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**ASSESSMENT OF TAX AUDIT PRACTICE: THE CASE OF
HAWASSA CITY ADMINISTRATION**

**ATHESIS SUBMITTED IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR THE DEGREE OF MASTERS
IN ACCOUNTING AND FINANCE**

BY:

NETSANET BIBISSO

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HAWASSA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS SCHOOL OF
MANAGEMENT AND ACCOUNTING
HAWASS, ETHIOPIA

JUNE, 2014

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We, the undersigned, members of the Board of Examiners of the final open defense by Netsanet Bibisso have read and her thesis entitled “**Assessment of tax audit practice: The case of Hawassa City Administration**”, and examined the candidate. This is, therefore, to certify that the thesis has been accepted in partial fulfillment of the requirements for the degree of Masters of Science in Accounting and Finance.

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ACRONYMS

BoFED	Bureau of Finance and Economic Development
BPR	Business Process Reengineering
GDP	Gross Domestic Product
EC	European Commission
ECC	Ethiopian Chambers of Commerce
ERCA	Ethiopia Revenue and Custom Authority

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MoFED	Ministry of Finance and Economic Development
NGO	Non-Governmental Organization
OECD	Organization for Economic Co-operation and Development
RAP	Repetitive Audit Procedure
RRCA	Regional Revenue and Customs Authority
SIGTAS	Standard Integrated Government Tax Administration System
SNNPR	Southern Nations Nationalities and People's Region
VAT	Value Added Tax

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ABSTRACT

The study was focused on assessing tax audit practice of Hawassa city administration Revenue Authority. Mixed research approach and descriptive survey was employed. Questionnaire and interview were used to collect data..Questionnaire and interview was designed to eleven tax auditors and seven Revenue Authority officials respectively. It is challenging to get secondary data from the authority due to documentation problem and reluctance of some officials to provide the required data. But the researcher used different techniques to get the required data.The result of the study revealed that the Revenue Authority of Hawassa city administration extensively use comprehensive types of audit. Due to this the audit coverage of the revenue authority was too low, cases were selected based on associated risk but not used the standard risk identification criteria as of BPR.The Authority was not perform the audit work in predetermine time. Generally the revenue authority was not performing tax audit according to the standards.

Key words: Taxation, Tax Audit, Audit effectiveness



CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Laymer and Oat (2009) noted that taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago. It becomes an issue of worldwide concern, from the time of its inception. This is due, in great part, to effects on the life of virtually every human being. Taxation has gained importance not only as a tool for raising revenue but also help to meet the administrative costs of governance, the provision of public services such as medical care, education, infrastructure, security and maintenance of law and order, but also as a tool available to planners, policy makers and implementers aiming to regulate the economy in order to bring about desired economic development (Dymond,, 2008).

Developing countries are in difficult situation to provide these basic public goods and services from taxes due to weak tax collection and administration (Damme, 2008). Tax administration is a complex and dynamic responsibility. On a regular basis, leaders are faced with new issues, conflicting priorities, taxpayer compliance and emerging commitments (Thomson 2008).



According to Berhan and Jenkins (2005), the government tries to design different strategies for collection of taxes and give great emphasis on policy and administration of taxes to solve the problem and to generate the required revenue for the public expenditures. A good tax system should not affect the ability and willingness of the people to work, save and invest. If not, it will affect the development of trade and industry and the economy as a whole. Thus, a sound tax system should contribute in the economic development of a country (Ramaswami 2005)

Effective tax administration tries to minimize compliance cost and increase revenue, minimizes distortion of resource allocation and simplifies its administration (World Trade Organization 2003). Tax involves every aspects of income generating activities and consumption items, and requires not only administrative capacity of revenue authority but also the involvement of private sectors through proper accounting and reporting (Tadros 2009).

Tax audit is a detailed exploration into the activities of a taxpayer to determine whether he/she has been correctly declaring the tax liabilities (OECD 2006). The inspection of the taxpayer's activities indirectly drives voluntary tax compliance, and directly generates additional tax revenue collections. As a result, both (compliance by the taxpayers and the additional tax



revenue collected) help tax agencies to reduce the tax gap between the amount due and collected (Barreca and Ramachandran 2004).

According to Biber (2010), tax audit is an examination to determine whether a taxpayer has correctly reported and assessed their tax obligations. However, the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. An effective audit program will have significantly wider impacts than just raising revenue directly from audit activities. By selecting the highest risk cases, efficiently detecting non-compliance, applying appropriate sanctions, and publicizing results of audit activity (either generally or specifically), taxpayers are put on notice that attempting to avoid tax will result in a high likelihood of detection and imposition of significant sanctions. Thereby, a well-planned audit program can provide the administration with significant leverage across the community rather than only impacting on the taxpayer selected for audit and collecting the tax that should have been paid in the first place.

1.2 Statement of the Problem



The primary purpose of taxation is to raise revenue for government expenditures. However, government has several other ways to raise revenue (Morse 2005). Most of the world's governments practice to use taxation in order to raise most of its fiscal requirements. This is because tax is the most viable source of revenue.

Ethiopia made different tax reform for improving revenue generation, enhancing the efficiency of the tax administration and improving equity in the tax system. For instance, the replacement of VAT to the existing sales tax, due to high tax rates, the complexity of tax legislation, complications in the procedures that taxpayers must follow in order to pay taxes, unsatisfactory treatment of taxpayers by tax officials, taxpayer ignorance of the benefit derived from public revenue, a negative image of public administration, a fairly generalized lack of social conscience on the part of the public, weakness in tax administration tax payers were eager to evade the tax. Tax evasion is the commission or omission of an act knowingly, with the intent to deceive, so that the tax reported by the taxpayer is less than the tax payable under the law (Dymond, 2004). It significantly reduces the amount of collectible taxes, that is, the amount of compulsory payment to governments. It also disables them from performing tasks that are constitutionally and legally assigned to them. In reality, under inadequate tax



administration system, the potential amount of tax revenue in developing and transitional countries has not been collected in an efficient and equitable manner (Edmiston and Bird 2004).

Like many other jurisdictions, Ethiopia's tax system is fraught with evasion. One factor that significantly contributes to tax evasion is lack of intensive audits and absence of predetermined audit criteria. Also, the low level of computerization in the ERCA encourages evasion. These means that some tax procedures have to be conducted manually, making it harder to detect evasion (ERCA, 2010).

Hawassa City administration Revenue Authority office 2005 Annual report highlights there is tax evasion and a gap between tax reported by taxpayers and actual taxable income. Tax reported by the taxpayer is less than the tax payable under the law. Increasing operating expenses, exaggerating non –VAT sale, incorporating un related expenses to business are the reasons for decreasing taxable income. The report also shows that the Revenue Authority collects less revenue from business profit tax (63%) compared with the plan. This is due to lack of awareness about taxes by business men, low tax collection and administration system



which leads to tax evasion and tax fraud and in effective tax audit practice (Revenue Authority 2005 annual report).

To solve the above problem effective tax auditing is so vital. Effective tax audit could assist in that direction to monitor tax payers in complying with tax procedures so as to reduce tax evasion and then to increase the revenue generation through tax by creating good tax administration and collection system. This study was focus on assessing Tax Audit practice performance of Revenue Authority.

1.3 Research Questions

The researcher formulates the following research questions:

1. What types of tax audit are frequently performed in the Hawassa City Administration Revenue Authority?
2. How Hawassa City Administration Revenue Authority select cases for audit?
3. What are the factors that hinder effective tax audit program in the city revenue authority?
4. What are the existing performances of Tax Audit in the city?



1.4 Objectives of the Study

1.4.1 The General Objective

The general objective of this study was assessing Tax audit practice of Hawassa city administration Revenue Authority.

1.4.2 Specific Objectives

The specific objectives of the study were:

1. To identify types of tax audit frequently used in the revenue authority
2. To assess tax audit case selection techniques
3. To investigate factors that hinder effective tax audit program in the Revenue Authority.
4. To evaluate the existing performance of tax audit program of Hawassa city administration Revenue Authority

1.5 Significance of the Study

The study would have different significances. In the first place, Revenue Authority understands the existing Tax Audit performance, evaluating Tax Audit practice to make some



adjustment in the procedure and strengthens the weakness of Tax Audit practice. Secondly, it may be helpful for the stake holders and Tax payers to have knowledge on tax audit. Finally, it is an initiation for those who are interested to conduct a detailed and comprehensive study regarding tax audit practice.

1.6 Scope of the Study

The spatial scope of the study was delimited to Hawassa City Administration. The study focuses on the tax audit practices of Hawassa City Administration Revenue Authority on Category “A” and “B” Tax payers. The practice for Category “C” taxpayers have not been treated in this study because category “C” taxpayers are not required by the law to keep their records and they pay tax liability based on the assessment by the revenue authority. There is no document to audit the transaction. The study was limited to Hawassa City Administration because of lack of time and money, and also makes to deal with data that could be handled and managed properly.

1.7. Limitations of the study

Shortages of adequate secondary data and the reluctance of some officials to provide the required data were some of the limitations of the findings. Shortage of time and absence of



research fund were also other limiting factors of the findings of the study. However, necessary precautions were made so that these limitations was not affect the findings of the study through taking appropriate sample size and triangulating different data collection methods.

1.8 Organization of the study

The research is structured in five chapters. The first chapter consists of introduction, statement of the problem being focused, objectives of the study, research questions, significance of the study, scope and limitation of the study and organization of the thesis. The second chapter is concerned with the review of different researches and related literature dealing with the assessment of Tax Audit. Third chapter are presented methodologies used in conducting the study and description of the study area, research design, data sources, sample size and sampling procedures, data collection instruments, data collection procedures and methods of data analysis. Chapter four is the main body of the study results and discussion of statistical data are presented in this chapter. Final chapter recapitulates the study in terms of summary, conclusions and recommendations of the study.



CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Meaning and concepts of Tax

Tax has been defined by various authorities and professionals in various ways. Conceptually, tax can be defined or seen as a compulsory transfer of resources from the private to the public sector (Uremadu, 2000). According to Adesola (1998), tax is a compulsory levy which a government imposes on its citizens to enable it to obtain the required revenue to finance its activities. And the other scholars Lymer and Oats (2009) tax is defined as ‘a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives expenditure, or capital assets, for which the taxpayer receives nothing specific in return’.



2.2 Category of Taxpayers

Taxpayers are grouped in to different categories under the law. According to Ethiopian proclamation number 285/2002, Taxpayers are classified into the following three major categories: Category “A”Taxpayers, Category “B”Taxpayers and Category “C”Taxpayers

Category “A” Taxpayers: Ethiopian Tax proclamation 285/2002 describes category ‘A’ taxpayers as any company incorporated under the laws of Ethiopia or in a foreign country and any business having an annual turnover of Birr 500,000 or more. They are required to submit to balance sheet and profit or loss statements to Revenue Authority at the end of the year. Balance sheet, profit and loss statement incorporate gross profit and the manner in which it is computed, general and administrative expense depreciation expenses and provisions and reserves (ECC, 2005).



Category “B” Taxpayers: Unless not already classified in category “A”, any business having an annual turnover of over Birr 100, 000 would be classified under Category “B” taxpayers. This category of taxpayers should submit to the Revenue Authority profit and loss statement at the end of the year similar to category ‘A’ taxpayers. And Category “C” taxpayers are taxpayers that are

not classified under Categories “A” and “B”, and businesses whose annual turnover is estimated up to Birr 100, 000 are classified under this category of taxpayers. A standard assessment method should be used to determine the income tax liability of category C taxpayers. The taxpayer should pay the tax determined in accordance with standard assessment (ECC 2005).

2.3 Tax gap

Tax gap can be defined by different professionals. Adams (1921) defines that the difference between the taxes that the law seeks to collect and those in fact collected. Andreoni (1998) defines tax gap as if there were 100 percent compliance difference between the actual revenue collected and the amount that would be collected though there are some variations. Tax gap



leads to low revenue collection. Andreoni (1998) represents tax gap happen by means of both tax avoidance and tax evasion.

Similarly, compliance gap is also defined in (FIRA, 2000) as the break between the actual and the potential tax revenue. Tax compliance may be seen in terms of tax avoidance and tax evasion. The two activities are conventionally distinguished in terms of legality, with avoidance referring to legal measures to reduce tax liability and evasion to illegal measures. James (2000) describes tax avoidance as the legal manipulation of an individual's affairs in order to reduce tax. However, if taxpayers go to inordinate lengths to reduce their tax liability, this could hardly be considered 'compliance', even if it were within the letter of the law. Since taxation is not always precise, Seldon (1979) in James et al (2003) has also coined the term 'tax Evasion' to describe circumstances where the law might be unclear.

2.4 Overview of Auditing

As per Auditing and Assurance standard: Basic Principles governing an Audit (AAS 1) Audit published by the Institute of Chartered Accountants of India, Audit refers to the independent examination of financial information of any entity, whether profit oriented or not, and



irrespective of its size or legal form, when such examination is conducted with a view to express an opinion thereon.

According to Spicer and Pegler (2008), “Auditing is such an examination of books of accounts and vouchers of business, as will 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”.

2.5 Meaning of tax audit

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD 2006).



As Biber(2010),Tax audit is extending beyond verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Most taxpayer's report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected. Barreca and Ramachandran (2004) noted that the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations.

2.6 Types of tax audit

There are different types of Tax Audit which are implemented in different countries. Ebrill(2001), Grandcolas (2005), Harrison and Krelove (2005), and Biber (2010) noted that, there are different tax audit program. These are desk audit or verification, field audit, registration check, advisory audit, record keeping audit, refund audit, issue-oriented audit, comprehensive or full audit and fraud investigation.

a) Desk audit or verification



Desk 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 crosschecking 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 (Ebrill,2010).

b) Field Audit

According to OECD (2006), field audit is a types of audit focuses on 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. 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.

c) Registration check

Registration check is a form of unannounced visits to taxpayer's premises for new enterprises (mainly small and medium sized) to detect businesses operating outside the tax system and a



quick check on businesses to establish that they are correctly registered. It should not take more than half a day (OECD, 2006) According to Ebrill (2001) in this visit, the tax officer ensures that the taxpayer: (1) has a basic understanding of their obligations; (2) keeps appropriate records (book keeping review should be mandatory in case of voluntary compliance when the turnover of the taxpayer is below the registration threshold); and (3) issues proper invoices when required by law.

d) Advisory audits

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

e) Record keeping audit

It is unannounced visits to the taxpayers' business premises to check whether the appropriate records are kept and VAT invoices are issued. The visit points out the obligations of the



taxpayer regarding the keeping of records and followed up with penalties if the taxpayer continues to disregard record keeping requirements (OECD,2006).

f) Refund audit

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

g) Issue-oriented audit

According Grandcolas (2005), issue oriented audit focus on a single tax type and covers no more than one or two reporting periods. It should be directed at verifying items for which errors have been detected in the returns (atypical ratios, gross revenues, comparison of gross sales to imports). Single-issue audits are confined to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single-



issue audits typically take less time to conduct and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance (OECD, 2006).

h) Comprehensive or full audit

Ebrill (20011) defined comprehensive audit as comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. This audit may cover all tax obligations over a number of tax periods, or extended to several years up to the limit provided for in the law. All cases where serious underreporting or evasion has been detected under any of other audits should be forwarded to a unit responsible for undertaking comprehensive audits of all tax liabilities. The objective is to determine the correct tax liability for a tax return as a whole. As this audit is usually time consuming and costly to undertake, it should only be applied to those taxpayers if there is an indication of under reporting that may impact across taxes. It requires considerable resources and reduces the rate coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types.

i) Fraud investigation



Fraud investigation is a type of tax audit that investigates criminal which arises from where the most serious cases of noncompliance. It helps to detect fraud, evasion, and criminal activity Krelove (2005). Fraud investigation requires special skill including meeting evidentiary requirements, seizure of evidences or records, testimony from key witnesses and preparing briefs for courts. Hence, it should be undertaken in accordance with criminal procedure laws. OECD (2004a) stated that, Revenue authorities should maintain a dedicated organizational unit responsible for the handling of serious cases of tax fraud or evasion. According to OECD 2006 the types of tax audit is categorized in different based on the scope and its intensity of the audit performed. Based on the scope and intensity there are different types of audit activities.

- i. 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.

- ii. 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.

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

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

2.7 The Effective Tax Audit Program

Tax auditing program is a key for tax administration. The tax audit program provides visibility to the compliance and enforcement arm of the tax administration (Thomson 2008). The auditing and spot-checking of records, coupled with a system of adequate penalties for detected cases of fraud, is the universal method for tax control and the prevention of tax



evasion. According to Tait (1988), effective tax auditing minimizes tax evasion and also helps tax agencies to achieve revenue objectives that ensure the fiscal health of the country and individual states. It derives voluntary compliance and generates additional tax collections, both of which help tax agencies to reduce the tax gap between the taxes due and the amount collected (Barreca and Ramachandran 2004). Furthermore, a well-structured tax audit program can provide valuable support in gathering information on the health of the tax system (including patterns of taxpayers' compliance behavior), educating taxpayers (improving future compliance), and identifying areas of the tax law that require clarification or addressing deficiencies in the law (OECD 2006a).

Accurate and timely self-assessment and compliance with tax by taxpayers is achieved only through highly visible and effective audit programs, including the consistent application of strong sanctions where noncompliance is encountered. Taxpayers must feel that there is a good chance that unreported liabilities and other forms of non-compliance have been detected during an audit (Biber 2010). When an audit program is ineffective, it may result in the deterioration of tax compliance and a loss of credibility of the tax administration. Taxpayers may not be deterred from minimizing their tax liabilities if they believe that there is a little chance of being audited (Ebrill et al. 2001). A good audit program employs strategies to



optimize both the direct and the deterrent effects of audits. The first can be achieved by auditing a higher percentage of the large taxpayers (Biber 2010). Although the frequency of audit is a contentious issue, the judgment is always a delicate balance between the treat of audit to check the temptation to evade and the cost. Where the tax system is fairly well established, audits of 15 percent to 20 percent of registered traders a year are sufficient. However, it is not only the crude number of audits that is the most useful measure of need (Tait 1988). In the case of VAT, Ebrill et al. (2001) stated that effective VAT audit program should cover a 25 to 30 percent of the taxpayers each year. In addition, VAT audit need to be closely coordinated with other tax liabilities especially income tax. Since most countries have integrated VAT and income tax administrations, the development of an effective VAT audit program significantly improves income tax compliance.

The deterrent effect is best achieved by extending the program to as many taxpayers as possible at all levels (Tait 1988). Through adequate audit strategy, tax administrations must foster, and not simply enforce, tax compliance. Tax compliance can be facilitated through improving services to taxpayers by providing them with clear instructions, understandable



forms, and assistance and information as necessary. Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance (EC 2006).

Voluntary compliance is generally enhanced by increasing the number of taxpayers audited than by auditing fewer taxpayers with large tax potential. Perversely, revenue is increased by concentrating on those taxpayers where a large amount of revenue is at risk. But there should be a careful planning when there is a widespread belief that most tax returns are underreported, otherwise there may be an over selection of returns for audit, with the result that the inventory of work in process may increase to unmanageable proportions and make an orderly approach to an annual audit work plan impossible (Tait 1988). Thus, the actual number of audits planned should depend on the audit resources available to the program. The international standards as to the total staff assigned to audit should be close to 40 percent of the total staff of the tax administrations (Biber 2010).

Further, audit capacities of field offices are determined by calculating the number of returns that can be audited. The calculation made using estimates of the number of returns each tax auditor can reasonably be expected to complete during a given audit period. There should be



an over selection of 25 percent to 30 percent of audit capacity (Tait 1988). With proper audit planning, strong supervision, and effective use of the review staff as a training vehicle, it is not unreasonable to expect an office auditor to complete an average of 10 to 20 cases a month, and for a field auditor (exclusive of auditors dealing with controlled cases) to complete an average of 4 to 6 cases a month. Allocation of about 200 cases a year should be reasonable for experienced junior auditors, who should be eligible for advancement to senior auditor after four years of satisfactory service in that grade (Tait 1988). Therefore, planning an adequate audit strategy is a key success factor in post-fraud detection (where audits are intended to detect tax evasion and fraudulent claims) as well as proactively preventing tax frauds and evasions (Gupta and Nagadevara undated).

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

According to OECD (2006), effective audit plan should be:



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

2.8 Audit Case Selection Methods

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



the selection of inappropriate audit candidates (Milack undated). Hence, managing an effective auditing program involves decisions as to the selection of best audit case strategy or combination of strategies. The selection strategies may vary by tax type. It may be based on either reported tax amounts or the industry type (Barreca and Ramachandran 2004).

Case selection through the use of risk management techniques is necessary to ensure that the audit program is fully in line with the administration's compliance strategy, and to set up the necessary audit trails to show why cases have, and have not, been made the subject of an audit (OECD 2006). Ebrill et al. (2001) noted that the most effective systems utilize taxpayer profiles and criteria to identify the highest risks for the revenue. These systems are frequently based on the crosschecking of internal information. In tax administration, a risk is anything that can negatively affect the administration's ability to achieve its compliance and revenue objectives. Risk management is a formalized and systematic approach, based on sound analysis, designed to set the best course of action under the uncertainty of risk. The technique involves identifying, assessing, understanding and acting on risks that impinge on the organization's ability to achieve its objectives (Thomson 2008).



Risk management starts with risk identification, which includes a rough estimation of the risk related tax gap, the number of taxpayers involved and possible relations with other risk areas (EC 2006). The tax gap (the potential tax yield minus the actual tax revenues) reflects the financial extent of the risk field. Although the determination of the tax gap is not easy, a rough estimation is usually done. The calculated gap can be further broken down into areas such as barely legitimate tax avoidance, fraud, serious noncompliance, error, and debt. This provides additional information on areas of risks that should be addressed. Strictly theoretical, the sum of the aforementioned individual risks identified must be equal to the entire tax gap (EC 2006 and EC 2010). According to EC (2010) and Thomson (2008), compliance risk reduces tax yield, and can be categorized as register risk, filing risk, payment risk, and declaration risk. This classification makes tax administration in a stronger position to determine the appropriate treatment technique.

Register risk includes reduction of tax yield because ineligible taxpayers for tax registration become registered and/or remain registered when eligibility ceases, fail to register by those that fulfill registration requirements, and registration with erroneous information. Payment risk and filing risk are closely related but they should be analyzed separately since the treatments



may vary. Payment risk is non-payment of amounts due on tax returns and assessments whereas filing risk is failure of taxpayers to file their returns by the due date. In order to provide the correct preventive and corrective treatments there is a need to be able to target those taxpayers likely to file their returns late, or not at all. Finally, declaration risk is a risk that the amounts shown on the tax return are incorrect by error or deliberate act and many tax administrations traditionally concentrated on this risk area with the intention of determining which cases should be selected for conducting audit activity (EC 2006 and EC 2010). In addition to compliance risk identification, in an efficient audit management structure, there are pre-audit case management factors that need to be recognized to assure the taxpayers in that the burden of audits not fall disproportionately on any segment. These include inappropriate auditors' contact with taxpayers, audit cycle or enquiry window, materiality, and collectability (OECD 2006).

Inappropriate auditors: It is useful to have regulations to preclude individual auditors from repeatedly auditing the same taxpayer and to require an auditor to exclude itself from taking up an audit where they are acquainted with the taxpayer selected for audit. Such rules protect both auditor and the customer from the danger of such inappropriate contacts. The policy of



repetitive audit procedures (RAP) may be used which holds that if a taxpayer is audited for non-business issues only (similar to an audit aspect) for the current year and the audit results in no additional taxes owed, the taxpayer is granted relief from audit for the next two years if no substantial changes take place. The intent is to eliminate non-productive and time-consuming audits for tax authorities and to reduce the hardship associated with repetitive audits for fully compliant taxpayers (OECD 2006).

Audit cycle or enquiry window: Regulations may be established to require that all audits must be started or completed within a predetermined timeframe. However, it gives certainty to taxpayers that after some period of time the danger of audit may pass. Thus, it needs to be supported by powers of discovery to overturn the enquiry window where substantial tax fraud is found (OECD 2006).

Materiality: OECD(2006) noted that business selected for audit was based on the level of noncompliant high-risk , the materiality of the projected tax consequence versus the auditor's labor cost of pursuing the high-risk item may override the non-compliance aspect.



Collectability: The collectability concept implies that a taxpayer's inability to pay a future proposed tax assessment would be sufficient basis for not conducting the audit. Those administrations that do not use this concept report that collectability is a secondary objective and should not diminish the primary objective of a correct assessment of tax liability. In addition, the limitation of collectability considerations to the current tax period may not provide a complete financial picture for the taxpayer as it excludes consideration of future payment potential (OECD 2006).

According to Barreca and Ramachandran (2004), Audit selection methods range from simple random selection to more complex rule-based selection, sophisticated statistical and data mining techniques. Selection strategies can vary by tax type and even within a single type. The common case selection methods include random selection of cases, screening or case review by auditors, rule base and automated risk scoring systems, and data mining and statistical analysis.

Random selection: It has no bias in audit case selection, and useful to fight corruption. This method is perceived as fair by taxpayers. However, it clearly not focused on highest risks, may



have high opportunity cost if used as sole case selection method (Vellutini 2010).Gupta (undated) noted, simple random selection has a major drawback in that both honest and dishonest taxpayers are equally treated since probability selection give equal chance of being selected for both. However, the criteria or information based selection system too has a drawback in that it presupposes certain clue of noncompliance, which may actually be sign of other things such as change in economic condition in that particular trade(OECD, 2006).

Screening or case review by auditors: It is the traditional method by which audit cases have been selected, and dates from the time when there was little or no IT support, the data available was in any case limited, and the compliance risk management techniques at a strategic level less well developed. Such a methodology has a benefit that it makes full use of local knowledge, creates significantly less caseworkers resistance, can be used to attack specifically defined risks and can be operated substantially without IT support (OECD 2004a and OECD 2004b). Manual selection of audit cases is based on the auditors own knowledge of the taxpayers' behavior and environment. However, it cannot find out patterns of noncompliance hidden in the history of noncompliance in the same area, sector, or as



determined by other taxpayer attributes. It also favors rent seeking and corruption in the tax administration since it is discretionary and subjective approach (Vellutini 2010).

Rule base and automated risk scoring systems: It allows for the bulk processing and risk assessment of returns data. The data is reviewed against a set of risk indicators and the results be ranked in terms of the risk of noncompliance identified. Such system is an essential tool in facilitating the exclusion of bulk of returns with no or very low identified risks and allowing the resources for risk identification to concentrate their efforts only on those cases with significant identified risks (OECD 2004a). However, this system has its own inherent challenges. First, many of the rules by which a case is scored are dependent on financial ratio analysis and other industry benchmarking that can be changed overtime. The rules also may be, in themselves, standard factors to be achieved when they become known within the population. Thus, attention needs to be given to continually update the risk rules. Second, the rules need to be responsive to the local knowledge of the front line staff who is working on the cases when selected. Final case selections need to be able to reflect the local knowledge of the caseworkers themselves whilst retaining appropriate propriety within the case selection system. Automated selections with no opportunity to be influenced such local knowledge can



create resistance and lead to suboptimal working once the cases are underway. In addition, the risk rules need to be responsive to the knowledge gained by front line workers from working their cases. Such knowledge can be about new risks, changes in commercial behaviors, or new technical tax devices and the impact of that knowledge can be significantly leveraged if it can be captured within a flexible and developing set of risk rules. Third, the rules should bring together from dissimilar sources such as tax returns, third party information, and public domain information from internet. This level of analysis requires considerable investment in IT resources. Finally, the rules need to have the capability to be changed reasonably and quickly to take in to account new strategic appreciation of compliance risk. Once again, if the rules are themselves hardwired in to IT coding then this may be a resource intensive business (OECD 2004a).

Data mining and statistical analysis: It is becoming increasingly common to base case selection methodologies on the results from statistical analysis. As Barreca and Ramachandran (2004), data mining is the exploration and analysis of large quantities of data in order to discover meaningful patterns and rules. Organizations use this information to detect existing fraud and noncompliance and to prevent future occurrences. The use of data mining



techniques identifies patterns of noncompliance in the past and those characteristics in the current population. It enables organizations to leverage their data to understand, analyze and predict noncompliant behavior. However, data mining requires significant investments in IT both hardware and software and it may be difficult to acquire accurate data on which IT programs can operate. It is a difficult road to go down when electronic infrastructure do not support such investments or the skills are not available to the tax administration (OECD 2004a). OECD (2004b) noted, statistical analysis is often used to examine taxpayer data and to find the correlation between the data and non-compliance. It typically involves using prior tax audits results, which are then analyzed in conjunction with taxpayer data.

2.9 Examination Techniques

Biber (2010) noted that, there are different approaches to investigate and review the organization record depending on up on the area of risk, nature of the tax payers operation and the tax payers' condition. The decision regarding the type of tests to be undertaken as well as the records needed by the auditor to address specific issues is influenced by the nature of the taxpayer's operations, adequacy of books and records and materiality of potential adjustments. OECD (2006), indicated that there are different techniques used for tax audit examination.



Those are analytical review, investigative approach, field examination and counter party examination

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 (OECD 2006).

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(OECD 2006).



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(OECD 2006).

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(OECD 2006).

Counterpart examination: It is an examination performed based on third party information where warranted. 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.



2.10 Audit Workforce Capabilities

OECD (2006a) mentioned that, revenue bodies must manage and develop their audit workforce to deliver their planned outcomes through increasingly designing and implementing capability or competency models. Capability or competency model refers to a formal specification of the skills, knowledge and attributes of staff that are required to perform a specific job in an efficient and effective manner. The model generally contains job descriptions, functional descriptions and competency profiles using task-related competencies. It is typically supported by training and educational requirements to ensure and build capability. Different capabilities are required for work performed in different market segments or on clients exhibiting different behaviors towards tax compliance. Typical points of difference are capabilities required for noncompliant aggressive clients, audit work with large businesses (deeper and more specialized knowledge about specific regulations is required for this segment), performing system and electronic data base audits, and conducting criminal and fraud cases (OECD 2006b).



Required capability According to OECD (2006a) the required capabilities of auditors are generally identified by analyzing the activities required to perform particular audit tasks and through practice and experience. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex tax laws and conduct intensive examinations of taxpayers' books and records. 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).

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).

Improving competency and addressing capability gaps: 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 2006).



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Description of the study area /organization

Hawassa is located in the Southern Nation's Nationalities and Peoples Region on the shores of Lake Hawassa in the Great Rift Valley; It is located at about 273 km south of Addis Ababa along Ethio-keniya high way. It served as the administrative center of the Southern Nations

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Nationalities and Peoples Region. The city lays on the Trans-African High Way, an international road that stretches from Cairo (Egypt) to Cape Town (S.Africa).

According to the data from the city's Revenue Authority, there are 1535 Category "A" taxpayers, 1274 category "B" taxpayers and 7619 Category "C" taxpayers, in Hawassa city administration.

3.2. Research Design

For this study, the researcher applied descriptive analysis using the fact that a descriptive research design is used to describe the data and characteristic about what is being studied. Descriptive survey also enables to obtain the current information. It is also used in fact finding studies and helps to formulate certain principles and give solutions to the problems concerning local or national issues. Descriptive survey method focuses on investigating the current status, practice and problem related to tax audit of Hawassa city administration.

3.3 Research Method Adopted



This study incorporated both quantitative and qualitative research approaches (used mixed method) in order to generate the advantage of both approaches like; to address different objectives of the study, which cannot be achieved by a single method and to enable one approach to inform another approach, either in design or in interpretation. It also helps to triangulate the findings of different approaches (either performed concurrently or sequentially) in an effort to provide greater confidence to the study.

Kerchar (2010) argues that “each strategy has its strength and weaknesses and the drive for mixed method research is to use one strategy to inform, validate, or compensate for the weaknesses of another.” In other words, the combination of both quantitative and qualitative methods is a more pragmatic approach to gain a better understanding of the phenomenon under study.

3.4. Sources of Data

The data used in this study consists of both primary and secondary data. The primary data were collected through questionnaire and interview. The questionnaire comprised of both closed and open ended questions. Closed ended questions are quicker and easier both for



respondents and researcher. Most of the closed ended questions are designed on an ordinal level of measurement basis, and others are designed as multiple choice, some of the closed ended questions were a five scored likert scales (Kothari, 2004) to provide respondents a wider range of alternatives with end points where ‘5’with the statement strongly agree, and ‘1’ indicates with the statement refer to strongly disagree. Adding open ended questions allows respondents to offer an answer that the researcher didn’t include in the questions. And also, interviews were made for those most related tax officials.

Secondary data were also collected from the city Revenue Authority annual report from 2003-2005 E.C, to number of tax payers registered , number of Audited taxpayers, and gained revenue due to tax audit and categories of tax payers which are selected for audit. In addition to annual report, tax declaration and BPR manual were used to collect data. While collecting and using these data for the study, more considerations were given to their time period, reliability, and relevance to the purpose of the study.

Thirteen questions were developed as a guide for the semi-structured interview sessions. These interview questions were formulated with reference to the topics under study.The



interviews was designed and administered to seven tax officials. The prepared interviews guide were verified and checked for its authenticity for the use in this study. The interview aims at eliciting information on the tax audit practice, regarding types of Audit performed, case selection techniques, capability of the staffs and the overall tax administration system.

3.5 Sample Design

In order to select the appropriate representative of the total population and to make the research findings more relevant and accurate, the sample design would be well structured.

3.6. Population and Sampling procedure

Population of the study: The study population/participants were all Tax Auditors of Hawassa City Revenue Authority. 11 Tax Auditors were available in the city revenue authority.

Sample: It is the portion of the study population and used when addressing the total population in the study is not possible. But in this case, since the number of Tax Auditors were small, the study assumed the data of all Tax Auditors taking as a sample. Or there was no need of taking sample from the frame. Therefore, the sampling frame and the sample was the same.

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Thus in this case the sample size was almost equal to the population which enabled to make appropriate generalization to the overall population.

3.7. Methods of Data Analysis

In accordance with the data types, quantitative and qualitative data analyses were employed. The quantitative data were analyzed by Statistical Package for Social Science (SPSS) version 20, whereas the qualitative data analysis described qualitative data by themes.

3.8 Data Presentation

The researcher used simple percentage, tables, figures and graph to present the data findings.

3.9 The Pilot Study

The pilot study was conducted 4 revenue authority official to see whether the intended instruments could work as planned. The study suggested that certain items of the questionnaires and interviews need to be modified. Accordingly, some inconsistencies among the items were avoided and the ambiguous questions were corrected.



CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1. Introduction

Tax administration authorities, throughout the world, are responsible for the assessment, collection and enforcement of the tax laws or statues for their government. As the government's principle revenue collecting agency, the performance and efficiency of Town Revenue Authority has direct and immediate impact on the economy. SNNPR Revenue and Customs Authority give the authority in year 2011/12 for Hawassa City administration Revenue Authority to collect revenue from category A and B taxpayers and assess as well as audit the mentioned taxpayers. Before 2011/12 category 'A' tax revenue was collected by Regional (RRCA).

Due to less experience Hawassa City Administration Revenue Authority, it faces different problems in administering taxes. The reasons are lack of awareness by taxpayers, inefficient tax audit, result in low audit coverage, tax policy and complexity of law, legal and economic environment, and availability of administrative inputs, skilled man power and tax evasion. The Revenue Authority only focus category 'A' for Audit and not consider other categories. As



described in the above, this study discusses and analyzes Tax Audit practice in Hawassa City Administration Revenue Authority.

4.2. Characteristics of the Respondents

4.2.1. Demographic characteristics

Table 1 shows that majority of respondent tax auditors (72.7 per cent) were under the age category of less than 30 years. Out of the total respondents, 72.7 per cent were males and 27.3 per cent were females. This indicates that Hawassa City Administration Revenue Authority recruit more male than female.

Table 1 Back Ground Information of Tax Auditors

Age Group (years)	Sex				Total	
	Male		Female		Count	%
	Count	%	Count	%	Count	%
Less than 30 years	8	72.7	3	27.3	11	100%
31-40	-	-	-	-	-	-
41-50	-	-	-	-	-	-
Above 50	0	0	0	0	0	
Total	8	72.7	3	27.3	11	100.00



Source: field survey, 2014

4.2.2 Socio-economic status of respondent Tax Auditors

Educational levels, field of study and work experience of the tax auditors in general are the most important variables that can affect the performance of tax audit as well as tax administration system. In line with these attempts have been made to assess the educational level of the respondents, Field of study and work experience. Generally the respondent's socio-economic status is presented in Table 2.

Table 2 Socio- economic status of respondents

S.N	Item		Frequency	Percentage
1	Educational back ground	BA/BSC	9	81.8
		MA/Msc	2	18.2
2	Field of Study	Accounting &Finance	9	81.8
		Economics	1	9.1
		Management	1	9.1
3	Work experience as Auditor	Less than 2 years	9	81.8
		2-4 years	2	18.2



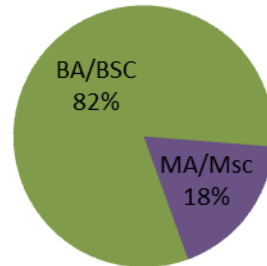
Source: Field survey,2014

In regarding field of study, majority of the respondents are specialized in Accounting and Finance which accounts for 81.8% of the total sample. The remaining 18.2 % were specialized in management and Economics. As indicated in item four of Table 2, 81.8% of the respondent Tax Auditors have service year ranging from 0- 1 year, while 2% of the respondent have service years of 2-4 years. This shows that above 80% of Hawassa City Administration Revenue Authority Tax Auditors has less work experience for the current position. As it is discussed on the above, the majority of the respondents have a good level of educational qualification that is BA or BSc degree and Msc Degree which enables the respondents to have idea of the Tax Audit. Moreover, majority of the respondents studied the field related to business which enables them to understand the implementation of taxes and related issues.

In case of working experience, most of the respondents have no enough experience in their current position (81.8%) they work less than 1year.This implies that the tax auditors in Hawassa Town Revenue Authority had no enough experience.



Chart 1-Auditors Qualification



Source: field survey, 2014

As it can be seen from the above chart out of 11 sample respondents, 9 (81.8%) have BA or BSc degree in different field of specialization and the remaining 2 (18.2%) have Msc Degree. As indicated in the above Hawassa City Revenue Administration has qualified audit staff, more than 80 percent of Auditors have BA degree.

4.3 Types of Audit performed

The survey results showed that Hawassa City Administration Revenue Authority exhaustively conducts comprehensive audit (72.7%), desk audit (27.3%). The survey further stated that comprehensive audit is conducted to ensure compliance on the taxpayers selected by risk criteria and third party information and on taxpayers those need to dispose over 50



per cent of their business fixed assets or close the business. Hawassa City Administration Revenue Authority performed desk audit for data cleaning purpose to confirm whether the data submitted by the taxpayers is genuine (Table 3).

As the responses of interview Hawassa City Administration Revenue Authority commonly used comprehensive audit to ensure compliance behavior of taxpayers and desk audit for data cleaning and increasing the number of Audit coverage. This indicates that the authority was not used different types of tax audit as per the intensity of cases and business character.

Table 3 Types of Tax Audit Performed

S.N	Variable	Tax Auditors response	
		Freq	%
1	Desk Audit	3	27.3
2	Field Audit		
3	Comprehensive Audit	8	72.7
8	Other		



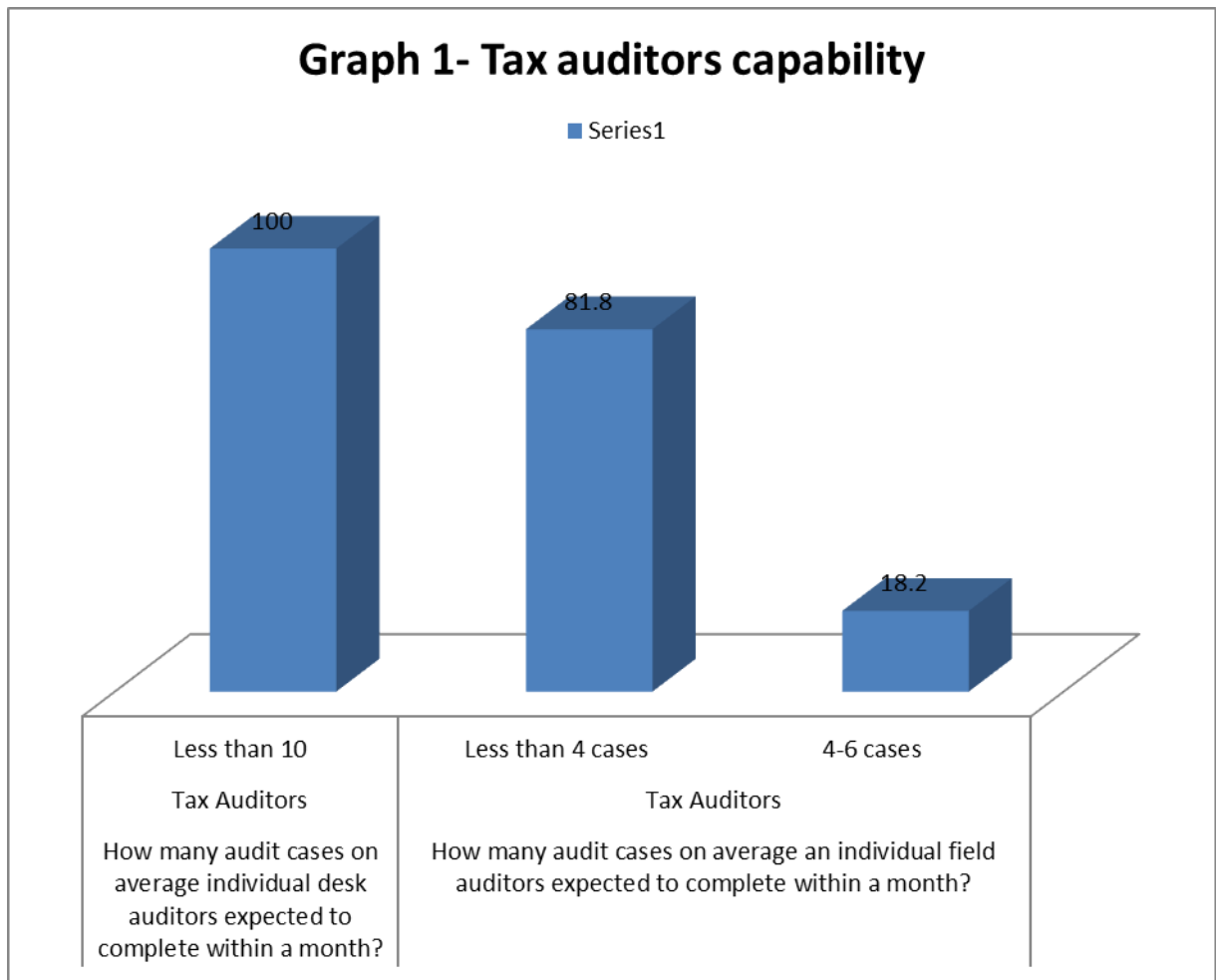
	Total	11	100
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Source: field survey, 2014

4.3.1 Audit performed by Auditors

Graph 1 shows that, Tax auditor's responses concerning Audit performed by Tax Auditors. As it is clearly indicated on below graph, 81.8 % of Tax Auditors reported that an individual desk auditor completes less than 10 cases on average per month. The result also showed that an individual field auditor performs less than 4 cases on average per month as responded by 81.8 per cent of Tax Auditors .The survey respondents further stated that most tax auditors conduct their audit work less than the standard. This shows that Tax Auditors perform their audit work without preparing pre-audit plan. Developing an Audit plan is necessary to determine the number of cases to be audited in the period by the offices, and to segment industry, tax types and audit type (OECD,2006).





Source: field survey,201

4.4 Case Selection

Table 4- Repetitive Tax Audit performed by the Revenue Authority

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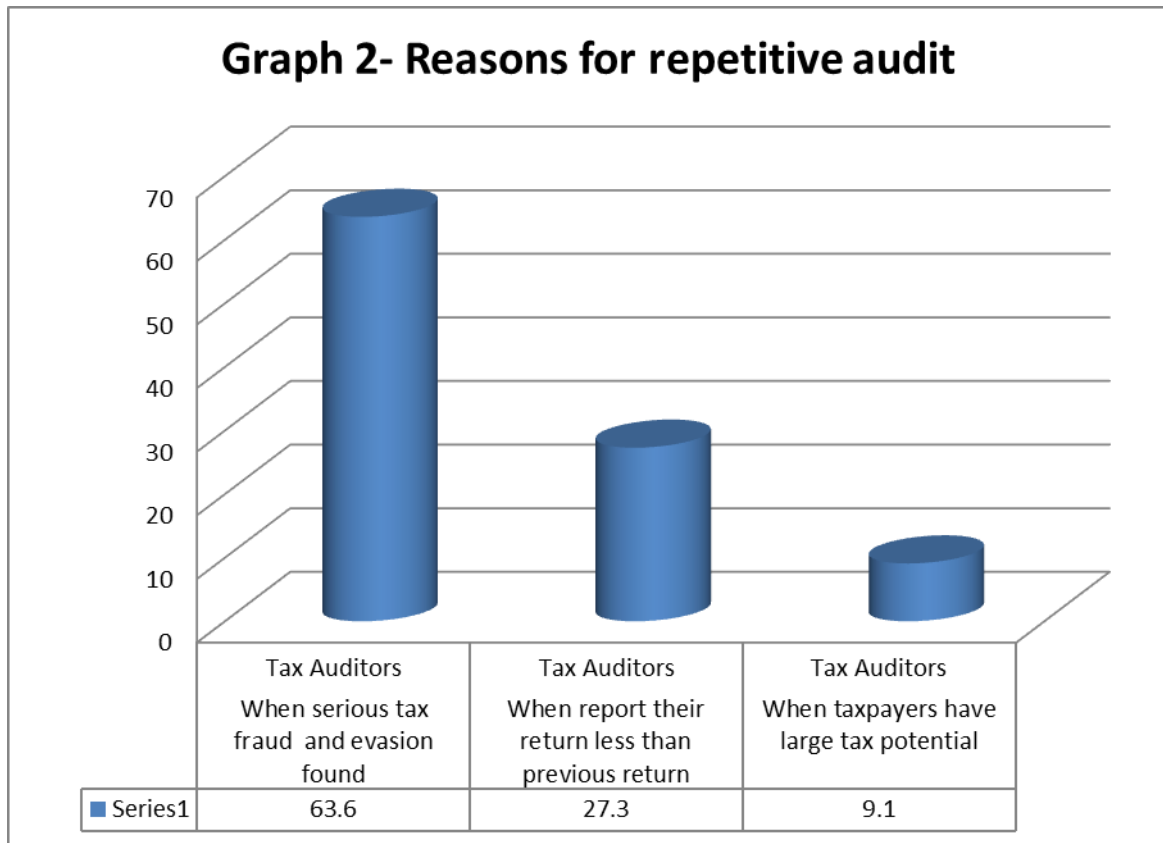
S.N	Item	Respondents		Frequency	percentage
1	Tax auditors repetitively audit the same tax payer in consecutive period?	Tax Auditors	Yes	1	9.1
			Usually	0	0
			Sometimes	8	72.7
			No	2	18.2

Source: Field survey, 2014

Regarding audit frequency as show in Table 4, out of 11 respondents 8 (72.7%) of tax auditors stated that sometimes similar tax payers are selected for audit in a consecutive years,(18.2 %) of the respondents stated that tax payers who audit in previously were not selected for the next audit, the remaining 1(9.1%) respondent stated that there is a possibility to audit similar tax payers in consecutive years. This implies that Taxpayers are selected for audit for consecutive audit period. This results in wastage of time.



Reasons for Repetitive Audit



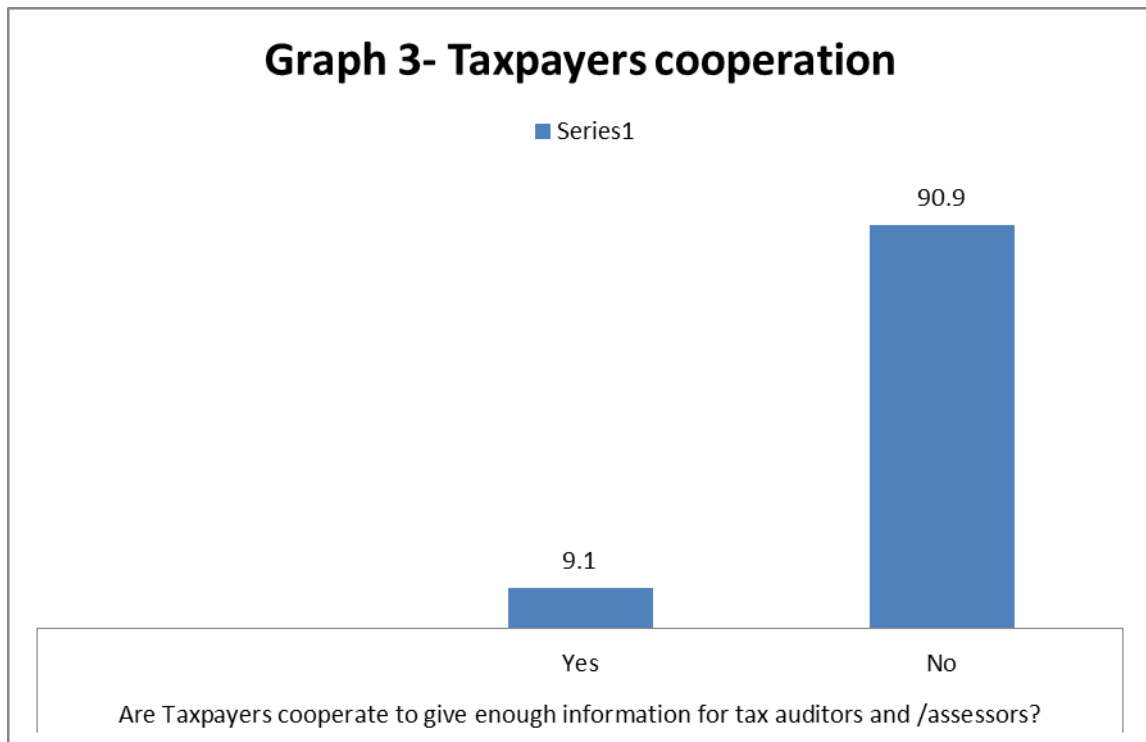
Source: Field survey,2014



Regarding the reason for repetitive audit, 7(63.6) of respondent tax auditors s were replied that when serious tax fraud and evasion found, the taxpayers company is selected for audit for a consecutive audit period. As it is clearly indicated in the above graph, 27.3 percent of Tax Auditors replied that taxpayers were selected for repetitive audit, when report their return less than previous return, Only a small portion of respondent Tax Auditors (9.1 percent) replied that repetitive tax audit is found when taxpayers have large tax potentials.

Graph 2 and Table 4, inferred that repetitive audit on individual taxpayers were found. This situation might have effect on compliance behavior of taxpayers and Tax audit effectiveness.





Source: Field survey, 2014

Regarding taxpayers cooperation to give enough information for tax Auditors and assessors, Graph 3 reveals that taxpayers are not cooperate to give enough information regarding their businesses for Tax Auditors or Tax assessors. Table 6 shows that 90.9 percent of respondents Tax Auditors were not cooperative to give sufficient information for Tax Auditors and Tax Assessor. And small portion of respondents replied that taxpayers were cooperating with Tax



Auditors and Tax assessors. 9.1 percent of respondent Tax Auditors replied that taxpayers were cooperate to give information for Tax assessor and Tax Auditors. General as the above graph the cooperation of taxpayers with tax auditors as well as tax assessor was low.

According to Table 5 and graph 3, Taxpayers were not fully cooperating for the effective tax administration system. They are not given enough information for tax Authority.

Table 5. Taxpayers cooperation to give information for Tax Auditors and assessor

	Item		Tax Auditors	
			Frequency	percentage
1	Are taxpayers cooperating to give enough information for Tax Auditors /Tax assessors?	Yes	1	9.1
		No	10	90.9
	Total		11	100

Source: Field survey, 2014



According to Table 6, Tax Auditors and Investigators get information from different sources. Majority of respondents agreed that Tax Auditors get information from third party, by reviewing previous case history of taxpayers and taxpayer's business profile. Table 7, showed that 45.5 percent of respondent Tax Auditors reported as Tax Auditors were getting information from third party like financial institution and other agency. 27.5 percent of respondent Tax Auditors replied that Tax Auditors get necessary information of Taxpayers from business sector profile. Generally tax auditors get information from third party rather than other means of getting information regarding taxpayers business.

Table 6- Methods of getting information regarding taxpayers

S.N	Item	Tax Auditors	
		Frequency	%
1	By reviewing the previous case history of taxpayers	3	27.3
2	Using information from third party such as financial institution	5	45.5



3	Using business sector profile	3	27.5
	Total	11	100

Source: Field survey, 2014

Table 7 deals with Tax Auditors access to get information held by taxpayers and others. 72.7 of respondent Tax Auditors replied that tax auditors and investigators have good access to information held by taxpayers and others.

Table 7 - Tax Auditors access for information

S.N	Item		Percentage				
			S/Ag	Agree	Neutr	Disagre	S/disag
1	Tax auditors and investigators have good access to information held by the taxpayers and others	Audito		72.7		27.3	

Source: Field survey, 2014



Regarding Case selection criteria, 63.6 per cent of the respondent Tax Auditors replied that taxpayers have been selected based on their associated compliance risk (compliance risk indicators) for audit purpose. Item 2 on Table 8, Tax Auditors oppose that case selection was not based on the availability of resources for Audit or Revenue Authority.

Item three on Table 8 shows that taxpayers select for tax audit was not based on taxpayer's tax potential. 63.5 percent of the respondent Tax Auditors replied that high tax potential of taxpayers was not a base for case selection. Item four of Table 8 elicits that case selection is based on serious evasion and fraud.. More than 70 percent of the survey result shows that case selection was based on the commitment of serious evasion and fraud. As 72.7 percent respondent tax auditors' response, taxpayers select for audit when they commit serious fraud and evasion. Tax auditors were not select cases manually based on their knowledge of taxpayers behavior and environment.63.4 percent of respondent tax auditors strongly disagree that taxpayers were not selected manually. Generally table 8 depicted that tax auditors selects cases based on associated risk, and commitment of tax fraud and evasion.



As the interview result, Hawassa City Revenue Authority conduct Tax Audit based on service and associated risk. Service Audit is un- planned Audit which performed by auditors based on the interest of taxpayers. If taxpayers want to shut down their business or change type of business, they inform to Revenue Authority and the Authority assign Auditors to perform the Audit work.

Table 8 Case selection

No	Item	Percentage					
		S/Agree	Agree	Neutral	Disagree	S/disagr	
1	Taxpayers (audited) are selected based on their associated compliance risk	Tax Auditor	63.6	36.4			
2	Case selection is based on the availability of resource for audit	Tax Auditors		9.1	18. 2	72.7	
3	Selection is based on taxpayers high tax	Tax Auditor			18.	63.6	18.2



	potential				2		
4	Series evasion and fraud are basis for selection	Tax Auditor		72.7		27.3	
5	Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment	Tax Auditor		36.6		63.4	

Source: Field survey,2014

Item 1 on Table 9 depicts that Tax Auditors responses regarding case selection through screening and case review. Here, in this item, the result revealed that taxpayers were not selected through screening and case review method. 90.9 percent of respondent Tax Auditors agreed that to select cases for Audit screening and case review was not the base.

In table 9 item two the respondents were requested to rate on cases were selected randomly. Hence, high percentage (81.8%) of Tax Auditors respondents said “disagree” and “strongly disagree”. And 9.1 percent of respondent Tax Auditors are neutral. The large portion of Tax Auditors rated on “disagree” and “strongly disagree”. This implies that Tax Auditors select cases non- randomly. This may be encouraging tax payers to commit tax Evasion.



Item 3 of Table 9 shows that respondent Tax Auditors view in relation to case selection through data mining techniques. Accordingly, 100 percent of respondent Tax Auditors said “Strongly Disagree”. This indicates that Taxpayers selected for audit is not based on data mining techniques. The survey result shows that case selected for audit was not based on data mining techniques.

In table 9 item four, the respondents were requested to rate on case selection by using statistical techniques and prior period audit. Hence, high percentage (81.8. %) of respondent tax auditors said “strongly disagree” .This shown that Tax Auditors were not use statistical techniques to select taxpayers for tax audit. Respondent tax auditors were disagree for the issue that Tax Auditors select cases by using statistical techniques of prior period audit.

Item five in the same table, respondents were requested to rate their suggestions on identification of non- compliance taxpayers based on rule base and automated risk scoring system. The minority of the respondent Tax Auditors (54.4 %) said “strongly disagree. This implies that Taxpayers select for audit were without standard rule base and automated risk identification system. Revenue Authority has fourteen point risk identification criteria, but Tax Auditors were not using these standard criteria. As the response of the interviewee, the reason



for not using the standard risk identification criteria was the complexity of the risk identification criteria and difficulty to understand.

According to the interview results Hawassa City Revenue Authority was not used the standard risk identification criteria which are written on BPR manual due to complexity of the criteria. Currently they used the trend of delay in tax payment, non-filing tax returns, nil tax declaration, showing abnormal and repetitive loss report, profit significantly deviated from previous periods as identification criteria

Table 9 Techniques of case selection

No	Item	Percentage					
		S/Agree	Agree	Neutral	Disagree	S/disagree	
1	Tax payers selected for audit is through screening and case review	Tax Auditors				9.1	90.9
2	Tax auditors select audit cases randomly.	Tax Auditors			9.1	81.8	9.1
3	Taxpayers to be audited was selected through data mining techniques	Tax Auditors					100



4	Tax payers to be audited selected using Statistical techniques using prior tax audit results	Tax Auditors				18.2	81.8
5	Rule base and automated risk scoring system that	Tax Auditors				45.5	54.5

Source: Field survey,2014

As indicated in table 10 below, tax auditors were not selecting any item of business frequently. Construction Company and real estate were not usually selected for tax audit. All respondent tax auditors 100 percent replied that “strongly disagree” that Tax Auditors were not select construction company for audit. The case selection systems were not focus on any business type. It focuses only on associated risk and the Revenue authority has no strategy to segment the business based on similar character or riskiness of the business. Risk identification was based on riskiness of individual business rather than business in different segment. The finding revealed that no specific business is selected for tax audit and tax auditors were not given priority to select Construction Company.



Item 2 of table 10 depicted that respondents were not agreed that financial sectors were selected for audit. This implies that Revenue Authority has no specific segment to give prior position for audit. According to the response of the interviewee, Revenue Authority has not use segmentation of business for audit and risk identification procedure.

Table 10 Type of Business selected for audit

No	Item	Percentage										
		S/A	gree	Agr	ee	Neu	tral	Dis	agr	S/di	sagr	ee
1	Construction and real estate sectors are most usually selected for audit.	auditors								100		
2	Financial sectors sectors are most usually selected							90.9		9.1		

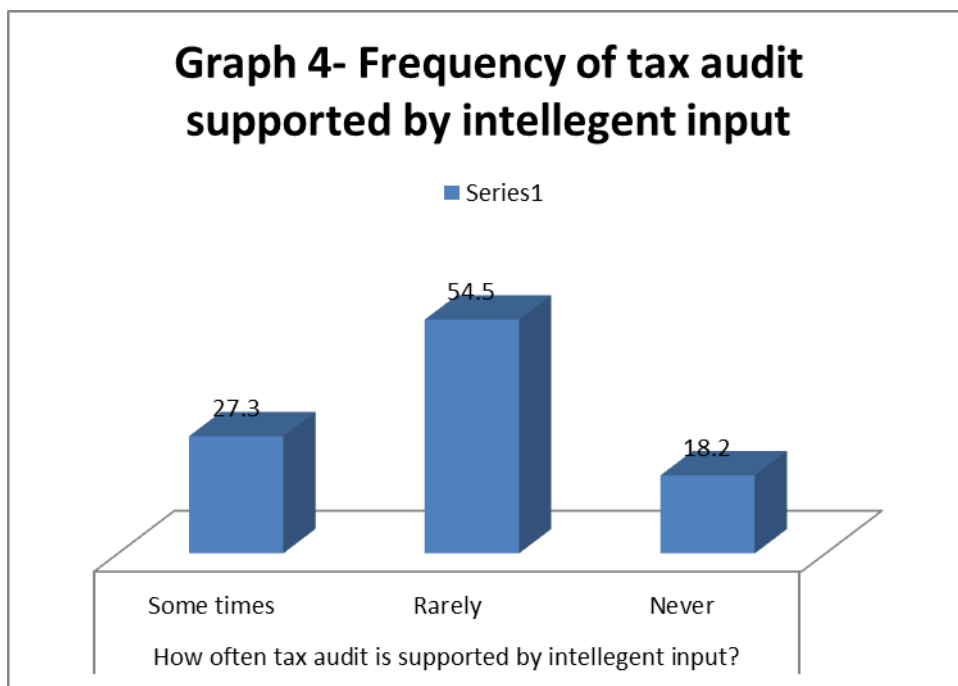
Source: Field survey, 2014

4.5 Effectiveness of Tax Audit

Audit effectiveness is dependent on auditor’s capability and efficiency to perform audit activities in a well-organized manner, tax auditors resources allocated for audit and the



Revenue Authority tax administration system. The other factors that affect the effectiveness of audit work is the link between intelligent information and tax audit.

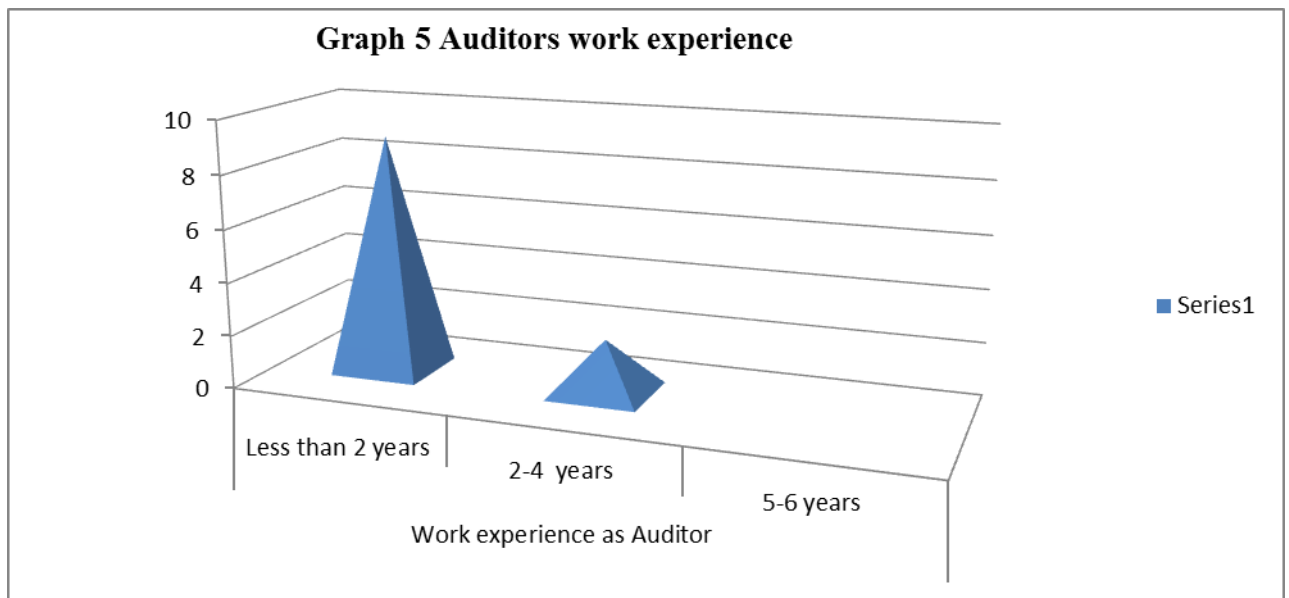


Source: Field survey,2014

The above graph depicted that how often tax audit work was supported by intelligent input. According to the result, majority of audit work was not supported by the information from the intelligent team. 54.5% of respondent tax auditors reported that the audit works



performed by tax auditors were rarely supported by intelligent team information. 27.3 % of respondent tax auditors replied that Hawassa City administration Revenue Authority sometimes use intelligent team information for audit work. According to 18.2 percent of tax auditors response audit work performed by the auditors were not supported by the intelligent information. This result revealed that the city revenue authority audit work was not as such supported by intelligent work/information and it leads to ineffective tax audit.



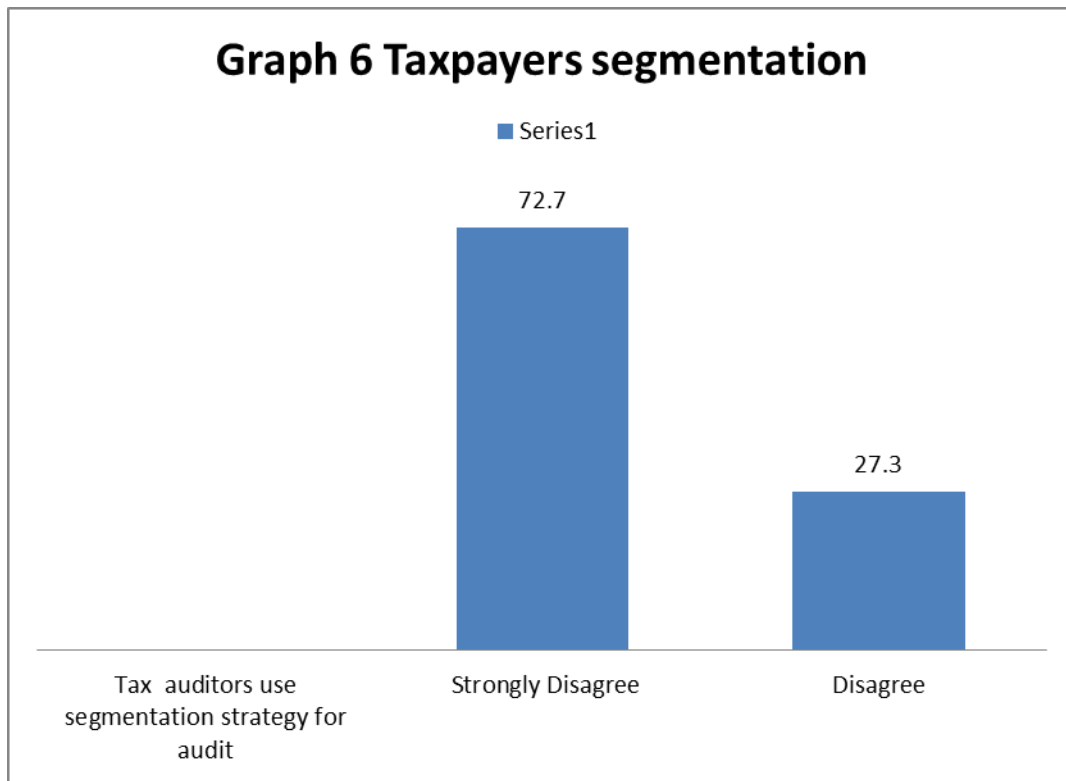
Source: Primary data,2014



Regarding effectiveness of Tax Audit, the above graph depicted that audit effectiveness is depend on work experience of Tax Auditors. Accordingly, majority of the respondents agreed that educational back ground and work experience affect the effectiveness of audit. As 90 percent of the respondent tax Auditors, tax audit quality was affected by education and work experience. The survey result shown on table one and graph 5, Tax Auditors has no enough audit experience and more than 80 per cent of survey respondents have an experience of less than two years in their current position.

The interview result also revealed that educational qualification and work experience affect the quality of tax audit. According to their response, Revenue Authority prefers to recruit Tax Auditors who have no experience than experienced auditors to minimize corruption. Tax rules, regulation and directives are complex to understand easily and interpret. Additionally, it takes time for less experienced auditors to adopt with the system and perform the audit works in efficient manner because Audit needs additional skills like statistical knowledge, communication approach , Economic as well as marketing knowledge and research and analysis.





Source: Field survey,2014

As depicted in the above graph, 27.3 % of respondent Auditors replied that “disagree” that Hawassa City Administration Revenue Authority has taxpayer segmentation approach. As depicted in item two of table eleven and graph 6, 72.7 % Tax Auditors replied “Strongly Disagree” on the issue that the Revenue Authority use segmentation approach. This indicates that the City Revenue Authority has no business segmentation strategy and also not tailored



its audit work to specific sectors and taxpayer segments, and currently not used a segmentation approach to conduct tax audit in order to provide a highly integrated and one spot customer service for taxpayers. Taxpayers have not been segmented into Large Taxpayers Office (LTO), Medium, Small, and Micro Size taxpayers.

Segmentation of taxpayers might help the Authority to recognize the complexity levels of audit cases in audit activities and to distinguish the competency requirements, classification, and remuneration of tax auditors to plan staffing accordingly. Such appropriate allocation and compensation of tax audit staff might encourage tax auditors to conduct properly their audit activities, which might result in low audit performance in terms of coverage and quality.



Table 11 Factors affecting audit effectiveness

No	Item	Percentage					
			S/Agree	Agree	Neutral	Disagree	S/disagree
1	Audit is performed based on audit manual	Tax Auditors				100	
2	taxpayers can easily understand and be aware of the rules, forms	Tax auditors		9.1	18.2	72.7	

Source: Field survey,2014

Table eleven indicated that the view of respondent Tax Auditors regarding tax audit performed by the city revenue authority was based on Audit manual. An audit manual is required to provide: (1) consolidation of policies and procedures; (2) a reference guide for auditors; (3) a training tool; (4) consistency in approaches; and (5) aid quality assurance, governance and accountability (OECD, 2006). In order to deliver quality outcomes, auditors



need access to approved procedures, policies and tools. Obviously, such products vary considerably with the variety and complexity of the regimes administered by individual tax administrations. Nevertheless it is possible to identify certain pre-requisites that must be in place if auditors are to be able to carry out their work efficiently. The first essential tool is a comprehensive audit manual. Such a tool can help to achieve consistency when dealing with taxpayers, the proper interpretation of legislation, and the correct use of operational procedures. It can also assist in the interpretation of information and in responding to requests for information by external bodies.

According to the result, more than 80 percent of respondent Tax Auditors agreed that Hawassa city administration Revenue Authority has no audit manual and the Audit performed was without Audit manual.

Regarding registered tax payers awareness level on tax rules and regulation, 72.7 % and 57.5 % of respondent Tax auditors said “disagree”. This shows that tax rules and regulations are complex and it is difficult to understand easily by registered taxpayers.



According to table eleven, 9.1 percent Tax auditors were agreeing that taxpayers easily understood rules and regulation of tax. The survey result shows that taxpayers were not easily understood laws and regulations regarding tax. It is a complex for taxpayers as well as for tax administrators.

Table 12 Audit effectiveness

No	Item	Percentage					
		S/Agree	Agree	Neutral	Disagree	S/disagree	
1	Continuous and sufficient	Tax auditors				81.8	18.2



	trainings for tax auditors						
2	Apply standard risk identification criteria for identify highly risky business for audit	Tax auditors				9.1	90.9
3	a continuous assessment to improve the capability or competency of staff resources, auditors and investigators	Tax auditors		18.2	9.1	63.6	9.1
4	The audit work to be started and completed within a predetermined timeframe	Tax auditors		27.3		72.7	

Source: Field survey .2014

Table twelve of item 1 depicted that views of Tax Auditors regarding the Revenue Authority provide continuous and sufficient training for Tax Auditors to increase their efficiency. 81.8 percent of respondent Tax Auditors disagree on the issues that tax authority provides continuous and sufficient training for the Auditors.



The interview result also supports the responses given by tax auditors. As the responses of the interviewers Revenue Authority recruit less/no experience audit staff and provide only 15 days training before the auditors enter in to the audit work and give examination for the attendants of the training for assessing the efficiency of the auditors but not provide continuous and efficient training to upgrade less experienced staff. SNNPR plan to provide training for auditors only once a year. To maintain standards of auditing it is essential that revenue authority are give 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.

Majority of the respondents rated on “disagree” for the questions that tax auditors use standard risk identification criteria for effective tax audit and sample selection for tax audit.90.9 percent of the respondents rated on “strongly disagree”. These shows that Auditors were not use standard risk identification criteria. The Revenue Authority has fourteen point risk identification criteria on the Business Process Reengineering (BPR) manual but the auditors were not using the standard criteria due to complexity of the criteria.



According to BPR manual, the time to complete a single audit was 15 days. Due to complexity of taxpayers' business transaction and the size of the taxpayers .Hawassa City Revenue Authority were not use the standard time to complete the audit. As the result of the survey, tax auditors not start and complete the audit work as of BPR standard. More than 70 percent of the respondents agreed that the audit work was not start and complete with in predetermined time frame. This implies that the Revenue Authority has no standard time for complex and simple cases (Table 12).

Table 13 Hawassa City Adminstration Revenue Authority Tax Audit plans Vs Achievement

s.n	Year	No of Taxpayers	No of files to be audited	No of files audited	Plan vs accomplshment	Planned Revenue	Revenue obtained
1	2003	649	48	14	29%	400000.00	933,109.00
2	2004	2874	51	16	31%	1,950,000.00	1,917,639.31
3	2005	3125	90	23	23%	3,297,049.00	15,931,142.03



**Source: Hawassa city Administration Revenue Authority Annual Report 2003-2005
(Summarized)**

As 63.6 percent of respondent Tax Auditors, volume of tax audit was the indicator for effective tax audit. The respondents agreed that the effectiveness of tax audit was measured by volume of tax audit or coverage of tax Audit performed. According to table 13, the revenue authority of Hawassa city performs below 30 percent when compared with plan and less than 3% when compared with registered taxpayers (Category A and B). The report and the survey result show that the audit performed by the Revenue Authority of the city was very low. As indicated in the literature review in chapter two, in a fairly well established tax system, audit rate of 15 to 20 percent of registered traders a year is sufficient. However, Hawassa City Administration Revenue Authority audited only 14 taxpayers out of 649 registrants (2 per cent), and have detected and found evaded tax revenue of birr 933,109.00 in the 2011/12 fiscal year. Similarly, in 2012/13 fiscal year, the authority audited 16 taxpayers out of 2874 registrants (0.5 per cent), and found additional tax revenue of birr1,917,639.31 (Table 13). It indicates that the revenue authority might detect compliance risk and get more additional tax revenue as the audit coverage is increased. Thus, there is low and insufficient audit rate in the revenue authority of Hawassa city. The low audit rate



(coverage) might be due to conducting extensive comprehensive audit mainly on taxpayers those with large tax revenue and complex transactions, along with insufficient audit resources including qualified tax auditors, and equipment such as computers. Generally, audit performed by the authority was very low when compared with plan as well as the standard which is 15-20 % of registered taxpayers.

As shows in the table fourteen below the effectiveness of tax audit was measured by productivity and yield of audit. Majority of the respondents reported that productivity and audit yield was indicator for audit effectiveness. More than 60 % of the respondent agreed that the audit effectiveness was measured by productivity and yield of audit.

Table 14 Measurement of audit efficiency and effectiveness

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S.N	Item	Percentage					
		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
1	Effectiveness of tax audit is measured by volume of the audit performed	Tax Auditors		63.6		36.4	
2	Effectiveness of tax audit is measured by productivity and yield of audit	Tax Auditors		100			

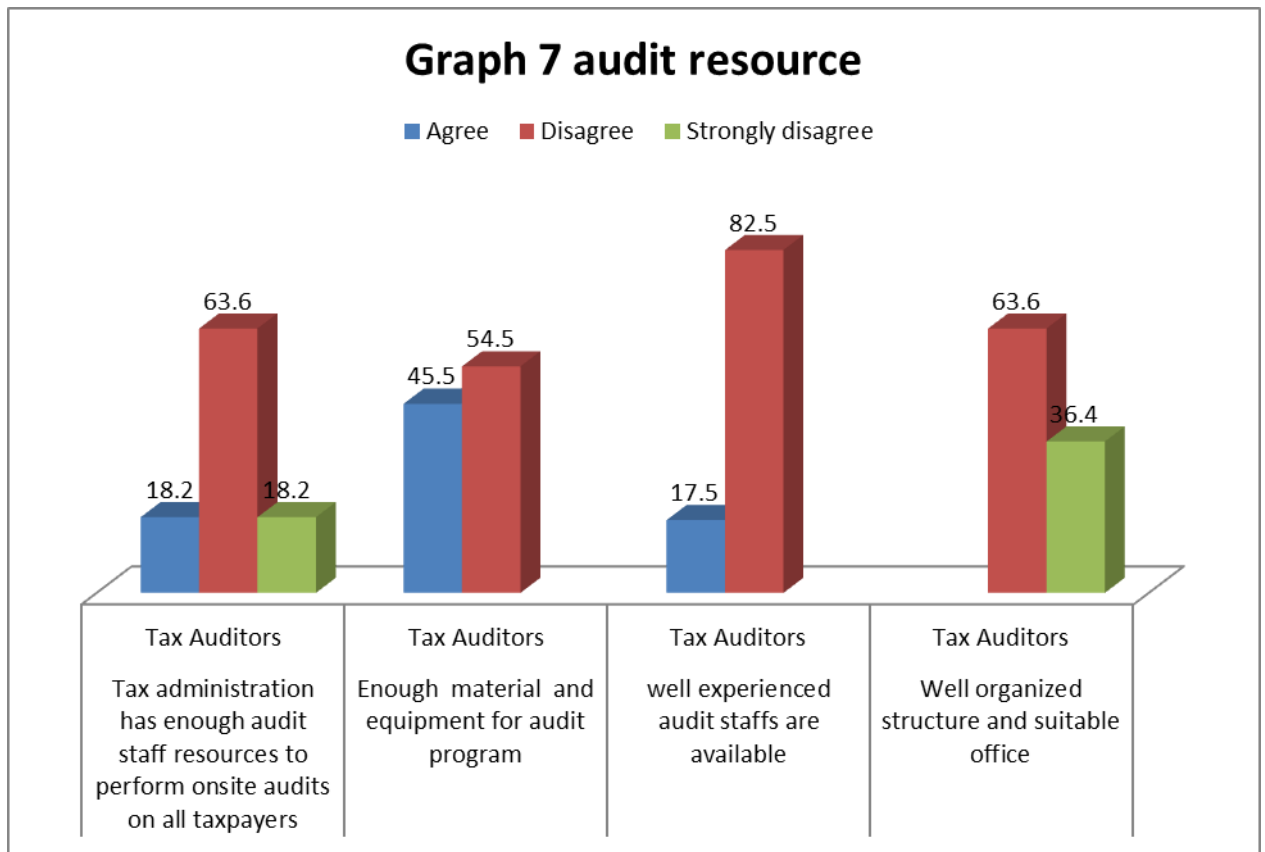
Source: Field survey, 2014

4.6 Audit Resources

Audit resources include audit staffs, materials and equipment needed for facilitating audit work. As OECD(2006),The Revenue authority should have enough audit resources to perform effective audit and to minimize tax evasion and increase voluntary compliance. Auditors



qualification and capabilities, taxpayers awareness regarding tax rules and regulation and resources required for audit are factors that hinder audit effectiveness.



Source: Field survey,2014



According to the above graph ,more than 60 percent of respondents indicate that Hawassa city Revenue Authority has no enough audit staff to perform onsite audit on all taxpayers. In city revenue authority law enforcement process unit there are only 10 Auditors and one process unit owner. Graph 7 indicates that only small portion of the respondents 18.2% of Tax Auditors were agreed that the authority has enough staff s to conduct on site audit. The survey result on Table fifteen item one and graph seven shows that the revenue Authority has no enough audit staff to perform on site audit.

For the effective and efficient tax audit not only the skill and qualification of tax auditor's but also adequate number of tax auditors, materials and equipment necessary for audit have greater impact. Table 15 item two, shows that Hawassa City Administration Revenue Authority has no enough materials and equipment to facilitate audit program. 54.5 percent respondents were responded that the Authority have no well experienced audit staffs to perform audit.



The result shows that Hawassa City Revenue Authority has no suitable offices to perform Audit. The Revenue Authority has small and uncomfortable offices to perform audit work as well as to put taxpayers' document in a safe way. The office is also not safe to discuss with tax payers and other people on tax related issues. Generally, Hawassa City Administration Revenue Authority has no enough audit staffs, no enough materials needed for audit and not have suitable offices. This leads to in effective audit work.

Table 15 Resource of Tax Audit

S/N	Item	Percentage					
		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
1	Tax administration has enough audit staff resources to perform onsite audits on all taxpayers		18.2		63.6	18.2	
2	Enough material and equipment for audit program		45.5		54.5		
3	well experienced audit staffs are available	Tax Auditors		17.5		82.5	
		Taxpayers		7.5	7.5	85	
4	Well organized structure and suitable	Tax Auditors				63.6	36.4

Source: Field survey, 2014



4.7 Purpose of tax audit

According to table 16 item one, the primary purpose of Tax Audit is to ensure compliance behavior of taxpayers. 54.5 percent of the respondent tax auditors were agreed that tax audit performed in the city revenue authority is to ensure compliance behaviors of the taxpayers. According to the response of the Taxpayers, revenue authority performed tax audit was not for ensuring compliance behavior of taxpayers. According to Table 16 item2, majority of the respondent tax auditors agreed that tax audit was for assessing taxpayers and need additional revenue for the Government.

Item three of table 16 depicted that, tax audits is not allow tax auditors to educate taxpayers on the application of tax laws,54.5 percent of respondent tax auditors were not agreed on the issue that tax audit is for educating taxpayers. Only small portion agreed that tax audit is for educating taxpayers. The result revealed that tax audit was not allow tax auditors to educate taxpayers.81.5 percent of respondent Tax Auditors replied that Tax auditors perform tax audit to detect non- compliance behavior of taxpayers.



The in-depth interview with tax officials also showed that the purpose of tax audit is primarily to assess unreported income and additional revenue for the Government. The interview respondents further stated that the duty of taxpayers' awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. Consequently, Hawassa City Revenue Authority tried to create tax awareness through electronic media, printed materials. However, taxpayer awareness creation through such mechanisms might depend on the literacy level of the target taxpayers and the accessibility of such materials to the public within a given tax jurisdiction. The respondents further stated that taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant. In addition, there is a communication gap between Hawassa City Revenue Authority and taxpayers, which leads taxpayers to mistrust. The taxpayers do not have easy access to new rules introduced and amendments in the existing tax law, and do not get any clarification on the complex tax rules and regulations.

Tax audit is for reducing tax evasion and tax fraud. The survey result shows that tax audit is vital for reducing tax evasion. As 63.6 percent of respondent tax auditors tax audit has positive effect on reducing tax fraud and tax evasion.



The respondent tax auditors give suggestion for the improvement of the overall tax administration and audit quality. Strength service delivery to create strong enforcement, make clear and accountable work environment must be created, create awareness give weekly/monthly meeting with tax payers, given information through Radio and TV on local areas language, magazines, workshops, brushers, newspapers , house to house impressively and openly discusses with tax payers to curb tax evaders and corruption, recognize model tax payers as well as tax officials, adjusting rules and regulation based on tax payers feedback, monitor and evaluate the tax employees, creating tax day celebration, strengthen strong political commitment, penalty does not teach tax payers instead education, respect every taxpayers as customer, make a notice before any harsh measurement. And given enough time for document preparation to taxpayers which were selected for tax audit.

Table 16- Purpose of Tax Audit

S.N	Item	Percentage					
		Strongly agree	Agree	Neutral	Disagree	Strongly disagree	
1	The primary purpose of tax audit performed in tax administrations is	Tax Auditors	54.5		27.3	18.2	



	to ensure compliance in accordance with tax law .						
2	The primary purpose of tax audit performed in tax administrations is to assess and collect additional tax revenue.	Tax Auditors	45.5	54.5			
3	Tax audit performed in tax administrations is to educate taxpayers.	Tax Auditors		36.4	9.1	54.5	
4	Tax-auditors, investigators and assess to perform during an audit period is de compliance behavior of individual tax	Tax Auditors		81.8		18.2	
5	Tax audit is for reducing tax evasion and tax fraud	Tax Auditors		63.6	18.2	18.2	

Source: Field survey, 2014

4.8 Techniques used to test the accuracy of return

Regarding techniques used to check the accuracy of taxpayers record. More than 80 percent of the respondents agreed that the accuracy of tax returns have been tested through review of financial statements and returns, 45.5 percent of respondent tax auditors replied that observing, discussing and reviewing documents of taxpayers were the means for checking the accuracy and physical checks of businesses' current operation including transactions,



assets and other aspects (54.5 percent) were the means for checking accuracy. The survey result showed that Revenue Authority used different techniques for checking the accuracy(Table 17).

Table 17- Techniques of checking taxpayers

S.N	Item	Percentage				
		Strongly Agree	Agree	Neutral	Disagree	Strongly disagree
1	Review of financial statements and returns type of tests are conducted to check the accuracy of tax returns.		81.2	18.2		
2	Observing, discussing and reviewing documents of taxpayer's are conducted to check the accuracy of tax returns		45.4	18.2	36.4	
3	Physical checks of current transactions, vouchers, assets and other aspects type of tests are conducted to check the accuracy of tax returns.	9.1	54.5	9.1	27.3	



Source: Primary Data field, 2014

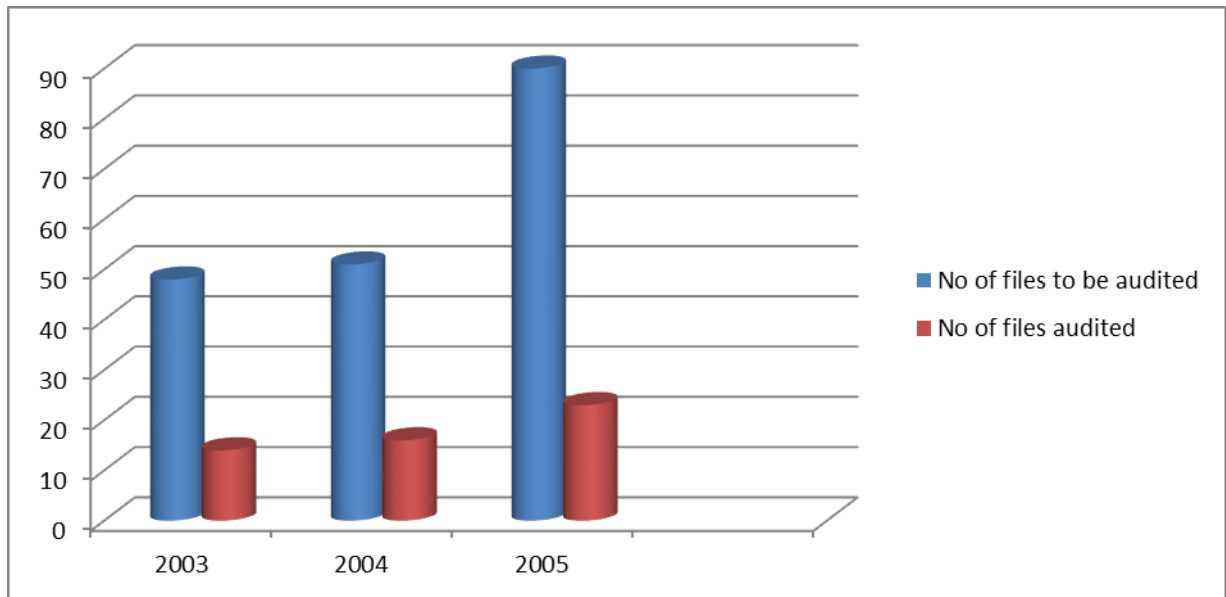
4.9 Documentary analysis results

During document analysis, the researcher see the Hawassa City Revenue Authority annual report and get information regarding audit coverage, the total number of taxpayers administered by Hawassa City Revenue Authority, the revenue found through tax audit. According to the document of Revenue Authority, 3315 taxpayers were registered as category “A” and category “B” taxpayers in 2013/14 fiscal year. From the total number 1917 taxpayers were category “A” and 1398 were category “B” taxpayers. Regarding the audit coverage Hawassa City Revenue Authority has audited 14 category “A” taxpayers (2 per cent), and found additional tax revenue of birr 933,109.00 in 20011/12 fiscal year. In 2012/13 fiscal year, the authority covered 16 taxpayers through audit out of 2874 (0.5 per cent), and found additional tax revenue of birr 1,917,639.31(annual report 2012/13) and Hawassa City Revenue Authority audited 23 Taxpayers out of 3125 taxpayers and found additional tax revenue of birr 15,931,142.03 in 2013/14 fiscal year (Table 9). As indicated in the literature review in chapter two, in a fairly well established tax system, audit rate of 15 to 20 percent of registered traders a year is sufficient (Tait 1988). But the document shows that



Hawassa City Revenue Authority cover small number of taxpayers audit and the rate is below 3 percent.

Graph 8- Audit Coverage



Source: 2003-2005 Audit report of the city revenue authority

According to Graph 8, Hawassa City Revenue Authority covers less audit work when compared to plan. Additionally the authority was not give emphasis for all taxpayers but it gives emphasis only for a particular categories, Category “A” in particular, the unaudited



category of taxpayers would feel that their underreporting and other noncompliance activities have little chance of being detected due to less probability of being audited.



CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

The key source of revenue for the government is tax. However, the potential tax revenue is not collected due to absence of taxpayers' compliance with the tax law both deliberately and unknowingly. Thus, tax audit performed by Hawassa City Revenue Authority is to determine the taxpayers' 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, and reliable and accuracy of tax returns and financial statements. The analysis addresses the tax audit practice in Hawassa City Revenue Authority with respect to the type of audit performed, effectiveness of audit program in terms of educating taxpayers and improving voluntary compliance and revenue performance, the appropriateness of case selection methods, examination techniques, and experience and capability of tax auditors.



Depending on the review of related literature as well as analysis and interpretation of the data, the findings are summarized and presented as follows:

- The primary issue to be considered in tax audit is designing audit plan. The Revenue Authority should plan before conducting audit and type of audit performed. Regarding the types of Audit, Hawassa City Revenue Authority widely used comprehensive type of audit rather than other types of audit. An effective audit program should be with vigorous range of audit types directed to a wide range of taxpayers and tax types. Appropriate selection of tax audit types depends on the compliance risk needs to be addressed, the desired audit rate (coverage), audit quality, and the overall deterrent effect that needs to be accomplished. The results of the study revealed that Hawassa City Revenue Authority exhaustively conducts comprehensive audit with intensive examination of ten-year taxpayer data exclusion of other audit methodologies. Comprehensive audit is intensive and deep in its nature, consume high audit resources and result in low coverage of audit that affects the overall deterrent effect and future tax revenue. Such excessive examination of taxpayer data may create collision between taxpayers and tax



official and auditors' error in such examination may also damage business activity that result in negative impact in economy, tax system in particular.

- Appropriate audit selection is a key to the effectiveness of tax audit program. Hawassa City Revenue Authority select taxpayers for audit based on associated risk. Hawassa City Revenue Authority select cases based on deviation from previous period's profit (underreporting income) and they think that it is an indicator for evasion. Economic factors, firm performance, management skills and others are factors for reduction of profit but the authority was not considering the mentioned issues. As BPR manual Hawassa City Revenue Authority has standard risk identification criteria (Risk matrix) but not implemented. However, case review method, data mining system, risk-based audit program, were not yet in place, and the audit functionality of SIGTAS is not being fully utilized for risk assessment.

- The other things to be considered for audit were grouping Taxpayers. Taxpayers have different characteristics and present different risks to revenue Authority. Segmentation based on industry type or turnover is vital to improve revenue collection of the town as



well as to improve audit performance. In a tax administration context, segmenting the taxpayer population into sub-populations of taxpayers with similar characteristics and behaviors facilitates more precise identification and categorization of compliance risks. This, in turn, leads to a richer understanding of the true compliance risks and should ultimately assist in the specification and delivery of risk treatments. However, Hawassa City Revenue Authority was not implemented this segmentation approach.

- Hawassa City Revenue Authority tax audit activity is not properly supported by intelligence team product, even if the authority has intelligence department. And also, there is a delay in audit coverage of selected tax payers due to these, there is an obstacle to improve revenue collection performance. Taxpayers were not willing to provide sufficient information for tax auditors and assessors regarding their business. The Authority gets information from third party and business profile.

- The effectiveness and efficiency of Audit work was affected by staff qualification, experience and resources for audit. Auditors have the ability to interpret rules and laws, analyses the compliance behavior of taxpayers, investigative and advisory skill.



The survey and the interview result revealed that Hawassa City Revenue Authority recruit qualified but less experienced audit staffs.

- The number of auditors in Hawassa City Revenue Authority was very less compared to the business .Similarly the revenue authority has no enough resource and equipment like computer and suitable office to conduct audit work. Regarding auditors' capability, the in-depth interview with tax officials showed that tax auditors have not standardized knowledge regarding clarification of unclear tax rules and regulations, and are incoherent in giving information regarding identical tax issues. In addition, tax auditors lack willingness to give advising services to taxpayers rather they simply intimidate them by raising the consequence of not being compliant.

- The tax officials, auditors in particular, also fail to keep properly taxpayers data that have been already submitted by taxpayers, and they unnecessarily request taxpayers to submit the report yet again.



- The Revenue Authority recruits youngest people using their qualification and provide only 15 days pre work training regarding audit, tax laws and directives. Southern Nation Nationalities and people Revenue and Custom Authority provide only one training within a year. Continuous upgrading training is necessary based on the gap and the need identified. The authority upgrade less experienced auditors by use different system like coaching, grouping with experienced auditors, evaluating through one to five strategy and soon. This was is not sufficient for upgrading the performance of audit and need continuous and intensive training.

- According to BPR tax audit timeframe, Hawassa City Revenue Authority has a rule that requires an individual audit case to be started and completed within 15 days period regardless of the complexity of the cases and the size of the taxpayers to be audited. In general as per the level of the researcher understanding and the finding what she has got in the previous chapters the researcher conclude that the allocation of equal period for both complex and simple cases might result operational inefficiency including decrease in audit quality and coverage although there is no standard timeframe for both complex and simple cases.



- The standard time frame on the BPR manual was not sufficient to perform and conclude complex cases. Individual Auditors might not properly detect noncompliance due to time scarcity and the required audit quality might not be achieved; whereas auditors those expected to complete simple cases might complete even before the elapse of stated period and might consume working time improperly so that feasible audit coverage might be reduced.

- The primary purpose of tax audit performed in Hawassa Town Revenue Authority was to assess and additional revenue for the Government. According to Table 12 Tax Audit was for assessing taxpayers and need additional revenue for the Government. Tax audits allow tax auditors to educate taxpayers on the application of tax laws, to identify improvements required for record-keeping and to identify areas of tax laws that taxpayers need clarification .Tax audits is not allow tax auditors to educate taxpayers on the application of tax laws. Taxpayers’ awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. Consequently, Hawassa City Revenue Authority tried to create tax awareness through electronic media, printed materials. However, taxpayer awareness creation



through such mechanisms might depend on the literacy level of the target taxpayers and the accessibility of such materials to the public within a given tax jurisdiction. The respondents further stated that taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant.

- In addition, there is a communication gap between Hawassa City Revenue Authority and taxpayers, which leads taxpayers to mistrust.

- Regarding examination techniques, various types of information might be reviewed namely tax returns, financial statements in Hawassa City Revenue Authority. The techniques used to test the accuracy of tax returns include: examination of information from third parties banks and informants; analytical review of financial statements and returns; examination of taxpayers' records; investigation through observing, discussing and reviewing documents of taxpayers; and on sight survey of the taxpayers' current business condition through physical checks of current transactions, assets and other aspects . Field examination (on sight survey of business condition) is



applied when a particular taxpayer needs to sell its business fixed assets or close the business. Effective auditing requires more than verifying that a taxpayer has correctly included a particular transaction in his books of account along with the adoption of investigative approach.

- However, the application of investigation approach is not as such in Hawassa City Revenue Authority. The accuracy of taxpayers' tax liability is determined mainly through analytical review of financial statements and returns. Thus, Hawassa City Revenue Authority may not be able to determine what wealth the taxpayers have accumulated but not documented or recorded in their books of accounts and financial reports without the conduct of appropriate investigation. It may not be also possible to ERCA to establish the completeness, accuracy, credibility, and validity of taxpayers' declarations, disclosures and other financial arrangement.

5.2 Conclusion

To achieve the objectives of government revenue objective a well-structured tax audit program is vital to ensure the fiscal health of the country, and sustain the health of the tax system by reducing tax gap through voluntary compliance improvement and additional tax collections.



Further, it might provide valuable support in identifying areas of the tax law that require clarification or addressing deficiencies in the law, and to influence compliance across the broader taxpayer community at all levels.

This paper has attempted to analyze current status, the performance of tax audit practice of the Hawassa City Revenue Authority. In particular, the study explored Types of Tax Audit performed, and effectiveness of tax audit and risk identification criteria for case selection. These investigations were addressed by employing survey questionnaires, semi structured and structured interview given to tax officials and reviewing published and unpublished documents. Finally, on the basis of qualitative and quantitative analysis of data, the findings of this study are summarized as follows:

Hawassa City Revenue Authority audit used intensively comprehensive audit and the Audit program is unchanged and not used different types of audit in relation to simplicity and complexity of cases. Taxpayers are selected for audit based on risk criteria, and selected audit cases are expected to be performed within 15days period regardless of the complexity of audit cases and the size of the taxpayers. Taxpayers might be repetitively audited if there is an



indication of serious tax fraud and when they report less tax return than previous return. As a result, there is unreasonably consumption of audit resources as well as increase the hardship associated with repetitive audits for fully compliant taxpayers. Corruption might also arise due to repetitive contact between the same taxpayers.

Hawassa City Revenue Authority did not adopt segmentation approach this result in low customer satisfaction, and increases both taxpayer compliance costs and tax administrative costs. However, tax audit program is mainly focusing on Category of “A” taxpayers which large tax potential with less emphasis to medium and small category of taxpayer’s community. In addition, the audit coverage is unsatisfactory that might be due to inappropriate audit type adopted and resource constraint. Case selection was only based on associated compliance risk.

The Revenue Authority of Hawassa City Revenue Authority not fully used automated risk score system and previous case selection system (random selection). Regarding audit staff, there is no competency assessment model, and less emphasis is given for continuous upgrading the capability and knowledge of staff resources once they have given and held a particular position.



5.3 Recommendations

In light of the aforementioned conclusions of the study, the researcher wish to make the following recommendations to minimize the problems of Hawassa City Administration Revenue Authority tax audit program so that to improve voluntary compliance and to meet the revenue needs of the government.

- ❖ Hawassa City Revenue Authority must adopt different ranges of audit types to increase the audit coverage and voluntary compliance having inadequate staff resources; the Hawassa City Revenue Authority should adopt a wide range of audit methodologies rather than use of full comprehensive audit because to address risk and audit quality. The spot (issue) audit should be widely applied to increase the audit coverage, and education type audits that are not yet in place should be implemented to improve taxpayers' awareness and voluntary compliance. In addition, Hawassa City Revenue Authority should give emphasis and assign adequate resources for investigation audit.

- ❖ The Hawassa City Revenue Authority should design pre audit procedure to select highly risky business. In addition to pre-auditing the authority should use data mining, case review and full risk-based audit selection strategy that rewards taxpayer



compliance with a light touch approach and openly demonstrates that valuable taxpayer resource is being deployed against the non-compliant.

- ❖ The Authority should use standard risk identification criteria to give priority for highly risky businesses and to encourage compliance taxpayers by minimizing taxpayers' compliance cost.

- ❖ Hawassa City Revenue Authority should give emphasis for taxpayer segments to improve future overall taxpayers' voluntary compliance that may affect future tax revenue, and to be capable to sustain confidence in the tax system and its administrations. And also perform audit work including other category of taxpayers. Focusing only on category A taxpayer leads to tax evasion. Underreporting and other noncompliance activities have a good chance of being detected due to high probability of being audited.

- ❖ The Revenue Authority should perform audit activity in cooperation with the intelligence information. And should use Audit manual for better efficiency.



- ❖ Hawassa City Revenue Authority should revise the stated 15 days audit period with the consideration of the complexity of the cases and the size of the taxpayers to be audited. The authority should dispense more time for complex cases and audit of large taxpayers to properly detect noncompliance and achieve the required audit quality.

- ❖ Tax payers have lack of awareness regarding tax rules, regulation directives and procedures and directives. This is due to level of awareness is dependent on taxpayers educational background and exposure. To increase the awareness level Hawassa City Revenue Authority should give great attention to educate communities as well as taxpayers through different techniques like mass-media, preparing broacher and using different structures (School,church, and kebele 1 to 5 approach). In addition to this the revenue authority provides house to house education and discussion by considering the type and size of taxpayers.

- ❖ Hawassa City Revenue Authority should sufficiently use an investigative approach to check the accuracy of tax returns to establish what have not been recorded in the accounting system. It should use an investigatory approach to establish the



completeness, accuracy, timeliness, credibility and validity of taxpayers' declarations, disclosures, and other financial arrangements.

- ❖ To make effective audit the Hawassa City Revenue Authority audit should increase number and capability of audit staffs through appropriate need assessment and employees and identified gap. Auditors should have been taken continuous training so that their skills are kept up-to-date and relevant. Further, the authority should supply sufficient computers and other necessary audit resources for auditors.
- ❖ The authority should use appropriate short cut techniques to increase the audit quality and coverage.



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APPENDIXES

Appendix I

QUESTIONNAIRE

Hawassa University

College of Business and Economics

School of Management and Accounting

Msc program in Accounting and Finance

Questionnaire to be filled by Tax Auditors

This questionnaire is designed to meet the objective of research titled “Assessment of Tax audit practice in Hawassa Town administration” Therefore; the data from this questionnaire will help the researcher to obtain reliable and valid information. Your open and genuine response is highly appreciated.

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Do not write your name on the questionnaire.

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

Thank you for your cooperation!

Netsanet Bibisso

Part –I : Background information

Please provide your responses by marking a tick (√) in the relevant boxes.

1. Gender: 1.Male 2. Female

2. Age: 1. Less than 30 years 2. 31-40 years 3. 41-50 years 4. Above 51 years

3. Education : 1. Certificate 2. Diploma 3. BSc/BA 4. MSc/MA and above

4. Field of study: 1. Accounting & finance 2. Economics 3. Management



5. Others, Please specify _____

5. How long did you work as an auditor?

1. Less than 2 years 2. 2-4 years 3. 4-6 years 4. Above 6

Part - II Question regarding Tax audit practice

6. What types of Audit are usually performed?

1. Desk Audit 2. Field Audit 3. Comprehensive audit
4. Issue audit 5. Advisory audit 6. Registration Audit
6. Refund Audit 7. Fraud investigation 8. Other

7. How many audit cases on average an individual (one) desk auditor has expected to complete within a month?

1. Less than 10 cases 2. 10 to 20 cases 3. 20 to 30 cases



4. Above 30 cases

8. How many audit cases on average an individual field auditor has expected to complete in a month?

1. Less than 4 cases 2. 4 to 6 cases 3. 7 to 10 cases 4. Above 10 cases

9. Tax auditors in Hawassa Town tax administration repetitively audit the same tax payer in consecutive period?

1. Yes 2. Usually 3. Sometimes 4. No

10. If your answer for Q 9 is yes what is the condition those taxpayers may be audited?

1. When taxpayers reported tax returns less than previous period return

2. When serious tax fraud case is found

3. When taxpayers have large tax potential 4. Other please specify----



11. What are the main activities that tax auditors, investigators and assessors expected to perform during an audit period (multiple answers are possible)?

1. Detecting noncompliance behavior of individual taxpayer

2. Gather information on the health of the tax system including compliance behavior

3. Educating taxpayer's

4. Interpreting complex tax rules and regulations for taxpayers

12. How often tax audit is supported by intelligence input?

1. Always 2. Sometimes 3. Rarely 4. Never

13. How do you evaluate the tax audit performance?

1. Efficient 2. Medium 3. Weak 4. I cannot evaluate

14. How do you evaluate the performance of tax audit in enforcing illegal trader?



1. Excellent 2. Good 3. Fair 4. Poor

15. Is there key performance indicator for Tax audit? 1. Yes 2. No

16. How tax auditors and investigators can get the required information?

1. By reviewing the previous case histories of taxpayers

2. Using information from third parties such as financial institutions

3. Using business sector profile

4. Others, please specify _____

17. Are taxpayers cooperate to give information for tax auditor/Assessor?



1. Yes 2. No

Put a “√” mark in one of the columns provided for each possible indicator. Use the scales:

Strongly agree (5), Agree (4), Neutral (3), Disagree (2), strongly disagree (1)

	Statement	Strongly Agree	Agree	Neutral	disagree	Strongly
	Questions regarding Audit case business for audit					
18	Tax auditors and investigators have good access to information held by the taxpayers and others					
19	Selection is based on taxpayer’s cooperation to give essential information necessary for performing an audit.					
20	Taxpayers (auditee) are selected based on their associated compliance risk					
21	Case Selection is based on the availability of resource for tax audit					
22	Selection is based on taxpayers high tax potential					
23	Series evasion and fraud are basis for selection					
24	Auditors select audit cases manually based on their own knowledge of taxpayers behavior and environment					
25	Tax payers selected for audit is through screening and case review					
26	Tax auditors select audit cases randomly without any analysis					



27	Taxpayers to be audited was selected through data mining techniques					
28	Tax payers to be audited selected using Statistical techniques using prior tax audit results					
29	Rule base and automated risk scoring system that identifies risk of noncompliance are the possible techniques in selecting taxpayers to be audited.					
30	Construction and real estate sectors business sectors are most usually selected for tax audit.					
31	Financial sectors business sectors are most usually selected for tax audit.					
	Questions regarding the effectiveness of tax audit program					
32	Education and experience on tax audit affect tax audit effectiveness					
33	use taxpayers segmentation for audit					
34	Audit is performed based on audit manual					
35	Tax registered traders can easily understand and be aware of the rules, forms and instructions regarding tax					
36	Effectiveness of tax audit is measured by volume of the audit performed					
37	Effectiveness of tax audit is measured by productivity and yield of audit					
38	Continuous and sufficient trainings for tax auditors					
39	Apply standard risk identification criteria for identify highly risky business for audit					
40	a continuous assessment to improve the capability or competency of staff resources, auditors and investigators					



41	The audit work to be started and completed within a predetermined timeframe					
	Questions regarding the Purpose of Tax Audit					
42	The primary purpose of tax audit performed in tax administrations is to ensure compliance in accordance with tax law .					
43	The primary purpose of tax audit performed in tax administrations is to assess and collect additional tax revenue.					
44	Tax audit performed in tax administrations is to educate taxpayers.					
45	Tax auditors, investigators and assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer.					
46	Tax audit is for reducing tax evasion and tax fraud					
	Questions regarding tax audit resources					
47	Tax administration has enough audit staff resources to perform onsite audits on all taxpayers					
48	Enough material and equipment for audit program					
49	Qualified audit staff /well experienced staffs are available					
50	Well organized structure and suitable office					
	Questions regarding frequency of tax audit					
51	Every businesses audited once a year					



52	Every businesses audited once within two years					
53	Tax auditor or investigator usually performs the audit work repetitively					
54	Taxpayers that were audited in the previous audit period and found no tax liability during an audit is not selected for the next audit					
	Questions regarding techniques of checking tax payers liability					
55	Review of financial statements and returns type of tests are conducted to check the accuracy of tax returns.					
56	Observing, discussing and reviewing documents of taxpayer's are conducted to check the accuracy of tax returns					
57	Physical checks of current transactions, vouchers, assets and other aspects type of tests are conducted to check the accuracy of tax returns.					

58. What are the challenges of tax administration ? what do you suggest for the improvement of Tax administration and tax audit program? _____

Appendix II - Tax officials in-depth interview instrument

1. Is there any Audit manual to perform tax audit Activities?



2. How and in what condition desk audit, field audit, comprehensive audit, single audit, advisory audit, registration audit, record keeping audit, refund audit, and fraud investigation is performed in Hawassa Ciy Adminstration Revenue Authority? Which audit type is mostly performed? Why could it be?
3. Which category of taxpayers and sectors are usually selected for tax audit? What would be the reason behind this selection?
4. What is the primary purpose of conducting an audit? Does Hawassa Ciy Administration Revenue Authority provide awareness creation for taxpayers? How?
5. Does Hawassa Ciy Adminstration Revenue Authority use appropriate short cut techniques and Tax payer segmentation?
6. How audit cases are selected? What are the bases considered for selecting the audit case?
7. How the decision to audit or investigate a certain taxpayer is conducted? What inference or criteria considered for such decision?
8. How Hawassa Ciy Adminstration Revenue Authority recruit Auditors?
9. How and by what criteria audit cases are assigned to auditors?
10. Is there anybody to evaluate tax audit performance? Who and How?



11. Could you tell me about the auditor's capability to clarify unclear rules and regulation, willingness to advise taxpayers and decision giving procedure of tax auditors?
12. Does Tax Auditors keep the documents of Taxpayers safely?
13. Does Hawassa Ciy Adminstration Revenue Authority set key performance indicator for evaluating the performance of Tax Auditors as well as Tax Audit performance?

