EFFECTS OF TAX AUDIT ON REVENUE GENERATION

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Abstract:
Taxation is a compulsory payment or transfer of resources from private to public sector levied on the basis of the determined criterion and without reference to specific benefits received in order to accomplish some of the nation's economic and social objectives. The study was undertaken to address the tax audit practice in Jimma and Hawassa Branches of Federal Ministry of Revenue. To conduct the study a mixed method or quantitative and qualitative approach has been executed to address issues that could not be obtained by adopting a single method. Further, the study both descriptive and explanatory research design were employed. To achieve the objective of the study, purposive sampling techniques has been employed and the sample size was computed scientifically. Therefore, in order to address the research objective, the researchers used the survey data collected through questionnaires. The data collected via questionnaire has been analyzed with the aid of statistical software. Accordingly, SPSS Version 20.0 and Stata software have been employed. the study revealed that tax audit techniques applied and provision of training to the taxpayers are positive factors affecting the tax revenue generation significantly, on the contrary, an illegal practice of taxpayer is negative factor that affecting the tax revenue generation. It is recommended that ministry of revenue should consider factors affecting revenue generation.

1. Introduction

A tax audit is an investigation of whether a taxpayer has correctly calculated and reported their tax liability and fulfilled other obligations (OECD, 2006). Tax revenue is defined as the revenues composed from taxes on income and profits, social security contributions, taxes levied on goods and services, payroll taxes, taxes on the possession and handover of property, and other taxes. Money received by the State thanks to taxation. It is the leading income for the state, funding public expenditure and other items, tangibly expressing the common efforts of the public (Mutarindwa & Rutikanga, 2014).

Rittenberg and Schwieger (2005) defined revenue as the enhancements or inflows of assets of a firm or payments of its liabilities during a period from delivery or producing goods, rendering service or other activities that constitutes the entity's ongoing major operations. All governments, thus, undertake huge community expenditure on behalf of their inhabitants for the provision of basic facilities and other social services. To meet up with these responsibilities, governments thus want plenty amount of funds and taxes are the most significant and greatest reliable funding much more than any other sources (Kennedy and John, 2014). For example, as a percent to Gross Domestic Product (GDP), statistics indicate that tax contributes 15% for low- income African countries, 22.5% for medium income and over 29% for high-income countries (Okonjo-Iweala, 2013).

According to Ogbonna (2011), the tax system is a prospect for the administration to raise additional revenue separately from other sources of income, required to transfer out its responsibilities. Thus, in order to meet their

mission in general and revenue collection in specific, every organization in this nation should sort their internal governor including tax audit more vigorous that assume incessant changes that this world is fronting today. Tax audit is the checkup of an individual or organization's tax report by the significant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state (Jennings, A.R. & Thomson A Kircher, 2008). Tax audit just like financial audit involves the collecting of material and treating it for determining the level of compliance of an organization with tax laws of the territory. For a effective audit, it is necessary that the auditor categorizes his work in such a way that the assignment is accomplished completely and efficiently (Adediran, Alade & Oshode, 2013).

Statement of the problem

Developing countries are in struggle to collect taxes efficiently, because of many serious challenges they face as to tax design and administration (Damme et al. 2008). According to Ittner et al (2003) study, effective internal control for revenue generation and preservation involves; applicable laws and regulations, regular a review of the reliability and reliability of financial and operating information, a review of the controls employed to safeguard assets, assessment of workers' compliance with management policies, an evaluation of the efficiency and effectiveness with which management achieves its organizational objectives. Internal control has a much wider purpose such that the organization level of control problems associated with lower revenues, which explore relations between disclosure of material weakness and fake, earnings management or restatements (Doyle et al., 2005).

The is three perspectives of scope of tax audit ; one is from tax payers and the second one is, from tax collectors or officers and the third is the tax system that brings payers with the collectors (Thomson 2008).

The main objective of the study is to assess the effects of Tax Audit on Revenue Generation a Case of Ethiopian Ministry of Revenue with the specific objectives:

a) To examine the illegal practice of taxpayers to tax revenue generation of Ethiopian Ministry of Revenue
b) To identify the effects of objective of tax auditing on revenue generation in the case of Ethiopian Ministry of Revenue
c) To examine the impacts of providing adequate technical training on revenue generation in the case of Ethiopian Ministry of Revenue
d) To analyze the effects of tax audit technique applied on revenue generation in the case of Ethiopian Ministry of Revenue.

2. Literature Review

Tax audit is a review of a taxpayer's business registers and financial concerns to guarantee that are the amount of tax described and paid are in harmony with tax laws and regulations. This is an additional audit to the statutory audit and is supported out by tax officials from a relevant tax authority. This is not the same as the statutory audit with respect to the requirement of the Company and Allied Matter Act (CAMA) 1990. It should also be renowned that the standards for selecting cases for tax audit include persistent loses, zero tax returns, refund cases, no submission of returns, low tax yield, suspicion of tax avoidance, fraud or evasion, transfer mispricing, thin capitalization and most often when the taxpayers request for tax clearance certificate among others (Bitrus, 2014, Okonkwo 2014, Oyedokun 2014).Tax audit exercise as concluded by Okonkwo (2014) is a very important compliance tool in most tax jurisdictions all over the world. It has subsidized immensely in building awareness amongst stakeholders, strengthening of the self- assessment tax system, bringing of more taxpayers into the tax net, increased generation of tax revenue and checking of numerous abuses in the tax system.

2.1. Tax Audit Types

There are two types of audit;

i. Field audit which is conducted at the taxpayer's principal place of business and generally applies to trades and professions and will involve a comprehensive review of the books, records and returns.
ii. Desk audit which is conducted at the Revenue office and generally applied to investment and rental income

2.2. Government Revenue Generation

Revenue is defined as all totals of money received by a government from outside sources for example those creating from "outside the government" net of refunds and other improving transactions, proceeds from issuance of debt, the sale of investments, agency or private trust transactions, and intra-governmental transfers (Ahmed, 2010).

Financial resources of government constitute the bulk of its revenue and this relate to monies generated in the economy (Obiechina, 2010).

Olotu (2012) mentioned that today, taxation is already sowing seed of transformation in many states of the federation of Nigeria. She pointed that only lost month, Tell Magazine carried a cover story titled, "the new cash cow". In that write up the magazine reveals how "more and more states across the country are now turning to taxation to shore up their revenue to finance critical infrastructural projects". A revenue audit is a checkup of the information and figures revealed by a taxpayer in their tax returns in contradiction of those shown in their business records. Therefore, the auditor needs to see all books and records in relation to the tax for the period being audited and these should be available on the first day of the audit.

2.3. Objective of tax audit

Tax audit have different objective. Among others, it manages and impose the tax programs in an impartial manner, determines correct reporting of the taxpayers audited, stimulates correctness in self-assessments of taxes by educating taxpayers in the application of tax statutes and regulations of taxpayers through "visibility" of audit presence (Audit & Compliance Division of the New Mexico Taxation and Revenue Department , 2009).

3. Research Methodology

3.1. Research Design

The aim of the study is assessing tax revenue audit practice and to test the hypothesis to meet the goal of the study. A mixed method or quantitative and qualitative approach has been executed to achieve the objective of the study. The purpose of using such a mixed method is to gather data that could not be obtained by adopting a single method. Further, the study adopted both descriptive and explanatory research design.

3.2. Data Sources and Collection Methods

To address the objective of the study primary sources of data has been employed. Structured questionnaire has been prepared with a composition of open and close ended questions which is useful for collecting data from management of the Ethiopian Ministry of Revenue Jimma Branch and Hawassa Branch, employees, and tax auditors. The questions incorporated in the questionnaire are some of them developed in a statement form and the others are based on five point Likert scale and also with "yes" or "no" questions.

3.3. Target Population and Sample Size of the Study

The target population of the study was employees, officers of each sub-department, tax audit officers and top management of Ethiopian Ministry of Revenue Jimma and Hawassa Branches who are currently working in Ministry of Revenue at federal level. Accordingly, the target population of the study was 156.

According to Yamane (1967)), sample size can be computed in the formula,

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

Where, n= sample size
N= population size of the study e= level of precision
Sample size determination on the study effect of tax audit on the government revenue generation and effects of tax audit on the taxpayers' compliance is the same.

To these studies the sample size computed as:
$$n = \frac{255}{1+255(.05^2)} = 156$$

3.4. Sampling Techniques

Judgmental sampling technique has been applied for data collection through questionnaires to address the tax officials who have participation in the tax audit practice directly or indirectly.

3.5. Model Specification

The researchers employed multiple regressions to estimate the effect of one variable up on the other. According to Alan O, (n.d.), it allows additional factors to enter the analysis separately so that the effect of each can be estimated. Therefore, the multiple regression and model equation will be utilized in this study is presented as follows;
The model is specified from both dependent (represented by 'Y') and independent variables- represented by X (X1, X2, X3 and X4).

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

Where: Y= Tax Revenue generation X1= Objective of tax audit
X2= Adequacy of tax audit resource X3 = Provision of training to taxpayers X4 = Illegal practice of taxpayers
B0 – β4 are co-efficient each variable including the constant

3.6. Independent Variable
3.6.1. Objective of Tax Audit

Objectives of auditing is to prevent fraud and errors, to detect any form of irregularity, evaluate the effectiveness of the firm's internal regulator system, support the management in the establishment of effective auditing system, advise on financial matters for efficient decision making by the management, and discover and ensure that an enterprise conform with legal and specialized requirement (Adeniji ,2012) .

3.6.2. Adequacy of Tax Audit Resource

Revenue Authorities have at a finite level of resources to conduct the day to day business of revenue Audit. In some countries, revenue Authorities has inadequate option as to how staff resources are to be extent to various areas of work, whereas in others broad decision is given to management to be allocated. Regardless of how the overall budget of resources for audit work is arrived at, a key issue for the audit function is how those resources will be spread over the various segments of taxpayers. The roles played by the taxpayer audit function, relatively large proportion of staff resources devoted to this function. In many member countries, the proportion of the revenue body's overall staff resources devoted to audit and other verification activities exceeds over 30 % (OECD, 2006).

3.6.3. Provision of Training to Taxpayers

According to Abinet (2016) Tax audit is a specialty which entails thorough knowledge of the relevant laws and regulations. It should make available intensive and frequent training for tax auditors taking advantage of the training facilities available in their local tax department's training institutions. Audits can assist clarify the application of the law for individual taxpayers and to identify improvements required to recordkeeping and thus may contribute to improved compliance by tax payers in the future.

3.6.4. Illegal Practice of Taxpayers

According to Corina Miculescu (2010) Excessive tax illegal practice on the trend of taxable results in its disappearance, knowing that tax kills tax. In conditions of transition to a market economy, economic and financial legislation was drafted late, adaptation to reality, trying to settle both massive bureaucratic state apparatus and incentives to promote private initiative. The result of illegal practice has resulted in blocking economic system, rejecting large potential investors' abroad uncontrolled leakage of national wealth and artificial concentration of important material and money in the hands of businessmen. If ignorance is added to these activities by officials of the state apparatus is functioning principles of the market economy and corruption that included tax audit professionals resulting economic and social environment promising for economy. In a market economy, financial authorities are faced with a phenomenon that has corpus scale tax evasion as a result of the trend to evade the law under substantial taxable income. The consequence of imperfect legislation or lack of regulations is the proliferation of illegal acts especially in finance and economics. The concern to the taxpayer to violate tax laws in force is tax fraud. In addition, tax evasion can be national and international.

4. Result and Discussion

The main objective of the study is to assess the effect of tax audit on the revenue generation by employing the qualitative and quantitative approach of the research. The data collected from 136 respondents with the response rate of 87%. Both descriptive statistic and regression analysis were employed to analyze the data. The descriptive statistics is used to analyze independent variables that affect contribution of government revenue generation, whereas regression analysis has been employed to identify extent in which tax revenue of the government affected by the independent variables specified.

The descriptive statistics such as mean, median, minimum, maximum and standard deviation of the distribution were employed to study and present an overview of both dependent variable (RM) and independent variables objective of tax audit (OTA), tax audit technique applied (TATA), provision of training to taxpayers (PT) and illegal practice of taxpayers (ILPTP) used in the study. For both dependent and independent variables mean value of each respondent has been taken to enter the data in the SPSS because each variable has five likert scale questions from strongly disagree to strongly agree extents. The following Table shows, the descriptive statistical results of corresponding 136 total observations of each variable in the study.

Table 1.1 Descriptive Statistics

	N	Range	Minimum	Maximum	Mean		Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
RM	136	2.86	1.43	4.29	3.0390	.04438	.51760	.268
OTA	136	2.91	1.36	4.27	3.0208	.04960	.57843	.335
TATA	136	3.60	1.00	4.60	3.4059	.06314	.73633	.542
PT	136	2.60	2.00	4.60	3.0507	.04505	.52536	.276
ILPT	136	3.40	.20	3.60	1.9118	.06177	.72040	.519
Valid N (listwise)	136							

Source: Field Survey of 2019

In the output presented above the information requested for each of the variables is summarized. As it has been discussed in the descriptive statistics Table above of the dependent and independent variables above, the mean values for revenue mobilization (RM), objective of tax audit (OTA), tax audit technique applied (TATA) and provision of training to taxpayers (PT) were 3.0390, 3.0208, 3.4059 and 3.0507 respectively which is above the moderate value of 3 with their respective standard deviation of 0.51760, .57843, 0.73633 and 0.52536. The result indicates that, the deviations of data from the mean for 136 respondents were below one and the average value was also above the moderate level of mean value. Similarly, the mean value for ILPTP was 1.9118 and its standard deviation of 0.72040. The result shows that the mean values of ILPTP was below the moderate value of mean and its standard deviation indicates deviation from the mean for 136 respondents was below one.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.667a	.444	.428	.39163	.444	26.202	4	131	.000	1.869

a) Predictors: (Constant), Illegal Practice of Taxpayers, Objective of Tax Audit, Tax Audit Techniques Applied , Provision of Training to the taxpayers
b) Dependent Variable: Revenue mobilization Source: Field Survey of 2019

The above model summary table shows that tax audit effectiveness on revenue mobilization and Four independent variables are significantly correlated with the correlation coefficient R=0.667. The table above also reports the model of effects of tax Audit on Revenue mobilization with the coefficient of determination $R2 = 0.444$. The coefficient of determination indicated that 44'4% of the variation in effect of tax audit on revenue mobilization for the sample of 136 tax officials can be explained by the changes in, ILPT, OTA, TATA and PT. According to Signh (2007), an adjusted R square of above 75 per cent is very good; between 50–75 per cent is good; between 25–50 per cent is fair and below 25 per cent is poor and in the given case therefore, the adjusted R square is 44.4% which is in the range of fair but it is nearest to the range of good.

Table 14 ANOVAa of the effect of Tax Audit on Revenue Mobilization

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	16.075	4	4.019	26.202	.000b
	Residual	20.092	131	.153		
	Total	36.168	135			

a) Dependent Variable: Revenue mobilization
b) Predictors: (Constant), Illegal Practice of Taxpayers, Objective of Tax Audit, Tax Audit Techniques Applied , Provision of Training to the taxpayers
Source: Field Survey of 2019

The ANOVA table discuses the analysis of variance and F-statistics, which reveals the value of F (4, 131) = 26.202, p value is significant at the 1 % level. The value of F is large enough because F-calculated is greater than table value of F (4, 131) = 3.45 it can be concluded that the set of independent variables (Illegal Practice of Tax payers, Objectives of Tax Audit , Tax Audit Technique Applied and Provision of Training) as a whole contributing to the variance of revenue mobilization and therefore, the model indicates the actual practice of the effectiveness of tax audit on revenue generation under.

Table 15 Coefficientsa of the effect of Tax Audit on Revenue Mobilization

Model	Unstandardized Coefficients	Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	Correlations	Collinearity Statistics

		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	1.533	.349		4.396	.000	.843	2.223					
	OTA	.229	.060	.256	3.802	.000	.110	.348	.380	.315	.248	.937	1.068
	TATA	.193	.053	.275	3.649	.000	.088	.298	.493	.304	.238	.749	1.335
	TPT	.170	.075	.173	2.279	.024	.022	.318	.457	.195	.148	.737	1.357
	ILTP	-.190	.055	-.264	-3.467	.001	-.298	-.081	-.504	-.290	-.226	.732	1.367

a) Dependent Variable: Revenue Mobilization Source: Field Survey of 2019

Econometric Model from SPSS Result:

RM= 1.533+.256 OTA+.275TATA + .173 TPT -.264ILTP

Where, RM = Revenue Mobilization, OTA= Objective of tax Audit , TATA = Tax Audit Technique Applied , TPT= Training provision for tax payers , ILTP, illegal practice of tax payers Multiple regressions were done to investigate the Objective of tax Audit, Tax Audit Technique Applied, Training provision, for tax payers, illegal practice of tax payers to predict effect of tax Audit on revenue Mobilization . Employing multiple regressions necessitate variables to satisfy the assumptions of multicollinearity, outliers and normality (Hair et al., 2009).

Introductory analyses were conducted to ensure violation of the assumptions of normality, outliers, multicollinearity, and data Normality. Also, the correlations between the predictor variables included in the study have been examined. All predictor variables were statistically correlated with effectiveness tax audit on revenue mobilization which indicates that the data was suitably correlated with the dependent variable for examination through multiple linear regressions.

In the table above, all predictor variables were statistically significant with $p< 0.01$ and $p<0.05$, ($\beta1 = 256$, $p=0.000$), ($\beta2 = .275$, $p=0.000$), ($\beta3 = .173$, $p=0.024$), ($\beta4 - .264$, $p=0.000$). The results were confirmed the expected sign of hypothesis for all predictor variables.

4.1. Objective of Tax Audit

The main objective of auditing is to ensure the financial reliability of any organization. Independent opinion and judgment form the objectives of auditing. Auditing also helps to ensure that the books of accounts are kept according to the rules stipulated in the Companies Act and whether the books of accounts show a true and fair view of the state of affairs of the company or not (Tutorials, 2017)

The tax audit is a technique through which the facts related to acts of a tax nature are verified and analyzed. It is a method used to inspect both companies and individuals, that is, all those subjects who are taxpayers and have tax obligations for the Public Administration or the State the tax audit has different objectives, based especially on the scope of entity. Its objectives is that the balances of the liabilities of the balance correspond to outstanding debts to the Public Treasury at the closing date of the fiscal year, that the debit balances to the Public Treasury have been valued according to the Accounting Principles and the pertinent fiscal regulations, Evaluate that the accounts are correctly classified in the balance sheet, between assets and liabilities, Check that, if there are claims raised by the Public Administration that are not resolved at the closing date, they are correctly accounted for and evaluate that the procedures have been carried out in accordance with good faith, ensuring that the established legal regulations have been complied with (Farooq, 2018).

As it has been reflected from table labeled coefficient, the objective of that Audit was positively related to the effect of tax Audit on Revenue Mobilization with ($\beta1 = 256$, $p=0.000$) thus, expected hypothesis was strongly supported in the study. The result indicates when other predictors are constant, for every increase of Probability of being audited, the Texa revenue mobilization increases by 0.256

4.2. Illegal Practice of Taxpayers

Tax evasion is an illegal activity in which a person or entity deliberately avoids paying a true tax Liability. Those caught evading taxes are generally subject to criminal charges and substantial penalties (www.investopedia, 2019)

Tax evasion and fraud is illegal and intentional misrepresentation of tax obligations. It can involve deliberate omission or falsification of income or revenue, as well as efforts to be invisible to tax authorities altogether. This results in the reduction of income that lawfully belongs to the government, and to the people (OECD, 2017).

At face value it may appear that aid reduces tax effort: countries with higher aid-to-GDP ratios have a habit of to have lesser tax-to-GDP ratios. In all likelihood, this is basically because poorer countries have lower tax revenues and obtain more aid. Other way conditions associated with aid may reduce tax revenue, such as tariff reductions as part of trade reform. In general, aid can support improved public finance management and tax collection systems that over time may increase tax collection (Hazel Granger, 2013).

The coefficient shows that shows Illegal Practice of Taxpayers was negatively related to the Effect of taxa Audit on the revenue Mobilization with (($\beta2 = -0.264$, p=0.001)) thus, expected hypothesis was strongly supported in the study with p<0.01. The result indicates when other predictors were constant, for every increase of effect of tax Audit on Revenue mobilization, the Revenue mobilization decreases by - 0.264.

4.3. Tax Audit Techniques Applied

Evidences are very important for an Auditor to form an opinion regarding financial statements. If Auditor fails to collect proper evidence, it will reduce the reliability of audit report. The method of collecting evidence is called audit technique that includes Confirmation, Vouching, Testing, Reconciliation, Analysis, Scanning, Inquiry, Verification of Posting, Flow Chart and Observations (Tutorials, 2017).

The coefficient shows that Tax Audit Techniques Applied was positively related to the Effect of taxa Audit on the revenue mobilization with (($\beta2 = .275$, p=0.000)) thus, expected hypothesis was strongly supported in the study with p<0.01. The result indicates when other predictors were constant, for every increase of effect of tax Audit on Revenue mobilization, the Revenue mobilization increases by 0.275.

4.4. Provision of Training to the Taxpayers

The coefficient shows that Training provision for tax payers was positively related to the Effect of taxa Audit on the revenue mobilization with (($\beta2 = .173$, p=0.024)) thus, expected hypothesis was strongly supported in the study with p<0.01. The result indicates when other predictors were constant, for every increase of effect of tax Audit on Revenue mobilization, the Revenue mobilization increases by 0.173.

Training taxpayers: Audits can support to clarify the use of the law by every taxpayer and to identify advances required in book keeping and thus may contribute to improved compliance by taxpayers in the future. Audits may bring to light areas of the tax law that are instigating confusion and difficulties to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws 'requirements and/or to better educate taxpayers on what they must do to comply into the future (SARFO, 2015).

5. Conclusions and Recommendations

5.1. Conclusions

Tax revenue is the income generated and collected by the different level of tax revenue collectors or authorities based on the income generating capacities of the payers. There are variety of indicators that were used by institution to convey different measurements for organization revenue generation and collection performance.

i. Based on the analysis result of data, illegal Practice of Taxpayers is negative significant factor that is affecting the tax revenue generation in Federal Ministry of revenue of Hawassa and Jimma Branch.

ii. Objective of auditing is to find reliability of financial position and profit and loss statements. It ensures that the accounts reveal a true and fair view of the business and its transactions. Whereas, tax audit has objective of ensuring a true and fair view of the business and applicability of tax legislatives. Data analysis result indicates that the objective of tax audit is significantly affecting the revenue generation of the government in positive direction.

iii. Tax audit may be risk based which is initiated by tax authority or service based that initiated by the taxpayer him/herself. In both cases tax audit ensures the fair presentation of financial statements in line with international accounting standard and tax laws of the country. As per the data analysis result, audit technique applied is positively affecting the revenue generation of the government.

iv. Training is crucial issue that has multidimensional in order to increase the revenue generation of the government. The result of data analysis indicates that the provision of training for taxpayers positively significant factor that is affecting the revenue generation of the government.

v. Since illegal Practice of Taxpayers is negative significant factor that is affecting the tax revenue generation, concerned body should put educative and strong penalty scheme that is applied to the illegal act of taxpayers.

5.2. Recommendations

i. Concerned body should put clear objective of tax audit that taxpayers and tax authority can understand and its benefit to the country in general and to the tax authority in particular.

ii. As far as the end result of tax audit is generating tax revenue of the government by ensuring the fairness of the tax payment trend among taxpayers to bring the fair competition among taxpayers. Ministry of revenue should apply appropriate tax audit technique based on the nature of taxpayers and intention of tax audit.

iii. Ministry of revenue should provide regular training in order to encourage self-assessment and that in turn improves voluntary compliance of taxpayers', which results enhancing tax revenue of the government.

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