



**THE ASSESSMENT OF TAX AUDIT PRACTICE
AND ITS' EFFECT ON TAX EVASION: IN THE
CASE OF KOLFE KERANIYO SUB CITY SMALL
TAX PAYERS BRANCH OFFICE**

BY

LEDET DAGNE DEBELA

JANUARY, 2024

ADDIS ABABA, ETHIOPIA

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Misraku Molla (Ph.D.). All source of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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

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ST. MARY'S UNIVERSITY
GRADGUATE STUDIES
SCHOOL OF BUSINESS

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Abstract

The main objectives of this study was to assess the tax audit practice and examine its effect on tax evasion in Addis Ababa city administration Kolfe Keraniyo, sub-city small tax payer's branch office. The descriptive research design along with qualitative research approach were used. The study used primary data collected using closed-ended questionnaire. Using simple random sampling technique about 161 respondents were selected from a total population of 270 tax payers. In addition, the sample includes 18 tax audit team and the 2 official which makes actual respondents 181. Descriptive statistics was employed to analyze each of the objectives in detail. The result shows that audit case selection indicates that the tax audit case selection strategy in the selected area was poor. Furthermore, the result shows Audit case selection is not done in cooperation with taxpayers whereas, taxpayers are not selected using statistical techniques using prior tax audit results. Overall, the audit case selection has not done based on the business sectors. In addition, the tax audit department lacks sufficient audit employees qualified and experienced staff, well-organized structure office continuous and adequate training for tax auditors. The findings of tax evasion shows that respondents in the research area had a low level of general knowledge about tax evasion and its effect on the economy. The result suggest that the rise of tax evasion reduce the amount of government services provided and they disagree with the idea that tax evasion harm the country's capacity to grow its economy. Tax evasion doesn't cause the government to incur needless debt in order to close the budget imbalance. Therefore it is recommended that the tax auditor should consider the business sector when selecting audit cases, tax auditors should develop a risk-based tax audit approach that entails identifying high-risk taxpayers, governments should raise taxpayers' awareness of tax evasion using different mechanisms.

Keywords: Tax evasion, Tax audit case selection, Tax audit program, Tax audit resources

Acronyms and Abbreviations

A.A	Addis Ababa
AACG	Addis Ababa City Government
AACGRA	Addis Ababa City Government Revenues Authority
AK	Addis Ketema
KK	Kolfe Keranyo
LTP	Large Tax Payers
STP	Small tax payers
PAYE	Pay as you Earned
SAS	Self Assessed System
SPSS	Statistical Package for Social Science
WB	World Bank
VAT	Value added tax

CHAPTER-ONE

INTRODUCTION

1.1 Background of the study

The government of Ethiopia has several options to finance its public expenditures and pursue its fiscal policy. These options include imposing of taxes on businesses and persons, and non-tax revenues such as service fees, loans (both domestic and foreign institutions), property and investment income, privatization of public enterprises, and domestic and foreign grants (Misrak, 2011).

Tax in Ethiopia is as old as the country itself. All kings, leaders and land lords of ancient time have levied different types of taxes for various purposes. During those times the tax that was levied and collected all-most all in kind was spent for military purposes. Traditional taxes were paid in kind ,however taxes in the form of money has become applied in 19th and 20th century due to the circulation of money and modernization of government policies (Worku, 2008).

However, the modern tax system has been started during Emperor Haileselesie in 1942. To reach the current stage the Ethiopian tax has passed through different stages. According to the existing constitution of Ethiopia adopted in November 1994, the federal democratic republic of Ethiopia would comprise a federal state and member states in which both organs shall have their respective, legislative, executive and judicial powers. All financial requirements necessary to carry out duties and responsibilities that have been given to the federal government and the city are envisaged to be covered by the respective organs and the sharing of revenue between the federal government and the city follow the arrangements of the powers of the government./ proclamation No. 33/1992/

The proper amount of tax must be collected on a timely manner for successfully improving and maintaining steady economic progress of a nation. To do this, the enforcement powers of the tax administration, including tax audit, must be applied judiciously and in an even handed fashion(Baurer, 2005) .

Bauer, (2016) noted, the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayers reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Tax audit may increase tax revenue in two ways: directly through assessment of additional taxes, and indirectly by improving taxpayer compliance with the tax laws and regulations (Micci-Barreca & Ramachandran, 2004).

Tax evasion is a serious issue that affects the revenue and development of many countries, especially in Africa. According to a report by the United Nations Economic Commission for Africa, Africa loses an estimated \$50 billion annually due to illicit financial flows, which include tax evasion, money laundering, corruption and other illegal activities. However, there is limited empirical evidence on how tax audit practices can influence tax evasion behaviour among small taxpayers in Addis Ababa city administration. The aim of this research were to assess the impact of tax audit practices on tax evasion among small taxpayers and to provide recommendations for improving tax compliance and revenue collection.

1.2. Statement of the Problem

Properly designed and administered taxation system is very essential for generating revenue as well as increasing the tax base to the government. In Ethiopia there are various reasons why revenue administration reform may be needed. Because it is required, 1) to increase the government revenue to support social programs and alleviate poverty, 2) To broaden the tax base and improve tax compliance among different sectors and regions, 3)To encourage trade and investment by simplifying the tax system and reducing tax evasion and corruption, 4) To promote equity and fairness in the tax system by reducing tax exemptions and loopholes (Legesse, 2019). While tax policy and tax laws create the potential for raising tax revenues, the actual amount of taxes flowing into the government treasury, to a large extent, depends on the efficiency and effectiveness of the revenue administration. Inadequate tax administration including insufficient and ineffective audit program, the potential amount of tax revenue has not been collected in an efficient and equitable manner (Bird, 2004). It is unmoving under a number of challenges regarding to its operation and administration that are not yet resolved. Further, weak tax administration may make the tax system unfair in that honest taxpayers would bear heavier and disproportional burden. It, in turn, may have impact on the

efficiency of tax operation, and also may encourage businesses to work in the illegal economy (Bird, 2003).

Tax systems are usually elaborated without proper discussion with the business community (Lin & Jia, 2019). In addition, the business owners do not have easy access to and clarification on information of the tax laws. The tax agencies do not also provide advising services. As a result, taxpayers misinterpret tax rules and regulations. Moreover, they have lack of awareness regarding the tax type to be imposed on their doings, purpose and operation of goods and services exempted from tax, negative upshot of smuggling trade, and reporting and filing requirements of the tax law. Therefore, a successful audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue and prevent tax evasion. To the greatest possible extent, tax systems should be supported by clear and straightforward laws and procedures that facilitate revenue collection, develop taxpayers “awareness, and minimize taxpayers” effort and compliance costs. The administration should be provided with appropriate enforcement tools, including conduct of effective audit (Cordoş & Fülöp, 2014).

Low tax to GDP ratio is a key problem for Ethiopia and many other African countries. Tax to GDP ratio is a measure of the tax revenue collected by the government as a percentage of the gross domestic product (GDP) of the country (Ayenew, 2016). It reflects the capacity of the government to mobilize domestic resources and finance public services and development (Okunogbe & Santoro, 2022). According to the World Bank, Ethiopia’s tax to GDP ratio was 6.2 % on 2020, which is one of the lowest in Africa and well below the average of 16.8% for sub-Saharan Africa (Ayenew, 2016). There are many factors that can affect the tax to GDP ratio, such as the structure and performance of the economy, the tax policy and administration, the level of informality and corruption, and the social and political context (Daba & Mishra, 2014). To address this problem, Ethiopia needs to improve its tax system and increase its tax revenue in a fair and efficient way.

The tax auditing systems are experiencing challenges from the taxpayers as well as tax office. Few studies (e.g., (Begashaw, 2020); (Ayenew, 2016); Mirera, 2011) were carried out on the problems of tax audit practice and its effects on tax collection and voluntary tax compliance behaviour. Previous studies on tax audit practices and tax evasion in Ethiopia have focused mainly on large taxpayers or specific sectors, such as

manufacturing or trade. However, there is a lack of empirical evidence on how tax audit practices affect the tax evasion behaviour of small taxpayers, who constitute a large and diverse segment of the Ethiopian economy. Moreover, most studies have used aggregate or secondary data, which may not capture the complex and dynamic factors that influence tax compliance decisions at the individual or firm level. Therefore, this study aims to fill this gap by conducting a survey with small taxpayers in Addis Ababa city administration and analysing their perceptions, attitudes and responses to tax audit practices. These study were provide new insights into the impact of tax audit practices on tax evasion among small taxpayers and offer recommendations for improving tax compliance and revenue collection in Ethiopia.

1.3 Research Questions

This study addresses the following specific research questions.

1. What types of tax audit case selection strategies are utilized in kolfe keraniyo sub city?
2. Does kolfe keraniyo sub city have adequate tax audit resources (human, material, training, technology)?
3. What mechanisms are being employed by the tax audit staff to carry out the tax program?
4. What are the effects of tax audit on minimizing tax evasion?

1.4 Research objectives

1.4.1 General Objective

The main objective of this study was to assess the current tax audit practice and examine its effect on tax evasion in Addis Ababa city administration kolfe keraniyo, sub-city small tax payer's branch office.

1.4.2 Specific Objectives

This study addressed the following specific objectives.

1. To evaluate tax audit case selection strategies used in kolfe keraniyo sub city.
2. To assess whether there exist adequate human, technological, financial and other resources to perform tax audit resource and its effects in tax evasion.

3. To investigate the mechanisms being employed by tax audit staff to ensure quality of tax audit program.
4. To examine the effect of tax audit on tax evasion.

1.5 Significance of the study

The study findings will contribute primarily to the ministry of revenue to have better understanding of why some taxpayers evade their income and prepare themselves to solve this problem and also to contribute towards the understanding of tax evasion in developing countries. And identifying factors that affect tax evasion in the targeted study area. In addition, other researchers can also use this study as an input for further and detailed studies. The study also clearly show the effects of tax audit practices and state the mechanism to overcome the problems which helps the branch office to see its level and performance in minimizing tax evasion activities, and learn some lessons and build some corrective measures for the weaknesses based on recommendations to be forwarded. The study was also useful for tax payers to build their confidence in the tax system and to avoid penalties from authorities by promoting tax compliance.

1.6 Scope of the study

The study encompasses the effects of tax audit practice on minimizing tax evasion in Kolfe Keraniyo sub city small tax payer's branch office. In particular category "C" "taxpayers those prepare profit and loss statement and Balance sheet to declare their taxes.

The study examined the effects of tax audit practice, and focused on the effectiveness of audit program in terms of improving voluntary compliance and minimization of tax evasion, tax audit and revenue performance, audit coverage achieved, audit case selection methods used, examination techniques applied, and availability of audit resources, proficient and experienced tax auditors in particular.

1.7 Delimitation of the study

While studying effects of the tax audit practice, the present study, considers only the tax audit practice and its impact on tax evasion in kolfe keraniyo sub city small tax payer's branch office, so that the scope may be somehow limited due to lack of data and other materials constraints. Moreover, it was also be difficult to assess all tax audit reforms

that affect tax evasion and tax revenue collection. So that the researcher limited the scope of this research only one of the tools of revenue administration the so called tax audits.

1.8 Organization of the study

The rest of the thesis organized in to five chapters, the second chapter review related literature, the third chapter deals with methodology while the fourth chapter deals with data analysis presentation and the fifth chapter conclusion and recommendation.

CHAPTER-TWO

REVIEW OF RELATED LITERATURES

This chapter presents theoretical and empirical literature related to the subject under investigation. At the end, it presents summary and knowledge gap and later the conceptual framework of the study.

2.1. Review of theoretical Literature

2.1.1. Meaning of tax and taxation

Tax is a financial obligation that is imposed by a government or a taxing authority on individuals or entities, such as income, property, sales, etc. (McLure, Neumark, & Cox, 2015). Taxation is the process or system of collecting and managing taxes. The main purpose of taxation is to raise revenue for the government to fund public services and expenditures, such as health, education, defense, infrastructure, etc (Panteleeva, 2021). However, taxation can also serve other purposes, such as redistributing income, influencing economic behavior, correcting market failures, or promoting social welfare¹²³.

2.1.2. Overview of Tax Audit

Auditing is such an examination of books of accounts and vouchers of business, as were enable the auditors to Satisfy himself that the balance sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and that the profit and loss account gives true and fair view of the Profit/loss for the financial period, according to the best of information and explanation given to him and as shown by the books; and if not, in what respect he is not satisfied (Micci-Barreca & Ramachandran, 2004).

Auditing is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they relate (Kumar & Sharma, 2015) .

Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (The American Accounting Association, 2014)

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. In other words, tax audit is an extension of the normal audit generally conducted for the purpose of expressing an opinion as to the fairness of the accounts examined by the auditor, and the certification of financial statements for tax purposes (OECD, 2006a). It is meaningful if based on the knowledge of tax laws, similarities and dissimilarities between commercial accounting and tax accounting also reporting to the tax department and recognizing their requirements to enable the latter to compute taxable income. It includes what a tax official can look for when aiming to complete an assessment of tax. It covers also the disclosure of all significant accounting practices employed in the organization, a report on the financial accounts, i.e. the balance sheet, profit and loss account and other related accounts and schedules which are part and parcel of the financial reports. Furthermore, information is required to compute the assessable income as well as to ensure that the compliance of the tax laws and regulations is proper.

In a narrower sense, audit is an “attestation communication” because it presents the auditor’s opinion or judgment concerning the degree of correspondence between accounting information and established criteria. To the tax administration, a tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD, 2006a). As (Bauer, 2016) 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 taxpayers’ 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 (Bauer, 2016). Thus, tax audit results in increased tax revenue in two ways: (1) directly through assessment of additional taxes; and (2)

indirectly by discouraging tax evasion and underreporting of liabilities by all taxpayers. Further, (Micci-Barreca & 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.

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.(kircher, 2008)

The subsequent subsections discuss thoroughly about tax audit in a tax administration system that includes characteristics of effective audit program, types of tax audit to be performed, audit case selection methods, examination techniques to be applied for tax audit, and characteristics and required capabilities of effective tax auditors.

2.1.3. Nature and Scope of Tax Audit

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

According to (Badara, 2012), audit tax objectives include to establish a viable and effective tax administration in order to deal with constantly changing economy, to put strategies in place in order to resolve tax dispute between the tax office and the liable tax payers, to maintain a strong mechanism to deal with tax avoidance techniques which are available to various organizations, but are susceptible to tax abuse, to bring defaulting tax payers to the net of tax authorities, to prove the completeness, accuracy and timely filing of tax returns submitted by the tax payers. (Niu, 2011) in a study found a positive association between the audit and the voluntary compliance. The finding suggests that the audit productivity may be under estimated in many studies in the literature. It reminds us that when considering the productivity of the audit work. Besides the direct audit collections, we should also take the audit impact on the voluntary compliance into consideration. For this reason, the finding may provide tax professionals and tax authorities with incentives to strengthen the audit power and to better structure their audit organization to generate more revenue for the state. Jin Kwon (2004) study in Korea observed that a more rigorous analysis to evaluate the determinant of tax culture for the study of tax compliance and tax audit.

(Cremer, Marchand, & Pestieau, 1990) concluded that “International tax laws have their domicile in their domestic tax laws of respective states (countries)”. Countries enact laws in order to enable their tax authorities to collect tax funds for public welfare and stimulation of domestic investment and business. From the explanation, it can be seen that the international taxation system has taken an important role in many countries of the world. The tax system is so important that world bodies were organized to deal with administration, collection and prevention of tax avoidance, tax evasion and double taxation of multinational corporations (MNCs). Therefore, an international tax audit is the examination of MNCs tax reports to ascertain compliance with applicable tax laws and regulations, domestic and foreign.

(Erard & Feinstein, 1994) mentioned some reasons for tax audit which include, among others: To assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to minimize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to

improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

James (1993) identified a priority list of tax audit mission as follows: To establish a viable and effective tax administration in order to deal with constantly changing economy, to put strategies in place in order to resolve tax dispute between the tax office and the liable tax payers, to maintain a strong mechanism to deal with tax avoidance techniques which are available to various organizations, but are susceptible to tax abuse, to bring defaulting tax payers to the net of tax authorities, to prove the completeness, accuracy and timely filing of tax returns submitted by the tax payers.

2.1.4. Types of Audit Scheme

The audit scheme found in the tax compliance literature might be classified as: Random Tax Audit Scheme, Cut-Off Tax Audit Scheme and Conditional Tax Audit Scheme (Beck & Jung, 1989).

Random tax audit scheme: Simply provides each self-report of income an equal chance of being chosen for verification by an audit. No information is used to select the report to be audited. (Beck & Jung, 1989)

Cut-off audit scheme: Audit resources are employed to verify reports of the tax payers reporting the lowest income levels.(Beck & Jung, 1989).

Conditional audit scheme: It requires in addition to the reported income, sources of information representing a noisy signal of tax payers' thorough income earning potentials. The cut-off and conditional audit schemes incorporated the preliminary information transmitted when tax payers self-reports income and the corresponding tax liability. (Beck & Jung, 1989).

2.1.5. Types of tax audit

Audits can vary in their scope and the level of intensity to which they are conducted. For this reason, various terminologies have evolved to describe different types of audit activity (Ebrill et al. 2001; Grandcolas, 2005; Harrison and Krelove, 2005).

2.1.51 Full audits

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

2.1.5.2 Limited scope audits

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

2.1.5.3 Single issue audits

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

In practice, the scope and nature of any audit activity undertaken for a particular taxpayer were depend on the available evidence pointing to the likely risks of noncompliance and a taxpayer's prior history. Extensive audit inquiries may also be justified simply because a taxpayer's financial and /or business activities are unusually complex. Periods under examination: Audits can focus on one financial year or accounting period, or be extended to cover multiple fiscal periods. An audit can focus on specific parts of the taxpayer's activities (such as sales, goods in stock etc.), specific incidents or transactions or activities (such as those carried out in a branch or subsidiary), or specific tax obligations. An audit can vary in its level of detail. Sometimes the taxpayer's affairs are examined

in detail and in other situations, subject to the level of risk perceived, merely superficially.

2.1.5.4 Desk audit or verification

This type of audit usually carried out annually and primarily based on: (1) a review of income tax and VAT returns, or basic ratios comparing with previous periods or other taxpayers in similar industries, and (2) the cross checking of information included in the taxpayer files. It involves basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination. Information technology (IT) systems should provide strong support for these verifications.

2.1.5.5 Field Audit

It is a detailed examination of taxpayers' books and records to determine whether the correct amounts were reported on the tax returns. The auditor may also obtain information from other sources such as banks, creditors and suppliers, to confirm items on returns. A field audit usually includes one or more of the following taxes: income, franchise, sales and use, withholding, and excise taxes. The audit is conducted at taxpayers' place of business, home, or at the office of their accountant, attorney, or other person who may represent them. The auditor tries to select the place that is most appropriate under the circumstances and most convenient for them.

2.1.6. Examination techniques

A tax auditor applies various techniques to examine the books and records behind a return. The techniques to be used depend on the taxpayer and the tax regime concerned. As (Bauer, 2016) noted, an effective case plan can be cognizant of a range of investigative and analytical approaches that may vary depending upon the area of risk and the circumstances of the particular taxpayer. The decision regarding the type of tests to be undertaken as well as the records needed by the auditor to address specific issues is influenced by the nature of the taxpayer's operations, adequacy of books and records, and materiality of potential adjustments. According to OECD (2006a), the techniques used for audit examination purposes include analytical review, investigative approach, field examination, record examination, and counterpart examination.

2.1.6.1 Analytical review

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

2.1.6.2 Investigative approach

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

2.1.6.3 Field examination

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

2.1.6.4 Record examination

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

2.1.6.5 Counterpart examination

It is an examination performed based on third party information where warranted. As OECD (2006a) stated, information can be obtained during the course of an audit from third parties to verify the taxpayer's income, for example:

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

- ❖ Information from Government regarding social benefit payments, and employer information concerning salary and wages paid and tax deducted, both for income and non-monetary benefits; and
- ❖ Matching foreign source income.

2.1.7. Auditors Required capability

According to OECD (2006a) stated, the required capabilities of auditors are generally identified by analysing the activities required to perform particular audit tasks, and through practice and experience. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex tax laws and conduct intensive examinations of taxpayers' books and records. Hence, revenue bodies pay close attention to the overall management of the tax audit function, and particularly to the strategies and methods used for recruiting, developing and managing individual audit staff. Thus, tax auditors should have a capability to: conduct investigations, determine compliance, tax accounting and financial analysis, conduct research and analysis, make effective decisions under the law, effective communication, apply work processes and procedures, and manage own work and relationships (OECD, 2006b).

In addition to the required core capabilities, greater attention and emphasis is needed on soft skills and other attributes. These include behavioural and motivational competencies, personal attributes such as work and integrity, feeling for the detection of fraud and irregularities, observe and detect relevant indicators in surroundings, identifies patterns and describes their significance to the situation, and effective observational skills. Familiarity with basic accounting, bookkeeping, and business and industry practices is also generally expected for all staff (OECD, 2006b). Moreover, the required capabilities of audit managers and directors are typically identified based on the notion of coaching, communication, and leadership skills. The required capabilities for audit managers and directors often focused on leadership and management skills, technical expertise, advanced audit skills, achievement orientation, ability to develop and coach others, high level communication skills, and ability to make strategic decisions (OECD, 2006b).

2.1.8. Competency assessment

It is important for tax administrations to assess and evaluate the competencies of their staff. The direct manager commonly performs competency assessments during recruitment and promotional processes on an annual or semiannual basis for those staff maintaining current positions (OECD 2006a). Assessments performed as part of recruitment processes are often performed by external specialists, human resource departments and/or panels of internal subject matter experts. Other events triggering capability assessments include prior to performing a new type of work, prior to starting a new role, and ongoing informal assessments and learning and development activities (OECD, 2006b).

Assessment methods used include knowledge-based assessments administered online, formal tests and exams to attain a recognized qualification, peer reviews, a tutor to support and assess newly hired staff, and technical evaluations. The measurement and tracking process of the audit workforce provides management with tangible information of the resource and capability mix or trends across the whole audit workforce, providing valuable data for workforce and succession planning. Many revenue bodies indirectly attain a measure of the competency level of their audit workforce by considering: key performance indicators and results, quality assurance results, client or professionalism survey results, quantity of audits performed, training course and other assessment results (OECD, 2006a).

Further, tax administrations may record the skills (including qualifications) and areas of expertise of individual staff. Using and sharing this information across the organization, tax administrations may better allocate work and identify specialist resources or skills (OECD, 2006b).

2.1.9. Improving competency and addressing capability gaps

Responsibility and accountability for improving auditors, audit managers and audit directors commonly lies with the staff member in question and their direct manager and/or local management team. Competency improvement should be integrated (not be seen as extra task) into normal business activities. Together with tax auditing or training departments, human resource departments (where applicable) often have joint responsibility and be significant contributors to the improvement process (OECD,

2006a). Revenue bodies may develop staff and address capability gaps through recruitment processes and the use of programs such as training and development programs, mentoring and coaching programs, accreditation models, job rotation and/or placement programs, career paths, knowledge sharing initiatives and knowledge tests. Capability gaps are typically gathered from various sources including quality management system results, performance system interviews and appraisals, client professionalism, satisfaction and other similar surveys, and training program evaluations (OECD, 2006b).

Tax administrations must recruit audit staff specifically to carry out tax audits. To attract the right staff in increasingly competitive and skilled labour markets, effective recruitment policies are essential. Audit staffs are generally recruited either fully trained so they can be effective in post very quickly, or selected because they have strong potential to become auditors through in-house training and education. A minimum standard of specific academic qualifications, such as a diploma or degree or being a chartered accountant, is often required for some grades of audit staff. There is also an assessment of applicants against competencies relevant to their audit work in the areas of problem solving, analytical skills, interpersonal skills, self-management, decision making and oral and written communications. Further, all auditors required to have computer skills with other more specialized skills, such as legal experience or specific types of tax knowledge being needed for posts that are more technical (OECD, 2006a). In order to maintain standards of auditing it is essential that auditors are given both initial training (classroom and on-the-job instruction) to bring auditors up to the required level, and continued training so that their skills are kept up to date and relevant. The extent and nature of this training and the balance between the two varies according to need, and relates to the recruitment and development policies adopted. Initial training varies depending on the level of qualifications and experience expected of new recruits. For instance, recruit staff without professional qualifications need much more extensive initial training in tax law and auditing, in-house testing is generally used to confirm that trainees reach the required standard (OECD, 2006a).

To deliver on-going training and development, a number of methods are used including training courses, computer based training packages, memos, guidance notes, self-study packs, facilitated workshops and discussion forums, on-the-job training, coaching and

mentoring, and virtual university and learning tools. As a rule, continuing professional training is not normally examinable and the amount of training undertaken varies between countries and over time (OECD, 2006a).

2.1.10 Location of audits

Tax audits can be conducted in different locations. Sometimes there is a need to carry out the audit at a taxpayer's business premises. In other situations, the books and records required to complete an audit can be collected by, or sent to, the revenue body and the audit work performed in the office. Tax audits can be categorized as 'field audits' or 'office or desk audits' on this basis. Given that audits can vary in terms of their scope and intensity revenue bodies should have a clear policy on the types (and numbers) of audits to be conducted, and the circumstances in which specific types of audits are to be carried out, so that audit officials (including managers) understand what is expected of them (Bauer, 2016).

2.1.11. Approaches and standards of Tax Audit

In conducting a tax audit the audit should apply the generally accepted practices of auditing as one would do in the case of other audits, e.g. an audit of a company under the companies act. The generally accepted auditing practices are communicated in the various pronouncements of the respective country. The auditor should get the financial statements as well as the statement of particulars authenticated by the assessed before he verifies them. The auditor can apply the technique of selective verification (statistical sampling/ test-checking), depending on his evaluation of the internal control system prevalent in the entity under audit and the materiality of transactions.

In conducting the audit the auditor should keep in mind that the basic objective behind is to assist the authorities in assessing the collect income of the assessed. For conducting the tax audit effectively an auditor needs to develop an approach which is a synthesis of taxation laws and auditing principles. The nature of tax audit is such that an auditor has to rely on various legal pronouncements in the field of taxation (Bauer, 2016).

2.2. Review of Underpinning Theories

Any strategy to prevent tax evasion should begin with the theory of why people cheat on their taxes. Naturally, much of it is unconvincing and ambiguous. Nevertheless, to give an indication of the full range of variables that social scientists have studied in an attempt to answer this question. The Forum on Tax Administration (2004) “identified some of the basic theories of tax compliance” which include, among others: Economic theories, Psychological theories and Sociological theories.

2.2.1. Economic Theories

Economists approaching the question of why people fail to comply with the law began by constructing a theory based upon the assumption about human behaviour that underlies all economics; namely that individuals generally act rationally in evaluating the cost and benefit of any chosen activity. Consequently, in modelling the choice confronting individuals who are deciding whether to engage in tax evasion, their basic model assumes that people would commit evasion when the expected utility of their criminal act exceeds its expected disutility (Slemrod, 1992).

The most common economic theory of tax compliance is the economic deterrence model, which assumes that taxpayers weigh the expected benefits and costs of evasion, such as the tax rate, the probability of detection, and the penalty rate. According to this model, taxpayers were comply if the expected cost of evasion is higher than the benefit (Andreoni, Erard, & Feinstein, 1998). However, this model has been criticized for ignoring other factors that may affect tax compliance, such as social norms, moral values, trust in government, tax fairness, etc. Therefore, alternative or complementary theories have been developed, such as the fiscal and social psychology model, which incorporates these psychological and behavioral aspects into the analysis of tax compliance (Devos & Devos, 2014). These theories aim to provide a more realistic and comprehensive understanding of tax compliance and its determinants.

2.2.2. Psychological Theories

Many analysts have suggested that the economic model of human behaviour reflects a too simplistic view of human beings and, in the real world of everyday life, is without any predictive value. Like economists, psychologists also tend to explain human behaviour in terms of variables that relate to individuals. However, they tend to model

human behaviour in much more complex terms than economists. Unlike economists, they would not think of modelling tax payers, in this context, as perfectly amoral, risk averse utility maximizers. Instead, they might be interested, as key independent variables, in tax evasion decision in factors such as: the individuals are moral beings with ideas and values of their own and that commands and their own impulses filter through and are affected by this moral screen (Slemrod, 1992)

2.2.3. Sociological Theories

Sociologists tend to see the cause of variation in human behaviour in the structure of the social system. Thus they explain people's actions by examining the forces that impinge on the position that they occupy within the system. Among other things, this means that they extend the basic economic model of crime control by making the point that law is not the only source of punishment and rewards. Tax payers live and work in society. They have families, friends and co-workers who are sources of reward or punishment. These social forces shape behaviour just as effectively as the reward and punishments administered by the state. Given their basic assumptions about human behaviour, sociologists are also likely to look to attitudes towards government views relating to the enforcement of tax laws, views about the fairness of the tax system, contact with the tax department and demographic characteristics as independent variables (Slemrod, 1992). Beron (2002) is of the view that Social scientists from almost every discipline have turned their attention to tax evasion as social phenomena. What have we learned from their efforts? In a perfect world, by now we would have a theory about why people comply with the tax laws from which an interested tax administration department could deduce a comprehensive compliance strategy. However, compliance with the tax law typically means: True reporting of the tax base, Timely filing of the tax return, and Timely payment of the amount due (Slemrod, 1992).

2.3. Review of Empirical Literature

Tax evasion represents a major source of inequality irrespective of the redistribution goal in a country. This Special Issue of Economics of Governance seeks to investigate the impact that some new challenges, strictly related to taxpayers' behavior, may have on social equity and perceived fairness (Argentiero, Casal, Mittone, & Morreale, 2021).

However, without disputing (Scully, 2003) optimal taxation policy, empirical evidence in both developed and developing countries suggests that in economies with high tax evasion rates there is also a great extent of fiscal corruption with serious consequences on the equity and efficiency of any economic system (Chatzimichael, Kalaitzidakis, & Tzouvelekas, 2019). In a bid to control the level of tax evasion and increase government revenue, tax audit and investigation have been applied by tax authorities both at the state and federal level (Olaoye, Ogunleye, & Solanke, 2018)

According to Abebe (2018), tax audit practice has a positive and significant effect on tax revenue growth in Ethiopia. The study found that tax audit increased the voluntary compliance of taxpayers and reduced the tax gap. The author suggested that improving the quality and frequency of tax audit, enhancing the competency and independency of auditors, and creating awareness and positive attitude among taxpayers are some of the strategies to increase the effectiveness of tax audit practice. This evidence supports the hypothesis that tax audit practice can reduce tax evasion in Addis Ababa City Administration Small Tax Payers Branch Office.

The Study by (Yeshiwas, 2019) on Assessment of Tax audit practices and its Effect in increasing revenue in Ethiopia a case in ERCA explores the effect of tax audit in promoting tax revenues growth in Ethiopia and identifies the challenges and opportunities of tax audit practices, According to (yeshewas, 2019) the situations which affect and hinder the Tax collections process and the Tax Audit activity are; Insufficient number of Tax Auditors, Manual Tax Audit System, Uncompetitive salary payment scale, Poor Awareness Raising and customer relation Activity, Tax Payers Complain, Insufficient Training Service, Absence of strong control of tax evasion and avoidance mechanism, and Weaker tax payers reward mechanism

Therefore the researcher concludes that, the above findings are a base for noncompliance and tax avoidance, which have a negative impact in decreasing Governments revenue. Tax evasion and inequality by (Mohammed et al., 2018): some theoretical and empirical insights from Italy examines the concepts of economic inequality and tax evasion and provides an empirical picture of the relationship between income inequalities and tax evasion. The representative taxpayer in this model is exclusively affected by economic reasons: when the penalties and the detection probability are low, the taxpayer has an economic incentive to evade. Therefore, according to such a classical approach, reducing economic

incentives by increasing the probability of detection and/or the penalties effectively increases tax compliance

Study entitled Determinants of Tax Audit Effectiveness by (Tefera, 2021): In Case of Gondar Zone Revenue Authority investigates the factors that affect the effectiveness of tax audit. They find evidence that competency, independency, management support, awareness and attitude of taxpayers are the main factors tax audit effectiveness.

Tax Audit Performance in Ethiopia by (Mihret, 2011): The Case of Western Addis Ababa Large Taxpayers Office evaluates the tax audit performance in Ethiopia in terms of audit coverage, revenue yield and other qualitative measures. It also identifies the factors that affect the tax audit performance and suggests some recommendations for improvement. According to (Mihret, 2011), Ethiopian Revenues and Customs Authority (ERCA) should highly support the information system by making the information system is more appropriate and give relevant and appropriate short term trainings for the existing tax audit staffs those who have not taken any trainings in order to clearly understand the tax legislation, audit manuals, directives, regulations, guidelines, and appropriately manipulate the information system. Moreover, the tax authority should give more attentions for experienced tax audit staffs to maintain for long period of time by different mechanism like covering educational fee in the universities available in order to upgrade the tax audit staffs' education level and giving incentives. Also based on the findings tax legislation has a negative relationship to tax audit effectiveness, the tax authority policy makers should give more attention and revise the tax legislation, directives and regulations in order to the tax audit staffs use it simply and easily.

- Study by (Yeshiwas, 2019) entitled Assessment of Tax Audit Practice in Addis Ababa City Government Revenue Authority in the case of Addis Ababa No. 1 Medium Tax Payers Branch Office assesses the tax audit practice, experience and capability of auditors, and the challenges and opportunities of tax audit in Addis Ababa, The researcher recommended; 1) The tax administration must maintain adequate management information system to help taxpayers on time. So that, taxpayers must receive clear, concise and up-to-date information from tax administration; 2) Make independent the tax auditors to audit findings to perform their tax audit work effectively and efficiently, 3) Should have organized offices to perform tax audit, it needs to put taxpayers' document in safe way and easily to perform their tax audit work, 4) Payers Branch Office to give more attention for the tax auditor continuous training should be provided,

working environment should be improved and, maintaining tax fairness and equity, building capacity of the tax authority, conducting extensive awareness creation programs, and also to maintain public trust and confidence in the performance of tax administration.

Mohammed et al., (2018) introduces the concept of tax evasion, its causes, consequences and remedies under Ethiopian tax laws and Suggested Organizations should emphasize the moral obligation to pay taxes through training and communication programs. In addition, they should increase awareness of social norms: through campaigns and training programs. This can help to increase the perception of social pressure to pay taxes and reduce tax evasion. Provide tax knowledge training: training to employees, especially to those who are responsible for tax payment. Moreover, they should ensure tax fairness: Organizations should ensure that the tax system is perceived as fair by taxpayers. This can be achieved through transparency in the tax system, clear communication of tax policies and procedures, and appropriate distribution of tax revenue. Monitor tax compliance rates: to identify any patterns or trends in tax evasion. This can help to target areas where tax evasion is more likely to occur and take appropriate action. Enforcing consequences for tax evasion: to deter employees from engaging in such behavior. This can include penalties, fines, or legal action if necessary. Enforcing consequences sends a clear message that tax evasion will not be tolerated and helps to maintain the integrity of the tax system.

Beyene, (2021) examines the extent, causes and effects of tax evasion among small taxpayers in Lideta Sub City, and proposes some strategies to reduce tax evasion. The branch office needs to implement strong tax assessment and has to have satisfactory audit coverage to deliver the aspiration of helping customers to pay the right tax at the right time and with the minimal administrative and compliance cost to both the tax office and customers. The tax office needs to strengthen itself by educating and training its employees, by computerizing and system support its operations, and devoting additional resources. Facilitate detection and successful prosecution of certain classes of tax evasion. Taxpayers tend to evade tax to the extent they feel that the tax office is weak and unable to enforce the law. Therefore, the branch office needs to be strong enough in order to implement the tax law effectively and efficiently. Efficient service delivery to taxpayers is a key factor against which the strength of the branch office is judged. The branch office needs to do much on creating compliant attitude and perceptions among the tax payers in which it could put in to practice that self-assessment, self-payment and law abidance by tax payers to its maximum level. Moreover, tax payers need to have positive attitude towards the tax system and tax rules, regulations and proclamations that the branch office is responsible to implement.

Netsenet (2014) has attempted to analyse the existing tax audit practices and its performance in the Hawassa city revenue authority. According to this study, the revenue authority audit department has been applying compressive audit intensively and there is less flexible tax audit programme. The authority has not used different types of audit options in relation to simplicity and complexity of the audit cases. The study also identified that there is unreasonably consumption of audit resources as well as increase the hard ship associated with repetitive audits for fully compliant tax payers.

Getaneh, (2011) assess the problems of tax audit practice and its effects on tax collection and voluntary tax compliance behaviour by the tax payers in Ethiopian tax system. The findings of this study indicated that tax audit programme of Ethiopia federal government remains undeveloped with an emphasis on compressive and desk audit with the exclusive of other tax audit types which are known in empirical world. In addition, even though the audit programme performed in federal government of Ethiopia could detect non-compliance behaviour of individual tax payers, and used as a compliance enforcements tool to collect unpaid or evaded tax return and to ensure the deferent efficient, its tax audit practice is still a weak tool in improving voluntary compliance through helping tax payers to understand their tax and customs obligation that could generate the right tax revel at the right time.

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

2.4. Summary and Knowledge Gap

Tax audit practices are a current issue for both developing and developed countries. Here is a summary of the knowledge gap on tax audit practice on tax evasion in Addis Ababa:

There is a lack of empirical evidence on the effectiveness of risk based tax audit in Ethiopia, especially in the small taxpayer segment. In addition, there is a need to assess the challenges and opportunities of tax audit practice in Addis Ababa City Government Revenue Authority, such as the adequacy of resources, the quality of audit reports, and

the compliance level of taxpayers. There is a gap in understanding the factors affecting tax audit performance in Ethiopia, such as the audit planning, the audit techniques, the audit feedback, and the audit follow-up.

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 compliance improvements and fraud detection, and the impact of competent reporting requirements on taxpayer's incentives to misstate the tax liability.

Based on these gaps in the literature together with the problems stated in chapter one and in order to attain major objectives of the study, the following research questions were addressed. How audits practices are affecting tax evasion in kolfe keraniyo sub city small tax payers with respect examined challenges and practices of tax audit, the effectiveness of audit program in terms of improving voluntary compliance, tax revenue performance, audit coverage achieved, audit case selection methods used, examination techniques applied, and availability of audit resources, proficient and experienced tax auditors in particular.

2.5. Conceptual Frame work.

A conceptual framework illustrates the expected relationship between variables. It defines the relevant objectives for research process and maps out how they come together to draw coherent conclusions (www.scribbr.com, 2022)

This study conceptualises tax evasion is directly affected by tax audit practices and it's moderately affected by case selection strategies, audit resources and tax audit quality mechanisms. The overall framework to be followed for the literature review of determining the factors that causes tax evasion is

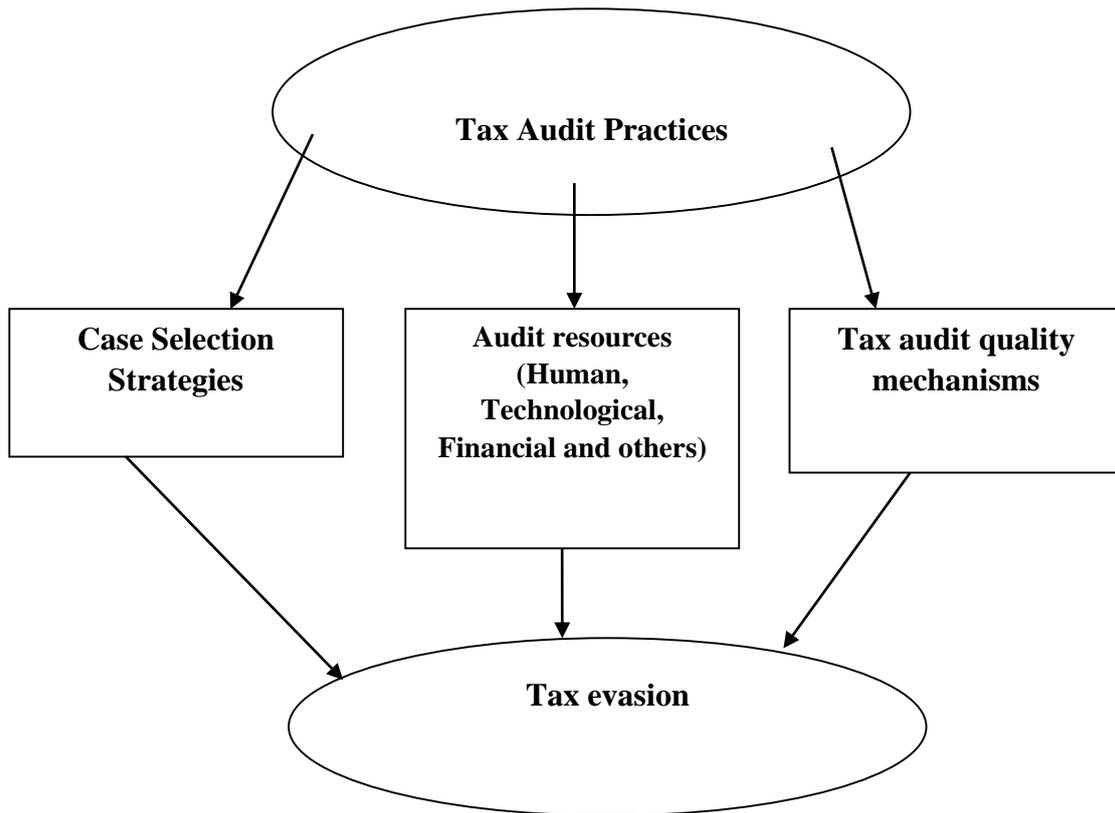


Figure 4- Conceptual framework (self-developed), September 2023,

CHAPTER - THREE

RESEARCH METHODOLOGY

This section deals with research design and methods, source of data, samples and sampling techniques, data collection instruments, procedures of data collection and methods of data analysis.

3.1. Research design

Research designs are plans and the procedures for research that span the decisions from broad assumptions to detailed methods of data collection and analysis (Creswell, 2009). A research design presents a frame work or arrangements of action for study.

The main objective of this study is to assess tax audit practice and evaluate its impact on reducing tax evasion. Thus, the study employs a descriptive research design. Descriptive research design describe data on variables of interest, provide an accurate and valid representation of the factors or variable that pertain or relevant to the research question.

3.2. Research approaches

According to Cresswell (2003), there are three types of research approach; qualitative, quantitative and mixed. This study employ quantitative research approach because it assess the tax audit practice and evaluate its effect on tax evasion.

3.3. Population of the study

Population refers to a set of people or items with similar characteristics that a researcher intends to study and to draw statistical inferences or conclusions (Gall et al., 2006). The population of the study comprised of kolfe keraniyo sub city taxpayer's branch office, thus the population to this study were consists of 18 tax auditors, 2 official and 270 registrant small taxpayers (taxpayers` service database, 2014 E.C) was taken as a target area for the research.

3.3.2. Sampling sample size and sampling technique

A sample design is definite plan for obtaining a sample from the sampling frame. It refers to the technique or the procedures the researchers would adopt in selecting some sampling units from which inferences about the population is drawn.

The population to this study were consists of 18 tax auditors, 2 official and 270 registrant taxpayers (taxpayers` service database, 2014 E.C) was taken as a target area for the research.

Since their numbers are manageable, the tax auditor's team (18), and the officials team (2) was chosen purposefully with census sampling technique. However, the sampling techniques for the registered small taxpayers (270) were chosen by using the following formula for determining sample sizes.

According to Yamane, (1967) for any sample given the estimated population proportion of 0.05 and 95% confidence level, the sample size is given by

$$n = \frac{N}{1 + N(e)^2}$$

Where

n= is the sample size

N= is the total population size, and

e= is the level of precision or sampling error = (0.05), Taro Yamane (1973)

Therefore, the sample size for the general employee is calculated as;

$$n = \frac{270}{1 + 270(0.05^2)} = 161$$

Therefore, the total sample size for this study was the sample of 18 tax audit team, 2 officials and 161 registered tax payer a total of 181 respondents.

3.4 Data sources and data collection methods

In this study, both the primary and secondary data was used to get adequate information about the assessment of tax audit practice and its effect on reducing tax evasion in kolfe keraniyo sub city taxpayer's branch office.

Primary data used to get first-hand information from tax payers, officials and tax auditors through questionnaires. Secondary data used to strengthen the primary sources of the study. Hence, Secondary data are also collected from audit file by referring previous documents and bulletins issued by the tax office.

The researcher used English and Amharic Self-developed questionnaire for both audit officers and for tax payers respectively, the questionnaire have six sections and the questions are close ended which focus on the objectives of the study, With respect to this, Creswell (2003) instruments help the researcher to combine strengthen and amend some of the inadequacies and for triangulation of the data.

3.5 Data analysis methods

After the questionnaires were collected, the data obtained from the respondents was first tailed and coded in to SPSS software version 20 and proper analysis was followed.

Therefore, detail descriptive statistics mean, standard deviation and percentages are used to make the analysis based on each objectives of the study. Finally the findings were present using tables, charts, and graphs.

3.6. Reliability and validity

3.6.1. Reliability

The accuracy of primary data is critical because the study relies heavily on respondents' opinions. The research tools was written in plain and clear language to ensure that respondents understand what each question is asking, and a series of questions is requested to maximize the possibility of a consistent answer. The comprehensive survey was carried out by ensuring that the validity question was addresses and that researchers followed scientific research processes. A reliability coefficient of 0.70 or above was regarded as acceptable. From our test our SPSS obtained Cronbach's Alpha of 0.839.

Before the main study started, a pilot study was carried out with randomly selected 5 taxpayers from each category of "A" and category "B" taxpayers from the branch office to check the validity and reliability of the questioners. Based on the result from pilot study, the questionnaire was translated into Amharic language in order to simplify the understanding of the question by the respondents.

3.6.2. Validity

The extent to which differences identified using a measuring instrument represents genuine differences between individuals being evaluated is referred to as validity (Kothari, 2004) . The most important criterion is validity, which reveals how well an instrument measures what it is designed to assess. To ensure quality, the researcher was checked the research's substance and construct validity. According to (Kothari, 2004), content validity is a measure of how well a measuring instrument/s provides adequate coverage of the topic under investigation and how well it provides adequate coverage of the topic under study, whereas construct validity is the degree to which test scores can be accounted for by the defining construct of a sound theory. The questionnaire was examined for validity.

3.7. Ethical Considerations

In this study the researcher were consciously consider ethical issues in seeking consent, avoiding deceptions, maintaining the confidentiality, respecting the privacy and protecting the anonymity of respondents that was participated in the study.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRITATION.

This chapter presents the data analysis carried out based on the methodology described in the chapter three. A questionnaire was distributed to the targeted sample representative which is 181 and the responses from the questioners have been collected. The response rate was 100%. The researcher strictly follow up in order to have full and completed responses. The entire returned questionnaires were completed and useful for analysis. The data was thereafter subjected to analysis and interpretation. Discussions of the study's findings were also made by contrasting the findings with the literature review and empirical evidence.

4.1. Demographic characteristics

Table 1 presents the demographic characteristics of respondents. Among the 181 participants, 105 of them are male and 76 respondents are female which is 58 percent and 42 percent respectively. Both gender are represented well, it's helpful to have good perception from both group about tax audit practice and its impact on tax evasion form Addis Ababa city administration small tax payer's branch office.

Table 1: Demographic characteristics of respondents

Descriptions	Categories	Frequency	Percent
Sex	Male	105	58.0
	Female	76	42.0
Age	18-27	22	12.2
	28-37	78	43.1
	38-47	46	25.4
	48-57	35	19.3
Education background	below Certificate	128	70.7
	Diploma	24	12.2
	First Degree	22	13.3
	Second degree and above	7	3.9
service year	1-5 year	98	54.1
	6-10 year	45	24.9
	11-15 year	29	16.0
	more than 16 year	9	5.0
Working Position	tax Auditor	18	9.9
	Officer	2	1.1
	Tax payers	161	89.0
Marital status	Married	108	59.7
	Single	71	39.2
	Divorced	2	1.1
	Total	181	100.0

Source: own survey 2023

In terms of age, 12.2 percent of them are from age group 18-27 and 43.1 percent of them are from age group 28-37, 25.4 percent of them are from age group 38-47, 19.3 percent of them are from age group 48-57, this indicate that most of the participants are young aged and middle aged.

The education background of the respondents shows that most of the participants are not equipped with higher level of education with 70.7 percent represent below certificate graduate and 12.2 percent had diploma, 13.3 percent had degree and the remaining 3.9 had master's level graduate. Hence, it is difficult to say most of the tax payers in the study area have a much better understanding about the subject matter as clearly. Among the 181 participants 108 of them are married and 71 are single and 2 of them are divorced which 59.7 percent, 39.2 and 1.1 percent respectively.

4.2. Results

In this section the detail description and analysis of tax audit practice and its impact on tax evasion from Addis Ababa city administration small tax payer's branch office was presented. The analysis and discussion on results is made concurrently.

4.2.1. Tax audit case selection strategies

Table 2 presents tax audit case selection strategies of small tax payers. Measures of central tendency were computed to summarize the data for the Tax audit case selection strategies variable. Measures of dispersion were computed to understand the variability of scores for this variable. The following are the results of this analysis;

$N = 181$, $M=2.71$, $SD=0.55$. When we look at the mean, it appears that, the overall Tax audit case selection strategies in the study area were poor. However, based on the small standard deviation, it looks like that the Tax audit case selection strategies varied quite small.

In general the majority of responses from the data analysis indicate that Audit case selection is not done in cooperation with taxpayers $M=1.92$, $SD=0.59$, were as tax payers are not selected using statistical techniques using prior tax audit results $M=2.04$, $SD=0.60$, and furthermore, audit case selection has not done based on the business sectors $M=2.04$, $SD=0.54$.

According to (Ojulong et al., 2017) when selecting cases for audit, it is important to maintain a cooperative relationship with taxpayers. This is because the role of revenue authorities is to maintain and improve compliance, and this can be achieved through assistance, education, and enforcement. Good case selection leads to more effective audits which means more compliance and ultimately more revenue is collected (Ojulong et al., 2017). Furthermore, according to (Elliott & Rogers, 1972) there are various statistical techniques that can be used for selecting taxpayers for audit. The objective of this technique is to maximize the effective use of statistical sampling in tax examinations, and at the same time, ensure that estimates of adjustments to tax liabilities resulting from statistical samples are statistically sound and legally defensible. In general when selecting cases for audit, it is important to consider the different business sectors. According to a handbook by the Pacific Islands Tax Administrators Association, case

selection is about effective use of the audit or enforcement resource (Boskou, Kirkos, & Spathis, 2019).

Table 2: Tax audit case selection strategies

SN.	Descriptions	Mean	SD
1	Audit case selection is done with cooperation of taxpayers to give essential information for performing an audit.	1.92	.59
2	Taxpayers are selected based on associated compliance risk	3.79	.46
3	Audit case selection is based on the availability of resources for tax audit	3.70	.51
4	Selection is based on taxpayers' high tax potential	3.59	.67
5	Serious evasion and fraud are basis for selection	3.73	.67
6	The office selected taxpayers using Statistical techniques using prior tax audit results	2.04	.60
7	Automated risk scoring system that identifies risk of noncompliance is the possible techniques in selecting	2.17	.58
8	Audit case selection has been done based on the business sector	2.04	.54
9	The tax audit department has selected audit cases randomly without any analysis	2.01	.51
10	Auditors select audit cases manually based on their own knowledge about taxpayers behavior and environment	2.09	.43
	Overall mean	2.71	.55

Source: own survey, 2023

4.2.2. Tax audit resources

Table 3 presents the summary on tax audit resources. For the tax audit resource variable, measures of central tendency were computed to provide a summary of the data. In order to comprehend the scoring variability for this variable, measures of dispersion were generated. The analyses' findings are as follows: $N = 181$, $M = 2.18$, $SD = 0.56$. The general quality of the tax audit resource in the research region appears to have been low when we look at the mean. However, it appears that the tax audit resource fluctuated very little, based on the modest standard deviation.

Additionally, the majority of replies from the data analysis show that the tax audit department lacks sufficient audit employees to handle all sorts of tax audits. $M=2.12$, $SD=0.52$, lack of qualified and experienced staff $M=2.04$, $SD=0.45$, lack of well-organized structure and appropriate office $M=2.58$, $SD=1.19$, lack of continuous and adequate training for tax auditors $M=2.19$, $SD=.67$, lack of use of advanced and automated technology in the process $M=2.06$, $SD=.54$.

According to (Gramling, Maletta, Schneider, & Church, 2004) increasing the number of audit staff with good qualifications and adequate training can help organizations improve their financial reporting processes, reduce the risk of fraud and errors, and enhance their reputation. Furthermore, organized and appropriate office is essential for audit staff. A well-organized office can help audit staff work more efficiently and effectively, which can ultimately lead to better outcomes for the organization (Lehmann, 2020).

Table 3: Tax audit resource

SN	Discretions	Mean	SD
1	The tax audit department has enough audit staffs for all tax audit types	2.12	.52
2	Qualified audit staff/well experienced staff are available	2.04	.45
3	Well organized structure and suitable office	2.58	1.19
4	Continuous and sufficient trainings for tax auditors	2.19	.67
5	The authority uses advanced and automated technology in the process	2.06	.54
6	Enough materials and equipment for audit program	2.11	.55
	Overall mean	2.18	.56

Source: own survey 2023

According to (Fedyk, Hodson, Khimich, & Fedyk, 2022) Audit software can help with risk assessment, building an audit plan, completing the audit work, performing reviews, creating an audit report, creating audit committee reports, and following up on open issues .

4.2.3. Tax audit program

Table 4 presents tax audit quality maintaining mechanisms. In order to comprehend the scoring variability for this variable, measures of dispersion were generated. The study's findings are as follows: N = 181, M = 2, 60, SD = 0.67. When we look at the mean, it seems that the investigation area's overall tax audit program was unsatisfactory. However, it appears that the tax audit program changed very little, based on the minimal standard deviation.

Furthermore, the majority of replies from the data analysis show that they don't Use taxpayers segmentation for tax audit M=2.25, SD=0.66, they don't apply standard risk identification criteria to identify highly risky business for audit M=2.96, SD=.62, the audit work would not started and completed within a predetermined timeframe M=2.01,

SD=0.45, and the office don't have a risk-based tax audit strategy by identified risk scoring criteria M=2.17, SD=.68.

Table 4: Tax audit quality maintaining mechanism

SN	Discretion	Mean	SD
1	Use taxpayers segmentation for tax audit	2.25	.66
2	Audit is performed based on audit manual	3.50	.75
3	Effectiveness of tax audit is measured by volume of the audit performed	2.98	.68
4	Effectiveness of tax audit is measured by enhanced tax compliance and revenue collection	3.56	.72
5	Continuous and sufficient trainings for tax auditors	3.40	.76
6	Apply standard risk identification criteria to identify highly risky business for audit	2.96	.62
7	The audit work is started and completed within a predetermined timeframe	2.01	.45
8	The office have a risk-based tax audit strategy by identified risk scoring criteria	2.17	.68
	Overall mean	2.85	.67

Source: own survey 2023

According to a report by the World Bank, risk-based tax audits, which involve segmenting taxpayers based on their risk profile, have been shown to be effective in improving tax compliance and revenue collection (Khwaja, Awasthi, & Loeprick, 2011). According to the International Monetary Fund (IMF), risk-based tax audits, which involve segmenting taxpayers based on their risk profile, can be an effective way to improve tax compliance and revenue collection (Abdullatif & Kawuq, 2015). Furthermore, the auditor may need to perform further audit procedures in response to an identified and it is required that all misstatements are communicated to management on a timely basis, along with a request to amend the misstatement identified (Hiles, 2012).

4.2.4. Tax evasion

Table 5 presents the respondents perception on the tax audit practices. The data for the tax evasion variable were calculated as measures of central tendency. In order to comprehend the scoring variation for this variable, measures of dispersion were generated. The analysis findings are as follows: N = 181, M = 2.90, SD = 1.05. The mean suggests that respondents in the research location had a low level of general knowledge about tax evasion. However, it appears that there was a significant amount of variation in tax evasion based on the large standard deviation.

Additionally, the majority of responses from the data analysis argue the idea that the rise of tax evasion were reduce the amount of government services provided $M=2.53$, $SD=0.74$, and they disagree with the idea that tax evasion were harm the country's capacity to grow its economy $M=2.71$, $SD=1.23$. Additionally, they responded that tax evasion doesn't cause the government to incur needless debt in order to close the budget imbalance $M=2.45$, $SD=1.05$.

Table 5: Tax evasion practices

SN	Descriptions	Mean	SD
1	The expansion of tax evasion were increase the amount of resources accumulated by the individuals	3.93	1.18
2	The expansion of tax evasion were reduced the amount of public services supplied by the government	2.53	.74
3	Tax evasion has a negative consequences for economic growth of a country	2.71	1.23
4	Tax evasion lead the government to unnecessary debt to bridge the fiscal gap	2.45	1.05
	Overall mean	2.90	1.05

Source: own survey 2023

When tax evasion occurs, it can lead to a reduction in the amount of revenue that the government collects, which can in turn lead to a reduction in the amount of government services provided to citizens (Cockfield, 2020). Tax evasion is a serious issue that can have a significant impact on a country's economy. When individuals or businesses evade taxes, they are not contributing their fair share to the government's revenue, which can lead to a decrease in public spending on essential services such as healthcare, education, and infrastructure (Gale & Krupkin, 2019).

4.2.5. Tax Audit and Tax Evasion

According to the questioners sent to the respondents, the majority of respondents strongly believe that tax audit increases the compliance level of taxpayers. They contend that 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

According to the table below the taxpayers with positive attitude to the tax audit authorities or trusting tax authorities was very good and strongly agree tax audit helps to improve voluntary tax compliance N= 181, M=3.08, SD= .92 and Taxpayers with positive attitude towards tax audit will tend to be more complaint, whereas taxpayers with negative attitude towards tax evasion will be more compliant. Hence, it is concluding that a majority respondent suggests taxpayers with positive attitude towards tax audit are more complaint.

Many respondents suggest that tax audit is a sole treatment for compliance risk available to administrations that allows exercising effective sanctions (imprisonment and penalties and/or interest). Tax evasion can be brought to light only by a means of an effective audit program. The tax audit program provides visibility to the compliance and enforcement arm of the tax administration. Most tax payers strongly agree that Tax audit to determine the taxpayer’s correct tax liabilities for a particular accounting or tax period with examination of taxpayers’ organizational procedures and financial records in order to assess compliance with tax laws and verify the true, fair, reliable, and accuracy of tax returns and financial statements.

As majority respondents showed, tax audit is performed to ensure compliance in accordance with tax law. The tax audit is also conducted to assess and collect additional tax revenue, check tax evasion or fraud, and educate taxpayers. Last five years the number voluntary compliance became increasing year to year so that when taxpayers are increased then the tax revenue also increased.

S.N	Descriptions	Mean	SD
1	Tax Audit enhances tax payers compliance level	3.65	.97
2	Tax payers attitude towards auditing	2.96	.76
3	Audits are usually conducted to prevent tax evasion	2.56	.80
4	Tax evasion could be easily handled through auditing	3.96	.96
5	The tax audit makes the tax payers to render a satisfactory return.	2.25	.56
	Overall mean	3.08	.81

Source: own survey 2023

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary of the Finding

The aim of this study were to assess the tax audit practice and evaluate its effect on tax evasion in Addis Ababa city administration kolfe keraniyo, sub-city small tax payer's branch office. A descriptive research design was employed, questionnaire were used as data collection method. The population of this study consists of 18 tax auditors, 2 official and 270 registrant taxpayers (taxpayers` service database, 2014 E.C), 161 samples from the tax payer was drown for this study. The final sample of the study were 181 respondents. The summary of findings from the data analysed are presented below.

- The overall mean and standard deviation ($M=2.71$, $SD=0.55$) indicates that the tax audit case selection strategy in the selected area was poor.
- The responses from the data analysis indicate that Audit case selection is not done in cooperation with taxpayers $M=1.92$, $SD=0.59$, were as tax payers are not selected using statistical techniques using prior tax audit results $M=2.04$, $SD=0.60$, and furthermore, audit case selection has not done based on the business sectors $M=2.04$, $SD=0.54$.
- The overall mean and standard deviation ($M = 2.18$, $SD = 0.56$) indicates that the tax audit resources are not well equipped.
- The majority of replies from the data analysis show that the tax audit department lacks sufficient audit employees to handle all sorts of tax audits. $M=2.12$, $SD=0.52$, lack of qualified and experienced staff $M=2.04$, $SD=0.45$, lack of well-organized structure and appropriate office $M=2.58$, $SD=1.19$, lack of continuous and adequate training for tax auditors $M=2.19$, $SD=.67$, lack of use of advanced and automated technology in the process $M=2.06$, $SD=.54$.
- The study's findings from the tax audit program shows, $M = 2, 60$, $SD = 0.67$ which shows unsatisfactory tax audit program.
- the majority of replies from the data analysis show that they don't Use taxpayers segmentation for tax audit $M=2.25$, $SD=0.66$, they don't apply standard risk identification criteria to identify highly risky business for audit $M=1.96$, $SD=.62$, the audit work would not started and completed within a predetermined

timeframe $M=2.01$, $SD=0.45$, and the office don't have a risk-based tax audit strategy by identified risk scoring criteria $M=2.17$, $SD=.68$.

- The analysis findings of tax evasion with ($M = 2.90$, $SD = 1.05$.) which indicates that respondents in the research area had a low level of general knowledge about tax evasion and its effect on the economy of the country.
- The data analysis argue the idea that the rise of tax evasion will reduce the amount of government services provided $M=2.53$, $SD=0.74$, and they disagree with the idea that tax evasion will harm the country's capacity to grow its economy $M=2.71$, $SD=1.23$. Additionally, they responded that tax evasion doesn't cause the government to incur needless debt in order to close the budget imbalance $M=2.45$, $SD=1.05$.

5.2. Conclusion

This study's objective was to evaluate Addis Ababa city administration's kolfe keraniyo, sub-city small tax payer's branch office's tax audit case selection process, audit program, and tax evasion. Data was obtained from 181 respondents using a cross-sectional study methodology, and the conclusion from the summary of the findings was as follows:

- According to the study's findings, there were almost more male respondents than female respondents. Most of the men were also younger, and less educated, and most of them were married. The vast majority of responses are tax payers, auditors, and officials, all of whom have a direct stake in the majority of the issues at hand. The auditor and official are front-line employees who spend most of their time carrying out these routine taxing duties.
- The investigation concludes that the selection of audit cases is not done in collaboration with taxpayers that taxpayers are not chosen using statistical methods based on the outcomes of previous tax audits, and that the business sectors are not taken into consideration.
- The tax audit department also requires a sufficient number of skilled audit professionals, a suitable office with a well-organized structure, ongoing training for tax auditors that is adequate, and the use of modern and automated technology.

- The audit work would not begin and be finished within a predetermined timeframe, and the office lacks a risk-based tax audit strategy by identified risk scoring criteria. In addition, the auditor does not use taxpayer segmentation for tax audits, and they do not apply standard risk identification criteria to identify highly risky business for audit.
- According to the data summary, the growth in tax evasion won't result in a reduction in the number of services supplied by the government, and tax evasion won't have a negative impact on the nation's ability to expand its economy. They further argued that tax fraud doesn't result in the government taking on extra debt in order to balance the budget.

5.3. Recommendation

The aim of this study were to assess the tax audit case selection mechanism, audit program, and tax evasion in Addis Ababa city administration kolfe keraniyo, sub-city small tax payer's branch office. Therefore based on the finding of the study the following recommendation was forwarded.

- The result indicates audit cases selection is not done in collaboration with taxpayers, & the taxpayers are not chosen using statistical methods, and the business sectors are not taken into consideration, therefore it is recommended that the tax auditor should consider the business sector when selecting audit cases and should applying different statistical methods for audit cases selection that can help them to obtain sufficient and appropriate audit.
- It is recommended that the auditor's office should enhance tax audit staff skills through on-going training on the use of modern and automated technology. This is because auditors who are proficient with technology can apply it to their audit work, saving countless hours by automating tedious manual tasks. Therefore, it is advised to develop cutting-edge, automated technology that may aid tax auditors in increasing their accuracy and efficiency.
- The analysis result shows that the audit office lacks a risk-based tax audit approach, that the auditor does not segment taxpayers for tax audits, and that they do not employ conventional risk identification criteria. It is thus recommended that tax auditors develop a risk-based tax audit approach that entails identifying high-risk taxpayers and giving them priority for audit. To

create suitable risk-based selection strategies and risk-scoring systems, it is important to segment the taxpayer population. To evaluate the risks related to various taxpayer segments in the research area, standard risk identification criteria must be applied.

- The study's findings show that taxpayers have a limited understanding of tax evasion; consequently, it is recommended that governments should raise taxpayers' awareness of tax evasion by creating workshops and seminars, publishing educational posts, and launching awareness campaigns through various media. These actions can assist people in comprehending the value of paying taxes and the implications of tax evasion. It is further advised that the government should modernize the tax structure and increase transparency.

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Appendix

ST. MARRY UNIVERSITY



School of Business and Economics

RESEARCH QUESTIONNAIRES

Dear Sir/Madam

The questionnaire is designed to collect primary data for conducting a study on “the assessment of tax audit practice and its impact on tax evasion: empirical evidence from Addis Ababa city administration small tax payer’s branch office in partial fulfillment of master’s degree at St. Marry University.

Hence the honesty and reliability of your information is highly required.

Your information will be used for research purpose only and your response is confidential to keep your response.

Choose the appropriate alternative and tick mark (✓) on the space provided.

Best regards

LEDET DAGNE DEBELA

JULY 2023

ADDIS ABABA, ETHIOPIA

SECTION A - Personal Information/respondents profiles

1. Sex A) Female B) Male
2. Age A) 18-27 B) 28-37 C) 38-47 D) 48-57 above 58
3. Qualification A) Certificate B) Diploma C) First degree D) Second Degree and above
4. Year of service/ 1-5 year 6-10 10 and above
5. Marital status A) Single B) Married C) Separated/Divorced
6. Your Current job occupation A) Tax auditor B) Officials C) Tax payers

Section B: questionnaire related to tax audit case selection strategies

Rating Scale 1= strongly disagree 2= disagree 3 = neutral 4 = agree 5=strongly agree

No	Question Items	1	2	3	4	5
1	Audit case selection is done with cooperation of taxpayers to give essential information for performing an audit.					
2	Taxpayers are selected based on associated compliance risk					
3	Audit case selection is based on the availability of resources for tax audit					
4	Selection is based on taxpayers' high tax potential					
5	Serious evasion and fraud are basis for selection					
6.	The office selected taxpayers using Statistical techniques using prior tax audit results					
7	Automated risk scoring system that identifies risk of noncompliance is the possible techniques in selecting					
8	Audit case selection has been done based on the business sector					
9	The tax audit department has selected audit cases randomly without any analysis					
10	Auditors select audit cases manually based on their own knowledge about taxpayers behavior and environment					

Section C: questionnaire related to tax audit resources

Rating Scale 1= strongly disagree 2= disagree 3 = neutral 4 = agree
5=strongly agree

No	Question Items	1	2	3	4	5
1	The tax audit department has enough audit staffs for all tax audit types					
2	Qualified audit staff/well experienced staff are available					
3	Well organized structure and suitable office					
4	Continuous and sufficient trainings for tax auditors					
5	The authority uses advanced and automated technology in the process					
6.	Enough materials and equipment for audit program					

Section D: questionnaire related to tax audit program

Rating Scale 1= strongly disagree 2= disagree 3 = neutral 4 = agree
5=strongly agree

No	Question Items	1	2	3	4	5
1	Use taxpayers segmentation for tax audit					
2	Audit is performed based on audit manual					
3	Effectiveness of tax audit is measured by volume of the audit performed					
4	Effectiveness of tax audit is measured by enhanced tax compliance and revenue collection					
5	Continuous and sufficient trainings for tax auditors					
6.	Apply standard risk identification criteria to identify highly risky business for audit					
7	The audit work is started and completed within a predetermined timeframe					
8	The office have a risk-based tax audit strategy by identified risk scoring criteria					

Section E: questionnaire related to tax evasion

Rating Scale 1= strongly disagree 2= disagree 3 = neutral 4 = agree
5=strongly agree

No	Question Items	1	2	3	4	5
1	The expansion of tax evasion will increase the amount of resources accumulated by the individuals					
2	The expansion of tax evasion will reduced the amount of public services supplied by the government					
3	Tax evasion has a negative consequences for economic growth of a country					
4	Tax evasion lead the government to unnecessary debt to bridge the fiscal gap					

Section F: questionnaire related to tax Audit and tax evasion

Rating Scale 1= strongly disagree 2= disagree 3 = neutral 4 = agree
5=strongly agree

No	Question Items	1	2	3	4	5
1	Tax Audit enhances tax payers compliance level					
2	Tax payers attitude towards auditing					
3	Audits are usually conducted to prevent tax evasion					
4	Tax evasion could be easily handled through auditing					
5	The tax audit makes the tax payers to render a satisfactory return.					

Thank you for your cooperation