KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY

(KNUST)

IMPROVING REVENUE COLLECTION THROUGH TAX AUDIT PRACTICE: THE CASE OF GHANA REVENUE AUTHORITY

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A THESIS SUBMITTED TO INSTITUTE OF DISTANCE LEARNING, KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF

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CERTIFICATION

I hereby declare that this submission is my own work towards the MBA and that, to best of my knowledge, it contains no materials previously published by another person nor material which has been accepted for the award of any other degree of the university, except where due acknowledgment has been made in the text.

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DEDICATION

This work is dedicated to my parents and all those who supported me in diverse ways throughout the period of my studies

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DEFINITION OF TERMS

AAA	American Accounting Association
CEPS	Customs Excise and Preventive Service
COBAC	Committee on Basic Accounting Concepts
DTRD	Domestic Tax Revenue Department
GRA	Ghana Revenue Authority
ICT	Information communication Technology
IFAC	International Federation of Accountants
INTOSAI	International Organizations of Supreme Audit Institutions
IRS	Internal Revenue Service
OECD	Organization for Economic Cooperation and Development
RPM	Research, Planning and Monitoring
SAI	Supreme Audit Institutions
VATS	Value Added Tax Service

ABSTRACT

The principal source of a government's revenue should normally be taxation, in Ghana this is often not the case. The country relies on foreign sources of finance namely foreign loans and aid due to its poor tax administration capacity and collection ability. To reverse this trend there is a serious need for revenue administration reform. As part of the reform an efficient and effective tax audit unit may be needed to enable the government to keep up with the increasing sophistication of business activity and tax evasion schemes. The main objective of the study is to find out whether tax audit practice plays a significant role in tax administration and to analyze the significance of tax audit in strengthening tax administration capacity, also to analyze the role and significance of tax audit in increasing tax revenue and to provide concrete suggestions to the issues relating to tax audit practice in Ghana based on the case study. The study was based on both qualitative and quantitative case study approaches. The Domestic Tax Revenue Division (DTRD) (Internal Revenue Service) of the Ghana Revenue Authority (GRA) acted as a case in the study. The quantitative study involved primary data collection through a field survey and secondary data collection from the DTRD of the GRA. And the qualitative research method was considered as a means of gaining access to unquantifiable facts. The result of the study showed that Tax Audit is very essential in enhancing revenue generation and has a major part to play in tax administration in Ghana. Even though the employees in the Tax Audit unit have the necessary skills which enable them to perform their duties and responsibilities, it is recommended that there must be adequate short term and refresher training to keep them abreast with current trends of auditing and investigations and also the numerous amendments to the tax laws.

In conclusion, an enhanced, expanded and well-resourced Tax Audit unit can help the nation in her quest to be self- sufficient in domestic revenue generation through taxation.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

It has become increasingly demanding for governments all over the globe to devise appropriate means of generating adequate revenue to finance government expenditure which continue to soar as a result of growth in population with its attendant demand for infrastructure and other social and economic investment. It is for this reason that taxation has become legally accepted all over the world as one of the most suitable means of generating revenue.

Governments however, do not earn any income on their own. They must therefore devise the means to generate revenue to undertake their responsibilities. Historically, this has been done through the levying of various forms of taxes. In pre-modern times, taxation was viewed as a direct exchange of bargain in which the taxing authorities on one hand, and the tax payer on the other hand, each expected to receive equal benefit in relation to what it gave out. Taxes were looked upon as the wages paid to government for its services, the chief among them being security. This concept became known as the 'bargain theory' (Danquah, 2007). The common view was that each one was to provide all his needs otherwise he paid the government authorities to do that for him.

Despite numerous tax reforms that were intended to improve the economic and social situation by supporting infrastructure and increasing the quality of public goods provided by the government, the situation in Ghana still remains fragile, and the country remains among the poor in the world. Ghana still lags way behind in its tax collections at the domestic level. The prevalence of poverty in Ghana demands that the country should improvise internal revenue generating projects to supplement, or better still, ultimately significantly reduce dependence on foreign funding. This way a self-sustaining economy will be built. One such internal revenue-generating mechanism and perhaps the most commonly used, is taxation. Moreover, based on approved budget for the financial each year, a widening budget deficit compared to the previous finances of each year has been reported. The persistence of budget deficits makes the case for a maximization of the tax base in Ghana.

The tax base can be expanded in two ways. First, the government can target the sectors that are currently untaxed especially the informal sector. This can be implemented for example, by introducing presumptive taxes based on the activities of these sectors. To the extent that the informal sector is where the bulk of the poor are employed, this choice has to be implemented while minimizing the regressive and distortionary effects on the sector. The second alternative is to minimize tax evasion. 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.

Expanded domestic revenue base (especially taxation) offers a promise of greater autonomy in the future and a break from restrictive aid and loan conditionalities. With this vision, the Ghanaian government over the years has tried to improve tax systems. For instance, in the case of Ghana Revenue Agency (GRA) which has evolved from the Central Revenue Department in the 1960’s, through the Internal Revenue Service in 1986 and Customs Excise and Preventive Service to the addition of the Value Added Tax Service in1998 then to the formation of the Revenue Agencies Governing Board (RAGB) in2001 which was aimed at fusing the boards of all the revenue collecting agencies to enhance decision making and now the Ghana Revenue Authority (GRA) in 2010, which has fused together all the processes and activities of all the tax revenue collecting agencies in Ghana. In an effort to increase the government's domestic revenue, the government introduced tax auditing into the mainstream of tax administration on 1st October 1986, this unit was introduced in the stead of the erstwhile Citizens Vetting Committee of the revolutionary era of the late seventies.

The Tax Audit unit of the erstwhile Internal Revenue Service was a unit under the Research Planning and Monitoring (RPM) department however with the coming into force of the Ghana Revenue Authority Law in 2010 budget; the unit now operates under the Domestic Tax Revenue Division (DTRD) of the (GRA). The core duty of the Tax Audit unit is to examine financial statements of tax payer's with the view of establishing their reliability, accuracy and completeness. It is also expected to detect and counter any tax evasion and avoidance schemes, optimize the declared tax liabilities, ensure compliance with the Tax Laws and advice the GRA on policy formulation. The unit is currently staffed with seventy four (74) officers with sixty five (65) members being active field officers and they contributed an average of one percent (1%) of the total collection of the Internal Revenue Service (IRS) which is now part of the Domestic Tax Revenue Division (DTRD) of the GRA between 2006 and 2010 (these contributions are potentially lost taxes which have been recovered). A well-resourced Tax Audit unit can contribute far more.

Tax audit is an extension of the 'attest function' of the historical financial audit. It is the audit of a tax payer's (an assessee) accounting and other documentary evidences for the preparation of current tax returns, as well as the supporting financial statements, followed by an audit report giving the auditor's opinion about the degree of correspondence between the information contained in the tax return and the regulatory provisions of tax laws. In other words, tax audit is an extension of the normal audit generally conducted for the purpose of expressing an opinion as to the fairness of the accounts examined by the auditor, and the certification of financial statements for tax purposes. It is meaningful if it is based on the knowledge of tax laws, similarities and dissimilarities between financial accounting and tax accounting and reporting to the tax department, recognizing their requirements to enable the latter to compute taxable income. It includes what a tax official can look for when aiming to complete an assessment of tax. It covers also the disclosure of all significant accounting practices employed in the organization, a report on the financial accounts, i.e. the balance sheet, profit and loss account and other related accounts and schedules which are part and parcel of the financial reports. Furthermore, information is required to compute the assessable income as well as to ensure that the compliance of the tax laws and regulations is proper.

1.2 Statement of the Problem

While the principal source of a government's revenue should be taxation, in Ghana this is often not the case. The country relies on foreign sources of finance namely foreign loans and aid due to its poor tax administration capacity and collection ability. There are various reasons why revenue administration reform may be needed in a country. First, while tax policy and tax laws create the potential for raising tax revenues, the actual amount of taxes flowing into the government coffers, to a large extent, depends on the efficiency and effectiveness of the revenue administration. Weaknesses in revenue administration lead to inadequate tax collections. Financing of the resulting budget deficit through borrowing or monetary expansion can cause an unsustainable increase in public debt and inflation, respectively.

In the alternative, revenue shortfalls shrink the budgetary resource envelope, thus, affecting the government's ability to implement its policies and programs and provide public services. Unexpected decline in revenue collections also cause budget cuts that result in major inefficiencies in the public expenditure management.

Second, the quality of revenue administration influences the investment climate and private sector development. Firms considering investments are not only concerned about the formal tax system, but also about how the system works. A revenue administration that is perceived to be arbitrary or predatory discourages investment. Further, weaknesses in the enforcement capacity of the revenue administration put law-abiding firms at a competitive disadvantage, as their competitors in the informal sector are allowed to get away with tax evasion. This reduces incentives for businesses to join the formal private sector.

Third, taxes and customs administrations are possibly near the top of public-sector organizations with a high incidence of corruption. The cost of this corruption is high, both for the government and taxpayers. The government suffers major revenue leakages as dishonest revenue officials allow unjustified tax breaks to willing tax evaders. Honest taxpayers suffer as corruption in revenue administration leads to harassment, inflated assessments, high litigation costs and leniency towards non-compliant competitors. Any serious effort to reduce corruption in a country and improve governance, in all likelihood, has to involve reform of the revenue administration.

Reform of the revenue administration that include efficient and effective tax audit may be needed to enable it to keep up with the increasing sophistication of business activity and tax evasion schemes. With globalization, goods and services are produced by taxable entities in multiple countries. This presents vast opportunities for manipulating transactions to reduce the tax burden. The existence of corruption, tax havens and increasing use electronic financial transactions pose major challenges in enforcing the tax laws. Without a matching increase in the professional and technological capacity of the revenue administration, its chances of monitoring taxable activity and countering tax evasion are seriously reduced. For this reason tax audit plays an important role to increase the revenue administration capacity. As tax audit is one of the tools of revenue administration, this study focuses on its significance and practice in Ghana taking the (IRS) / DTRD of the GRA as a case.

1.3 Objectives of the Study

The main objective of the study is to know whether tax audit practice plays a significant role in tax administration. Specifically, the study attempt to:

1. To trace out the basic concepts of tax audit along with the different methods of its implementations.
2. To analyze the significance of tax audit in strengthening tax administration capacity.
3. To analyze the role and significance of tax audit in increasing tax revenue
4. To provide concrete suggestions to the issues relating to tax audit practice in GRA based on the case study.

1.4 Significance of the Study

The study will provide feedback to tax payers and the tax authority regarding the significance, application and practice of tax audit. The study also contributes in evaluating the prevailing tax audit practice and in making some adjustments on the existing tax audit systems. Moreover, it will provide constructive feedback about the efficiency and effectiveness of the existing tax audit practice in GRA. For those who are interested to make further study on the related issue it may be used as an indication.

This project work is intended to provide immense benefit to tax administration and auditing in Ghana and also seeks among other things to establish the extent to which tax administration and auditing can be improved. Again, knowing the positive extent to which tax administration and auditing has helped and the purpose of which tax auditing has been introduced to help in planning the country's economy. Mechanisms used in tax administration and auditing in Ghana gives clear methodologies that are of great importance to the research work.

1.5 Scope and Limitation of the Study

The study analyses the tax audit practice in Ghana with special reference to the IRS/DTRD of the GRA. In particular tax audit practice, Large and Medium tax payers were considered in the study. While studying the tax audit practice, this study considers only the practice and its application in the IRS/DTRD of the GRA, thus the scope may be somehow limited.

However, since the general guidelines, application procedures and practice are the same throughout the country, it is supposed that this study can fairly reveal the tax audit practice and its significance in increasing the revenue of the country. It may have some limitations with the conclusions as well since there are some types of taxes which are not applicable in the IRS/DTRD of the GRA.

The following problems were encountered.

1. GRA in Transition: ACT 791 of December 2009, brought the Ghana Revenue Authority (GRA) into being and it took over the joint functions of Internal Revenue Service (IRS), Value Added Tax Service (VAT) and the Customs Excise and Preventive Service (CEPS) from January 2010. However available data on tax auditing relates mainly to the IRS therefore information gathered for this study came mostly from the IRS. This notwithstanding it is believed that the outcomes and conclusions are relevant for the GRA.

2. Unwillingness to give adequate information: Most tax payers were reluctant in giving information about the study since most believed that the result of a tax audit on their books and tax payment was something very confidential and therefore were not very willing open up.

3. Inadequate record keeping (Book-keeping): Some respondents were not keeping proper records of their business activities and therefore could not give adequate and correct information on the effect of taxation on their business activities and the rippling effect of tax audit practices on the economy of Ghana.

1.6 Organisation of the Study

The project work is categorized into five main chapters. Chapter one focuses on the background to the study, problem statement, objectives, significant of the study, research methodology, limitations and delimitations.

Chapter two is devoted to systematic review of existing literature. It provides evidence regarding the tax audit practice and its role in increasing revenue of the government.

The third chapter deals with research methodology including population, sampling techniques, methods of data collection and the research instruments employed.

Chapter four is also made up of detailed analysis of data collected and presentation of information with the aid of quantitative and statistical models.

The fifth chapter covers the summary, conclusion and recommendations.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Introduction

This section carefully reviews scholarly literature on taxation and tax audit practices. It provides an extensive and sufficient guide for the research and to assist other researchers who seek to replicate or delve more deeply into the thesis research topic

2.2 Definition of Taxation

Taxation is often defined as ‘the levying of compulsory contributions by public authorities having tax jurisdiction, to defray the cost of their activities’ (Arnold and McIntyre, 2002:6). No specific reward is gained by the tax payer. The money collected is used for the common good of the citizenry – for the production of certain services, as aforesaid, which are considered to be more efficiently provided by the State rather than by individuals e.g. maintenance of law and order or security, water, electricity, transportation, etc.

2.2.1 Purpose of Taxation

The definition of taxation given above underlines the main purpose of taxation, that is, to raise revenue to defray the cost of services provided by the State. Other purpose of taxation are to reduce inequalities arising from the distribution of wealth; to restrain certain types of consumption e.g. alcoholic beverages and cigarettes; to protect home industries and to control certain aspects of the country’s economy e.g. balance of payment, employment saving, investment and productivity.

2.2.2 Basis for Taxation

Governments have enumerable responsibilities. Some of these include economic infrastructure (roads, legal tender, enforcement of contracts, etc.), enforcement of law and public order, protection of property, public works, social engineering, welfare and public services (including education systems, health care systems, pension for the elderly and public transportation. Energy, water and waste management systems are also common public utilities) and the operation of government itself.

A number of revenue sources are available to a government to execute these responsibilities. Among the many sources is tax. Taxes consist of one prominent, prudent and feasible source of revenue for the government. Governments therefore tax the people in their country as they produce to earn income for themselves. Taxes form a high percentage of revenue to nations.

Funds provided by taxation have been used by states and their functional equivalents throughout history to carry out many of these functions outlined above. Governments use different kinds of taxes and vary the tax rates. This is done to distribute the tax burden among individuals or classes of the population involved in taxable activities, such as businesses, or to redistribute resources among individuals or classes in the population.

Historically, the nobility were supported by taxes on the poor; modern social security systems are intended to support the poor, the disabled, or the retired by taxes on those who are still working. In addition, taxes are applied to fund foreign and military aid, to influence the macroeconomic performance of the economy (the government's strategy for doing this is called its fiscal policy), or to modify patterns of consumption or employment within an economy, by making some classes of transaction more or less expensive.

2.3 Meaning of Tax Audit

An audit is the independent examination of financial statements of related financial information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon. The American Accounting Association (AAA) (2008) has provided a broader definition of audit which refers to a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. In a narrower sense, audit is an 'attestation communication' because it presents the auditor's opinion or judgment concerning the degree of correspondence between accounting information and established criteria.

To the tax administration, tax audit refers to the examination of tax returns by concerned tax officials primarily with respect to checking as to timely arrival, inclusion of all required forms and attachments, and arithmetical accuracy. This may be called internal tax audit.

A tax audit is one of the most sensitive contacts between the taxpayer and a revenue body. The presence of an auditor in a taxpayer's private dwelling or business premises, coupled with the exploration of private and business issues and the gathering of information from taxpayers' books and records, or just the disruption of day-to-day workflow, represents a burden on the taxpayer and may be seen by some as an unwarranted intrusion into their affairs. Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying provided information.

The tax audit function plays a critical role in the administration of tax laws in all countries. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the 'public face' of a revenue body. These factors, as well as the absolute size of the audit function in most revenues bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function.

Historically, the audit function conducted by public accountants has been associated with this activity of attesting to financial statements. Tax audit (expected to be performed by public accountants) can be thought of as an extension of this 'attest function'. For tax purpose, one assessee is liable to file a return to the concerned assessing officer with supporting documents sometimes required by tax law for simultaneous submission with the return. The assessee is sometimes called upon by the assessing officer under the tax law for producing the same. In this context, the question of tax audit may arise. And 'tax audit' means to audit an assessee's accounting and other documentary evidences to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in tax return and other required evidential statements regarding allowances and disallowance for deductions and all these are to be followed by an audit report giving the auditor's opinion about the degree of correspondence between the information content in the tax return and the regulatory provisions of the existing tax laws (AAA, 2008).

Thus, tax audit comprises the following:

Accounts and other evidences are required to comply with the 'tax basis of accounting', i.e. as per requirement of tax laws;

- Preparation of tax return, statement of computational working for items in the return and statements containing particulars of allowances and disallowance for deduction;
- Giving audit report portraying the attest function whether the tax return and statements have been fairly prepared as per the regulatory requirement of tax laws (Mukul, 2005).

When we think about who does tax audits, we first think of a public inspector, a civil servant, integrated in a public organization or agency of the government. Nevertheless, in the field of private financial statements audit, the audit must comprise all the economic-financial operations, including the taxes-originated ones, and the auditors opinion must also include whether the taxpayer has correctly assessed tax liability. For instance, according to Kamal Gupta & Ashok Arora, in India, the Income Tax Act, provides for compulsory audit of the accounts of certain income tax assessee's (i.e. persons liable to pay income tax) whose turn over exceed the specified limits. It was also practiced for some years in India but left after the 1997 E.C. election. The objective of such audit is to assist tax authorities in making the correct income tax assessment of the assessee's concerned. The tax auditor has to specifically report on certain transactions which have an impact on the income tax liability of the assessee concerned and are, thus important to the tax authorities (Ahymed and Stern, 1991).

2.4 Audit of Government Revenues

In recognition of the importance of an efficient revenue collection system for mobilizing the budgetary resources of the government, the need to establish revenue audit as a specialized and independent domain has been engaging the attention of the Supreme Audit Institutions for quite some time. The International Congress of International Organization of Supreme Audit Institutions (INTOSAI) held at Rio de Janeiro, Brazil in May, 1959 recommended that: Supreme Audit Institutions (SAI) ought to exercise the broadest possible supervision of revenues.

Supervision should not be limited to the checking of collection of revenues in line with the accounts rendered by the collectors but, wherever possible, a check should be made to see whether or not tax payments were in line with legislation.

SAIs should ascertain whether there has been negligence in the matter of collections or exaggeration in the estimates. The SAIs ought to be equipped to carry out their duties, especially as regards supervision of revenues, with mechanized accounting and statistical services.

The concept of tax audit was a sub-theme in the Third International Seminar of INTOSAI held at Bali, Indonesia in June 1988. The following guidelines were recommended in the area of tax audit.

(a) Audit mandate: SAIs should seek clear and specific legal authority for undertaking comprehensive tax audits in conformity with the relevant provisions of the Lima Declarations on Auditing Precepts.

(b) Audit of individual tax assessments: It is important that individual tax files are examined to evaluate the adequacy of the system and procedures of tax assessment and collection. As the examination of all tax files is neither feasible nor necessary, best results may be obtained while concentrating on high value and risk areas. Selective auditing of business income cases rather than salary assessment, investigations of reported evasions and use of suitable statistical sampling techniques in the review of files are preferred practices. Data and information on tax payers collected by the tax authority may be verified against other independent sources available.

(c) Interpretation of tax laws: SAIs should scrutinize the rules, regulations and notifications issued by the executive agencies under the tax statutes.

(d) Scrutiny of decisions of tax authorities: Where quasi-judicial and discretionary powers are vested in the tax officials, any decisions taken in the exercise of such powers should be scrutinized in audit.

(e) Audit methodology: Audit should be mainly system based and the objective should be to discover loopholes, lacunae and deficiencies not only in tax administration but also in tax laws. Adequate procedures for identifying and dealing with tax avoidance rising from deficiencies in laws could be considered so that remedial action including amendments to the laws could be taken promptly.

(f) Socio-Economic implication of taxation. The social and economic goals proposed to be achieved through tax concession and relief should be reviewed in audit.

(g) Reporting on the results of tax audit: Having regard to personal privacy considerations, it is imperative that confidentiality be maintained in reporting individual assessments in the audit reports.

(h) Training of tax auditors: Tax audit is a specialization which requires thorough knowledge of the relevant laws and regulations. SAIs should provide intensive and frequent training for tax auditors taking advantage of the training facilities available in their local tax department's training institutions as well as those in other SAIs.

2.5 The Roles of the Taxpayer Audit Program

The tax audit program of a revenue body performs a number of important roles that effectively carried out and can make a significant contribution to improved administration of the tax system. These roles are described briefly hereunder:

- Promote voluntary compliance: The primary role of the audit program is to promote voluntary compliance by taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized.
- Detect non-compliance at the individual taxpayer level: By concentrating on major areas of risk (e.g. unreported cash income) and those individual taxpayers most likely to be evading their responsibilities, audits may bring to light significant understatements of tax liabilities, and additional tax revenue collections.
- Gather information on the 'health' of the tax system (including patterns of taxpayers' compliance behavior): The results of normal audit activity may provide information on the general well-being of the tax system. Audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance, that over time can be used to identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on

future compliance improvement strategies, to refine automated risk-based case selection processes, and even support changes to tax legislation.

- Gather intelligence: Audits may bring to light information on evasion and avoidance schemes involving large numbers of taxpayers that can be used to increase major counter-abuse projects.
- Educate taxpayers: 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 taxpayers in the future.
- Identify areas of the law that require clarification: Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws' requirements and/or to better educate taxpayers on what they must do to comply into the future.

Given the broad range of roles to be performed a revenue body's audit program typically entails the largest allocation of a revenue body's total staff resources. From this perspective alone, the audit program represents a sizeable strategic investment that dictates the need for sound management policies and practices.

2.6 Government Revenues Scope and Extent

As mentioned earlier, government revenues are sourced from various tax and nontax receipts. The country papers bring out the dimensions of these two sources which in turn influence the areas of audit priority. These are tax and non-tax revenues. Government revenues are largely dependent on taxes legislated through various tax statutes. However, the spread of the two sources, viz. tax and non-tax revenues, varies from country to country.

The scope of audit activities varies across countries, in part as a result of the system of assessment in place. There are two generally accepted systems of tax assessment applied worldwide (administrative assessment and self-assessment) In around half of OECD countries, administrative assessment is employed to varying degrees in the administration of personal income tax and corporate profits/income tax. All countries administer VAT under self-assessment principles.

Assessment systems operate on the principle that all tax returns should be subject to a degree of technical scrutiny before a formal assessment is sent to the taxpayer. In practice, however, much of the scrutiny previously undertaken by technical staff has been replaced in many countries by the use of automated screening techniques to identify returns requiring scrutiny before a formal assessment is issued. To the extent that there is some level of scrutiny carried out by technical officers, it ranges in practice from a very cursory examination of some tax returns to a more in-depth examination where further inquiries may be made with taxpayers (sometimes by correspondence) before a formal assessment is issued. Even countries that operate administrative assessment regimes complement these arrangements with a formal program of post-assessment audits. However, in practice such programs tend to be conducted on a smaller scale than is the case in countries only applying self-assessment principles.

In countries where self-assessment principles are applied, returns are typically accepted as filed in the first instance (with the exception of returns containing mathematical errors or clearly erroneous deductions) and, for income tax, a formal assessment/ notice confirming/advising the tax liability is sent to the taxpayer before any inquiry. A sample of returns is selected for post-assessment audit, generally applying computer-based risk selection techniques and/or manual screening processes. Large scale matching programs may also be mounted on a post –assessment basis for the major categories of income (i.e. wages, interest, and dividends).

Since virtually all tax returns are accepted as filed without technical scrutiny when applying self-assessment principles, it is essential for the system to be supported by a reliable automated audit case selection system using risk-based screening techniques. Typically, such systems are developed using risk-based criteria derived from analyses of completed audit cases and are regularly updated to take account of the results of audit activities and to reflect important changes in the behavioral patterns of taxpayers. Examples of risk identification models and approaches are described in the companion note 'Audit Case Selection. As systems of administrative assessment and self-assessment have evolved over time in many countries there is something of a fine-line in practice between their features and relative efficacy.

According to the Ethiopian Federal Inland Revenue Authority's tax assessment and audit manual (2006), an assessment is basically an initial review by tax official of the tax declarations and information provided by tax payer and a verification of the mathematical and technical accuracy of the declared tax liability shortly after the submission of the declaration. The initial review also includes the application of various risk criteria to determine possible tax underpayments and the subsequent selection for tax audit.

An audit on the other hand, is the conduct by audit staff for appropriate verification of selected tax payers declared tax liabilities. This can include a review of tax payer's systems, books of account and other related information. It may also include cross checks of tax payer's records with those of tax payer's suppliers or with other source of information such as the custom authorities or other government departments and agencies.

2.7 Key Audit Characteristics

Compliance regimes operate within the unique legal, cultural and administrative background of individual member countries. Nevertheless, there are a number of common pre-requisite features and requirements that need to be in place to ensure a good level of effectiveness and efficiency from audit activities and to support continuous improvement. They are:

- A comprehensive legal framework, including an appropriate regime of sanctions.
- Well-defined organizational and management processes, including a comprehensive performance measurement framework.
- Well-defined audit techniques and adequate support arrangements; and.
- Adequate human resource management and development programs.

2.8 Need for Tax Audit

Four conditions tend to create the demand for the independent performance of the audit or attest function. They are as follows:

- Conflict of interests between those who prepare accounting information reports and those who use them;
- Consequence of information to users while using them in decision-making;
- Complexity of subject matter and audit process; and
- Remoteness of users from subject matter and preparer.

When audit function is extended to tax, the above-mentioned four conditions are also required to be satisfied. Here, the preparer of income tax return and relevant information (the assessee) has the conflicting relationship in terms of financial interest with his counterpart user or evaluator of the return (the assessing officer). Because, manipulated information in the tax return may reduce the tax liability.

Second, use of the tax return, assumed to be correct and complete, may have serious consequence on Government fiscal estimation and collection thereof. As a result, all the budgetary appropriations may stand for nothing but a baseless imagination.

Third, both financial accounting and tax accounting are recognized as a much complex discipline due to technicalities and their distinct characteristics of difficulties. Finally, between the preparer of the return and the information therein (by the assessee) and the assessing officer, there exists a wall of remoteness though the latter can call for any additional information from the former to be satisfied with the completeness and correctness of the information provided. But sometimes this may not be possible due to time and cost constraints and some other reasonable causes.

In this case, the tax authority can apply his best judgment, which may not be the expression of the reality and thus both the parties, the Government and the assessee may be affected by under- or over-charging of tax. Therefore, all the conditions creating the demand for audit with respect to tax can be found to be satisfied.

Besides, the Committee on Basic Auditing Concepts (COBAC) suggested that the subject matter of any extension of the audit function must have the following attributes:

- The subject matter has to be susceptible to the deduction of evidential assertions. Such assertions have to be both quantifiable and verifiable;

- There has to be an information system to record the actions, event or results thereof; preferably adequate internal controls have also to be in operation; and
- Consensus should exist on the established criteria against which the information prepared from the subject matter can be evaluated.

Each of the attributes stated above is essential. Two additional conditions are also needed. They are: auditor's competence and summarization of findings in a report. The COBAC of AAA has recognized that extension of the attest function to the audit of income tax return appears to satisfy all the attributes stated above. The subject matter allows the deduction of evidential assertions, which are verifiable as well as quantifiable. Tax law requires the maintenance of an 'information system' adequate for recording the actions and events, and the law also serves as a criterion for evaluating the subject matter information.

The International Federation of Accountants (IFAC) Ethics Committee, in the 'Code of Ethics for Professional Accountants' has defined 'professional service' as 'any service requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services'. Hence, an auditor must be competent first in accounting, inevitably in auditing, as well as thereafter in taxation.

Introduction of tax audit by qualified professional accountants is indeed the esteemed recognition of their specialized competence. The real benefit from compulsory tax audit, if legally enforced, is that the audit will ensure maintenance of proper books of accounts and other records. The growing accounting habit thus developed will enable creation of a transparency of the in the middle of grey area between assumed income and reported income. Thus, tax evasion will be markedly curbed through checking the fraudulent practices concerning colluded accounts. Other arguments in favor of tax audit include: tax return with added credibility and accompanied by tax audit reports as well as necessary supporting statements can reliably be presented before the authority facilitating tax administration, relieving assessing officers from carrying out routine verifications, and attending to more important investigation aspects of assessment cases through utilization of the saved time.

2.9 Types of Tax Audits

Audits can vary in their scope and the level of intensity to which they are conducted. For this reason, various terminologies have evolved to describe different types of audit activity (Mugume, 2006):

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

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.

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 noncompliance and a taxpayer's prior history. Extensive audit inquiries may also be justified simply because a taxpayer's financial and /or business activities are unusually complex.

Periods under examination: Audits can focus on one financial year or accounting period, or be extended to cover multiple fiscal periods. An audit can focus on specific parts of the taxpayer's activities (such as sales, goods in stock etc), specific incidents or transactions or activities (such as those carried out in a branch or subsidiary), or specific tax obligations. An audit can vary in its level of detail. Sometimes the taxpayer's affairs are examined in detail and in other situations, subject to the level of risk perceived, merely superficially (Bukenya, 1996).

2.10 Resources for the Tax Audit Function

Revenue bodies typically have at their disposal a finite level of resources to conduct the day to day business of revenue administration. Given the many tasks to be performed and the inevitable decisions that must made on priorities, a process is required to determine how those resources are to be allocated. In some member countries, revenue bodies have relatively limited discretion as to how staff resources are to be spread across the various areas of work, while in others broad discretion is given to senior management on how resources are 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. Determining how resources might best be allocated is a key element of a revenue body's strategy for compliance improvement and is dealt with in the following section[1]

The significance of the roles played by the taxpayer audit function, as described above is evidenced in part by the 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%[2].

2.11 Location of Audits

Tax audits can be conducted in different locations. Sometimes there is a need to carry out the audit at a taxpayer's business premises. In other situations, the books and records required to complete an audit can be collected by, or sent to, the revenue body and the audit work performed in the office. Tax audits can be categorized as 'field audits' or 'office or desk audits' on this basis.

Given that audits can vary in terms of their scope and intensity revenue bodies should have a clear policy on the types (and numbers) of audits to be conducted, and the

[1] Forum on Tax Administration's Compliance Sub-group

[2] Tax Administration in OECD and Selected Nonmember Countries: Comparative Information Series (2006)

circumstances in which specific types of audits are to be carried out, so that audit officials (including managers) understand what is expected of them.

2.12 Approaches & Standards of Tax Audit

In conducting a tax audit the auditor should apply the generally accepted practices of auditing as one would do in the case of other audits, e.g. an audit of a company under the companies act (Kangave, 2004). The generally accepted auditing practices are communicated in the various pronouncements of the respective country. The auditor should get the financial statements as well as the statement of particulars authenticated by the assessed before he verifies them. The auditor can apply the technique of selective verification (statistical sampling/test-checking), depending on his evaluation of the internal control system prevalent in the entity under audit and the materiality of transactions.

In conducting the audit the auditor should keep in mind that the basic objective behind is to assist the authorities in assessing the collect income of the assessed. For conducting the tax audit effectively an auditor needs to develop an approach which is a synthesis of taxation laws and auditing principles. The nature of tax audit is such that an auditor has to rely on various legal pronouncements in the field of taxation[3].

2.12 The Efficiency and Effectiveness Tax Audit

Audit effectiveness is measured by examining the amount of evidence selected for examination in relation to the total available evidence and an optimal level of evidence. Audit efficiency is then defined as audit effectiveness per unit of time by taking the audit

[3] Tax Administration in OECD and Selected Nonmember Countries: Comparative Information Series (2006)

effectiveness measure divided by minutes spent on the task (Kangave, 2004). The key findings were that time pressure (manipulated by four levels of a time budget for the task) affected performance only at the extremes, with the highest time pressure group performing more efficiently than the auditors in the lowest time pressure group. Efficiency was also affected by audit program structure, with high structure (more detailed audit procedures listed) being associated with increased efficiency.

Apostolou *et al*. (1993) defined audit efficiency as the ability to meet the budget and operationalize it as the percentage deviation between actual and budgeted hours. This research examined the effect of leader behavior on audit efficiency. Two leader behaviors; (1) facilitating cooperation and teamwork and (2) administering discipline; resulted in increased audit efficiency. On the other hand, showing consideration contributed to reduced audit efficiency (Apostolou *et al*., 1993).

In addition in an economic sense, the concept of efficiency is rooted in the ideas of minimization of inputs, absence of waste, and least cost production methods Auditing practitioners tend to define efficiency as accomplishing the audit task in less time thereby increasing profitability (McGrath and Hollingshead, 1993). The efficient and effective conduct of audit activities requires that a revenue body's audit and investigation staff have appropriate powers of access to information held by the taxpayer and other parties so that taxpayers liabilities reported in their returns can be properly verified or, in the absence of returns, be accurately established. There should also be an appropriate regime of sanctions to punish and deter non-compliance (Moyi and Muriithi, 2003).

For these reasons, revenue bodies require a set of powers and sanctions in the legal framework supporting the conduct of tax administration activities that includes the provision of adequate powers for obtaining information and an appropriate regime of sanctions covering the various offences that may arise (Cheeseman and Griffiths, 2005). In practice, this legal framework may be set out separately in the laws governing each tax administered or, preferably for ease of legislative maintenance, in a single comprehensive law on tax administration that provides a common set of provisions covering all taxes. In the US, an official form titled 'Cost Benefit Analysis' (Review of Cost Effectiveness of Investigations) is used to measure the cost benefit of continuing an audit. The form is being prepared at a predetermined stopping point in the audit (such as when 60 hours have been expended by the auditor) (Cheeseman and Griffiths, 2005). The form calculates cost benefit by assigning dollar values for the auditor's hourly labour costs and multiplying the cost by the hours projected to complete the audit. The auditor's total labor dollar cost is matched against the projected revenue anticipated (benefit of continuance). A negative cost benefit analysis may result in the early termination of the audit.

Collectibles is another factor for possible consideration. Some countries use collectability as a pre-contact consideration and other countries reported that it could become a factor during the course of the audit if bankruptcy were imminent (Kangave, 2004). 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 (Kangave, 2004).

2.13 Significance of Tax Audit in Fighting Corruption

Simply defined, corruption is the abuse of public power for personal gain or for the benefit of a group to which one owes loyalty. It occurs at the intersection of public and private sectors, when public office is abused by an official accepting, soliciting, or obtains by threat a bribe. Klitgaard (1996) has developed a simple model to explain the dynamics of corruption:

C (Corruption) = M (Monopoly Power) +D (Discretion) – A (Accountability)

In other words, the extent of corruption depends on the amount of monopoly power and discretionary power that an official exercises. Monopoly power can be large in highly regulated economies; discretionary power is often large in developing countries and transition economies where administrative rules and regulations are often poorly defined. And finally, accountability may also be weak, either as a result of poorly defined ethical standards of public service, weak administrative and financial systems and ineffective watchdog agencies. Tax is one of the most exposed issues for corruption since it is carried out by the interaction of the tax payer and the tax auditor.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Chapter 3 presents the blueprint of how the study was conducted to ensure that the most valid findings were reached. The most appropriate procedures were performed in order to provide answers to the research objectives. These include types of research design employed, the measuring instrument, the sampling procedure, data management and data analysis.

3.2 Research Design

The study was based on both qualitative and quantitative case study approaches. The IRS/ DTRD of the GRA acted as a case in this study. The study was based on case study approach because it involved an in-depth understanding of the services provided by a single unit within an organization. Moreover, case study provides more realistic responses than a purely statistical survey. The objectives of the study have certain implications for the design of the study. As noted earlier, the aim of the study is to identify the extent, efficiency and effectiveness of tax auditing in maximizing revenue generation. The focus of the study is to obtain some qualitative and quantitative data that would facilitate a conclusion about the practice of tax audit system and its impact on revenue of the country.

3.3 Quantitative Research Methods

The quantitative study involved primary data collection through a field survey and secondary data collection from the DTRD of the GRA. Quantitative research was carried out to provide some answers to issues raised to justify this study in Chapter 1.

3.3.1 Secondary Data Collection

The study made use of information obtained from documents in various forms, such as Acts, newspaper and reports from different institutions. Literature from libraries, archives, documents review, articles, constitution of Ghana, data bases and online resources. Most of these documents were obtained from DTRD of the GRA.

3.3.2 Data from Primary Sources

As adequate data could not be gathered from the institutional or secondary sources, additional data was collected from primary sources. Data collection from primary sources involved a field survey since it has the capacity for generating data from a large number of people. The survey was limited to staff and management of the DTRD. The managers were chosen because they were in better position to give detailed information required by the study.

This research strategy was deliberately chosen to see how results from primary data compared with the results obtained from secondary data. Research on the basis of primary data provided a different way of examining the same research problem examined by the secondary data. It meant that primary data served as complementary to secondary data.

In order to generate data from the primary sources, a written and self-administered questionnaire which was relatively cheap, time-efficient and free from interviewer bias was developed. Considering the time and costs involved in other instruments, this instrument was chosen despite objections from several authors on the ground that it yields incomplete responses, contains confused questions and lacks spontaneity. However, given the circumstances that constrained the use of other efficient instruments, it was believed that the advantages of a self-administered questionnaire far outweighed the disadvantages associated with it.

Questionnaire design for tax audit surveys typically helps to extract information on the characteristics of the audit practice, the time spent on each tax audit case by tax auditors, issues of tax evasion, and tax related malpractices by tax payers; and any other related issues. The questionnaire was designed to meet the following objectives:

- *User friendliness*: The questions were kept short and language was as simple as possible to encourage legibility and maximize the response rate.
- *Comprehensiveness*: the number of questions was kept to a minimum to encourage responses. However, it was necessary to collect a large amount of relevant quantitative and qualitative data.
- *Attitudinal questions*: Tax auditors were asked to respond on their attitudes towards the existing tax system and the significance of tax audit for the government as well as for the tax payer.
- *Respondents*: they had an opportunity to add any comments that they feel were not covered in the survey.

Questionnaires were distributed for some tax auditors in the DTRD of the GRA in Accra; sixty eight questionnaires were distributed out of which a total of fifty were returned. Around forty six were more or less filled; the remaining four were partially fulfilled.

The sample was drawn from a list of employees from the DTRD of the GRA offices in Accra. The list included managers in the DTRD of the GRA. The total sample size for the study consisted of sixty seven managers and staff using systematic random sampling. With this understanding, self-administered questionnaires, shown in Appendix, were personally administered to the sixty five managers during the first week of March 2011. The objectives of this questionnaire were to elicit information which was not available from secondary sources.

3.4 Qualitative Research

The qualitative research method was considered as a means of gaining access to unquantifiable facts. This method uses 'words as data' and it allows the researcher 'to share in the understanding and perceptions of others'. Qualitative methods unfold events over time which provides additional information often untapped by static quantitative methods. As this study deals with a single organisation, the qualitative research method was incorporated in the research design. However, the qualitative method was used in conjunction with the quantitative method as a multiple research strategy to increase the depth of understanding of the results of an investigation into the tax audit practice in Ghana. The reason behind the application of both research methods was to discover the commonalities across various findings to increase validity and reliability of the conclusions about the tax audit practice.

3.4.1 Interview

As a part of the qualitative research method, interviews were conducted by the researcher with a number of policy makers regarding the tax audit practice and its significance, among them were the officials of Ministry of Finance and Economic Planning (MoFEP) and some managers of IRS/DTRD of the GRA. The aim of such interviews was to find out the perceptions of these officials about the tax auditing situation in Ghana. As regards interviews with the officials of DTRD of the GRA, it is to be pointed out that prior to conducting interviews; attempts were made to gather information through unstructured interviews. Interviewees other than GRA staff were asked more questions about policy-related variables on tax auditing. Purposive sampling method was used to select the officials from this category.

3.5 Data Analysis Procedure

After data was collected, proper tools and techniques were applied for classification and analysis of data. The main tools that were applied for classification of data are tables, charts and graphs. The analysis of data involved computation of statistics such as ratios and percentage analysis methods. The analysis were based on the revenue collection performance of the IRS compared to yields from tax audit activities, budgeted revenues and tax audit practice in IRS/DTRD of the GRA using the various types of taxes applied throughout the country.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF RESULTS

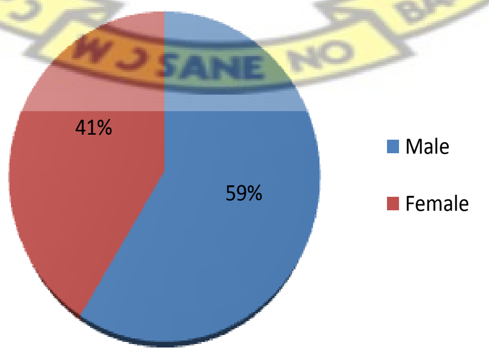
4.1 Introduction

This section is devoted to the presentation and analysis of data collected for the study. The analysis is based on the data collected from the field of study according to the response given by the respondents. The first section presents the characteristics of the respondents. The next section presents prevailing tax audit practice in Domestic Tax Revenue Division (DTRD) of Ghana Revenue Authority (GRA). The final section covers the assessment and audit at DTRD of GRA.

4.2 Characteristics of Respondents

This section provides information on the backgrounds of the respondents in the study. Personal details of respondents covered are sex, age and length of service with GRA. Figure 1 also shows the gender distribution of the respondents. Fifty-nine (59) percent were males, and forty- one (41) percent were female.

Figure 4.1 Gender Distribution of Respondents



Source: *Field Survey*, 2011

Regarding respondents' age distribution, a sizeable proportion of respondents (i.e. 20 percent) were below 30 years. Moreover, close to 36 percent of the respondents fell between 31 and 40 year age bracket. More than a quarter of the respondents (i.e. 26 percent) fell between 41 and 50 years, and eighteen (18) percent were older than 50 years (see Table 4.1).

Table 4.1 Ages of Respondents

Age Group	No. of Mentions	Percent
< 30 yrs.	10	20
31 – 40 yrs.	18	36
41 – 50 yrs.	13	26
> 50 yrs.	9	18
Number of Cases = 50		

Source: *Field Survey*, 2011

Respondents were asked about their experience in their field in general. The responses of workers detailed in Table 4.2 were diverse. Close to 34 percent of the respondents had 5 - 8 years of experience, 26 percent had 9 - 12 years and 18 percent had an experience of 13 - 15 years. Close to a fifth of respondents (i.e.18 percent) had four or less years of experience. However, only 4 percent of respondents had more than 15 years of experience.

Table 4.2 Years of Experience

Age Group	No. of Mentions	Percent
< 4	9	18
5 – 8	17	34
9 – 12	13	26
13 – 15	9	18
> 15	2	4
Number of Cases = 50		

Source: *Field Survey*, 2011

4.3 Prevailing Tax Audit Practice

To establish knowledge about audit practices, questions were designed to measure familiarity in terms of tax audit manual. Majority of respondents (92 percent) indicated that they are familiar with tax audit manual. Few respondents indicated that they are not very familiar with the tax audit manual.

Figure 4.2 Awareness of Tax Audit Manual

Source: *Field Survey*, 2011

Respondents were asked to evaluate the tax manual. Results from Table 4.3 indicated that more than half of the respondents evaluated the tax audit manual as clear and workable. Close to a third of the respondents saw tax audit manual as lacking some clarity. About 15 percent of the respondents viewed the audit manual as completely unclear

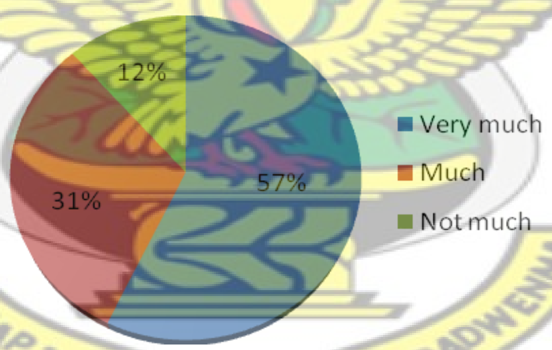
Table 4.3 Evaluation of Audit Manual

Response	No. of mentions	Percent
Clear and workable	25	54.3
Lacks some clarity	14	30.5
Completely unclear	7	15.2
Number of Cases = 46		

Source: *Field Survey*, 2011

Respondents were further asked to indicate the extent to which they were conversant with the tax laws. As indicated in Figure 4.3, about fifty-seven percent of the respondents indicated that they are very much familiar with tax laws. Close to a third of the respondents (31 percent) revealed that they are much familiar with the tax laws. Few respondents (i.e. 12 percent) indicated that they are not much conversant with the laws tax.

Figure 4.3 Extent of Familiarity with the Tax laws



Source: *Field Survey*, 2011

When asked about the way they carry out their audit function without familiarity with tax laws, a large proportion of the respondents indicated that they worked with someone who has better knowledge. The rest of the respondents indicated that they carry out their auditing with respect to the knowledge gained through education and training.

Majority of respondents indicated that when a single auditor carries audit work single-handedly, there is the risk of corruption. However there was a near consensus among the respondents that field audits have proved to be the best tool in combating tax avoidance and tax evasion, this is because majority of people and business in the tax net do not keep adequate records and therefore information provided to the tax offices are mostly not very reliable and it takes the work of tax auditors to bring out these weaknesses through the field audits. This not-withstanding desk audits also help in recovering lost taxes. They believe that field audit increases the risk of corruption by tax auditors. Some respondents said that the type of audit that is applied is determined by the situation. However, most of the time full audit is applied.

The response to the question regarding to administrative assessment vis a vis self-assessment is summarized in Table 4.4. From the table, it is evident that the main type of assessment that yields higher revenue to GRA is administrative assessment as responded by 76 percent of the respondents. Of course it is reasonable because the majority of tax payers do not maintain proper books of accounts and this situation certainly requires the use of administrative assessment.

Table 4.4 Type of Assessment

Response	No. of mentions	Percent
Administrative assessment	38	76.0
Self-assessment	12	24.0
Number of Cases = 50		

Source: *Field Survey,* 2011

Administrative assessment is basically based on estimation which may either lead to over taxing of the tax payer or a decline in government revenue. It is unquestionable that tax assessment based on estimation without evidences creates inconvenience on either the tax payer or GRA.

Respondents were further asked whether the auditors and investigation staff have appropriate powers of access to information held by the tax payers and other parties. All the respondents indicated that they have the mandate to access every information held by the tax payers and related parties. The efficiency and effectiveness of a revenue body's audit activities depends critically on the nature and scope of powers in the underlying legal framework in place, there is also an appropriate regime of sanctions to discourage and penalize non-compliance. Additionally for the effective and efficient tax audit, appropriate skill and qualification of tax auditors are also important. As revealed by the respondents, most tax auditors are degree holder's whiles others are qualified accountants. There is room for further training for tax auditors in order to sharpen their skills and to bring them abreast with contemporary accounting, auditing and taxation practices. Also adequate numbers of tax auditors can have a greater impact.

The response to the question regarding the type of audit usually applied by auditors is summarized in Table 4.5. From the table, most of the respondents said that the type of audit that is applied is determined by the situation. However, full audit is applied generally. In rare cases and under some conditions and for certain types of taxes, either single issue or limited scope audit may be applied.

Table 4.5 Type of Audit

Response	No. of mentions	Percent
Full audit	16	32.0
Limited scope audit	12	24.0
Single issue audit	8	16.0
Any of the three as appropriate	14	28.0
Number of Cases = 50		

Source: *Field Survey,* 2011

The effectiveness and efficiency of tax audit may be measured by the volume (number) of files audited from the planned. The responses to the effectiveness and efficiency measures are summarized in Table 4.6. Even if the effectiveness of tax audit is measured by a combination of the afore mentioned measures, 52 percent respondents said they have used volume as a measure of their audit activity. If we concentrate on effectiveness which is measured by quantity, it is difficult to achieve efficiency, since efficiency concentrates on the inputs utilized to achieve the desired outcome.

Table 4.6 How you measure the effectiveness of tax audit operation

Response	No.of mentions	Percent
Yield & productivity	8	16.0
Volume	26	52.0
Quality measures	5	10.0
A combination of two or more	11	22.0
Number of Cases = 50		

Source: *Field Survey,* 2011

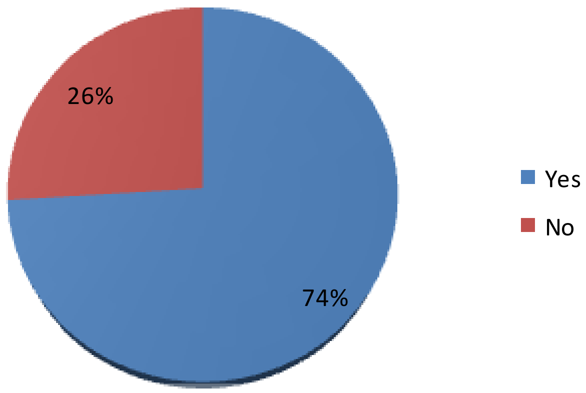
In addition, most of the employees engaged in the assessment and audit operations are not well motivated. This also has greater impact on the efficiency and effectiveness of audit and assessments. The other issue which affects the efficiency and effectiveness of tax audit is absence of adequate information, due to inadequate record keeping.

Respondents were asked whether there are mechanisms to evaluate the audit activities. It was revealed that there are mechanisms to evaluate the audit activities as responded by all the respondents. The work of the tax auditor is monitored by other individuals and they usually work in groups of two. As per the tax auditor's response, one file is usually audited by more than one individual auditor. This does not imply that, the tax audit is not exposed to the risk of corruption. Sometimes the tax auditors and the tax payers connive to deny GRA the opportunity to tap the required revenue, this is however not the norm. In the prevailing tax audit practice of GRA, tax audit may not contribute much to minimize corruption; it however helps to expose new trends of tax evasion and serves as a form of check on the work of desk officers, because tax audit is performed usually after the desk officer has completed the desk audit function. Furthermore, the wages and salaries paid to the tax officials and auditors are low as compared to private sector auditors.

The cases are selected at random. Moreover, the cases are selected by a group of audit supervisors. Most respondents replied that audit cases are selected based on the gross sales or revenue and the risk of exposure to evasion after reviewing the financial reports prepared by the tax payers however some cases are embarked upon through information provided by members of the general public and requests from authorities for a closer scrutiny of a particular sector of the economy or certain businesses.

When asked whether selected tax payers are notified in advance, about74 percent of the respondents indicated that the selected tax payers are given advance notice. About a fourth of the respondents, however, pointed out that some organizations are not given advance notice before they go in to audit. The findings suggest that a notice is served depending on the organization and the circumstance.

Figure 4.4 Notice sent to selected tax payers for audits



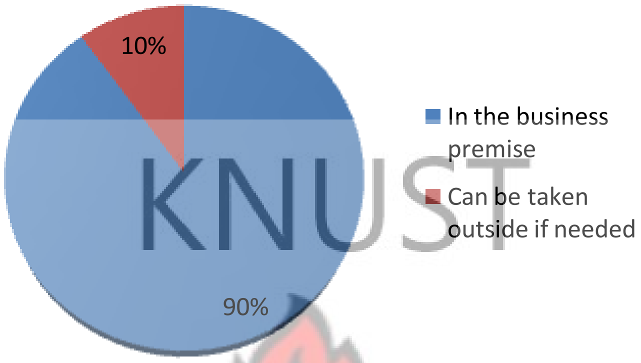
Source: *Field Survey*, 2011

When asked whether notification has impact on the audit activities, all respondents indicated that the practice really is helpful. This suggests that advance notice has positive impact on execution of auditors' work. The advance notification helps the about-to-be-audited organizations to organize themselves before the audit.

Respondents were further asked whether there was any legal framework to see the tax payer's record. All the respondents indicated that the tax auditors have the mandate to check on the records of selected organizations. According to the tax laws, all businesses should maintain their own accounting records. However in practice the situation is different. In practice, most tax payers that are eligible to maintain accounting records do not have proper accounting records. The main reason for this is that the tax payers usually not aware of the advantage of keeping proper books of accounts again the law which enjoins the tax payer to maintain proper accounting records is not strictly enforced by the responsible officers. This trend has encouraged some tax payers to believe that the tax that will be paid by estimation is less and it gives them an opportunity to negotiate with the assessor for favorable terms. In addition, they do not want to employ the services of accountants and tax practitioners which will bring them extra cost.

As to where to inspect the records, 90 percent of the respondents revealed that the firms' records are normally inspected in their business premises. However, 10 percent of the respondents revealed that the records sometimes taken outside the business premises.

.Figure 4.5 Location of Inspection of Records of Selected Tax Payers

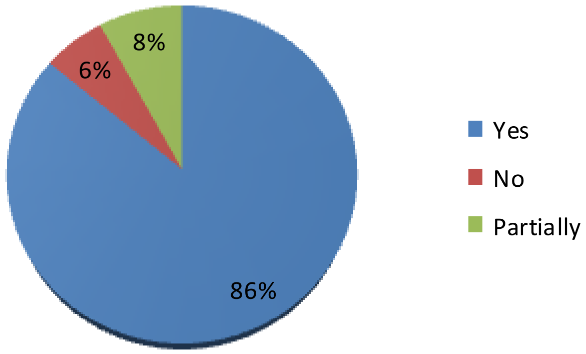


Source: *Field Survey*, 2011

When asked whether tax auditors have access to third party information sources, all the respondents revealed that tax auditors are mandated to have access to whichever information that can help their work. They also revealed that they can obtain information from other agencies when need be.

Regarding tax payers' co-operation to give essential information, majority of the respondents (86 percent) indicated that tax payers are usually not supportive at all. Few respondents indicated that some tax payers are partially accommodating or obliging at all.

Figure 4.6 Co-operativeness of Tax Payers



Source: *Field Survey*, 2011

Tax audit is one of the most sensitive contacts between the taxpayer and a revenue body, the presence of an auditor in a taxpayer's private dwelling or business premises, coupled with the exploration of private and business issues and the gathering of information from taxpayers' books and records, or just the disruption of day-to-day workflow, represents a burden on the taxpayer and may be seen by some as an unwarranted intrusion into their affairs. Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying information provided by the tax payer. Legal frameworks are essential to provide integrity in the way tax administrations carry out audits and to ensure that taxpayers' rights are properly protected.

When asked about the category of tax payers proven to be difficult to audit, most respondents (60 percent) mentioned self-employed individuals. This category of tax payers do not keep proper records nor maintain proper books of accounts. Those who manage to keep certain records or books of accounts are sometimes unacceptable. Respondents revealed that they normally assess the tax of self-employed by estimation. The next group that auditors find it difficult to work with is the Small and Medium scale Enterprises. The tax auditors revealed that they are more comfortable to work with large and medium businesses (corporate bodies) because they keep proper records, employ the right staff and are mostly knowledgeable about their tax obligations, they can therefore be easily audited. It must however be noted that this category of tax payers have the capacity to employ the use of tax avoidance schemes because they engage in international trade and the local tax offices are usually not equipped to unravel such schemes.

Table 4.7 Categories of tax payers difficult to work with

Response	No. of mentions	Percent
Self-employed	30	60
SME's	19	38
Corporate (large and medium)	1	2
Number of Cases = 50		

Source: *Field Survey*, 2011

4.4 Tax Assessment and Audit Performance

The study first analyzed the tax collected by GRA and how Domestic Tax Revenue Department helps in improving the collection of these taxes. As shown in Table 4.8 below, income tax is one of the main components of direct tax. Even if the share of business profit tax is high as compared to personal income tax, it does not increase at a constant rate while personal income tax increases at a constant rate. The reason is that, personal income tax is mainly collected from employment and without much effort. This source of tax does not need critical assessment other than checking whether the amount withheld by the employer is forwarded to the respective tax authority or not. However, business profit tax is collected from the profit of traders and corporate bodies and this need much effort to levy and collect due to the high risk of understatement and evasion. Some tax payers use all mechanisms that could understate their tax liability. This implies tax auditors have greater responsibility to audit and investigate any sort of understatement made by the tax payer and reassess the appropriate tax liability.

Table 4.8 Total Direct Tax Collection by Tax Type in the IRS/DTRD

	Tax type	Total Tax Collected(GH¢)	Target (GH¢)
2005	Personal Income Tax:		
	(a) PAYE	228,589.02	232,975.83
	(b)Self- Employed	31,300.00	3,273.32
	Corporate	317,613.30	337,582.58
2006	Personal Income Tax:		
	(a) PAYE	313,282.99	225,480.10
	(b)Self- Employed	35,888.81	42,780.00
	Corporate	315,372.23	378,874.80
2007	Personal Income Tax:		
	(a) PAYE	372,220,726.69	378,807,389.41
	(b)Self- Employed	45,589,162.24	45,997,914.01
	Corporate	418,669,151.54	387,871,045.20
2008	Personal Income Tax:		
	(a) PAYE	512,679,838.85	450,697,574.69
	(b)Self- Employed	64,180,049.77	60,245,391.61
	Corporate	554,992,960.90	509,771,606.26
2009	Personal Income Tax:		
	(a) PAYE	780,470,511.46	662,177,669.97
	(b)Self- Employed	75,086,078.90	82,479,694.65
	Corporate	737,472,078.64	676,852,236.59
2010	Personal Income Tax:		
	(a) PAYE	981,389,156.60	938,810,800.01
	(b)Self- Employed	96,782,430.14	107,197,871.51
	Corporate	1,003,859,281.53	929,033,083.94

Source IRS Commissioner's annual reports

The tax assessment and audit performance of IRS/DTRD of the GRA is shown Table 4.9. As shown in the table, overall the total assessment and audit performance was achieved 97% from the planned. The data showed that 174 out of 250 budgeted cases were audited by the tax audit unit of IRS/DTRD of the GRA in 2006. This means audit performance of 69.6 was achieved. Similarly, the Unit audited 178 out of 216 budgeted cases and achieved 82.4 percent in 2007. In 2008, the Unit audited 256 out of 300 budgeted cases and achieved 85.3 percent. However, the Unit performance rate reduced to 73.8 percent in 2009. Thus, the Unit managed to audit 236 out of 320 cases. The Unit achieved 173.7 percent of number of files audited in 2010 representing the highest so far. It far exceeded the target of auditing 300 cases.

Table 4.9 Tax Assessment and audit performance of Tax Audit Unit of IRS/DTRD

Year	No. of Files to be Audited/Assessed	No. of Files Audited/Assessed	Performance in Percent
2006	250	174	69.6
2007	216	178	82.4
2008	300	256	85.3
2009	320	236	73.8
2010	300	521	173.7

Source: Tax Audit Annual Report

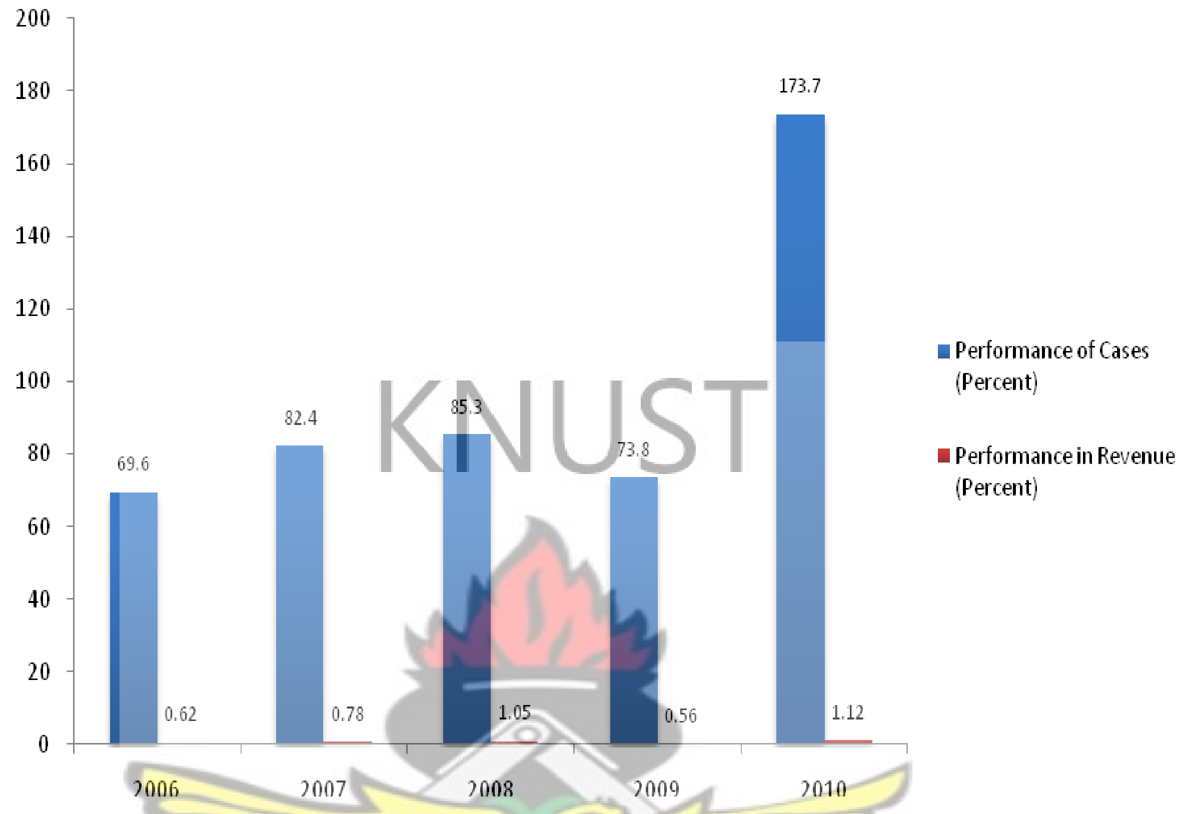
The trend of revenue performance can also been shown in Table 4.10. From the table, it can be observed that tax audit raked in additional 0.62 percent of revenue to GRA in 2006. This increased to 0.78 percent in 2007 and 1.05 percent in 2008. However, the additional revenue obtained through tax audit fell by 0.56 percent in 2009. The additional revenue obtained through tax audit rose again in 2010 to 1.12 percent. This suggests that GRA would have lost these revenues if tax audits had not been undertaken.

Table 4.10 Tax Assessment and audit performance of Domestic Audit Unit

Year	Revenue Obtained through tax audit (GH¢)	Total Annual Revenue (GH¢)	Performance in Percent %
2006	4,131.19	664,544.02	0.62
2007	6,490,506.45	836,479,040.47	0.78
2008	11,364,454.48	1,131,852,849.52	1.05
2009	8,832,237.87	1,593,029,542.45	0.56
2010	23,351,981.12	2,082,030,868.27	1.12

As seen in Figure 4.7, additional revenue mobilized through tax auditing increases/decreases with the number of cases handled by Domestic Tax Unit of GRA. For instance, while the cases of audits fell from 85.3 percent in 2008 to 73.8 percent in 2009, revenue obtained through tax audit fell by 0.49 percent. Similarly, while the cases of audits increased from 73.8 percent in 2009 to 173.7 percent in 2010, revenue obtained through tax audit also increased to 1.12 percent. This suggests that if Domestic Revenue Tax Division were to double their efforts, they would rake in additional revenue for the GRA.

Figure 4.7 Comparison of Cases of Audit and Additional Revenue Obtained through Tax Audit



As shown in Table 4.11, auditors depend almost equally on books of accounts of taxpayers and other documents from related parties in the performance of their duties; however on some occasions the auditors use their own judgment to estimate taxes for some taxpayers. Auditing based accounting records only was found to be below (40 percent). The main reason is that most of the tax payers do not maintain proper accounting records whiles others make all efforts to avoid or evade the payment of appropriate taxes, again for efficiency and reliability the auditor is obliged to seek for information about taxpayer's activities from other sources. It is worthy to note that if this is the practice in Accra and its environs where majority of the tax payers are assumed to be knowledgeable to a certain extent about the advantages of maintaining proper accounting records as well as where the bulk of accountants in Ghana can be found to offer their services and advice as compared to other parts of Ghana, then one can only imagine the tax situation in other places beyond Accra.

Table 4.11 Tax Assessment Modes

Response	No. of mentions	Percent
Based on book of accounts	19	38
Based on other documents	17	34
Based on estimation	8	16
A combination of two or more	6	12
Number of Cases = 50		

Source: *Field Survey*, 2011

Most of the respondents indicated that there are areas that are largely untapped or where tax evasion is considered to be rampant. They mentioned that these activities range from fishing, mining, manufacturing, construction, wholesale and retail trade, hotels and restaurants, transport, communication, real estate, education (private schools), health services (clinics and drug stores) and other services like saloons. In fact every facet of the Ghanaian economy holds huge potentials for expanding the tax net and improving upon domestic revenue generation. Unfortunately, because the Ghanaian economy is largely informal most businesses are not formally registered. They would therefore not be VAT registered neither would they be paying corporate tax on their profits or income tax for their employees.

While it is difficult to target these small scale and informal enterprises, by effectively expanding the tax audit operations GRA could be able to collect more revenue from those already registered and to rope in the large informal sector as well.

Also, a large proportion of staff rated the capacity Domestic Tax Revenue Division as inadequate. The size of the staff does not give the organization a good coverage of the nation. The staffing problems of DTRD have been a big hindrance to the operational activities and the deployment of personnel to various areas in the country. This situation has hindered the effective tax audit delivery in Ghana. Adequate staffing of the Tax Audit Unit in particular will be a major step in dealing with the situation.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1Introduction

This chapter provides concluding remarks of tax audit practices of Domestic Tax Revenue Division of GRA and how it can help improve revenue mobilization. The conclusions are supported by a summary of the results from the analysis on prevailing tax audit practice and tax assessment and performance. The chapter also contains a couple of recommendations aimed at improving the performance of DTRD and overall revenue mobilization of GRA.

5.2 Summary

The source of every government's revenue is mainly through taxation, however just like any developing country Ghana relies on foreign sources of finance like loans and grants; this is because the country has weak tax administration and collection ability. To change this situation there must be a major shift in the way tax matters are handled. This shift must include the setting up of an efficient and effective tax audit unit within the tax revenue collecting outfit. This will enable the government to keep up with the increasing sophistication of business activity and tax evasion schemes; it will also aid in identifying potential taxpayers and enlighten those who are already in the tax net about their rights and obligations. This study aimed at finding out whether the tax audit practice plays a significant role in tax administration and to analyze its significance in strengthening tax administration capacity in Ghana, it is also to analyze the role and significance of tax audit in increasing tax revenue. Due to the specialized nature of the tax audit practice data gathering was based on both qualitative and quantitative case study approaches in order to elicit the right responses and arrive at cogent conclusions. The Domestic Tax Revenue Division (DTRD) / (Internal Revenue Service), of the Ghana Revenue Authority (GRA), acted as the focus of the study.

The study showed that Tax Audit is a key component in any attempt to enhance revenue generation and has a major part to play in tax administration in Ghana, it has become even more important under the current dispensation of tax administration which is gearing more towards self assessment by tax payers rather than administrative or provisional assessment of taxpayers by tax officers. The self assessment regime requires for a very efficient and effective tax audit to maximize tax collection and eliminate tax avoidance and evasion. It is recommended that the tax audit unit be expanded to cover the whole nation and tax auditors be aided to be abreast with the tax law and their skills be enhanced through training, refresher courses and attachment to well established tax audits units of revenue collecting agencies of friendly nations.

5.3 Conclusions

With regard to individual taxpayers, the administration mostly applies a system of administrative or provisional assessment. The current orientation of the DTRD and GRA in general appears to be geared towards the promotion of more self-assessment. Nonetheless, the tax audit practice which is currently in place needs to be improved; this will position the unit to be prepared for the modern challenges posed by globalization and the reliance on Information Communication Technology (ICT) in doing business.

Regarding processes, the Unit performs virtually all processes manually; this seriously hampers accountability and transparency in the tax system, as well as the effectiveness and efficiency of the audit practice and tax collection. It also impairs supervision and access to many sources of information. Even though to the employees in the unit have the necessary skills which enable them to perform their duties and responsibilities, there is the need for adequate short term and refresher training to keep them abreast with current trends of auditing and investigations and also the numerous ammendments to the tax laws. The other important issue which should be seen seriously is that, the prevailing tax audit practice as seen in DTRD of GRA is carried out mostly based on documents produced by tax payers, these internally produced documents cannot be a wholly reliable source of information for tax purposes there is therefore the need to tool the unit to be able to source for third party information for verification and authetication of auditees' records . Furthermore, eventhuogh the tax audit is performed by tax auditors mostly in the tax payers premesis, there is the need to expand and improve on the number of field audits and in order to improve the efficiency and effectiveness of audit operation and to make a better impact on domestic revenue collection.

5.4 Recommendations

In the light of tax administration and in the context of tax audit practice with a special reference to the Domestic Tax Revenue Division of GRA and based on the findings obtained the following recommendations are made:

1. Continuous education should be provided to the tax payers by the Ghana Revenue Authority in order to create awareness about their rights and obligations so as to build and develop a better partnership with them and also to create citizens who have better understanding of taxation which will engender honest and voluntary compliance.

2. For effective and efficient revenue collection, there is the need to curb not only the tax evasion but also tax avoidance by applying effective and efficient tax audit based on reliable evidences and documents. Again adequate checks and controls must be put in place to manage the activities of tax auditors so as to maximize returns.
3. The tax collection system should be designed in such a way that not only the tax evasion but also the tax avoidance becomes very expensive for the taxpayer and compliance very rewarding.
4. Increased accountability and an open and honest relationship with taxpayers are crucial for maintaining public trust and confidence in the performance of tax administration. Taxpayers must be able to expect a high degree of certainty in their dealings with revenue agencies. This can only be achieved when tax laws, regulations, procedures, and administrative guidelines are made public, easily accessible, and applied in a consistent manner by avoiding unstable tax laws which creates confusion not only for tax payers but also for tax auditors.
5. Reforms of tax legislation and collection procedures, including measures to improve accountability, and transparency in the taxpayer-tax officer relations, should take place concurrently to reduce opportunities for corruption and the demand for corrupt services. The main ways in which the opportunities for corruption may be reduced include:
    - Clarifying, streamlining laws and procedures in order to reduce official discretion.
    - Making tax rules and regulations more transparent- In this case, simple measures such as publishing tax rates and charges prominently, disallowing

the use of non- mechanized receipts, and using Information Technology to disseminate statutory and non-statutory forms and other information could help minimize information asymmetry and reduce the discretionary power of low-level operatives. In this regard the GRA is attempting to connect all its offices with an ICT network to the head office and among the various offices as well.

- Tax guides written in simple and plain language that a layman can easily understand, could also help taxpayers to negotiate daily routines. The guide should include a code of conduct for tax officials including auditors and anyone who is assigned with revenue generating responsibilities.

6. The populace of any country generally does not want to pay taxes unless compelled by a situation where they are left with no option other than to pay the taxes. Therefore, for better tax compliance, a system should be designed that automatically extracts taxes rather than leaves the payment of taxes to the voluntary choice and morality of taxpayers. To this end tax audit is one of the most powerful revenue administration tools that can ensure that tax payers pay their tax liability with very little room for evasion. Therefore, the tax audit function should be strengthened to minimize both deliberate and innocence tax evasion made by many tax payers. Again appropriate expertise and the necessary resources should be allocated for this tax administration function.
7. To rope everyone including informal businesses into the tax net, it is very imperative that the National Identification program is completed as soon as possible, this will aid the GRA to easily identify and track all potential taxpayers and the taxable activities they embark upon. In addition the GRA would need to

undertake a special survey to establish the potential revenue that is not currently being tapped in order aid its strategic planning process.

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APENDIX A

(QUESTIONNNARE)

Survey questionnaire to study, (Improving Revenue Collection through Tax Audit Practice, the case of GRA). The purpose of the study is to analyze the prevailing tax audit practice and its significance in tax revenue generation. Responding to this questionnaire may not take much time. Any information provided would only be used for academic purpose. As a result it would be kept confidential and utmost secrecy would be maintained.

I thank you in advance for your cooperation.

Position of respondent__________________________

Qualification________________________

Number of years of experience in the tax job_____________

Sex __________

Age___________

Instruction: Please tick (√) or mark your thought and where appropriate give your opinion for the open ended questions.

1. Is there any tax audit manual?

- ☐ Yes
- ☐ No

2. If you have the manual how do you evaluate it?

- ☐ It is clear and workable
- ☐ It lacks some clarity
- ☐ It is completely unclear

3. How familiar / conversant are you with the tax laws?

- ☐ Very much
- ☐ Much
- ☐ Not much

4. If the answer for No. 3 is not much, how do you carry out your audit function?

- ☐ Referring tax laws
- ☐ Working with someone who has better knowledge
- ☐ As per the knowledge gained through education and training

5. What are the types of assessment practiced in Ghana?

- ☐ Administrative assessment
- ☐ Self-assessment
- ☐ Both

6. Which type of assessment contribute (generate) higher revenue?

- ☐ Administrative assessment
- ☐ Self-assessment

7. Which type of assessment is exposed to the risk of misappropriation?

Why?

____

____

____

____

8. Do the auditing and investigation staff have appropriate powers of access to information held by the tax payers and other parties?

☐ Yes

☐ No

9. If for the above, the answer is 'no', how do auditors perform their activities?

____

____

____

10. Do the respective government officials give/pay close attention for the tax audit for example by assigning appropriate & skilled persons allocating sufficient resources?

☐ Yes

☐ No

11. What are the types of audit most usually applied?

☐ Full audit

☐ Limited scope audit

☐ Single issue audit

☐ Any of the three as appropriate depends on the risk identified

12. How do you measure the effectiveness of any audit operation?

☐ Yield & productivity

☐ Volume

☐ Quality measures

☐ A combination of two or more of the measures as appropriate

13. Is there a mechanism to evaluate the audit activities?

☐ Yes

☐ No

14. If the answer is 'yes' who and how are they evaluated?

____

____

15. How are audit cases selected?

____

____

____

16. Does only one individual auditor select cases for audits?

- ☐ Yes
- ☐ No

17. Are audit selected taxpayers notified in advance?

- ☐ Yes
- ☐ No

18. Does notification have any impact?

- ☐ Yes
- ☐ No

19. If 'yes' negative or positive or both?

____

____

20. Could you state the significance or/and disadvantage of notification?

____

____

____

21. Is there any legal framework authorizing auditors to see taxpayers' records?

☐ Yes

☐ No

22. If yes, where can you see these records?

☐ Only in the taxpayers' business premise

☐ Can be taken outside the business premise if needed

☐ Both are applicable

23. Do tax auditors have access to third party information sources?

☐ Yes

☐ No

24. Is there any access to obtain information from other national revenue bodies?

☐ Yes

☐ No

25. Are the tax payers very willing to give essential information?

☐ Yes

☐ No

☐ Partially (not all)

26. For the above if the answer is 'No' what could be the reason behind?

____

____

____

27. Which tax category of tax payers are more difficult to audit?

☐ Large corporate

☐ Medium corporate

☐ Small corporate

☐ Self employed

28. What would be the possible measures (solutions) to solve the problem