

Assessment of Tax Audit Practice: A Case Study of Hawassa City Administration Revenue Authority, Hawassa, Ethiopia

***Netsanet Bibisso Doda, ** Prof. Dr. Anbalagan Chinniah**

*Lecturer in Accounting and Finance, Volaita University, Sodo, Ethiopia

**Professor of Accounting and Finance, School of Management and Accounting, College of Business and Economics, Hawassa University, Ethiopia, East Africa-Mobile; +251-932319331

Email: dr.chinlakshanbu@gmail.com

Abstract

The study was conducted with objective of assessing tax audit practice of Hawassa city administration Revenue Authority. The researcher used both quantitative as well as qualitative (Mixed research) approach. Semi structured questionnaire was prepared and distributed to eleven tax auditors of Hawassa City administration Revenue Authority and interview was designed to seven Revenue Authority officials. 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. There are different factors affecting audit quality. These are insufficient resource, less experienced audit staffs, less number of auditors, no audit manual. Generally the revenue authority was not performing tax audit according to the standards.

Key words: Taxation, Tax Audit, Audit effectiveness

Introduction

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).

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). 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 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).

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).

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.

METHODOLOGY

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 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.

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.

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.

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 themselves.

RESULT AND DISCUSSION

Hawassa City Administration Revenue Authority exhaustively conducts comprehensive audit (72.7%), desk audit (27.3%). 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 1).

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. This indicates that the authority was not

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used different types of tax audit as per the intensity of cases and business character.

Table -1 Types of Audit performed

Variables	Tax auditors response	
	frequency	%
Desk Audit	3	27.3
Field Audit	-	-
Comprehensive Audit	8	72.7
Fraud investigation	-	-
Issue Audit	-	-

Case selection

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. Tax Auditors oppose that case selection was not based on the availability of resources for Audit or Revenue Authority. 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 tax payers was not a base for case selection. 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 tax auditors selects cases based on associated risk, and commitment of tax fraud and evasion (Table 2). As the interview result, Hawassa City Revenue Authority conduct Tax Audit based on service and associated risk but they were not used standard risk identification matrix. 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 2- 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 potential	Tax Auditor			18.2	63.6	18.2
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	

Techniques of case selection: 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(Table 3).High percentage (81.8%) of Tax Auditors respondents said “disagree” and “strongly disagree” that taxpayers were selected randomly. This implies that Tax Auditors select cases non- randomly. This may be encouraging tax payers to commit tax evasion. Almostall respondent agreedthat taxpayers were not select based on data mining techniques. High

percentage (81.8. %) of respondent tax auditors said “strongly disagree” that taxpayers were selected on the basis of statistical techniques .This shown that Tax Auditors were not use statistical techniques to select taxpayers for tax audit(table 3).

Respondents were requested to rate their suggestions on identification of non- compliance taxpayers based on rule base and automated risk scoring system. Tax Auditors (54.4 %) said “strongly disagree. This implies that Taxpayers select for audit were without standard rule base and automated risk identification system.

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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 (Table 3).

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 3- 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

Effectiveness of Tax Audit

Audit effectiveness is dependent on auditor's capability and efficiency to perform audit activities, resources allocated and tax administration system. The other factors that affect the effectiveness of audit work are the link

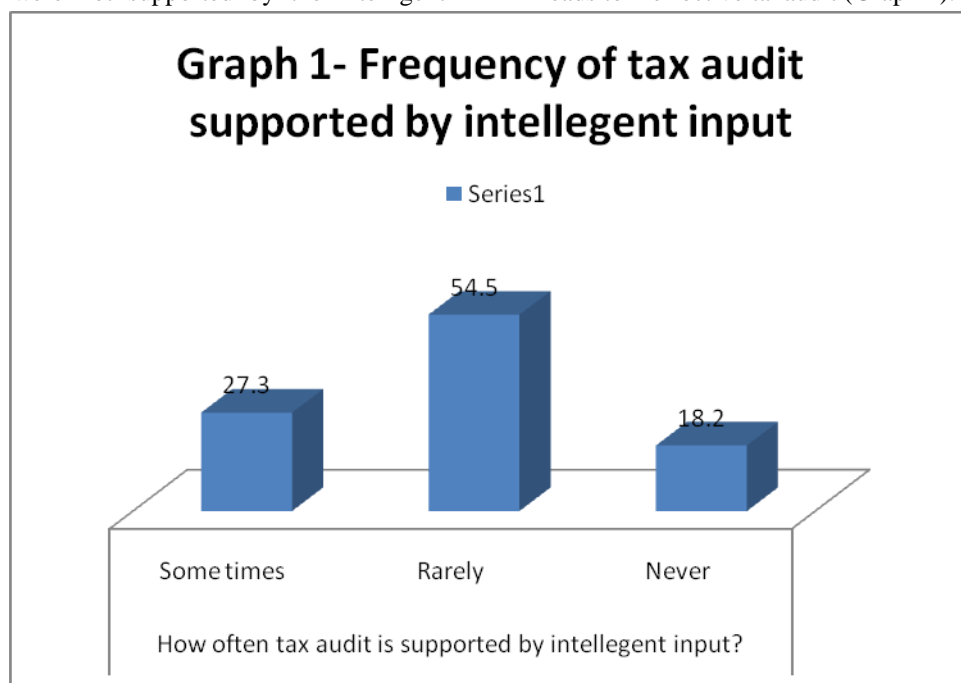
between intelligent information and tax audit and taxpayers cooperation.

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

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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

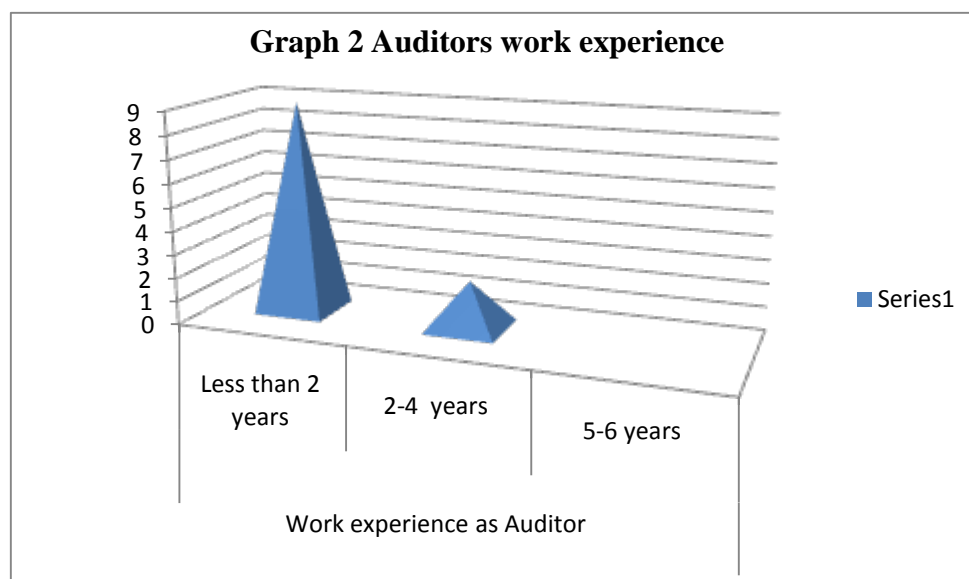
information. This result revealed that the city revenue authority audit work was not as such supported by intelligent work/information and it leads to ineffective tax audit (Graph 1).



Work experience: 90 percent of the respondent tax Auditors, tax audit quality was affected by education and work experience. More than 80 per cent of survey respondents have an experience of less than two years in their current position(Graph 2).

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.



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.

A comprehensive audit manual is essential to perform quality audit because it 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. 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 (Table 4).

Table 4- 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	
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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. 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. 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 (Table5).

Table5-Factors affecting Audit effectiveness

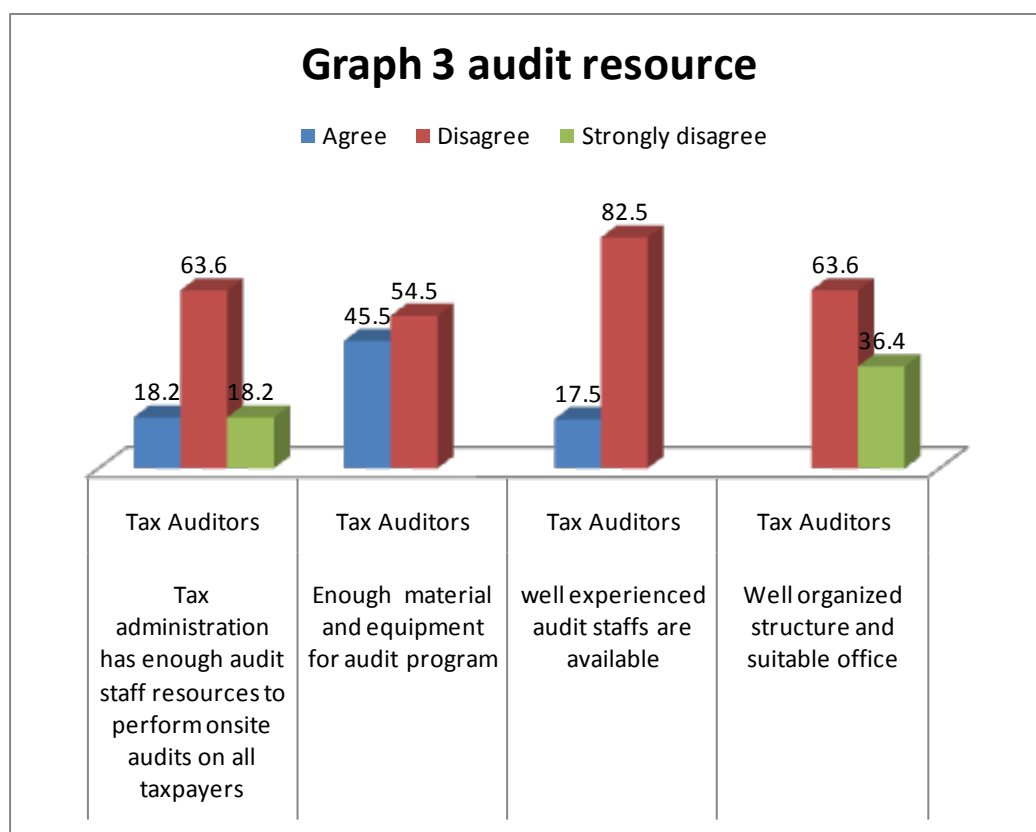
No	Item	Percentage					
			S/Agree	Agree	Neutral	Disagree	S/disagree
1	Continuous and sufficient trainings for tax auditors	Tax auditors				81.8	18.2
2	Apply standard risk identification criteria for identify highly risky business for audit	Tax auditors				9.1	90.9
3	a continuous assessment to improve the capability or	Tax auditors		18.2	9.1	63.6	9.1

	competency of staff resources, auditors and investigators						
4	The audit work to be started and completed within a predetermined timeframe	Tax auditors		27.3		72.7	

Audit Resources

63.6 percent of the respondents disagreed that Hawassa city administration Revenue authority should have enough audit staffs to perform effective audit and to minimize tax evasion and

increase voluntary compliance. 54.5, 63.6 percent of respondents disagreed that the revenue authority have enough materials and well organized office. The result revealed that Revenue Authority have no enough resources to perform audit activities (Graph 3).



Taxpayer's cooperation:As 90.9 percent of respondent's response, taxpayers were not cooperative to give sufficient information for Tax Auditors and Tax Assessor. And only 9.1 percent agreed that small portion of taxpayers were cooperating with Tax Auditors and Tax assessor.

Taxpayers were not fully cooperating for the effective tax administration system. And they were not given enough information for tax Authority (Table 5).

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

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 7). 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 (table 6)

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Table 6- Hawassa City Administration 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 accomplishment	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%	3,297,049.0 0	15,931, 142.03
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Source: Hawassa city Administration Revenue Authority Annual Report 2003-2005 (Summarized)

Conclusion

To achieve the objectives of government revenue, 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, effectiveness of tax audit and risk identification criteria for case

selection and factors that affect audit effectiveness. 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:

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

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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.

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.

1. 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.

2. 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.
3. 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.
4. 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.
5. The Revenue Authority should perform audit activity in cooperation with the

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intelligence information. And should use Audit manual for better efficiency.

6. 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.
7. 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.
8. 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.
9. 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.

10. The authority should use appropriate short cut techniques to increase the audit quality and coverage.

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