuous assessment to improve the capability or competency of auditors	4 (12.5%)	19 (59.4%)	4 (12.5%)	5 (15.6%)	-	2.31	0.89
The audit work is started and completed within a predetermined timeframe	-	8 (25%)	5 (15.6%)	19 (59.4%)	-	3.34	0.87
The office have a risk-based tax audit strategy by identified risk scoring criteria	2 (6.3%)	17 (53.1%)	4 (12.5%)	9 (28.1%)	-	2.63	0.98
<b>overall mean and standard deviation</b>						<b><u>2.97</u></b>	<b><u>0.94</u></b>

Source: Survey Result, 2018

With regard to tax audit program, as shown in the table 4.6 above, the survey result shows majority of respondents responded that the audit was performed based on the audit manual, the effectiveness of tax audit was measured by enhanced tax compliance and revenue collection by the office, the office has given continuous and sufficient trainings for tax auditors, the audit works undertaken in the office were started and completed within a predetermined timeframe

On the other hand tax payers segmentation mechanism was not used by the office for tax auditing, to identify highly risky business the office has not been applying standardized risk identification criteria, the office has not made a continuous assessment so that to improve the capability and competency of auditors, effectiveness of tax audit was not measured by volume of the audit performed in the office, the office has no a risk-based tax audit strategy identified by risk scoring criteria.

The overall mean value for questions related with tax audit program is 2.97 and the standard deviation for the questions is 0.94. This majority result indicated that there was weakness in applying the risk-based strategy of the audit work in the given office.

Table 4.7: Constructs of Challenges of Tax Audits

Questions	Strongly Disagree	Disagree	Neutral	Agree	M	SD
Taxpayers are unwilling to present important records for the audit work	5 (15.6%)	20 (62.5%)	4 (12.5%)	3 (9.4%)	2.16	0.81
Better understanding on tax laws by the taxpayers	3 (9.4%)	17 (53.1%)	3 (9.4%)	9 (28.1%)	2.56	1.01
Unavailability of enough audit resources	2 (6.3%)	14 (43.8%)	6 (18.8)	10 (31.3%)	2.75	0.98
Less skilled and low experienced auditors	-	6 (18.8%)	4 (12.5%)	22 (68.8%)	3.5	0.80
Existence of high corruption and fraud among auditors and the taxpayers	2 (6.3%)	13 (40.6%)	9 (28.1%)	8 (25%)	2.72	0.92
<b>overall mean and standard deviation</b>					<b><u>2.74</u></b>	<b><u>0.90</u></b>

*Source: Survey Result, 2018*

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As shown in the table 4.7 above, the survey result on challenges of tax audit revealed that majority of respondents reacted as taxpayers were voluntary to present important records, there were enough resources for the audit works and no high corruption and fraud among auditors and the taxpayers in the given office. On the other hand, low level of tax payers understanding on tax law, less skilled and inexperienced auditors were taken as challenges of the tax audit.

## **4.2. Documentary Analysis**

As Thomson (2008), tax audit is one of the long standing and accepted compliance strategies in tax administration and its program provides visibility to the compliance and enforcement arm of the tax administration. The study identified that tax audit is becoming one of the most important tools of treating compliance risk by tax administrators. With this view, the auditors were asked that whether the office has been giving due attention for tax compliance or not. In relation to tax audit works, as the survey result indicated tax compliance get less attention than tax revenue collection.

In addition, the audit respondents were asked whether the office has enough number of auditors in terms of both quality and quantity or not. As information from respondents and structure of department, currently the office has no enough and skilled auditors. The interview which held with a team leader in tax audit department also compliments this and said that the office has a problem of understaffed and unskilled auditors. Currently, there are only 35 auditors. This is less than the international benchmark of 30% of the total employees of the given organization (Selamawit, 2009). For example, currently, from 183 active employees, the share of auditors in the office is only 19 % ( 35). This indicated and lead to ineffective tax administration.

On the other hand, the study by Ebrill et al. (2001) identified that effective VAT audit program should cover 25 to 30 percent of the taxpayers each year. However, as it was obtained from documentary assessment, the audit program coverage rate in the office was 17%). This is below the international benchmarks (20% to 30%).

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This implies that the audit program in Adama revenues and customs office was not effective and it needed more effort from the office. The studies suggest that unless there is effective audit program, both tax compliance behavior and revenue performance can be affected.

### **4.3. Revenue Collection performance**

This section uncovered revenue collection performance of the Adama Revenues and Customs Office of the Authority. To examine the revenue collection of the office, the study used 3 years data obtained from the given office.

Here, for the selected 3 years, the tax revenue collection performance was analyzed against the plan for each fiscal year of Ethiopia. It was clearly understood that one of the core objectives of tax administrations in the country is collection of taxes while enhancing voluntary tax compliance under the country's tax laws. With this view, therefore, in this section the revenue collection performance was assessed against its targeted revenue for the last three years (2008-2010 E.C.).

The figure 4.6 below shows the tax revenue collection performance in Adama Revenues and Customs Office. The result presented in the figure included planned revenues, actual revenues and performance data of revenue in percent.



**Figure 4.6: Tax Revenue Performance**

Source: Adama Revenues Branch Office, 2018

As it can be shown the figure 4.6 above, even though the results in the figure reflected increasing trends of revenue collection from year 2008 to 2010(E.C.), the actual tax revenue collection was below its targeted tax revenue collection for the last three years. There were some improvements in tax revenue collection in the last three years; still the collection performance was below its potential. This in turn can signify under capacity of the tax administration or the office in raising as much revenue as its taxpayers' tax potential while other revenue collection affecting factors are equal.

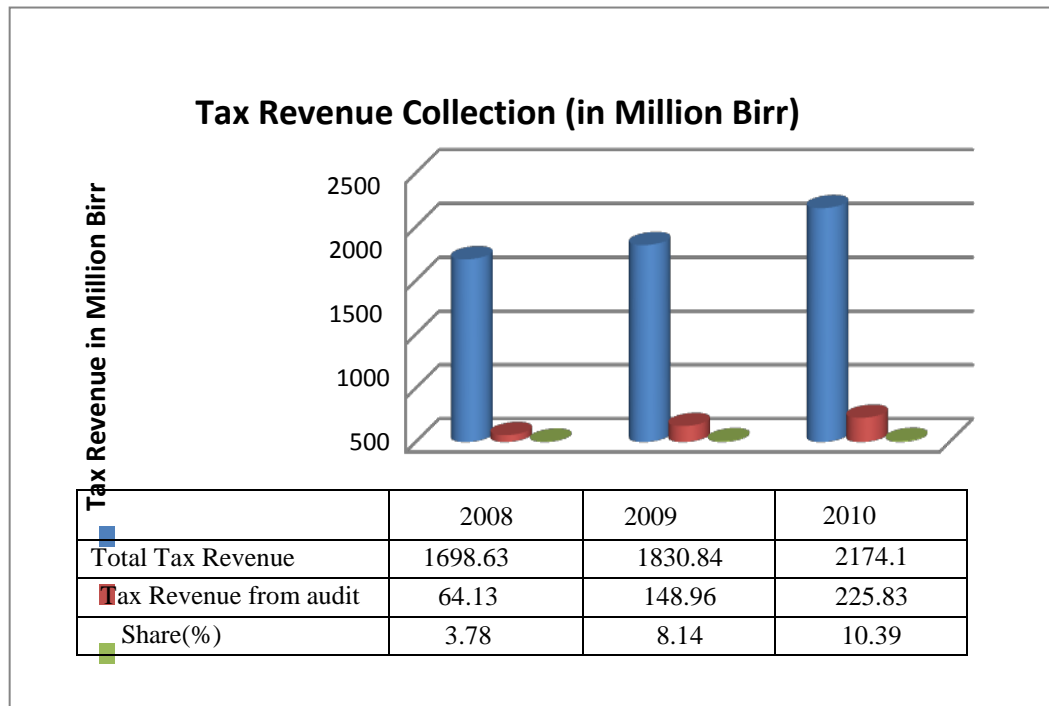


Figure 4.7: Share of Tax Audit Revenue from Total Tax Revenue

*Source: Adama Revenue Branch Office*

As shown in the figure 4.7 above, in year 2008 (E.C.) the tax revenue from tax audit was 64.13 million(2008E.C.), 148.96 million(2009E.C.) and 225.83(2010 E.C.). The tax audit share from total tax revenue collected in the office in the last three years was 3.78(2008 E.C.), 8.14(2009 E.C.), 10.39(2010 E.C.). Therefore, the collected revenue by tax audit and its share from total tax revenue in the last three years shows increasing role of tax audit in the performance of tax revenue collection in the office. As the information from the office, tax audit was considered as one important mechanism for enhancing the collection of revenue in the office. There was also revenue collection plan every year in the office. This means that in relation to the purpose of tax audit, revenue collection gets more attention than enhancing tax compliance behavior in the office. In addition, as the information from the office, there was no assessed compliance level achieved through tax audit. This indicated the less attention for tax compliance than tax revenue collection in the office.



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#### **4.4. Summary of Findings**

In this section, based on the survey results the study made discussions as follows. As the survey result (66%) indicated there was established role of tax audit in the office. According to 71.9% of the respondents the comprehensive audit was frequently performed audit type in the office in the last three years. There was also a situation in which the same taxpayer could be audited for more than one time in the fixed time period when there are reasons to audit the taxpayers. This was confirmed with 75% of respondents' response.

As it is known in the tax administrations, the effective tax audit tasks should be supported with the intelligence input from the concerned body. According to the response from 65.6% of the study participants the tax audit tasks undertaken in the office was rarely supported with the intelligence input.

In addition, this study focused on the issues rated with tax laws. In this case, the survey results (56.3%) indicated that the tax laws are not easily understandable by the taxpayers. The taxpayers have less awareness on the tax laws. In relation, the tax laws empower the auditors able to access the audit records and books. On the other hand, the laws forced the taxpayers keep the books and records for the next five years (53.1%). As 50% of the participants explained there is tax law that penalized those taxpayers who are not compliant to the existed law. Furthermore, the laws defined the rights and obligations of taxpayers clearly.

In relation to audit case selection, before the taxpayers are selected for tax audit, the tax administrations should consider the criteria such as compliance risk, tax potential of taxpayer, taxpayer's evasion and fraud record, business type and other relevant reasons. With this view the auditors were asked to respond on the practices of tax audit case in the given office. The survey results indicated during the tax of tax audit case, according to 53.1% of the participants' taxpayers were not cooperative.

On the other hand, the office selected taxpayers for audit based on associated compliance risk (46.9%), record of evasion and fraud (46.9%). However, there was no applied statistical (46.9%) and automatic risk scoring (50%) techniques for tax audit case section

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in the office. There was no practice of tax audit selection case that guide the taxpayers to be selected randomly (59.4%) and manually (43.8%) by the tax auditors.

According to the survey result (43.8%) the main purpose of the tax audit was not ensuring tax compliance behavior. the tax audit undertaken in the office in the last three years was with the very intention of improving tax revenue collection (50%) and to minimize tax evasion and fraud (46.9%). tax audit was not performed repetitively unless there is relevant reasons and intelligence input in the same time period (62.5%).

The tax audit task was undertaken based on the audit manual (46.9%). There was no enough and continuous assessment of efficiency of the auditors in the given office in the last three years. As 59.4% of the respondents the audit works undertaken in the office has been completed in the standardized time. According to 53.1% of the participants there was no risk based tax audit system in the office.

In relation to the challenges of tax audit, in a given office there was challenges from the taxpayers in not willing to provide important audit records and books needed by the auditors (62.5%). Further, as 53.1% of the respondents still there was weakness in understanding the tax laws in detail by the taxpayers. There was still less number of auditors and less skill from the auditors (68.8%). However, the corruption and fraud are not the major challenges of the tax audits in the office.

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## **CHAPTER FIVE**

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Conclusions**

The main objective of this study was to assess the tax audit practices and challenges in Adama Revenues and Customs Office. With this view, the survey results were analyzed and summarized in the previous chapter. Here, based on these survey results, the following conclusions were detailed and presented as follow.

Based on the findings detailed in chapter four, the role of tax audit was established. The comprehensive tax audit type is frequently performed tax audit type in the given office. As the information obtained from the office, without relevant reasons the tax audit task can't be undertaken for more than one time on the same taxpayer in the same period.

There was no intelligence input support for tax audit works in the office. The tax audit performance was found in medium level of success in the office in the last three years. Taxpayers have no well understanding on the existed tax laws. However, the tax laws empower the auditors to request necessary information from the taxpayers. The tax laws have power of penalizing the non-compliant taxpayers. The audit laws endowed with mentioned rights and obligations of the taxpayers.

Taxpayers showed less cooperation audit case selection. The office didn't apply the statistical, automated risk scoring and risk based techniques in their audit case selection. In this case, even though there were criteria for audit case selection, scientific and statistical techniques were not applied as expected. However, there was no manual selection by the auditors. There was practice of selecting audit case in group of employees and auditors from the office.

The main reason for audit works in the office was collecting extra revenue than ensuring the tax compliance behavior by the taxpayers. However, the audit works also focus on evasion and frauds by the taxpayers. There was problem in audit coverage in the office. The audit works in the office has been completed in the defined time period.

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There was no continuous assessment of the efficiency of the auditors. Lastly, less understanding and awareness on tax laws by taxpayers, less skilled and low number of auditors and scarcity in major audit resources were the major challenges of tax audit in the office.

## **5.2. Recommendations**

Considering the conclusions mentioned above, the researcher presented the following recommendations. The main aim of this study was to assess the tax audit practices and its challenges in the given office. Therefore, understanding the findings and conclusions detailed above, the researcher recommended the following points for the office.

- To improve the compliance level and audit coverage, in addition to comprehensive audit the office should due attention to conduct other types of audit.
- The office should train and deploy additional manpower to strengthen the intelligence team and supports the audit work with the intelligence input for better result achievements and for wise use of audit resources.
- The office must have a regular program to provide education and awareness creation program for its taxpayers.
- The office should have a mechanism of tax payer's segmentation to identify those of high tax potential taxpayers.
- For audit case selection purpose the office should apply statistical techniques and automated risk scoring system.
- The office should also give due attention for ensuring tax compliance not less than tax revenue collection.
- The tax office should secure enough skilled and experienced auditors, adequate material and equipment, well-organized structure and suitable office.

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**Appendix A**

**ST. MARY'S UNIVERSITY  
FACULTY OF BUSINESS AND ECONOMICS  
DEPARTMENT OF ACCOUNTING AND FINANCE  
SCHOOL OF GRADUATE STUDIES**

**Dear Respondent,**

I am pleased to inform you that I am a graduate student at St. Mary's University pursuing a Master's Degree in accounting and finance. As partial fulfillment of the Program, I am conducting a research assessment on Assessing the Tax Audit Practice and Its Challenges in the case of Adama Revenues and Customs Office. My research project endeavors to generate knowledge to be utilized in understanding Tax Audit Practice and Its Challenges. As a representative of office, your views are of important in my study and I would appreciate you responding to this questionnaire. This is purely for academic purpose and your response will be kept confidential and anonymous.

Yours faithfully!!!

**Belay Tafesse**



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**PART I: General Information**

**Answer all the questions by selecting appropriate letter or writing in the spaces provided.**

1. What is your gender?

- A) Male                       B) Female

2. How old are you?

- A) Below 25 years                       B) 26-34 years   
C) 35-44 years                       D) 45 years and above

3. What is your highest level of educational achievement?

- A) Certificate                       B) Diploma level   
C) Bachelor's Degree                       D) Master's Degree                       E. Other

4. How many years of experience do you have in your career field?

- A) Less than 2 year                       B) 2-3 Years   
C) 4-5 Years                       D) 6 years and above

5. What is your job title?

- A) Junior Auditor                       B) Auditor                       C) Senior Auditor   
D) Team Leader                       E) Process Owner

**PART II: Questionnaires related with Tax Audit Practices**

1) Are the roles of tax audit well established in your office?

- Yes                       No

2) Which tax audit type has been performed frequently in your office?

- A) Desk Audit                      C) Comprehensive Audit  
B) Field Audit                      D) Issue Audit E) if other, please (specify).....

3) Is there a situation that the office repetitively audits the same tax payer in a fixed period?

- A) Yes                       B) No

4) If your answer for question 3 is “yes”, explain the condition(s) for those taxpayers to be audited repetitively.

- A) The discrepancy of monthly reported tax returns
- B) Investigated repetitive tax frauds
- C) Tax potential of the taxpayer
- D) Higher frequency of nil and credit filing by taxpayers
- E) If other, please (specify) -----

5) How often tax audit is supported by intelligence input?

- 1) Always  2) Sometimes  3) Rarely  4) Never

6) How do you evaluate the effectiveness of tax audit performance in the office?

- 1) Efficient  2) Medium  3) Weak  4) I cannot evaluate

7) What are the main reasons for the noncompliance behavior of the taxpayers (multiple answers are possible)?

- A) Deliberate action of taxpayers
- B) Lack of awareness by taxpayers
- c) taxpayers carelessness
- d) weakness in tax administration

no	Questions Related with Legal Framework	5	4	3	2	1
8.1	Taxpayers can easily understand and be aware of the tax rules, the tax audit forms and instructions					
8.2	The Legal Framework empowers auditors to have access to taxpayers’ records and third party information					
8.3	Tax payers obligated to keep books and records					
8.4	There is a sanction or penalty for non-compliant tax payers					
8.5	Statements of taxpayers’ rights and obligations are presented in the tax laws					

<b>no</b>	<b>Questions Related With Audit Selection Case</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
9.1	Audit case selection is done with cooperation of taxpayers to give essential information for performing an audit.					
9.2	Taxpayers are selected based on associated compliance risk					
9.3	Audit case selection is based on the availability of resources for tax audit					
9.4	Selection is based on taxpayers' high tax potential					
9.5	Serious evasion and fraud are basis for selection					
9.6	The office selected taxpayers using Statistical techniques using prior tax audit results					
9.7	Automated risk scoring system that identifies risk of noncompliance is the possible techniques in selecting					
9.8	Audit case selection has been done based on the business sector					
9.9	The tax audit department has selected audit cases randomly without any analysis					
9.10	Auditors select audit cases manually based on their own knowledge about taxpayers behavior and environment					
<b>no</b>	<b>Questions Related With Purpose of Tax Audit</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
10.1	The primary purpose of tax audit performed in the tax office is to ensure tax compliance with tax law.					
10.2	The primary purpose of tax audit performed in the tax office is collecting additional tax revenue.					
10.3	The main purpose of tax audit performed in tax administrations is to educate taxpayers.					
10.4	Tax audit is for reducing tax evasion and tax fraud					

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<b>no</b>	<b>Questions Related with Resources of Tax Audit</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
11.1	The tax audit department has enough audit staffs for all tax audit types					
11.2	Enough materials and equipment for audit program					
11.3	Qualified and experienced tax audit staffs					
11.4	Well organized structure and suitable office					

<b>no</b>	<b>Questions Related with Frequency of Tax Audit</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
12.1	Every businesses audited once a year					
12.2	The tax work has been performed repetitively					
12.3	The audited taxpayer in the previous audit period and found no tax liability is not selected for the next audit					

<b>no</b>	<b>Questions Related with Tax Audit Program</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
13.1	Use taxpayers segmentation for tax audit					
13.2	Audit is performed based on audit manual					
13.3	Effectiveness of tax audit is measured by volume of the audit performed					
13.4	Effectiveness of tax audit is measured by enhanced tax compliance and revenue collection					
13.5	Continuous and sufficient trainings for tax auditors					
13.6	Apply standard risk identification criteria to identify highly risky business for audit					
13.7	A continuous assessment to improve the capability or competency of staff resources i.e. The auditors					
13.8	The audit work is started and completed within a predetermined timeframe					
13.9	The office have a risk-based tax audit strategy by identified risk scoring criteria					
<b>no</b>	<b>Challenges of Tax Audit</b>	<b>5</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>
14.1	Taxpayers are unwilling to present important records for the audit work					
14.2	Less understanding on tax laws by the taxpayers					
14.3	Unavailability of enough audit resources					
14.4	Less skilled and low experienced employees					
14.5	Existence of high corruption and fraud on both employees and the taxpayers					

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## **Appendix B**

### **Interview questions for leaders**

- 1) How the audit cases are selected in the office and explain the basis for the selection?
- 2) Which audit types are performed and which audit type is mostly performed?
- 3) What is the primary purpose of tax auditing in the office?
- 4) Which category of taxpayers and sectors are usually selected for tax audit? What would be the reason behind this selection?
- 5) What are the main challenges of tax audit department in Adama Revenues and Customs Office?