



**SCHOOL OF GRADUATE STUDIES  
MBA PROGRAM IN ACCOUNTING AND FINANCE**

**DETERMINANTS OF TAX AUDIT EFFECTIVENESS IN THE MINISTRY OF REVENUE  
EVIDENCE FROM LARGE TAXPAYER'S OFFICE.**

**BY  
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**JUNE, 2021  
ADDIS ABEBA, ETHIOPIA**

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OF REVENUE EVIDENCE FROM LARGE TAXPAYER'S OFFICE**


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**A Thesis Submitted to St. Mary's University School of Graduate Studies, in  
Partial Fulfillment of the Requirements for the Award of a Masters of  
Business Administration in Accounting and finance**

**JUNE, 2021  
ADDIS ABEBA , ETHIOPIA**

## APPROVAL OF BOARD OF EXAMINERS

As members of the Examining Board of the final MBA, open defense, we certify that we read and evaluated the thesis prepared by **Yeshiwork Zewdu** and recommend that it is accepted as fulfilling the thesis requirement for the Degree of Master of in Business Administration

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## **DECLARATION**

I declare that this MBA thesis is my original work, and has never been presented for the award of any degree in this or any other university and all source of materials used for the thesis have been duly acknowledged.

**Yeshiwork Zewdu** Signature\_\_\_\_\_

St. Mary's University

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## ACKNOOWLEDGEMENT

The Almighty God, I do not know how I can state for all; I am heartily indebted to him with his mother Saint Marry, for his bright gifts throughout my life from the beginning wherever I go.

First, I am heartily grateful to **Asst. Prof. Mohamed Seid**; he has played a key role and contributed at most, not only in the process of the research project, but also in the development and framing of the thesis's theme. More specifically, he give immediate response after reading the draft chapter's meticulously, he provided critical comments and criticism that contributed to the final write-up of the thesis.

My special appreciation and favor also go to **Hiwotbrihan Tsegaye**, without his intellectual support and encouragement; my work would not have been completed. I would like to thank my parents and friends for allowing me to join MBA program and covering the research expenses. I also extend my warm gratitude to thank all large taxpayers' staff who participates in survey and semi structured interview gladly and who provide invaluable documents for the conduct of my thesis.



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## Acronyms

AAT:	Audit Attributes
AICPA:	American Institute of Certified Public Accountants
ANOVA:	Analysis Of Variance
AQ:	Audit Quality
CLRM:	Classical Linear Regression Model
GDP:	Gross Domestic Product
IA:	Internal Auditing
IIA:	Institute of Internal Auditors
ISSAI:	International Standards of Supreme Audit Institutions
LTO:	Large Tax payer's Office
MOR:	Ministry Of Revenue
OECD:	Organization for Economic Co-operation and Development).
OID:	Organizational Independence
OLS:	Ordinary List Square
OST:	Organizational Setting
SPSS:	Statistical Package for Social Science
STO	Small Taxpayers' Office
TAE:	Tax audit effectiveness
TMS:	Top management support
TA:	Tax Auditing
VIF:	Variance Inflation Factor

## **Abstract**

*This paper aims to explore determinants of tax audit effectiveness in large taxpayer's branch office. The study adopted an explanatory approach and mixed research method in order to test a series research hypothesis, where by data from 86 tax auditors, by using questionnaires'' and semi structure interviews with tax audit head and team leaders. To achieve the objective of the study the researcher used Census method to select the survey respondents. The collected data were analyzed using both descriptive and inferential statistics. In the case of descriptive statistics, the study used frequency, percentage, mean and standard deviation, and the study used multiple regression analysis. With these research methods, the results of the study tell that tax audit effectiveness of large tax payer's office is highly affected by audit quality of the department, top managements, audit attribute and the organizations independence. In the end, the study forwards the possible measures to be taken by the large taxpayer office to mitigate problems in tax audit operation. Finally, this paper recommends further research experimental analysis may draw different conclusions.*

**Keywords:** *Tax audit effectiveness, agency theory, institutional theory, positive accounting theory*

## CHAPTER ONE

### 1. INTRODUCTION

#### 1.1. Background of Study

The efficiency and effectiveness of audit activities can be greatly facilitated by a broad range of support tools. Without competent staff tax audit activities will not achieve their objectives. Competency models and competency improvement activities help develop and manage the audit work force. Performance management is an important tool for shaping audit behavior and contributes to the attainment of audit program objectives. Monitor change in taxpayer compliance with record keeping, filing and payment obligations, as well as movements in reported tax subsequent to audit activities, as measures of the effectiveness of audit programs (Ayalew, 2014)

Tax audit is an examination to determine whether a taxpayer has correctly reported and assessed their tax obligations. However, 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. 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 leverage across the community rather than only impacting on the taxpayer selected for audit and collecting the tax that should have been paid in the first place. (Biber, 2010)

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 and Ramachandran 2004).

In other words tax audit is one of the most effective policies to protect the behavior of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much intensive the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, the second

element is so difficult to measure due to no published information about the process of tax audit. It is commonly measured by the first element to indicate the level of tax audit for practical comparison (Nicoleta2011).Tax audit is the part of compliance audit as well as compliance audit is conducted to determine whether the audit is following specific procedures, rules, or regulations set by some higher ministry office for private business. A major role and responsibility of the internal revenue agent (tax auditors) is to audit taxpayers' returns to determine whether they have complied with the tax laws. These audits are solely compliance audits. Moreover, the previous studies have reviewed the similarities between compliance audit and internal audit with its role and responsibilities (Mark 2003). Revenue bodies should aim to achieve a balanced program of audits one that balances 'coverage', 'audit quality', and 'overall deterrent' considerations. Audit policies and procedures should be based on principles of accuracy, efficiency, fairness, objectivity, transparency, completeness, consistency, and defensibility. The efficiency and effectiveness of audit activities can be greatly facilitated by a broad range of support tools. Without competent staff tax audit activities will not achieve their objectives.

To collect the necessary tax revenue from the tax payers, countries should design different mechanisms of tax collection. Effective tax audit is one of the mechanisms that help to collect the estimated governments' revenue from tax. Of course, there are factors that affect the tax audit effectiveness such as tax legislation, information system, education level of the tax auditors, experiences of tax auditors, and the trainings that are given to tax auditors (Drogalas et al. 2015). However little research has focused on the effectiveness of tax audits in general and in Ethiopia in particular; therefore, this study emphasis on the issues that affect the effectiveness of tax audit based on tax auditors' perceptions.

## **1.2. Statement of the Problem**

Among the factors that affect the collection of tax revenue of a country, tax audit effectiveness plays a vital role on the side of tax authority (OECD 2006, Drogalas et al. 2015 and Ayalew 2014). In reality, under inadequate tax administration including insufficient and ineffective audit program, the potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner (Edmiston and Bird 2004). in reality, under inadequate tax administration including insufficient and unsuccessful audit program, the potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner. According to Lamensch (2010), many developing and transitional countries audit

performance is weak aspect of tax audit administration. These countries do not yet have effective audit programs due to; insufficient numbers of the required highly skilled and appropriately paid audit practitioners, absence of a sound institutional audit practice, lack of clear political support for the tax administration, and the deficiency of an appropriate legal and judicial environment. Additionally, these countries have a tendency to offset weak tax audit by adopting complex procedures, such as increased filing requirements and massive cross-checking. This, in turn, might result administrative difficulties and increase the compliance cost of taxpayers (Hellenstein and McLure, 2005). It is unmoving under a number of challenges regarding to its operation and administration that are not yet resolved.

Particularly in developing countries tax audit program faced different challenges and problems which hinder the effectiveness of tax audit (Chalu & Mzee 2018, Tewabe 2016, Drogalas et al. 2015). In Ethiopia the main sources of government revenue is taxation. But different empirical literatures shows, in tax authorities' tax audits functions are not effective and the collection of revenue from taxes is affected by effective tax audit activities (Miheret 2011).

To diminish such problem, therefore, an effective tax Audit program should be implement which is capable, to investigate, detect and prevent loss of tax revenue which help ministry office to reduce the tax gap between the taxes due and the amount collected. Hence to create an effective tax audit system, it is paramount importance to assess tax audit function and draw practical lessons on the critical operational problem and constraints. This study, therefore, considers top management support, audit quality, organizational independence, organizational setting and audit attributes as independent variables and it verifies if they are influencing on tax audit effectiveness in large taxpayers' branch office.

### **1.3.Hypotheses of the study**

In order to achieve the broad objective of the study, the researcher developed the following five

- H1: Top management has a positively and significant impact on tax audit effectiveness.
- H2: Audit quality has a positively and significant effects on tax audit effectiveness.
- H3: Organizational independence has a positively and significant effects on tax auditing effectiveness.
- H4: Organizational setting has positively and significant impacts on the tax audit effectiveness.

- H5: Audit attributes for tax auditors has a positively and significant effects on audit effectiveness

#### **1.4. Research objective**

##### **1.4.1. General objective**

The major objective of this study is to examine the determinants of tax audit effectiveness in large taxpayer's branch office

##### **1.4.2. Specific objectives**

Based on the general objective stated above, the study addressee the following specific objectives.

- To examine the role of **top management** support for tax audit effectiveness in Ministry of revenue
- To evaluate the contribution of **organizational setting**, for tax audit effectiveness in the Ministry of revenue
- To investigate how **audit attributes** influence tax audit effectiveness in Ministry of revenue
- To evaluate how **organizational independence** influence tax audit effectiveness in Ministry of revenue.
- To find out how **audit quality** influence tax audit effectiveness in Ministry of revenue

#### **1.5. Hypotheses of the study**

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**H4:** Organizational setting has positively and significant impacts on the tax audit effectiveness.

**H5:** Audit attributes for tax auditors has a positively and significant effects on audit effectiveness

#### **1.6. Significance of the Study**

The results of this study are expected to be significant in various respects. First, on the basis of the study findings, the report has Conclusions and forwards some recommendations that will benefit large taxpayer's office to identify the determinants of tax audit effectiveness and to take corrective remedies to keep the existing factors through tax audit improvement. Second, it helps also tax policy

makers to make use of out puts of the study in addressing the determinants that influence tax audit effectiveness by the branch office. In addition, it helps the revenue office tax auditors to know their role in the tax system and the results offer an objective assessment of issues that will make them more effective, particularly for the application of regulations and standards for tax audit, as well as conducting a tax audit. 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 and on the other branches as well

### **1.7. Scope of the study**

Every research endeavor has its own delimitation that limits the application of conclusions to be drawn from the analysis. The scope of this study would be limited to the examination determinant factor that affect tax audit effectiveness in large taxpayer's branch office and the researcher proposed to distribute the questionnaires only for the tax audit officers in the tax audit department without considering the taxpayers for conducting this research. Even though wide ranges of variables were expected to be studied, this study contemplates on examination of tax audit effectiveness, top management support, audit quality, organizational independence, organizational setting and audit attributes, beyond the above mentioned were not included in this study.

### **1.8. Limitations of the Study**

The results of the study were suffered from some limitation. In spite of the fact that effort was be made to maintain the quality of the study in general and the data in particular, the following major limitation were encountered. When analyzing data, the researcher experienced some problems which are worth noting. Moreover, shortage of latest reference books and literature on the area in Ethiopian content was narrowed the study output.

### **1.9. Description of the study Area**

According to 'the domestic tax audit manual of May, 2019 head quarter of Ministry of revenue segmented its taxpayers into large taxpayer's office (LTO), medium taxpayer's office (MTO), small taxpayer's office (STO). The main purpose for the establishment of LTO is to control and provide services to those taxpayers who collectively account for between 60-70 % of the governments overall tax revenue each year.

Inclusion in the LTO program is determined by: - on the year, 2019 and 2020 three years average



annual sales turnover greater than 700 million, annual payment and total assets of the business is cut-off point medium and large taxpayers. Companies engaged in the mining, petroleum exploration, banking and insurance sectors are included in large taxpayers' category regardless of their annual sales turnover. First grade contractors are also included in this category, which only included private limited and share companies and all sister companies located in Addis Ababa after this circular they get all services from LTO, for comfortable situation on audit of sister companies. Though previously three star and above hotels were immediately as large taxpayers, not only those earning above 700 million birr will be considered.

MOR set a policy to revise its segmentation bracket every two years to factor in the change or growth of taxpaying business. The most important reasons for introducing Large Taxpayer's Department has been "to provide consistent and quality service to large taxpayer's to secure revenue, to improve audit programs, to improve collections and management of tax debts, and also to act as models or pilots for testing new processes, procedures, structures and systems" (MOR2019).

Currently, the number of large taxpayers had been between 785 and 782, adequate assistance and supervision to large taxpayers is necessary, because they contribute a major part of the revenue MOR collects."Large taxpayers are enterprises which engage in large-scale, complex/ specialized, and often global operations. Such enterprises are complex because of being characterized by multiple operating entities and/or diverse business interests, high volume of transactions in day-to-day business activities, large number of employees, international dealings, often involving cross-border transactions with related parties, wide spread in geographical terms, dealings in complicated issues involving complex tax law and accounting principles and complex financing and tax planning arrangements (OECD 2009).

#### **1.10. Organization of the Study**

The thesis is organized as follows. Chapter one is deals with introduction, which includes: Background of the study, background of the organization, statement of the problem, objective of the study, hypotheses of the study, significance of the study, and scope of the study; chapter two deals with the review of the related literature; chapter three contains the research methodology; which describes about the research approach, research methods, sampling design and sources of data, limitation of the study.

### **1.11. Operational Definition of key terms**

**Tax audit effectiveness:** - refers to the function's ability to satisfy the needs of tax audit program. As noted by Dittenhofer (2001) audit as effective if it is adequate to accomplish its purpose. This definition of IA effectiveness is also inspired by the concept in performance auditing, where effectiveness is considered a 'goal-attainment concept' (ISSAI 3000).

**Top management support:**-Management support refers to ensure that providing sufficient resources to hire the right number of high quality staff, to keep up-to-date in training and development, to acquire and maintain physical resources like computers (laptop), vehicles, enhancing the relationship with external auditors, and having an independent internal audit department and audit findings are accepted or responsible by top management.

**Audit quality:** - audit quality is a function of the level of staff expertise, the scope of services provided and the extent to which audits are identified risks, applies the correct law and technical interpretation, follows consistent procedures, properly planned, perform, communicate the results of audits, properly documented working paper and finally quality assurance is a proxy for audit quality.

**Organizational independence:** - refers to the auditors sufficiently independent from those they are required to audit that they can conduct their work without interference i.e. programming independence, investigative independence and reporting independence and the tax audit program has ethics of international profession in addition to which is free from any unethical practices including corruption.

**Organizational setting:** - is the framework established by Management which tasks and resources can be allocated, performed and co-ordinate for achieving the tax audit core purpose in addition the status of tax audit in the organizational Structure, the probity of tax audit office's internal organization, and the existence of sound organizational policies, procedures, audit manual that guide operation of audits and established criteria to evaluate audits' practices.

**Audit attribute:** - audit attribute with implications on audit effectiveness include the auditors' proficiency to efficiently and effectively meet organizational sub-goals, their attitude towards tax Audit, the co-operation or support of taxpayers at the time of auditing provided to the tax auditor, to have full and unrestricted access to all activities, records and properties, and be provided with cooperation from the audit.

## CHAPTER TWO

### 2. REVIEW OF RELATED LITERATURE

#### 2.1. Introduction

This section presents review of existing theoretical and empirical literature on tax audit. At the end of the review, an attempt is made to summarize the major Drawbacks of the existing empirical studies and to identify the knowledge gap to be filled in by further investigation.

#### 2.2. Theoretical Literature

Audit is defined as the structured examination of business' relevant commercial systems financial and non-financial records, physical stock and other assets, internally generated data and that produced independently of the business.

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 taxpayer's 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 crosschecks of taxpayer's records with those of taxpayer's supplier's or with other government departments and agencies source of information and its effectiveness and efficiency must be guaranteed by means of proper procedures and application of modern audit tools and techniques (OECD 2006).

A tax audit is one of the most sensitive contacts between the taxpayer and a revenue body. The presence of an auditor in a taxpayer's private dwelling or business premises, coupled with the exploration of private and business issues and the gathering of information from taxpayers' books and records, or just the disruption of day-to-day workflow, represents a burden on the taxpayer and may be seen by some as an unwarranted intrusion into their affairs. Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying provided information. 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 non compliance, tax auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the "public face" of are venue body. These factors, as well as the absolute size of the audit function in most revenues

bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function (OECD 2006).

Historically, the audit function conducted by public accountants has been associated with this activity of attesting to financial statements. Tax audit (expected to be performed by public accountants) can be thought of as an extension of this “attest function”. For tax purpose, one assesses 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. Assess is sometimes called for by the assessing officer under the tax law for producing the same. In this context, the question of tax audit may arise. And “tax audit” means to audit an assess accounting and other documentary evidences to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in tax return and other required evidential statements regarding allowances and disallowance for deductions and all these are to be followed by an audit report giving the auditor’s opinion about the degree of correspondence between the information content in the tax return and the regulatory provisions of the existing tax laws (OECD 2006).

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

The numerous roles assigned to tax auditors require a recruitment and maintenance of competent tax auditors with technical knowledge, audit skills, and tactical knowledge. Moreover, the attitudes of tax auditors during the conduct of an audit may affect tax payers’ compliance behavior in the future. If tax payers are treated with respect during the audit, tax payers may have a stronger incentive to comply voluntarily (Isa and Pope 2011); arbitrary audit procedures leave tax payers feeling helpless and thus reduce their intrinsic motivation to comply (OECD 2010).

### **2.2.1. Theories of Auditing**

Auditing theory helps explain why society needs auditing: the role and purpose of audit services in communication between a company and its environment.

#### **2.2.1.1. Agency theory**

Adams (1994) used agency theory to explain that it is in the interest of management to maintain a strong internal audit department. Implementation of audit recommendations is highly relevant to audit effectiveness (Van Gansberghe 2005) and the management of an organization is viewed as the customer receiving internal audit services. As a result, management's commitment to use audit recommendations and its support in strengthening internal audit is vital to audit effectiveness (Sawyer 1995).

Using agency theory, Xiangdong (1997) explained the role that internal audit plays in an economy and points out that internal audit has an advantage over external audit in obtaining information quickly and finding problems at an earlier stage; and Sparkman (1997), applying the theory of transaction cost economics, demonstrated how internal audit recommendations are important to the management of government organizations. Audit findings and recommendations would not serve much purpose unless management is committed to implement them. "Auditors are engaged as agents under contract but they are expected to be independent of the agents who manage the operations of the business. The primary purpose of audited accounts in this context is one of accountability and audits help to reinforce trust and promote stability".

#### **2.2.1.2. Positive Accounting Theory (PAT)**

Watts and Zimmerman seek to develop a positive theory of the determination of accounting standards. "Such a theory will help us to understand better the source of the pressures driving the accounting standard-setting process, the effects of various accounting standards on different groups of individuals and the allocation of resources, and why various groups are willing to expend resources trying to affect the standard-setting process" (Watts and Zimmerman 1979).

#### **2.2.1.3. Institutional theory**

The concept of institutionalization is related to organizations actions over time. Such actions are said to be legitimated within an organization and environment (Pfeffer 1982). Institutional theory suggests that internal operating processes loosely coupled with the observable structures accomplish

the real work of an organization. As a result, organizations with the appropriate structures in place will avoid deep investigations of their function by external auditors (Meyer and Rowan 1977). Organizations are subject to rules and regulations to which they must conform in order to ensure their legitimacy and thus have access to resources and ensure their survival (DiMaggio and Powell 1983). However, these rules and regulations don't necessarily guarantee that organizations will continue to operate efficiently (Scott 2008).

### **2.2.2. Objectives of tax Audit**

The overall objective is to improve the compliance of taxpayer's whether they declare the correct amount of tax and paid at the right time .the expectation by a taxpayer of an audit should have a deterrent effect and encourage the taxpayer to declare as far as possible a credible tax return .it also improves the taxpayer's understanding and awareness of the relevant taxes (MOR 2019). The main purposes of tax audit in MOR are: Establish the extent of risks and quantify any errors which may have arisen as a result, improve future compliance, support those who wish to comply and deter non-compliance.

As Biber (2010) noted, 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. Most taxpayer's report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected. 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.

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. Tax Audit would serve the following purposes: Firstly, Ensure that the books of accounts and other records are properly maintained, Secondly, Faithfully reflect the income of the tax payer and claims for deduction correctly made by him, thirdly, help in checking fraudulent practices, and lastly, facilitate the administration of tax by a proper presentation of accounts before the tax authorities and considerably saving the time of assessing officers in carrying out routine verifications like checking correctness of totals and verifying whether purchases and sales are properly vouched or not, thereby their time could be utilized for attending to more important investigational aspects of the case (OECD 2006).

The audit programs of a revenue body performs a number of important roles that, effectively carried out, can make a significant contribution to improved administration of the tax system. Firstly, promote voluntary compliance: The primary role of the audit program is to promote voluntary compliance by taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized. Detect non-compliance at the individual taxpayer level: By concentrating on major areas of risk (e.g. unreported cash income) and those individual taxpayers most likely to be evading their responsibilities, audits may bring to light significant understatements of tax liabilities, and additional tax revenue collections. Secondly, gather information on the “health” of the tax system (including patterns of taxpayers’ compliance behavior): The results of normal audit activity may provide information on the general well-being of the tax system. Audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance that overtime can be used to identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on future compliance improvement strategies, to refine automated risk-based case selection processes, and even support changes to tax legislation (OECD 2006).

Thirdly, gather intelligence: Audits may bring to light information on evasion and avoidance schemes involving large numbers of taxpayers that can be used to mount major counter-abuse projects. Fourthly, educate taxpayers: Audits can assist clarify the application of the law for individual taxpayers and to identify improvements required to record keeping and thus may contribute to improved compliance by taxpayers in the future. Finally, identify areas of the law that require clarification: Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws’ requirements and/or to better educate (OECD 2006).

### **2.2.3. Condition for Good Tax Audit**

For the tax inspector to carry out a good audit exercise, the following conditions must be fulfilled (MOR 2019).

1. The tax auditor must be familiar with the environment in which he works. It is a condition which is highly critical that the tax inspector must be properly schooled in the political, economic, social,

cultural and religious environment of the taxpayer. A good knowledge of his environment will affect the decision made by him.

2. The tax officials should be motivated to carry out tax audit, he should be properly trained and have experience in his area. The tax inspector should not be carried away by corrupt practices that render the aim of the tax audit useless.

3. The tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.

4. Specialization should be encouraged. The cases should be grouped. This will allow the tax audit staff to become specialist in specific field and the manner in which the audit is being carried out should be changed. The use of computer should replace the manual process as this will go a long way in facilitating the job and helping to preserve information for a long time. This will improve the efficiency of the exercise (MOR 2019).

### **2.3. Types of tax audit**

Based on Ethiopian Revenue and Custom Authority tax audit manual the types of audits are defined by the three major factors (MOR 2019).

- a) The audit scope and intensity
- b) The period(s) under examination
- c) The location of the audit activity

The major types of audit in ERCA are described below:-

#### **2.3.1. Comprehensive audit: -**

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 type for a given period. Given the broad scope, comprehensive audit is typically costly to undertake in terms of time and resources, and thus reduces the rate coverage of taxpayers that could otherwise be audited. Comprehensive audit is classified into very complex, complex and simple. This classification will depend on a number of factors ranging from size, group, trade or profession, volume of records or transactions, nature of business to location. In practice the scope and nature of any comprehensive audit activity to be undertaken will depend on the available evidence pointing to the likely risks of



non-compliance and a taxpayer's history .an audit may also be classified and justified as complex or very complex because of the taxpayer's financial and/or business activities which are unusually complex (MOR 2019).

### **2.3.2. Issue audit: -**

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

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

**2.3.2.2. Field issue audit:-** this is the escalation of a desk audit into afield 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 obligation in respect of vat/tot and excise tax, withholding tax or income tax normally for a specified tax period. Care should always be taken to guard against being derails and thus progressing field issue audits into comprehensive audits. The objective of the field issue audit is to focus on a shorter period for a single tax item for a faster and effective outcome. This audit type should therefore be the commonest and most effective audit type to be utilized for faster results.

### **2.3.3. Desk audit: -**

Desk audit is used as preliminary examination of declarations analyzing accuracy, completeness, and ratios and crosschecking information to determine if further audit or investigation is warranted.

### **2.3.4. Special audit projects: -**

Special audits can be organized as a separate project for a targeted or specific group of tax payer's in a given period to verify compliance in the sector. These audit projects may cover an industry, trade,

profession or a line of business. This will consist of specific checks and are used to address a particular risk or to establish the degree of non-compliance in a particular sector, industry or trade. For this audit type to be effective, all taxpayers in the targeted sector must be considered and handled with in the shortest time possible.

### **2.3.5. Advisory visit audits: -**

Advisory visit audits: all registered tax payers or business need to be visited with the aim of offering advice on tax obligation and the taxpayers rights, and any other development pertinent to the tax system and administration .it is highly recommended that auditors carry out these audits to keep abreast with compliance trends of their taxpayers and offer timely advise so as to improve compliance, these audits are expected to be spontaneous and hence should not take more than a day.

### **2.3.6. Refund audits: -**

Refund audits this is a verification of a taxpayer's claim for a tax refund prior to processing the refund. The predominant claim for refund is vat and/or withholding which is submitted monthly.

### **2.3.7. Investigation audit: -**

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

### **2.3.8. De-registration audits:-**

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

## **2.4. Risk assessment**

### **Need for risk based approach**

No tax administration has, nor should have the resources to control 100% of their taxpayers and transaction base .instead they increasingly rely on risk management methodologies to allocate better the available scarce resources in order to achieve an optimal compliance strategy (MOR 2019). Risks are those events that could negatively impact on organizations ability to deliver on its mission.

Risk assessment must therefore be an integral part of the entire audit process and should involve:-

- a) A review of the economy to identify risk prone sectors
- b) A review of the sectors to profile the various operators there in and
- c) A profile of the operators in order to identify risky trends or behavior

Risk assessment should also involve a review of the internal systems within an organization to obtain a picture of any in-house factors that influence the non-attainment of audit objectives. The adoption of risk based approaches goes beyond audit case selection and applies to more than direct revenue risk .a tax administration will usually have as part of its objectives, the need to deliver a certain amount of revenue to the government to meet budget objectives, but this will usually be supplemented by other objectives such as improving compliance; maintaining expenditure within a specific budget; minimizing tax payer compliance costs; and maintaining community confidence in the tax system(often an important political objective).the administration therefore has to manage the risks failing to achieve each of these objectives and not just the risks of non-compliance.

From an audit perspective, management needs to complement the administrations objectives. This requires a review of all activities related to the audit program and to assess the value they add to meeting the administrations objective. Only by having a clear understanding of the objectives, it is possible to formulate a risk based approach. As resources are limited, the administration needs to allocate resources to activities that will provide the greatest impact on the achievement of objectives; this usually means gaining the biggest improvements in voluntary compliance at the lowest cost to both the taxpayer and the administration, while maintaining community confidence in the tax system. If activities performed don't contribute to the attainment of these objectives, management needs to reconsider the performance of such activities. As there are likely to be more risks identified than can be adequately addressed by the administration, it is necessary to rank and prioritize the risks according to the likelihood and consequence of their impact on the objectives (MOR 2019).

### **Analyzing risk and file assignment**

Selecting file for audit should always be based on sound risk assessment sound risk assessment includes evaluating the potential collectability of a debt that could arise as a result of an audit action. Difficulty to collect a potential debt is only one aspect to consider in selecting a file for audit or closing a file early. The collection of an assessment is an important final step in the audit process. Audit files are assigned from the inventory of files selected by the concerned team and from other

sources. The team coordinator generally assigns audit files to the individual auditors based on gross revenue of the taxpayers and categories established for each group and level of auditors. In addition to gross revenue, the following factors must be considered when assigning audit files in order to be transparent:-

(1)The nature of the audit, (2) Rotation or specialization of auditors, (3) Training and development of auditors and (4) Idle or on duty of auditors (work in process). In addition to the risk criteria there are some conditions which need audit of the business in our branch .this conditions may appear if the taxpayer renders the following services from the authority:-

Withholding tax receivable (refund) request more than 1.5 million birr (the law made before 10 years). Request for business license return, closing business entity (liquidation of the business), and disposal of fixed asset more than 50% of its book value. Transformation of business from private limited company to share company, MOR is emphasizing the risk based approach. So every audit will be directed towards this approach, which is more explained as follows:-

Given the nature of the audit process, every audit assignment presents a different challenge to MOR, with no two audit assignments being the same. For example, no two entities are the same in terms of business sector, location, size, employees, governance issues, ethos, and complexity of operations there is no one single approach to auditing which ensures the performance of a perfect audit, however, it is generally accepted that for most entities of size, the risk based audit approach will minimize the possibility of audit objectives not being met. Auditors to adopt a risk based approach to audit in so doing; it requires auditors to make risk assessments of material misstatements at the financial statement and assertion level, based on appropriate understanding of the entity and its environment including internal controls (MOR 2019).

#### **2.4.1. Review of role of audited financial statement**

LTO auditor relies on external audit report but their report and opinions differ from the MOR auditor's report because the position of the taxpayer's representative can legitimately differ from that of the tax authority. The LTO auditors wouldn't accept without question the validity of external auditor's financial statements where judgments may have been made favorable to the taxpayer on legal or accounting issues (MOR 2019).

The auditor then obtains copies of the audited financial statements, supporting opinion, notes and schedules and the letter of engagement. The letter is necessary to determine .the letter is necessary to

determine if the taxpayer placed any limitations on the scope of the auditor's assignment. Sometimes the external auditor will make a disclaimer as to the accuracy certain aspects of the financial statements by indicating a reliance on the taxpayer representations rather than conducting an independent verification.

#### **2.4.2. Review of internal controls**

The establishment of internal controls is the responsibility of management of the taxpayer concern. The evaluation of internal controls is primarily the responsibility of the taxpayers internal audit department and the external auditor. The tax authority can point out weakness in internal controls which may have led to an assessment for additional taxes but usually cannot insist on the taxpayer introducing stronger control measures (MOR 2019).

According to MOR (2019), the tax auditor must review the system of internal control and internal checks to determine possible areas of weakness or to establish methods of determining if the taxpayer is deliberately manipulating the records to minimize tax liabilities .the auditor will conduct his verification1 activities in accordance with his/her findings .the audit checklist and the audit working papers dealing with the specific aspects of the taxpayer's operations include tests of the internal control system and internal checks.

#### **2.4.3. Risk, materiality and sampling**

##### **Audit risk**

Audit risk is defined as the risk that the auditor may unknowing fail to appropriately modify an opinion on financial statements that are materially misstated .audit risk can be thought of in terms of the following three component risks (MOR 2019).

**Inherent risk:** - is the susceptibility of an assertion to a material misstatement, assuming that there are no related internal controls.

**Control risk:** - is the risk that a material misstatement that could occur in an assertion will not be prevented or detected and corrected on a timely basis by the entity's internal control. Internal control consists of five components:

1. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.

2. Risk assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming basis for determining how the risks should be managed.
3. Information and communication are the identification, capture, and exchange of information in a form and time frame that enable employees to carry out their responsibilities.
4. Monitoring is a process that assesses the quality of internal control performance over time.
5. Control activities are the policies and procedures that help ensure that management directives are carried out.

**Detection risk:** - is the risk that the auditor will not detect a material misstatement that exists in an assertion.

**Materiality:** Materiality is one of several tools the auditor uses to determine that the planned nature, timing, and extent of procedures are appropriate as defined in financial accounting standard board. Materiality represents the magnitude of an omission or misstatement of an item in a financial report that, in-light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item. Materiality is based on the concept that items of little importance, which don't affect the judgment or conduct of reasonable user, don't require auditor investigation. Materiality has both quantitative and qualitative aspects. In practice, the materiality level will vary depending up on the level of audit risk assessed. When the level of risk assessed is high the materiality level will be set at lower level, and when the risk assessed is low, it will be set at a higher level (OECD 2006).

**Audit sampling:** Sampling is used to test the information and transactions to increase the efficiency and effectiveness of the audit. Cost and time constraints don't usually permit 100% verification of the taxpayer's information nor does the relative risk warrant 100% verification .however, in rare situations 100% verification may be required (MOR 2019).

Successful sampling depends on the auditor knowing the population, which must not be too variable, the auditor must know the objectives of the exercise, and have planned the sampling correctly. because of its complexity and (relative to file interrogation) lower accuracy, statistical sampling is a last resort for testing, and should only be considered when file interrogation is not possible or appropriate. Generally, the materiality level and sample size will vary depending up on the level of

audit risk assessed .when the level of risk assessed is high the materiality level will be set at lower level and sample size taken will be high, while the risk assessed is low, materiality level will be set a higher level and sample size will be taken out (MOR 2019).

#### **2.4.4. Tax Audit Performance Measurement**

The international best practice, although not very widespread, is to evaluate the tax authority's audit and its auditors by developing performance measurement systems. The measurement of the tax audit function can involve a balanced scorecard approach. Tax audit functions are primarily evaluated based on the quality of tax audit by the tax audit team leader and information provided to the Tax Audit Committee and top management. However, this is primarily qualitative and therefore not as easy as to measure. "Customer satisfaction surveys" sent to key managers after each tax audit project or report can be used to measure performance, with an annual survey to the audit Committee. Scoring on dimensions such as professionalism, quality of guidance, timeliness of work product, and convenience of meetings are typical with such surveys. Understanding the expectations of audit policy statement and the virtual audit committee represent important steps in developing a performance measurement process, as well as how such measures help align the audit function with tax risk priorities (OECD 2006).

#### **2.4.5. 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 Tait (1988), effective tax auditing minimizes tax evasion and also helps tax agencies to achieve revenue objectives that ensure the fiscal health of the country and individual states. It derives voluntary compliance and generates additional tax collections, both of which help tax agencies to reduce the tax gap between the taxes due and the amount collected (Barreca and Ramachandran 2004). 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 (Biber 2010). When an audit program is ineffective, it may result in the deterioration of tax compliance and a loss of credibility of the tax administration. Taxpayers may not be deterred from minimizing their tax liabilities if they believe that there is a little chance of being audited (Lamensch 2010). A good audit program employs strategies to optimize both the direct and the deterrent effects of audits. The first can be achieved by auditing a higher percentage of the large taxpayers (Biber 2010). Although the frequency of audit is a contentious issue, the judgment is always a delicate balance between the treat of audit to check the temptation to evade and the cost. Where the tax system is fairly well established, audits of 15 percent to 20 percent of registered traders a year are sufficient. However, it is not only the crude number of audits that is the most useful measure of need (Tait 1988). In the case of VAT, Lamensch (2010) and Ebrill et al. (2001) stated that effective VAT audit program should cover a 25 to 30 percent of the taxpayers each year. In addition, VAT audit need to be closely coordinated with other tax liabilities especially income tax. Since most countries have integrated VAT and income tax administrations, the development of an effective VAT audit program significantly improves income tax compliance.

The deterrent effect is best achieved by extending the program to as many taxpayers as possible at all levels (Tait 1988). Through adequate audit strategy, tax administrations must foster, and not simply enforce, tax compliance. Tax compliance can be facilitated through improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information. Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance (ECED 2006).

Voluntary compliance is generally enhanced by increasing the number of taxpayers audited than by auditing fewer taxpayers with large tax potential. Perversely, revenue is increased by concentrating on those taxpayers where a large amount of revenue is at risk. But there should be a careful planning when there is a widespread belief that most tax returns are underreported, otherwise there may be an over selection of returns for audit, with the result that the inventory of work in process may increase to unmanageable proportions and make an orderly approach to an annual audit work plan impossible (Tait 1988).



Thus, the actual number of audits planned should depend on the audit resources available to the program. The international standards as to the total staff assigned to audit should be close to 40 percent of the total staff of the tax administrations (Biber 2010). Further, audit capacities of field offices are determined by calculating the number of returns that can be audited. The calculation made using estimates of the number of returns each tax auditor can reasonably be expected to complete during a given audit period. There should be an over selection of 25 percent to 30 percent of audit capacity (Tait 1988).

According to Tait (1988) With proper audit planning, strong supervision, and effective use of the review staff as a training vehicle, it is not unreasonable to expect an office auditor to complete an average of 10 to 20 cases a month, and for a field auditor (exclusive of auditors dealing with controlled cases) to complete an average of 4 to 6 cases a month. Allocation of about 200 cases a year should be reasonable for experienced junior auditors, who should be eligible for advancement to senior auditor after four years of satisfactory service in that grade. Therefore, planning an adequate audit strategy is a key success factor in post-fraud detection (where audits are intended to detect tax evasion and fraudulent claims) as well as proactively preventing tax frauds and evasions.

As argued by Biber (2010), effective planning is required to ensure that the audit program is adequately developed to: focus on and address the most significant risks, target noncompliant taxpayers and not harass compliant taxpayers, make optimal use of limited resources and influence compliance across the broader taxpayer community. Based on OECD (2006), effective audit plan should be:

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

#### **2.4.6. Tax Auditor's Performance Monitoring and Evaluation**

Most revenue bodies have a formal process for setting out and monitoring performance, either at individual auditor level, or at the team level where team managers are responsible for ensuring that expectations of team performance are met. Expectations are expressed as personal performance

agreements, critical job elements and performance standards. Where formal performance agreements do not appear to be used, administrations use meetings and discussion to ensure individual performance is satisfactory. Measurement criteria for auditor performance include numbers of cases worked and casework quality. Yield is not universally used as a performance indicator. Some administrations are deliberately moving away from yield-based targets to focus more on targets based on quality (OECD 2006).

Interventions used to manage staff that fail to meet the required competency levels, performance outcomes and/or are disengaged typically include: identifying why the person fails to meet the capability standard or other benchmark, and applying learning interventions and additional training. Pay freezes, re-deployment to a more suitable role and/or dismissal of the officer may occur where the above is ineffective (OECD 2006).

## **2.5. Empirical studies**

This section reviews the empirical evidence on tax audit effectiveness and determinants of tax audit effectiveness. A number of empirical studies examined tax audit administration in both developed and developing countries, tax audit program in particular. For instance, Chalu and Mzee (2018), Belay (2017), Abera (2016), Leilina (2015) , Drogalas et al. (2015), Masood and Lodhi (2015), Ayalew (2014), Bibibiso and Chinnah (2014), Alzeban and Gwilliam (2014), Mihret (2011), Cohen and Sayag (2010), Gebeyehu (2008) and Mihret and Yismaw (2007) have been taken. All these mentioned above studies examined on the area of tax audit. A brief review of each of these studies is presented in the following discussions.

Chalu and Mzee (2018) studied determinants of tax audit effectiveness in Tanzania, the study used an explanatory approach, whereby data from 225 auditors in 23 tax regions in Tanzania were collected using a mailed questionnaire. The questionnaire had 25 statements representing factors and 5 statements representing the tax audit effectiveness. The collected data were analyzed using both descriptive and inferential statistics. In the case of descriptive statistics, the study used frequency, percentage, mean and standard deviation. For the inferential statistics, the study used exploratory factor analysis and multiple regression analysis. The study findings argued that tax audit effectiveness was affected by different factors. Specifically, it can be concluded that some factors had a strong positive relationship with tax audit effectiveness, namely, the availability and application of regulations and standards for tax audit and the adequacy of the tax audit unit. These

were followed, in order of importance, by implementation of tax auditors' recommendations by management and taxpayers' attitudes towards tax audit. Only one factor, leadership and tax policies on tax audit, was found to have a weak positive relationship.

The study conducted by Belay (2017) examines challenges of tax audit administration in Addis Ababa evidence from small tax payer branches, and investigates key problems in tax audit operation regarding the appropriateness of audit type used, verification of tax payers income, framework of regulation, audit rate, audit case selection methods, evaluation and performance measurement, audit examination techniques used, and the experience and capability of audit staff resources. The study adopts mixed method approach in order to achieve the research objectives and to answer research questions. Specifically, the techniques used in the study include survey with tax auditors, semi structure interviews with tax audit head and team leaders and documentary analysis. With these research methods, the results of the study reveal that tax audit program faced different challenges and problems which hinder the effectiveness of tax audit. The study also shows low audit coverage.

Abera (2016) studied the factors affecting tax audit effectiveness in large taxpayer's branch office. For this study, the researcher applied quantitative (questioner) and qualitative (interview and document analysis) methods. The researcher distributes the questioners to the 62 tax auditors of LTO and the data was processed on SPSSv20.0 to make multiple regression and descriptive statistics. The results of the study is audit quality, organizational setting organizational independence, audit attributes as well as top management support as a linear combination significantly influence tax audit effectiveness in the organization studied. However, as individual predictors: organizational setting and audit attributes are not significant enough to undermine tax audit effectiveness.

Leilina (2015) assess the audit quality determinant factors in Ethiopian manufacturing share companies. To collect the necessary data the study adopted structured review of documents. Data were analyzed through E-views 6 software package; the study selected a sample of twelve (12) companies for the period of five years (2009-2013) with the total of 60 observations. Then companies were selected based on simple random sampling method to avoid biases and represent firms within manufacturing companies. The results of panel least square regression analysis show that audit firm industry specialization and certified audit professionals ratio have statistically significant and positive relationship with manufacturing share companies' external audit quality. On the other hand, the joint provision of audit and non-audit service has a negative and statistically significant relationship with manufacturing share companies' external audit quality. However, the

relationship for audit firm size and audit firm tenure is found to be statistically insignificant.

Drogalas et al. (2015) the main objective of the study was to examine the relationship between tax audit effectiveness, tax legislation and the use of specialized information system tools. The study has two hypothesizes; the extent of information system (IS) effectiveness has a positive effect on tax auditing effectiveness and the extent of tax Legislation has a negative effect on Tax Audit Effectiveness. The research design is based on a questionnaire. Survey methodology is used as one of the most appropriate methods in the collection of primary data. Structured questionnaire was used. Over 200 questionnaires were sent to 205 tax auditors 93 complete questionnaires were returned, representing a response rate of 45.3 per cent. The data was analyzed with the use of the SPSS software. Factor Analysis and multiple regression analysis were employed in order to examine the hypotheses. The finding of the study shows that. There is a positive and significant relationship between “Information Systems” and “Tax Infringements Tracking” and Tax Legislation” found be negative and significant associated with” tax infringements tracking.

A study by Masood and Lodhi (2015) was to explore the antecedents behind ineffective audits at government level. Exploratory and qualitative research approach has been used. The data has been collected from fifteen senior government auditors and it was a cross sectional study. In depth face to face interviews (which have 20 questions) were conducted with government auditors at their workplace. Pearson correlation coefficients have been generated to determine the relationship between several antecedents and ineffective government audits. The finding of the study shows massive corruption, conservative auditing methods, lack of cooperation from audit, low morale of auditors, lack of financial independence, lack of power to take action against malpractices, lack of financial, technological and human resources, lack of qualified trainers and ineffective training institutes are antecedents of ineffective audits which ultimately make it difficult to bring transparency and accountability in the public sector.

Study conducted by Ayalew (2014) aims to analyze factors affecting tax audit effectiveness of the Bahir Dar city revenue office. It uses quantitative method of research approach. Data was collected through survey of questionnaire analysis of revenue offices tax auditors and taxpayer's analysis, auditors and taxpayer's selected based on simple random sampling method of census and lottery method. The study selected 333 sample participants from a total of 1518 observations, from this 265 were returned. Data was then analyzed on quantitative basis using Pearson's correlation, linear regression analysis and descriptive statistics. The finding of the study shows that; there is no

statistical significance negative relationship between audit attributes and tax audit effectiveness, There is no statistical significance positive relationship among organizational setting, top management support and tax audit effectiveness and there is strongly significance positive relationship among audit quality, organizational independence and tax audit effectiveness.

Research carried out by Bibibiso and Chinnah (2014) focused on to investigate tax audit practice of Hawassa city administration revenue authority. The author used mixed research approach and descriptive survey was employed, Questionnaire and interview were used to collect data. Questionnaire and interview was designed to eleven tax auditors and seven Revenue Authority officials respectively. The result of the study revealed that the Revenue Authority of Hawassa city administration extensively use comprehensive types of audit. Audit coverage of the revenue authority was too low; audit cases were selected based on associated risk but not used the standard risk identification criteria as of BPR and The Authority was not perform the audit work in predetermine time. Generally the revenue authority was not performing tax audit according to the standards.

Alzeban and Gwilliam (2014) on his study assess factors influencing internal audit effectiveness (IAE) in Saudi Arabia. Data were obtained from 203 managers and 239 internal auditors from 79 Saudi Arabian public sector organizations. Multiple regression analysis examines the association between IAE and five principal factors. Results suggest that management support for IAE drives perceived effectiveness of the internal audit function from both management's and the internal auditors' perspective. Management support is linked to hiring trained and experienced staff, providing sufficient resources, enhancing the relationship with external auditors, and having an independent internal audit department. Saudi Arabia is representative of many developed and developing environments, and its recent tradition of governance and audit is mirrored in countries worldwide. Moreover, its specific cultural traditions involving clan and tribal allegiances, and pervasive and core religious beliefs, characterize the GCC countries, the Arab World generally, and indeed, many other developing countries, irrespective of wealth. Thus, links between management support and internal Audit effectiveness are likely generalized beyond the Saudi public sector context.

The study of Mihret (2011) was conducted to investigate key problems in tax audit operation regarding the appropriateness of audit type used, audit rate, aptness of audit case selection methods and audit examination techniques used, and the experience and capability of audit staff resources.

The study adopted both quantitative and qualitative approaches. Specifically, the techniques used in the study include survey with tax auditors and investigators, in-depth interviews with tax officials and taxpayers, and documentary analysis. The results of the study reveal that tax audit program remains undeveloped with slight range of tax audit activities performed targeting aptly specific risks. The tax audit program is a toddler tool in improving voluntary compliance and increasing future revenue performance through educating and helping taxpayers to understand their tax obligations. The study also shows low audit coverage, the absence of compliance risk-based audit case selection strategy, scarcity of audit resources, tax auditors in particular, and absence of proficient and experienced tax auditors.

Cohen and Sayag (2010) investigated the importance and relevance of a scientific examination of internal audit's effectiveness and its determinants. It is exploratory factor analysis and uses conceptual model of research. The target population was all Israeli organizations. From these questionnaires' were mailed to 292 organizations, only 108 were returned the questionnaire. Correlation analysis was applied first to determine the interrelationships among the research variables and to examine the possibility of multi-co linearity. Regression analysis was used to test the other hypotheses. The finding of the study shows that audit's evaluations and the added contribution of internal audit were positive in the private sector, there is no significant correlations were found between the variables of professional proficiency and career advancement and auditing effectiveness, greater quality of audit work and greater organizational independence were positively related to audit quality and audit's evaluations.(the correlation is stronger in the case of organizational independence and perceived top management support was the only variable that was strongly and consistently related to three auditing effectiveness dimensions.

According to Mihret and Yismaw (2007) the main objective of the study was how audit quality, management support, organizational setting, audit attributes and the interplay among them, influence audit effectiveness in a public Sector organization. Data were collected via questionnaires distributed to internal audit personnel and an interview was conducted with the internal audit director. A review of relevant documents audit plans, audit programs, working papers, audit reports and audit manuals, all served as means of generating secondary data. The study was conducted on large public sector higher education institutions or university in Ethiopia with over 25,000 students. There are 14 auditors in the internal audit office of the university; the questionnaires' were distributed to all the auditors. The findings of the study shows .internal audit effectiveness is strongly influenced by

internal audit quality and management support and organizational setting and audit attributes don't have a strong impact on audit effectiveness.

## **2.6. Gaps the existing Literature and Conceptual frame work of Tax Audit effectiveness**

### **2.6.1. Literature Gap**

Tax audit administration is a current issue for both developing and developed countries. There is no sufficient theory regarding tax audit activities. In addition, there is no adequate literature regarding tax audit operation, developing countries in particular. The empirical studies that have been reviewed in the preceding section focused on the different problems that affect tax audit effectiveness. 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.

Ethiopia in particular; there is no studies that exhaustively examine the determinants of tax audit effectiveness. In Ethiopia, tax audit issues are the study by Belay (2017), Tewabe (2016), Abera 2016, Leilina (2015), Ayalew (2014), Bibibiso and Chinnah (2014) Mihret (2011), Gebeyehu (2008) and Mihret and Yismaw (2007) which have been reviewed in the preceding section

All of these studies did not comprehensively examine issues regarding to determinants of tax audit effectiveness. But the researcher wants to focus only on large taxpayer's office by considering issues such as top management support, audit quality, organizational setting, organizational independence and audit attributes. The main reasons for selection of such category of taxpayers for audit purpose are for their large tax potential and highly influential in investment and other economic activities. Large taxpayers are enterprises which engage in large-scale, complex/specialized, and often global operations. Apart from being complex, from the revenue bodies' perspective, large taxpayers present major tax Compliance risks due to various factors including: significant offshore activities, policies and strategies to minimize tax liabilities and large portion of tax assessments result from audit activity of large taxpayers. Furthermore, large taxpayers has a critical role in revenue collection due to size and the range of taxes they are responsible for, including their role as withholding agents for large numbers of employees (OECD 2009).

Based on these gaps in the literature together with the problems stated in section 1.2, the research question was established; how do audit quality, management support, organizational setting, audit

attributes, organizational independence and the inter play among them, influence audit effectiveness in large taxpayers office. This study contributes to fill the gap in academic literature on tax audit effectiveness by offering a definition, and by suggesting variables that determine tax audit effectiveness. 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.

### **2.6.2. Conceptual frame work of Tax Audit effectiveness**

Measurement of effectiveness is a key aspect in understanding the drivers of tax audit quality and effectiveness. Previous studies utilized a variety of approaches and measurement techniques. Some studies focused primarily on compliance with international Standards for the Professional Practice of Internal Auditing (Sprakman 1997 and Xiangdong 1997). However, that approach has been criticized for focusing entirely on the execution of procedures; it does not take into account outcomes in terms of the requirements of the principal stakeholders (Lampe 1994).

There are main approaches to the concept of IA effectiveness. According to the first approach, the effectiveness of internal auditing is determined by the fit between the audit and some set of universal standards extrapolated from the characteristics of audit. Such an approach was presented by Cohen and Sayag (2010) who advanced five standards for internal auditing: interdependence, professional proficiency, and the scope of work, the performance of the audit and management of the internal audit department. This approach requires the development of systematic and generally valid measures by which to gauge IA effectiveness (Dittenhofer 2001). One of the early efforts in this regard is that of who designed a questionnaire designed to elicit managerial feedback for each IA activity in an organization. The questionnaire covered four issues: planning and preparation; the quality of the audit report; the timing of the audit; and the quality of communication between the relevant actors. Based on managers' responses, an average score was calculated for the effectiveness of a given auditing task.

In a study sponsored by the Institute of internal auditors (IIA), identified 15 criteria used by 13 large private organizations to evaluate the effectiveness of internal auditing. They concluded that effectiveness is determined mainly by the fit between the auditing work and the goals set by managers, the qualifications of the internal auditor, management support for the internal auditing staff, and several characteristics of the internal auditing department. The previous study identified



15 factors that contribute to an effective audit and categorized them into three stages of the auditing process: planning, fieldwork, and reporting and review. They suggested measurements they considered valid and reliable for these factors. Moreover, Ziegenfuss (2000) developed a questionnaire that includes 84 criteria for effectiveness categorized into four main areas: the environment of the internal audit, input into the audit, the auditing process and the output of the audit.

Several studies considered tax audit effectiveness by reference to the function's ability to satisfy the needs of audits (Chalu and Mzee 2018, Belay 2017, Tewabe 2016, Abera 2016, Ayalew 2014, Devos 2014, Isa and Pope 2011 and Kastlunger et al. 2009). These studies sought to measure the audit's satisfaction with the work of the tax auditor. Other studies used indirect measures, especially the extent to which internal audit recommendations are endorsed and acted upon (Cohen and Sayag 2010, Arena and Azzone 2009, Mihret and Yismaw 2007, Van Gansberghe 2005, Ziegenfuss 2000 and Sawyer 1995). Dittenhofer (2001) argues in favor of wider measures of the capacity of internal audits to evaluate achievement of audits' goals and objectives and to provide remedies should these goals and objectives not be realized.

Measuring tax audit effectiveness is complicated by the lack of consensus on the indicators/dimension of effectiveness and the methodology for assessing it. In some cases, subjective dimensions have been used, for example, Drogalas et al. (2015) used indicators measured on a five-point Likert scale as per tax infringements, tracking form in Greece. The subjective questions captured items such as the difference between turnover submitted and that given on financial statements, differences in expenses, in stock quantity, as well as differences in the inventory valuation methods. Moreover, it included tracking fake invoices, differences in customer and supply records, differences in net profits, differences in value-added tax values, differences in transfer amounts, differences in bad debt provision, differences in expenses, which are not deducted from the total turnover and differences in other current taxes.

Kastlunger et al. (2009) measured tax audit effectiveness in terms of influencing taxpayers' behavior towards tax compliance. They recognized that there are debates about the effect of tax audit on deterring tax evasion, with some studies suggesting that tax audit can deter evasion, while others show only a weak relationship. From this perspective, Kastlunger et al. (2009) considered compliance (no tax evasion) as an indicator of tax audit effectiveness. Kastlunger et al. (2009) are supported by views provided by Devos (2014) that in a self-assessment tax system, it is important

for tax audits to operate effectively because they are drivers of compliance behavior of taxpayers. Tax audits are believed to convince taxpayers to be more careful in the preparation of returns and to reduce risks (Devos 2014). Devos (2014), then, argued that an effective tax audit is one which can improve deterrence measures by increasing the probability of apprehension, rather than imposing sanctions.

A study by Ayalew (2014) states tax audit effectiveness can be measured by the extent to which a tax audit office meets arguably a result of the interplay among five factors: audit quality; management support; organizational setting; and attributes of the audit, organizational independence. A tax audit function's capability to provide useful audit findings and recommendations would help raise management's interest in its recommendations. The management support with resources and commitment to implement the tax audit recommendations is essential in attaining audit effectiveness. Also, the organizational setting in which tax audit operates, i.e. the organizational status of the office, its internal organization and the policies and procedures applying to each audit, should enable smooth audits that lead to reaching useful audit findings. Further, the capability, attitudes and level of cooperation of the audit impact on the effectiveness of audits. Therefore, tax audit effectiveness should be viewed as a dynamic process that is continuously shaped by the interactions among the five factors mentioned above on large tax payer's office by taking tax audit is effective if it meets the intended outcome it is supposed to bring about.

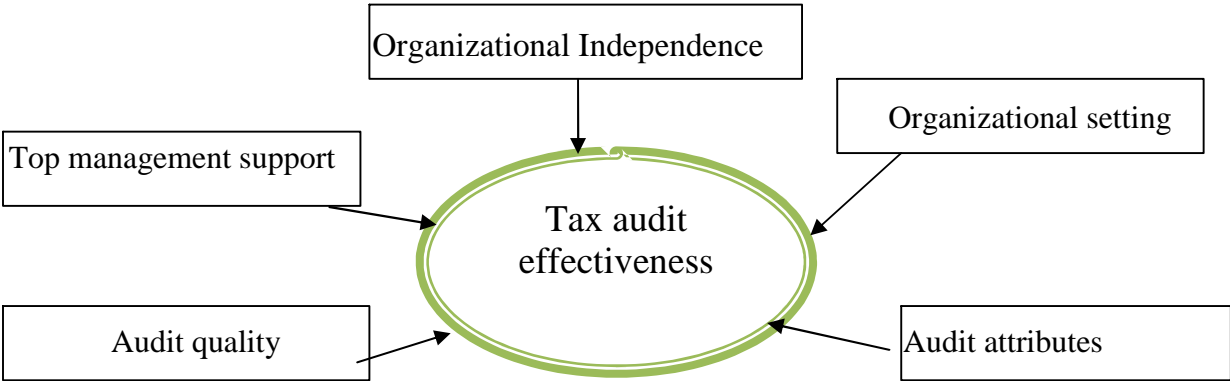
Isa and Pope (2011) conducted a study to examine the extent of taxpayers' perceptions of the tax audit experience and argued that if a tax audit is carried out effectively, it can improve the administration of a tax system, hence increasing voluntary compliance. Isa and Pope (2011) argued that effective tax audit can be measured in terms of enhanced voluntary compliance, by ensuring that tax payers comply with current tax laws and regulations, allowing tax conditions to educate tax payers, as well as identifying areas of improvement for record-keeping, and tax laws needing clarification. However, based on Isa and Pope's (2011) arguments, it can be observed that tax audit effectiveness can be measured by correct perceptions possessed by taxpayers. This can be considered to be psychological and economical because the taxpayers' perceptions are influenced by both psychological and economic factors.

The study of Alzeban and Gwilliam (2014) employs a measure of internal audit effectiveness based on quality of the function as perceived by audits, this overall measure was obtained by aggregating audit responses to survey questions on aspects of the internal audit function including: ability to

plan, improvement of the organization’s productivity, assessment of the consistency of results with established objectives and goals, implementation of internal audit recommendations, evaluation and improvement of risk management, evaluation of internal control systems, and recommendations for improvement.

Based on the reviewed literature, it can be argued that although measuring the effectiveness of tax auditing may be considered to be a simple task, there is little consensus about which type of measurements to apply. In this study, we used different types of measurements to express tax audit effectiveness. As such, we combined items such as a decline in the number of taxpayers evading tax, transparency in the tax audit to minimize complaints from tax payers, promotion of voluntary tax compliance, tax audit operation improves organizational performance, proper documentation of tax audit findings, reviews the compliance with policies, plans, procedures, proclamations and regulations the economical, effective and efficient use of resources as well as evaluates the internal control system of the company.

**Figure -1** Conceptual framework tax audit effectiveness



Source: own computation

## CHAPTER THREE

### 3. RESEARCH DESIGN AND METHODOLOGY

#### 3.1. Introduction

The previous chapter reviewed both theoretical and empirical studies, and it tried to give a brief conclusion and excavate the gap in the existing knowledge. This chapter presents research design and its methodology used in this study. It includes the research design, research approach, research methods, sampling technique, data collection method, data analysis method and other aspects of the research.

#### 3.2. Research Design

Orodho, (2000) defines a research design as the scheme, outline or plan that is used to generate answers to the research problems. A research design can be regarded as an arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance with the research purpose. It was the conceptual structure within which research was conducted. It constitutes the blueprint for collection, measurement and analysis of data Kothari, (2003).

For the purpose of this study both descriptive and explanatory research design were applied. Because, explanatory research design is used to for quantitative data it attempts to explain the relationship between the dependent and independent variables (Cruse, 2003) while descriptive research design is used for describing people 's views and opinions were sought and described accordingly and established how determents' of tax audit effectiveness

#### 3.3. Research approach

In ordered to accomplish the proposed research with respect to the objective and the nature of research questions of the study, both qualitative and quantitative methods were used because they supplement each other. Therefore, quantitative data analysis is quantifying the relationship between variables, such as tax audit effectiveness (Dependent variable). Whereas, factors affecting tax audit effectiveness such as top management support, audit quality, organizational independency, organizational setting and audit attribute (Independent variables).

To sum up, in order to achieve the research questions stated in the previous section, the researcher used exploratory research design since the research problem tends to be explanatory which seeks to explain the relationship between tax audit and its determinants.

### **3.4. Sampling Design**

A sample design is a definite plan for obtaining a sample from the sampling frame. It refers to the technique or the procedure the researcher would adopt in selecting some sampling units from which inferences about the population is drawn. Sample design specifies how to select the part of the population to be surveyed.

### **3.5. Target Population**

According to Dawson (2002) a population is the full universe of people or things which a sample will be drawn from Tax auditors were selected as a target population because, all are working in tax audit department and they are expected to know the determinants of tax audit effectiveness, the challenges and performance of tax audit operation of the branches. The target population of the study includes tax audit department or the entire set tax auditors which organized on the tax audit processes of large tax payer's office.

### **3.6. Sampling Techniques**

To achieve the objective of the study the researcher used Census method to select the survey respondents. Because Census method is most reliable sampling techniques especially if the number of population is small. In this case, since the number of tax auditors was small, the study assumed the data of all tax auditors taking as a sample. Or there is no need of taking sample from the frame.

A census is a systematic method that collects and records the data from the whole members of the population; it is a study of every unit, everyone or everything, in a population. It is known as a complete enumeration, which means a complete count. If a researcher has relatively few actual (and potential) customers, he can afford to take a census attempt to contact all of them. However, if the number of customers is in the thousands or millions, a census is much too expensive and sampling provides a very good alternative (Dawson 2002). Therefore, the sampling frame and the sample unit was the same.

Thus in this case the sample size was almost equal to the population which enabled to make appropriate generalization to the overall population. To ensure the validity of the findings, the researcher determined to accept at 5% sampling error and wanted to be at 95% level of confidence with the findings of this study. For the purpose of this study the total population which is the 86 tax auditors of LTO would be taken with 95% level of confidence

### **3.7. Source of Data**

#### **3.7.1. Primary Data Sources**

The main base for the study is primary data only which was collected through field work survey in order to get information on the issue of determinants of tax audit effectiveness through questionnaire and structured interview. The structured questionnaire consists of closed ended questions to collect quantitative data from the respondents. Along with some of the closed ended questions are five score Linker scales to provide respondents a wider range of alternative with end points where “5” the level of agreements is representing by 1 to 5. Strongly agree 5, agree 4, neutral 3, disagree 2, and strongly disagree 1.. Subsequently, these questionnaires were filled by tax auditors to reflect their work to the issue understudy.

#### **3.8. Methods of Data Analysis and Interpretations**

In this study the researcher were used multiple regression to analyze the data which will gathered from the company report by using the SPSS, because it's known that multiple regression will be useful if the researcher have one dependent variable and more than two independent or explanatory variables, hence the dependent variables of this study return on tax audit effectiveness and the independent variables are top management support, quality of audit, organizational independency, organization setting and audit attribute.

To evaluate the effects of various factors on the effectiveness of tax audit in LTO the correlation analysis was used. And also, as this research's the first research question contains the question of how the independent variables affect the dependent variables, a standard multiple regression analyses were conducted and the Statistical Package for Social Sciences (SPSS) version 20 were used for the data analysis. Multiple regression analysis is a powerful statistical test used in finding the relationship between a given dependent variable and a set of independent variables and is therefore the most suitable analysis tool for the current research (Pallant2005).

According to Field (2009): In a multiple regression analysis it is important for the researcher to check and ensure that the assumption of no Multicollinearity (heavily related variable) had not been violated by having any variables that were too closely related to one another by checking the Parson Correlation Coefficient, the tolerance level and the variance inflation factor (VIF) values between the three predictive variables. In order to assess the reliability and consistency of the instrument the

Cronbach's Alpha ( ) analysis was conducted. Whereas, to determine the relationship among the variables and to test the research hypothesis correlation and regression analysis method are used by meeting the ordinary least square (OLS) assumptions of the linear regression. During the regression analysis, important assumptions for a valid regression were elaborated and tested in order to ensure that the final regression models are not flawed. In this research context, it was decided that the most important tests would be assessing the appropriate number predictors compared to the sample size, testing the normality of the dependent.

In the preliminary data analysis then the total scale scores of all the different constructs were computed for every taking the mean of the different items. By taking the mean, the total scale scores are easier to interpret as the scores are back in the original scales (Pallant, 2005).

### 3.8.1. Multiple Linear regression model

A model or relationship is termed as linear if it is linear in parameters and nonlinear, if it is not linear in parameters. In other words, if all the partial derivatives of  $y$  with respect to each of the parameters  $\beta_1, \beta_2, \dots, \beta_k$  are independent of the parameters, then the model is called as a linear model. If any of the partial derivatives of  $y$  with respect to any of the  $\beta_1, \beta_2, \dots, \beta_k$  is not independent of the parameters, the model is called as nonlinear. Note that the linearity or non-linearity of the model is not described by the linearity or nonlinearity of explanatory variables in the model. When the function  $f$  is linear in parameters, then  $y = f(X_1, X_2, \dots, X_k, \beta_1, \beta_2, \dots, \beta_k) + \epsilon$  is called a linear model and when the function  $f$  is nonlinear in parameters, then it is called a nonlinear model. In general, the function  $f$  is chosen as  $f(X_1, X_2, \dots, X_k, \beta_1, \beta_2, \dots, \beta_k) = \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k$  to describe a linear model. Since  $X_1, X_2, \dots, X_k$  are pre-determined variables and  $y$  is the outcome, so both are known. Thus the knowledge of the model depends on the knowledge of the parameters  $\beta_1, \beta_2, \dots, \beta_k$ . To determine the model, we move in the backward direction in the sense that the collected data is used to determine the unknown parameters  $\beta_1$  and  $\beta_2$  of the model. In this sense such an approach is termed as regression analysis.

Therefore, the regression equation used for the model is:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

$$TAE = \beta_0 + \beta_1 (TMS) + \beta_2 (AQU) + \beta_3 (OID) + \beta_4 (AST) + \beta_5 (AAT) + \epsilon$$

Where:

### **3.8.2. Determinants of Tax Audit effectiveness**

Based on the extant literature about determinants of tax audit effectiveness; it can be observed that there are mixed results and different variables which express determinants for tax audit effectiveness. So, on this study the researcher stands to analyze tax audit effectiveness by using the five determinants which are management support, audit quality, organizational setting, organizational independence and audit attributes by focusing on large tax payer's branch office.

**TAE = Tax Audit Effectiveness**

#### **3.8.2.1. Top management support**

Several recent studies have demonstrated that support for tax auditing by top management support is an important determinant of its effectiveness (Abera 2016, Ayalew 2014, Cohen and Sayag 2010 and Mihret and Yismaw 2007). Management support is one of the two most important factors (the other being tax audit quality) influencing audit effectiveness. A number of empirical studies have found Top managers' attitudes and behaviors have also been found to be related to quality management practices (Flynn, Schroeder and Sakakibara 1994). Funding, of course, is an important measure of such support: IA departments must have the resource needed to hire the right number of high-quality staff, to keep up-to-date in training and development, to acquire and maintain physical resources like computers, and so on.

In a survey of Australian internal auditors, Leung, Cooper and Robertson (2004) found that chief audit executives are generally very positive about the performance of IA. They see themselves as a key part of the management team, and believe they can influence decisions; maintain a sufficient level of objectivity, integrity and competence in their jobs; and provide good support for their own staff. More importantly, they view the support of upper management as a key factor in ensuring the effectiveness of their role.

**TMS= Top management support**

#### **3.8.2.2. Quality of audits**

Audit quality is a function of the level of staff expertise, the scope of services provided and the extent to which audits are properly planned, executed and communicated. Audit findings and recommendations would not serve much purpose unless management is committed to implement them. Adams (1994) used agency theory to explain that it is in the interest of management to maintain a strong internal audit department. Implementation of audit recommendations is highly



relevant to audit effectiveness (VanGansberghe 2005) and the management of an organization is viewed as the customer.

As argued by Abera (2016), Ayalew (2014), Cohen and Sayag (2010) and Mihret and Yismaw (2007) audit quality to tax audit is considered as a determinant of tax audit effectiveness. A quality audit is one that the office's ability to properly plan, perform, communicate the results of audits, is focused on identified risks, Follows consistent procedures, applies the correct law and technical interpretation and properly documented is a proxy for audit quality. Therefore, audit quality is arguably a function of extensive audit planning, audit experience, execution & communication, working paper and finally quality assurance. To evaluate these determinants of audit quality, evidence from questionnaire responses from tax auditors. To support the results, supplementary information was collected through a review of relevant documents.

- **Audit planning**

Audit planning entails developing an overall audit strategy and a detailed plan for the nature, timing and extent of the audit. The auditor performs planning to determine an effective and efficient way to obtain the evidential matter necessary to report on the taxpayer's tax returns. The nature, extent and timing of planning vary with, for example, the entity's size and complexity, the auditor's experience with the entity, and the auditor's knowledge of the entity's operations.

A key to a quality audit, planning requires the involvement of senior members of the audit team. Although concentrated in the planning phase, planning is an iterative process performed throughout the audit. For example, findings from the internal control phase directly affect planning the substantive audit approach. Auditors should consider the needs of, and consult in a timely manner with, other auditors who plan to use the work being performed, especially when making decisions that require the auditor to exercise significant judgment (OECD2006).

- **Audit Experience**

Audit experience is an auditor's unique knowledge, competencies and capabilities that occur from job practices in auditing profession. It enhances the auditor's abilities to process information, make mental comparisons of alternative solutions, and initiate subsequent actions (Paithun 2010). It explicitly has an effect on decision making efficiency and effectiveness through a good memory of information necessary and an accurate judgment of audit tasks. It helps them identify clients' operational errors and search for their misstated accounts. Likewise, auditors with great experience are likely to

improve their judgments with more complete and complex classifications of risk assessments. Audit experience definitely promotes them to build and develop the consistency and consensus of risk judgments, assessments, and evaluations in auditing practices under other conditions, situations, and circumstances (Ayalew2014).

Thus, auditors with more experience tend to perform best audit practices, achieve superior audit outcomes, and gain outstanding audit success. They respond clients' needs, expectations, and requirements by being aware with auditing standards and practice their audit jobs. Audit experience supports the auditors to serve clients having financial difficulties and be made aware of such client situations and problems. Similarly, experienced auditors seem to have no agreements with clients' preferred accounting treatments and be concerned with retaining and pleasing auditing standards, procedures, and processes. They explicitly propose audit judgments and qualified opinions by increasing awareness of the potential adverse consequences of their audit practices. It definitely plays a significant role in attending negative audit evidences and assessing negative control risks. Experienced auditors tend to have more competencies for analyzing clients' evidences and transactions, and interpreting them and presenting audit comments and reports efficiently and effectively (Ayalew 2014).

#### **AQU= Audit Quality**

##### **3.8.2.3. Organizational independence**

Cohen and Sayag (2010) investigated that organizational independence to internal audit is considered as determinant of internal audit effectiveness. The role of internal audit in organizations is complex. Van Peurse (2004) identifies strong potential for confusion in the relationship between internal auditors and management: internal auditors are expected to aid managers in doing their jobs, and at the same time to independently evaluate management's effectiveness. Internal auditors are charged with upholding the best interests of their employer, but they may be reluctant to counter management, Regardless of the consequences.

Bou-Raad (2000) argued that the strength of an IA department must be assessed with respect to the level of independence it enjoys from management and from operating responsibilities. The IIA, the American Institute of Certified Public Accountants (AICPA) and others have likewise identified organizational independence as crucial to the viability of the internal audit function. Auditors should be sufficiently independent from those they are required to audit that they can both conduct their

work without interference, and equally important to be seen to do so. Coupled with objectivity, organizational independence contributes to the accuracy of the auditors' work and gives employers confidence that they can rely on the results and the report. Differentiate among three dimensions of independence: programming independence, investigative independence and reporting independence. They argue that organizational independence is more crucial to the effectiveness of internal auditors, as it protects the auditor from pressure or intimidation, and increases the objectivity of the auditing work.

The study conducted by Van Peurse (2004) based on interviews with Australian internal auditors, concluded that independence from management is a dominant feature of successful auditing programs. Those auditors able to set their own agenda seem to be the most powerful in this respect because their selection of what to audit and when they can include assessments of senior managers as well as assessments for them. Similarly, found that the independence of the internal audit department and the level of authority to which the audit staff report are the two most important criteria influencing the objectivity of their work.

To achieve effective audit work, the auditors are required to have full and unrestricted access to all activities, records and properties, and be provided with cooperation from the audit. The ease of access to required records in the university varies among the units audited. Whereas, others such as the finance department provide full access to records, though complete records as might be expected by the auditors are, at times, lacking. Still some other departments, such as purchasing, are at times reluctant to cooperate with the auditors. The capability of the audit to meet their objectives also reflects on audit quality. The interview responses and data from the questionnaire reveal that the poor record management system in some areas is more pronounced than the difficulty of access to files. The level of cooperation of the audit and audit capability in light of established criteria are never the less sound enough not to adversely influence audit effectiveness.

### **OID = Organizational Independence**

#### **3.8.2.4. Organizational setting**

Based on research carried out by Abera (2016) and Ayalew (2014) investigated organizational setting to tax audit effectiveness is considered as a determinant of tax audit effectiveness. Organizational setting includes the status of internal audit in the organizational structure; the probity of tax audit function internal organization; budgetary status of the tax audit program; and the

existence of sound established criteria to evaluate audits' practices. Organizational setting refers to the organizational profile, internal organization and budgetary status of the tax audit function; and also the organizational policies and procedures that guide operation of audits. It provides the context in which tax audit operates. Thus, organizational setting can exert influence on the level of effectiveness that tax audit could achieve. The audit attributes relate to the capability of the audit to meet its intended objectives.

### **OST=Organizational Setting**

#### **3.8.2.5. Audit attributes**

As argued by Mihret and Yismaw (2007) audit attributes to IA is considered as a determinant of IA effectiveness. The audit attributes relate to the capability of the audit to meet its intended objectives. Audit attributes with implications on audit effectiveness include the audits' proficiency to efficiently and effectively meet organizational sub-goals; their attitude towards tax Audit; and the level of cooperation provided to the auditor. Audit quality and management support strongly affects 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 returning of favor because the management would realize the contribution of tax audit to the achievement of organizational goals. This would positively reflect on audit quality and enhance audit effectiveness.

The management's commitment to implement audit recommendations improves the operation of the audit, as a result of which the audit attributes would improve to the benefit of audit effectiveness. Further, management retains the authority to improve the organizational setting and influence the audit towards a positive effect on audit effectiveness, which in turn, benefits audit quality. To achieve effective audit work, the auditors are required to have full and unrestricted access to all activities, records and properties, and be provided with cooperation from the audit (Cohen and Sayag 2010).

### **AAT = Audit Attributes**

Where Y stands for the mean values of the Tax Audit Effectiveness where as  $\beta_0$ , X1, X2, X3, X4, X5 and  $\epsilon$  denote the intercept of the equation, mean values of management support mean values of audit quality, mean values of organizational independence, mean values of organizational setting, and mean values of audit attributes, and error term of the equation respectively. In addition,  $\beta_1$ ,  $\beta_2$

3 4 and 5 are the parameters of the equation.

Descriptive analyses were used to describe patterns of behavior or relevant aspects of phenomena and detailed information about each variable. Thus, it shows the average, and standard deviation of the different variables of interest in the study. Moreover, it also presents the minimum and maximum values of the variables which help in getting a picture about the maximum and minimum values a variable can achieve and processed using SPSS V20.0. The study used multiple regression analysis and descriptive statistics to estimate the causal relationships between dependent and independent variables.

## CHAPTER FOUR

### 4. RESULT AND DISCUSSION

#### 4.1. Introduction

This section deals with the finding and discussion of data analysis results from the study about the determinant of tax effectiveness in ministry of revenue large tax payers. The main aim of this research was five selected determinant of tax effectiveness on ministry of revenue tax payers such as top management support, quality audit, organizational independence, organizational setting, audit attribute and audit effectiveness as a research variable. In this research, the researcher used both closed ended and open questionnaires' on the objectives of the study to measure the determinant of tax effectiveness on the ministry of revenue large tax payers and 86 questionnaires'' distributed to the ministry of revenue large tax payer's office

**Table 1** Response rate of respondents

<b>Questionnaires'' Distributed</b>	<b>Questionnaires' returned</b>	<b>Percentage (100%)</b>
<b>86</b>	<b>86</b>	<b>100%</b>

As shown in table 4.1 above, about response rate, 86 questionnaires were distributed and 86 were appropriately filled and returned.

#### 4.2. Demographic characteristics of respondent

The demographic variable of the respondents had the following variable such as, sex/gender, Age Educational qualification, Field of study, Position, and year of service. The demographic variable of the research participant was analyzed in the form of percentage. In order to determine the gender distribution in the organization, the respondent where asked to indicate there by checking either male or female in the questionnaires

**Table 2** Respondents Demographic Characteristics

<b>Variables</b>	<b>Value</b>	<b>Frequency</b>	<b>Percentage (100%)</b>
<b>Gender</b>	Female	27	31.4
	Male	59	68.6
	<b>Total</b>	<b>86</b>	<b>100.0</b>
<b>Age</b>	Between 22- up to 30	33	38.4
	Between 31-up to 40	50	58.1
	Greater than 41	3	3.5
	<b>Total</b>	<b>86</b>	<b>100.0</b>
<b>Educational level</b>	Diploma	2	2.3
	Degree	52	60.5
	Master	32	37.2
	<b>Total</b>	<b>86</b>	<b>100.</b>
<b>Field of study</b>	Accounting and Finance	68	79.1
	Management	6	7.0
	Economics	7	8.1
	Business administration	3	3.5
	Other	2	2.3
	<b>Total</b>	<b>86</b>	<b>100.0</b>
<b>Position</b>	Junior tax Auditor	5	5.8
	Tax auditor	22	25.6
	Senior tax auditor	47	54.7
	Team coordinator	12	14.0
	<b>Total</b>	<b>86</b>	<b>100.0</b>
<b>Experience</b>	Less than 2 years	6	7.0
	2-6 years	41	47.7
	Above 6 years	39	45.3
	<b>Total</b>	<b>86</b>	<b>100.0</b>

**Source: own computation, 2021**

The above table shows the demographic characteristics of the respondent and discussed here under. In order to determine the gender distribution in Ethiopian ministry of revenue large tax payer's office, the respondents were asked to indicate there by checking either male or female in the

questionnaire. The finding above showed that male respondents were more than female respondents. This indicates that among (86) respondents, 27 (31.4 %) were females whereas 59 (68.6%) were males, so in this research male participation was more than female.

As it can be clearly seen in the table, 50 (58.1%) of the respondents are between the range of 22 up to 30, 33(38.4) of them are between the range of 31 up to 40 and the rest 3(3.5%) are 41 and above. This shows that majority of the employees age in the organization are between the range of 22 up to 30. The table above shows that the respondents hold a wide range of educational qualification clearly as depicted. The majority of the sample groups were holding 52 (60.5%) of first degree, 32 (37.2%) of Masters and 2(2.3%) of diploma. This implies that people with different educational qualifications are assumed to work in the organization and the larger proportions of them are first degree holders followed by Master's degree.

In order to determine their job position, the respondents were asked. Among the total respondents of 47(54.7) were senior Tax Auditors, 22(25.6%) were Tax Auditors, 12(14%) were Team Coordinators and 5 (5.8%) were Junior Tax Auditors. So the above table shows that the majority job Position in Ethiopian ministry of revenue large tax payers office were senior Tax Auditor followed by Tax Auditor. In order to depict the field of study that the employees had undertaken, the respondents were asked. From the total 86 respondents, 68 (79.1%) of them are graduates accounting and Finance, 7 (8.1%) of the more graduates of Economics, 6(7%) are graduates of Management and the remaining 3(3.5%) are graduates of Business administration. This indicates that larger proportions the employees are graduates of Accounting and Finance followed by Economics. The respondents were also asked to indicate their service year or experience in the Ethiopian ministry of revenue large tax payer's office. Following that, 41(47.7%) of them have an experience between two up to six years. 39(45.3%) of them have above six years' experience and the rest 6 (7%) of them have below 2 years of experience which indicates that most of the employees in Ethiopian ministry of revenue have above 6 years of experience.

### **4.3. Descriptive Statistics**

According to Murry.J. (2013) and "kind of rule of thumb to create equal intervals for a range of five points Likert scale (that ranges from strongly disagree to strongly agree in the survey questionnaire). According to Scott 1999 explained for Likert scale data from 1(Strongly disagree) to 5 (Strongly agree) if the sample is approximately normally distributed the interpretation should be intended for



mean up to 2.8 is “disagree”, mean between 2.9 and 3.2 is “Neutral”, and mean above 3.21 is “agree. Therefore, the decision of each variable statistics is done based on these criteria.

**Table 3** Descriptive Statistics Results

Variable	Grand Mean	Std. Deviation
Top Management Support	3.196	1.0898
Quality Audit	3.706	0.912
Organizational Independence	3.314	1.026
Organizational Setting	3.32	0.9914
Audit Attribute	3.652	0.9474
Tax Audit Effectiveness	3.68	0.9912

**Source: own computation, 2021**

In the above descriptive statistics table 3, employees thought about the top management support of the organization is shown. The grand mean of the item is 3.196 which is neutral which implies that the employees of Ethiopian ministry of revenue large tax payer’s office neither agree nor disagree on the statements stated related to the top management support For the variable quality of audit, the descriptive statistics shows that the grand mean is 3.706 which indicates that the employees in Ethiopian ministry of revenue agreed that the tax auditors are able to cover all organizational units, that the findings of tax audits are always based on documents and reliable data and that the tax auditors in LTO have appropriate audit plan in all their audits and in all the stated statements under the variable. More over the Grand mean of the third variable organizational independence is 3.314 which implies that the employees agreed that there’s organizational independence in the organization and that there’s a strong audit management team led by an autonomous audit manager, that tax auditors have a regular and direct working relation with the general manager and the managerial team and also that it considered a stage in the organizational independence of employees in the organization. From the descriptive statistics the employees’ thought about the organizational setting is shown. The Grand mean value of the variable organizational setting is 3.32 which imply that the employees agreed on the statements mentioned under organizational setting. They agreed that tax administration has enough audit staff resources to perform on site audits on all tax payers and that the staffs are qualified and well experienced. Moreover, they agreed that the audit manual can give detailed explanation on the interpretation of tax laws and regulations and that there is enough

material and equipment for Audit program. Furthermore, the grand mean of audit attribute holds a value of 3.652 as shown in table 3. The respondents agreed that there is a transparent audit procedure and that audit decisions are made based on facts, tax payers have a good attitude and cooperation with the tax system and auditors and that they have an appropriate legal power of access to get any document from tax payer and third party information sources without restriction. They also agreed that large tax payers' office has an effective motivation scheme to the compliance tax payers. The grand mean of the variable tax audit effectiveness is 3.652 and the result shows that most of the employees agree that there is an effective and transparent tax audit procedure which minimizes number of complaints from the tax payers and that tax audit reviews the accuracy and reliability of financial reports and also it evaluates and improves the effectiveness of risk management and that tax audit evaluates the internal control system of the company.

**4.3.1. Validity and reliability of instrument**

Testing the validity and reliability of data collecting instruments before providing to the actual study subject is the core to assure the quality of the data (Yalew, (2013)). To ensure validity of instruments, initially the instruments were prepared by the researcher and developed under close guidance of advisor, who was involved in providing his inputs for validity of these data gathering instruments. To test for the reliability, the questionnaire was distributed for selected ministry of revenue workers. This was done on 86 employees of ministry of revenue. According to the results obtained, the data collection instrument was consistent and dependable in measuring what it intends to measure. From the result of the 86 distributed and evaluated questionnaires the following result was obtained using Cronbach's Alpha on SPSS

**Table 4** Test of reliability of Individual Variable

	Number of items	Cronbach's Alpha	Internal consistency
Top Management Support	5	.889	Good
Quality audit	5	.889	Good
Organizational independence	5	.911	Excellent
Organizational setting	5	.908	Excellent
Audit attribute	.5	.894	Good
Tax audit effective	5	.878	Good

**Source: own computation, 2021**

Cronbach's alpha reliability coefficient normally ranges between 0 and 1. The closer the alpha coefficient to 1 implies the greater the internal consistency. The closer the value of alpha coefficient to 0, the internal consistency is unacceptable. In this study, the researcher used the rule of thumb developed by (George and Mallery 2003), where an alpha value  $\geq 0.90$  is excellent,  $\geq 0.80$  is good,  $\geq 0.70$  is acceptable,  $\geq 0.60$  is questionable,  $\geq 0.50$  is poor,  $\leq 0.50$  is unacceptable. Since the value of Cronbach's alpha of all the constructs was at least acceptable as shown on table-above we can conclude that the data collection instruments were consistent and reliable through the stated measurements

#### 4.4. Multiple linear Regression result

To find out the linear relationship between dependent variable and with more than one independent variable linear multiple regression is used. The determinant such as top management support, quality of audit, organizational independence, organizational setting, audit attribute treated as independent variables and tax audit effectiveness as dependent variables. To develop the regression line formula, the dependent and the independent variables are denoted as, ( $X_1$ = top management support,  $X_2$ = quality of audit,  $X_3$  =organizational independence,  $X_4$ =organizational setting  $X_5$ =audit attribute) and the dependent variable,  $Y$ = Tax audit effectiveness. On the process of developing the equation of multiple linear regression, the researcher conducted the assumption that have to be fulfilled before testing multiple linear regression which are the assumption of normality, homoscedasticity, and Multicollinearity are discussed using SPSS/STATA. Model summary of the regression result, the ANOVA, and standardized coefficients have been presented to find out all the necessary relationships between the dependent variable (tax audit effectiveness) and independent variables.

##### 4.4.1. Assumption of Multiple Linear Regressions

##### 4.4.1.1. Assumption 1 Multicollinearity of problem

Variable	VIF	1/VIF
Quality of Audit	2.62	0.381938
Top Management Support	2.56	0.390669
Audit Attribute	2.29	0.436050
Organizational Setting	1.91	0.522413
Organizational Independence	1.69	0.592226
Mean VIF	2.21	

a. Dependent variable: audit effectiveness

As the above table indicated that there is no Multicollinearity problem in the data set because all variables the value of VIF is less than 10. There for all variables included in the regression analysis.

#### 4.4.1.2. Assumption 2 Heteroscedasticity

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity
Ho: Constant variance
Variables: fitted values of tax audit effectiveness
chi2(1) = 1.03
Prob > chi2 = 0.3109

The interpretation of Breusch -Pagan test is done using the p value, if the p value is less than 5% significant level it is the indication of Heteroscedasticity accordingly as show the table above the result of the test shows there is no Heteroscedasticity problem since the p value is greater than 5% significant level.

#### 4.4.1.3. Assumption 3 Normality

Variable	Skewness/ kurtosis tests for normality				Prob>chi2
	Observation	Pr(skewness)	Pr(kurtosis)	Adj chi2(2)	
Residual	86	0.1761	0.8601	1.92	0.3836

The interpretation of skewness for normality test is done using p value, if the p value is less than 5% significant level it is the indication of non-normality accordingly as shown the table above the result of the test shows there is no non normality problem since the p value is greater than 5% so this implies that the variable is normally distributed which mean the distribution of the variable are normally distributed

#### 4.4.2. Model Summary

Source	SS	Df	MS	Number of obs = 86 F (5, 80) = 49.77 Prob > F = 0.0000 R-squared = 0.7567 Adj R-squared = 0.7415 Root MSE = 1.8803
Model	879.90085 4	5	175.980171	
Residual	282.85496	80	3.535687	
Total	1162.75581	85	13.6794802	

The regression model considered tax audit effectiveness as dependent variable and the determinants of tax audit effectiveness for the individual factor as the independent variables. A multiple regression analysis is conducted to evaluate how well the five predict tax audit effectiveness. As it is depicted above the table, the linear combination of the four determinant are significantly related to tax audit effectiveness ( $R^2=0.7567$ ,  $F(5, 80) = 49.77$  and  $P < 0.0000$ ). This means that, 75% of the determinants explain the dependent variable tax audit effectiveness can be accounted for by the linear combination of the five factors that determine tax audit effectiveness which are top management support, audit quality, organizational independence, organizational setting and audit attribute.

The table above shows that the sig (ANOVA  $P=0.0000$ ) and it was indicated the overall significance of the model. generally, the ANOV Analysis table above clearly depicted or explained the existence of the relationship between the independent variable which were top management support, audit quality, organizational independence, organizational setting and audit attribute along with showing the normality distribution of the data or the overall significant of the variables are significant at a significant level of 5%.

**Table 5** Multiple Linear Regression Output

<b>Tax audit Effectiveness</b>	<b>Coef.</b>	<b>Std. Err.</b>	<b>T</b>	<b>P&gt;t</b>	<b>[95%con.interval ]</b>	
Top Management support	.2736792	.0966512	2.83	0.006	.0813372	.4660212
Quality of audit	.4078166	.1118602	3.65	0.000	.1852077	.6304256
Organizational independence	.2509036	.0846567	2.96	0.004	.0824314	.4193759
Organizational Setting	.0878983	.0845059	1.04	0.301	-.0802737	.2560703
Audit attribute	.2000263	.0982955	2.03	0.045	.0044119	.3956407
-cons	-3.801648	1.458177	-2.61	0.011	-6.703511	-.899783

$$Y = -3.80 + 0.274 X_1 + 0.41 X_2 + 0.251 X_3 + 0.200 X_4 + e$$

The regression model points out the relationship between the dependent and the independent variable. The model result suggested that top management support, quality audit, organizational independency, and audit attribute have a positive linear relationship and a significant at  $p < 0.05$  while organizational setting not statistically significant as the multiple linear regression results indicates.

The first variable coefficient top management support result of the model shows that  $=0.274$  which implies a one percent of top management support increase leads to an increase audit effectiveness by

27%. The literature shows that the result of empirical studies and against the proposition that audit effectiveness is positively related to its top management support. For instance Mihret& Yismaw (2007) in the case study of tax audit effectiveness on public sector shows that the component of top management support consists of the response to audit finding and the commitment of strength internal audit which has a positive significance influence of on audit effectiveness. Moreover, Sarens & Beelds (2006) argue that the overall acceptance and appreciate of audit within the company strongly dependent upon support they receive from top management the management support is almost crucial to the operation and audit because all other determinate audit effectiveness derive from the support of top management. Different empirical study also shows top management has appositive effect on tax audit effectiveness.

The second variable coefficient quality of audit result of the model shows that  $\beta = 0.41$  which implies that a one percent of quality of audit increase leads to an increase audit effectiveness by 41%. The literature shows that the result of empirical studies that audit effectiveness is positively related to its quality of audit. Different empirical evidence shows that quality of audit has a positive significant impact on tax audit effective's Shewamen, & Alagan (2014)

The third variable coefficient organizational independence result of the model shows that  $\beta = 0.25$  which implies that a one percent of organizational independency increase leads to an increase audit effectiveness by 25%.the literature shows that the result of empirical studies that audit effectiveness is positively related to its organizational independence. Moreover, according to Peurseem, (2005) organizational independency in fact exists when auditors are actually able to act with objective, integrity, impartiality and free from any conflict of interest. Then he concludes that organizational independency is appositive and significant impact on tax audit effectiveness.

The last variable coefficient audit attribute result of the model shows that  $\beta = 0.20$  which implies that a one percent of audit attribute increase leads to an increase audit effectiveness by 20%. Therefore, the multiple linear regression output indicated above among five detriment of audit effectiveness four of them is statistically significant at 5%

#### **4.4.2. Interview Results**

In the interview with the tax payer's cooperative to give the essential information the interview result indicated that some tax payers not give essential information. More over in audit manual it gives detailed explanation the interpretation of tax law and regulation the interview result indicts it

needs some amendment in order to give a detailed explanation of the interpretation of tax law and regulation. The interview respondents further stated that the audit manual focused on accounting treatment, tax law. To sum up the interview result of the respondents indicated that the audit manual its focused on some specific points and not clearly shows the tax law and regulation, the interview result indicated its need some amendment in order to give detailed explanation the interpretation of tax law and regulation as the interview respondent result suggested.

The interview results regarding the practical challenge have faced on operation with regards to tax audit actives as the interview result indicated that clarity, of regulation, lack of knowledge, lack of internet access, contradiction between tax audit objective practices application of revenue generation, lack of technique training, and work place it crowded by offices no clean file Box cabinet are the practical challenge in the ministry of revenue .the interview respondent ,further stated that the major challenge are lack of internet access and the audit manual are not Cleary detailed explain the interpretation of tax regulation.

The interview result of respondents regarding to the recommendation to improve the performance of tax audit effectiveness the respondents recommended that, to give technical training the workers, update the auditor manual. The interview result further stated that in order to improve the tax audit effectiveness awareness creation to tax payers about the importance of tax audit.

#### **4.4.3. Hypothesis Test**

Moving to the hypothesis testing the first hypothesis is top management support has appositve effect on tax audit effectiveness. Based on the regression analysis, implied that top management support is positively related with tax audit effectiveness. Furthermore, positive beta signs and statistically significant with tax audit effectiveness hence hypothesis one was supported. Previous study supported that a positive and significant relationship between tax audit effectiveness and top management support Mihret& Yismaw (2007).

Coming to the second hypothesis of this study audit quality has a positive effect on tax audit effectiveness. The offices ability to properly plan, accomplish and communication the result of audits a proxy for audit quality. Based on the regression result indicated that audit quality is positively related with tax audit effectiveness. Moreover, positive beta signs and statistically significant with tax audit effectiveness hence hypothesis two was supported. Previous study supported that a positive and significant relationship between taxes audit effectiveness and audit quality Elias Ayalew (2014).

The third hypothesis is to test organizational independence has appositive effect on tax audit effectiveness. Organizational independence of the tax audit department was measured by different item. Based on the regression result indicated that Organizational independence is positively related with tax audit effectiveness. Moreover, positive beta signs and statistically significant with tax audit effectiveness hence hypothesis three was supported. Previous study supported that a positive and significant relationship between taxes audit effectiveness and audit quality Shewamen, (2014).

The fourth hypothesis is to test audit attribute has appositive effect on tax audit effectiveness. Audit attribute related to the capability of audit to meet its intended objectives. Based on the regression result indicated that audit attribute is positively related with tax audit effectiveness. Moreover, positive beta signs and statistically significant with tax audit effectiveness hence hypothesis three was supported. Previous study supported that a positive and significant relationship between tax audit effectiveness and audit attribute Alagan, (2014)

**Table 6** Summary of hypothesis testing

<b>Hypothesis</b>	<b>Statement</b>	<b>Tools</b>	<b>Result</b>
Ho	Top management has a positive effect on tax audit effectiveness	Regression Model	Accepted
Ho	Quality of audit positively effects tax audit Effectiveness	Regression Model	Accepted
Ho	Organizational independence has no positive effects on tax auditing effectiveness	Regression Model	Accepted
Ho	Organizational setting has no positive effect on tax audit effectiveness.	Regression Model	Rejected
Ho	Audit attribute has no positive effects on tax audit effectiveness	Regression Model	Accepted

**Source: own computation, 2021**



## CHAPTER FIVE

### 5. SUMMERY, CONCLUSION AND RECOMMENDETION

#### 5.1. Summary of Major finding

The general objective of this study was to study the determinants of tax audit effectiveness in the case of Ethiopian Ministry of Revenue evidence from Large Tax payers Office. In its systematic analytical process, it used five independent variables. (Top management support, Quality of Audit, Organizational independence, organizational setting and Audit attribute) and dependent variable 'Tax audit effectiveness'. Moreover, quantitative method of analysis, particularly descriptive and regressive was used to depict the degree of the relationship between the dependent variable and independent variables. In the first section of descriptive analysis grand mean score and standard deviation of each item were presented and grand mean value was used to interpret the data.

The descriptive analysis indicated that majority of the employees of Ethiopian Ministry of Revenue Large Tax payers Office agrees with the statements stated under the variables such as Quality of Audit, Organizational independence, organizational setting and Audit attribute. When it comes to top management support, the employees neither agree nor disagree.

Multiple regressions analysis was applied to see the effect of the independent variables on the dependent variable and the result obtained was that the variables (determinants) are positively and statistically significant to determine tax audit effectiveness. The model of the regression explained 75% of the variance in tax audit effectiveness by the independent variables. The Multiple regression analysis indicated that these selected determinants of have a statistically significant relation with tax audit effectiveness.

Each independent variable was regressed to examine their effect on Tax Audit effectiveness, so the multipleregressionanalysisproducedpositiveandsignificantassociationbetweenthevariableandthe beta coefficient value indicated that each independent variable affects Tax Audit effectiveness significantly except the variable organizational setting. Moreover, the regression model also represents the contribution of each independent variable to show effect on tax audit effectiveness as follows, top management support ( $X_1=0.274$ ,  $p=0.006$ ), quality of audit ( $X_2=.041$ ,  $p=0.000$ ), organizational independence ( $X_3=0.251$ ,  $p=0.004$ ) and audit attribute ( $X_4=0.200$ ,  $p=0.045$ ). Accordingly, it is evident from the regression table that quality of audit ( $\beta=0.41$ ,  $p<.05$ ) is found to have the highest significant effect on Tax audit effectiveness followed by top management support

(  $\beta = 0.274, p < .05$ ) organizational independence (  $\beta = 0.25, p < .05$ ) and audit attribute (  $\beta = 0.20, p < .05$ ).

## **5.2. Conclusion**

This study has been conducted to examine the determinants of tax audit effectiveness in the Case of Ethiopian Ministry of Revenue Evidence from Large Tax payers Office. To carry out the research, Ethiopian Ministry of Revenue Evidence from Large Tax payers Office has been selected purposely. To choose the best-fitted model that explains the dependent variable and the explanatory variables, the regression model has been considered based on the assumption test result.

The descriptive analysis result shows that the employees of Ethiopian Ministry of Revenue Large Tax payers Office agrees with the variables such as Quality of Audit, Organizational independence, organizational setting and audit attribute which implies that there is a good quality of audit and also there exists an organizational independence and that the organizational settings are vital factors for determining the tax audit effectiveness in the organization. On the other hand, the employees neither agree nor disagree to the statements that describe the variable top management support. The multiple regressions analysis result indicated that the stated factors (Top management support, Quality of Audit, Organizational independence and Audit attribute), have significant effect in explaining the variance in the dependent variable Tax Audit effectiveness. The model of the regression explained 75% of the variance in Tax Audit effectiveness by independent variables.

The finding of the study indicates that the explanatory variables such as Top management support, Quality of Audit, Organizational independence, and audit attribute are considered as vital factors for inducing the Tax Audit effectiveness in the study area. To this end, the stated independent variables and Tax Audit effectiveness has a positive and significant relationship and so can be stated as best determinants for tax audit effectiveness in Ethiopian Ministry of Revenue Large Tax payers Office.

## **5.3. Recommendation**

Based on the findings and conclusions illustrated so far, the following points are suggested as possible solutions used to control major limitations found to be holdups. In order to improve the tax audit effectiveness, large taxpayer's office, the tax audit department and the tax policymakers should consider the following points:-

- The finding of this research proved that top management support, quality of audit organizational independency and audit attribute were statistically significant and positive impact on tax audit effectiveness in Ethiopia ministry of revenue.

- Thus the ministry of revenue should support more for the tax audit by facilitating the audit worker.
- To make effective tax audit the large tax payer office should increase the number of senior auditor capability of audit staffs through need assessment employee and identify the gap. In order to increase the examination reporting and presentation audit quality the Ethiopia ministry of revenue facilitating the important materials.
- The tax auditors of Ethiopian ministry of revenue office should have recommended to maintain and improve their effective contribution for the tax audit effectiveness in their office, by using the supports from their offices management team appropriately, by improving their professional certification in line with the institute of internal audit standards and organizational guidelines and by introducing themselves with modern technologies that improve their tax audit effectiveness function for their office.

#### **5.4. Future Researcher**

This research study has been focused on determinant of tax audit effectiveness. However determinants such as top management support, audit quality, audit attribute, organizational independency and organizational setting should be further conducted at different area in various organizations since the study is limited to five determinants.

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

**Dear participants: -**

This study is entitled “**Determinants of tax audit effectiveness in the Ethiopian Ministry of Revenue evidence from large tax payer’s office**”. The researcher is **Yeshiwork Zewdu** who is currently an MBA (in accounting and finance) student at St. Mary’s University.

The aim of this study is to investigate determinants of tax audit effectiveness particularly in large tax payer’s office audit department. To supplement the data obtained from selected documents study and in-depth interview, the investigator seeks to gather relevant information from all tax auditors and audit directors using self-administered questionnaire. Your participation in this study is completely on voluntary bases and you have the right to refuse, to take part or to contact at any time. But the information that you will give us is quietly useful to know about large tax payer’s office audit effectiveness

We would like to assure you your name will not be mentioned in anywhere. The information that you will give us will be kept confidential and only be used for the research purpose.

For further information, please contact Yeshiwork Zewdu by the following address:

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**PART ONE: Demographic information**

1. Gender: Female  Male
2. Age \_\_\_\_\_  
 Between 22-up to 30  Between 31-up to 40  Greater than 41
3. Level of education  
 Diploma  First Degree  Masters  PhD and Above
4. Field of study  
 Accounting  Management  Economics  Business Administration  Other
5. Your current position at large taxpayer’s office in tax audit department  
 Junior tax auditor tax auditor senior tax auditor Team Co-coordinator
6. Working experience in this department  
 Less than two years 2-6 years Greater or equal to six years

**Part II: Questions related to Measure Tax Audit Effectiveness**

Listed below are a series of statements that represent **determinant of Tax Audit Effectiveness** with respect to your own feeling about these organizational, please, indicate the degree of your agreement or disagreement with each statement by putting a tick mark ( ) on one of the five alternatives.

*Responses are measured on 5- point scales with the following verbal anchors: Strongly Disagree (1), Disagree (2), Neither Disagree or Agree (3), Agree (4) and Strongly Agree (5).*

1	Top management support	Strongly Disagree (1)	2	3	4	Strongly agree (5)
1.1	The number of employees in tax audit is sufficient given the amount of auditing work planned and needing to be done in the near future?					
1.2	Management is sufficiently aware of the needs of tax audit, as demonstrated by the small budget assigned to this process?					
1.3	The management encourages by providing adequate					

	support for professional education and training for staff in the tax audit					
1.4	Audit reports are valued by top management					
1.5	Management provides necessary equipment to carry out tax audit,					
<b>2.</b>	<b>Quality of Audit</b>	<b>Strongly Disagree (1)</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>Strongly agree (5)</b>
2.1	Tax auditors are able to cover all organizational units and all issues in their audit activity					
2.2	The response of tax payer's to the audit is submitted in written and has a power to appeal on the findings					
2.3	Quality assurance is an appropriate tool to ensure quality of audit work in LTO					
2.4	The findings of tax audits are always based on documents and reliable data					
2.5	Tax auditors in LTO have appropriate audit plan in all their audits					
<b>3.</b>	<b>Organizational Independence</b>	<b>Strongly Disagree (1)</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>Strongly agree (5)</b>
3.1	There is a strong audit management team led by an autonomous audit manager					
3.2	Tax Auditors have regular and direct working relations with the general manager and the managerial team					
3.3	Terminating the work of the TA requires doesn't need the approval of the TA group leader, and/or the department head					
3.4	Tax audit is considered a stage in the organizational independence of employees in the organization					

3.5	All organizational data pools (data bases, contracts, etc.) are accessible to the tax auditor and examined by the auditor					
4	<b>Organizational setting</b>	<b>Strongly Disagree (1)</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>Strongly agree (5)</b>
4.1	Tax administration has enough audit staff resources to perform onsite audits on all taxpayers					
4.2	In large taxpayer's tax Audit department there is enough material and equipment for audit program					
4.3	There is qualified audit staff /well experienced staffs are available currently at LTO Audit program					
4.4	Audit manual can give detailed explanation the interpretation of tax laws and regulations					
4.5	Tax audits are finalized according to consistent process and assurance a level of customer satisfaction					
5	<b>Auditee Attributes</b>	<b>Strongly Disagree (1)</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>Strongly agree (5)</b>
5.1	In Large tax payer's office, there is transparent audit procedure and audit decisions are made based on facts					
5.2	Taxpayers have a good attitude and cooperation with the tax system and auditors					
5.3	Tax auditors have appropriate legal power of access to get any document from taxpayer and third party information sources without restriction					
5.4	Large tax payer's office has an effective motivation scheme to the compliance taxpayers					
5.5	Auditors give sufficient education to the taxpayers about the tax laws and regulations during auditing.					

**PART THREE: Questions related to Tax Audit Effectiveness**

6	Tax Audit Effectiveness	Strongly Disagree (1)	2	3	4	Strongly agree (5)
6.1	Transparent tax audit procedures minimizes number of complaints from the taxpayers					
6.2	Tax audit reviews the accuracy and reliability of financial reports					
6.3	Tax audit reviews the means of safeguarding assets					
6.4	Tax audit evaluates and improves the effectiveness of risk management					
6.5	Tax audit evaluates the internal control system of the company					

### **Part IV General Questions**

1. Is the tax payer's cooperative to give essential information's?
2. Is audit manual can give detailed explanation the interpretation of tax laws and regulations?
3. What are the practical challenges you have faced in your operation with regard to Tax Audit activities \_\_\_\_\_?
4. What would you recommend to improve the performance of tax audit operation?  
\_\_\_\_\_
5. Is there anything to add in relation to tax audit effectiveness in ERCA Large taxpayer's branch Office? Describe in detail please  
\_\_\_\_\_  
\_\_\_\_\_

**Thank You for your cooperation**

## Appendices 1

Source	SS	df	MS	Number of	obs =	86
Model	879.900854	5	175.980171	F(5,	80) =	49.77
Residual	282.85496	80	3.535687	Prob > F	=	0.0000
Total	1162.75581	85	13.6794802	R-squared	=	0.7567
				Adj R-squared =		0.7415
				RootMSE =		1.8803

Tax audit effective	Coef.	Std. Err.	t	P> t	[95%Conf.	In
Top management support	.2736792	.0966512	2.83	0.006	.0813372	.
Quality audit	.4078166	.1118602	3.65	0.000	.1852077	.
organizational independence	.2509036	.0846567	2.96	0.004	.0824314	.
Organizational setting	.0878983	.0845059	1.04	0.301	-.0802737	.

. vif

Variable	VIF	1/VIF
Quality audit	2.62	0.381938
Top management	2.56	0.390669
Audit attributet	2.29	0.436050
organisation~g	1.91	0.522413
organisation~e	1.69	0.592226
Mean VIF	2.21	

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of taxauditeffective

chi2(1) = 1.03

Prob >chi2 = 0.3109

Skewness/Kurtosis tests for Normality					
Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adjchi2(2)	joint Prob>chi2
resid	86	0.1761	0.8601	1.92	0.3836