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1. INTRODUCTION

ERCA was established in 2008 (by proclamation number 587/2008) through the merger of the former Ministry of Revenues, Federal Inland Revenue Authority and the Ethiopian Customs Authority. The formation of ERCA signals the Ethiopian Government's commitment to establishing a modern tax and customs administration dedicated to meeting the requirements of the business community, encouraging voluntary compliance, combating smuggling, tax evasion and fraud as well as other illegal activities, thereby, contributing to the economic and social development of Ethiopia. In response to these requirements, ERCA has developed a Strategic Plan, which sets out how it is planning to meet these challenges over the next five years.

This Tax Audit Policy and Strategy has been prepared to support the successful delivery of the ERCA Strategic Plan. Tax audit is one of the components of the compliance risk management strategy that is designed to support the delivery of the voluntary compliance concept. Conducting tax audit involves significant costs to ERCA as well as to the taxpayer. Therefore, ERCA needs to use its limited tax audit resources very judiciously to achieve maximal taxpayer compliance, minimum intrusion, and minimum costs.

This is best achieved by the development of a risk based audit program that rewards taxpayer compliance with a light touch approach and openly demonstrates that valuable taxpayer resource is being deployed against the non-compliant. The tax audit policy and strategy is designed to deliver the aspiration of helping customers pay the right tax at the right time and with the minimal administrative and compliance cost to both ERCA and customers alike.

2. BACKGROUND

Before introducing ERCA's tax audit policy and strategy, it is necessary to provide the context to the development of this document. This will help provide the background and explain/justify the choices that ERCA has made by adopting this approach to tax audit. This section will link the proposed approach to tax audit to:

- Country tax policy;
- ERCA's Vision , Mission and value;
- Existing policies and activities; and
- Observations and Recommendations from Independent Reviews of Tax Audit in Ethiopia.

2.1 Country TAX policy

Ethiopian tax policy geared towards promoting investment, supporting industrial development; and broadening the tax base and decreasing the tax rate, at least maintaining the current reduced tax rates compared to most other countries, in view of financing the ever-growing needs of the government expenditure. On the other hand the policy is designed towards discouraging certain production and consumption activities, which had /and will have bad effects on health, moral, economic and social settings of the community. ERCA has the mission for accomplishment of these policy objectives.

2.2 ERCA Vision and Mission

ERCA's Vision, Mission and Value form the backdrop against which all policies, procedures and operations should be designed and implemented. In summary:-

Vision: - *“To be leading fair and modern tax and customs administration in Africa by 2028 that can be financing the Government expenditure through domestic tax revenue collection“*

Mission: - *“ERCA shall promote the voluntary compliance of the taxpayers, ensure integrity and develop the skill of the employees, support modernization, trade and investment facilitation and harmonization of the taxes and customs administration system, contribute to the economic development and social welfare through effective revenue collection.”*

Values

- *Customer focus service delivery (Trust, Respect, Protect, Support);*
- *Protect the wellbeing of society;*
- *Integrity;*
- *Professionalism; and*
- *Team working.*

These statements form the backbone of this tax audit policy and strategy. The key guiding principles of the tax audit policy and strategy are drawn directly from these statements. They are:

- **Fair and modern tax and customs administration:** the tax audit policy and strategy will establish a robust and transparent risk based approach to ensure a consistency of approach and treatment to a particular taxpayer segment by taking into consideration one size does not fit all approach.
- **Effective revenue collection:** the tax audit policy and strategy will introduce a broader range of tax audit activities that are more targeted and appropriate to specific risks, which will result in more proportionate and measured responses.
- **Promote voluntary compliance:** the tax audit policy and strategy will establish the concept that tax audit can be a strong and effective tool in helping taxpayers understand their tax/customs obligations and can help taxpayer put systems in place that will generate the right tax at the right time.
- **Develop the skill of ERCA's employees:** the tax audit policy and strategy will focus on the development of the professionalism, integrity and competence of ERCA's tax auditors to ensure the successful delivery of high quality tax audit.

2.3 Links to On-going Activities

2.3.1. Information Technology (IT) STRATEGY

ERCA is implementing (2008/9-2013/14) HR, Communication and IT strategic plans apart from its corporate strategy (2004/05-2009/10). The tax audit policy and strategy also links to these essential strategies and the prospective future change.

An IT Strategy has been prepared to support the successful delivery of the ERCA Strategic Plan. The IT Strategy sets out how the organization will align its resources to ensure the delivery of business objectives. At the same time, the strategy provides the framework for the future development of IT systems to support the reform and modernization of the organization. The IT Strategy Action Plan prioritizes activities and reinforces the need for significant investment in the development of a robust IT infrastructure, the automation of systems and procedures in accordance with international standards, improvements in the levels of IT skills and the need for the implementation of IT security protocols and procedures. The Tax Audit Policy and Strategy designed the audit program function with a robust IT infrastructure that helps to shift the Tax and Post-Clearance auditing practice from manual to automated system and the selection of audit cases based on risk management system.

2.3.2. Data, Risk and Compliance Management Strategies

In October 2009, ERCA's top management approved three key strategies for ERCA covering the issues of Data Management, Risk Management and Compliance Management. The three strategies are closely interlinked, as the delivery of the data management strategy will enable enhanced risk assessment to take place, which will in turn drive targeted compliance activity. The core principles of these strategies will be mirrored and complimented by the core principles and approach contained in this tax audit policy and strategy.

2.3.3. Balanced Scorecard

Following the implementation of the Business Process Re-engineering exercise in ERCA that resulted in the merging of the Ministry of Revenue, Federal Inland Revenue Authority and the Ethiopian Customs Authority, ERCA has been developing and implementing an enhanced performance management system – the Balanced Scorecard. The Balanced Scorecard includes performance indicators in four perspectives:

- **Financial Perspective** – measuring performance out come in terms of reducing administrative costs (to both ERCA and customers) and in terms of raising revenue.
- **Customer Perspective** – measuring performance in terms of providing good customer satisfaction.
- **Learning Perspective** – measuring performance in terms of how well ERCA can improve itself through the professionalisation of its workforce.

- **Internal Perspective** – measuring performance in terms of how well ERCA manages its own internal operations.

This tax audit policy and strategy fully reflects the performance indicators and philosophy of the Balanced Scorecard.

2.4. Tax and Post-Clearance Audit in Ethiopia: Current state of play

Tax and customs administration is an extremely important area for public sector reform in Ethiopia as it is a key issue to facilitating international trade and raising domestic revenue to support the delivery of Ethiopia's public services. Improvements in the field of Tax and Post Clearance Audit are integral and critical to this reform project. During the preparation of this policy document, reviews and observations have made on the current Tax and Post Clearance Audit activities of ERCA. The findings of these reviews are helpful to redevelop this Tax and Post Clearance Audit Policy and Strategy document.

1. Once taxpayers have been provided with the necessary means to meet their obligations, they must believe that there will be consequences of not complying. Therefore, a detailed audit program that identify risks and focus on customers who are not complying should be implemented. Taxpayers who are complying should benefit by not being subjected to harassment and unnecessary audit activity. This approach minimizes costs of administration and reduces taxpayer compliance costs. It also builds integrity in the tax system.
2. Whilst significant effort has previously gone into developing audit capacity, the audit program at the ERCA remains largely under-developed. Prudent audit practice dictates that resources are distributed to effectively address areas of highest risk with maximum impact in terms of coverage. In this regards, the standard practice in the region into dedicate about
 - 20% of audit resources to desk audits, while the rest is dedicated to:
 - Issue orientated audits – 50-60%
 - Comprehensive audits - 5-10%
 - Other special types of audit will be 30% (attached annex part)
3. Audit performance is low indicating weaknesses in audit planning. Auditors need to adopt an investigative approach. Effective auditing requires more than verifying that a taxpayer has correctly

included a particular transaction in his books of account. In a cash economy, it is important to establish what wealth the taxpayer may have accumulated that is not documented or recorded in books of account. In the large taxpayer segment, focusing on the taxpayer's interpretation of the law and business process mapping is more likely to provide results in these areas. Auditor's performance should be evaluated not by the amount of initial assessments made, but by the amount of actual collection. To ensure the effective collection of the additional revenue assessed continuous follow-up through the in-placed systems of ERCA is compulsory.

4. Audit manuals exist for both Tax and Post Clearance Audits. They are comprehensive and document different audit types to be used, audit checklists, reporting procedures and the conduct of auditors when dealing with the taxpayer. Operational plans exist for the Tax Audit Directorate together with a Balanced Scorecard that documents Key Performance Indicators, Expected Outcomes and Strategic Initiatives. Measuring the quality of the audit has been addressed by the development of a Tax Audit Quality Control framework. Therefore, ERCA already has in placed a system that, if followed, should produce standard quality audits across its branches.
5. The compliance approach, in the form of a risk based audit program, is not yet in place. The audit functionality of SIGTAS and ASYCUDA++ Tax and Customs automation systems are not being fully utilized for risk assessment. Tax audit is not guided by risk management principles, there is low audit productivity and the audit program remains undeveloped with an emphasis on Desk and Comprehensive Audit to the exclusion of other audit methodologies.
6. In some audit cases, there is a communications gap between ERCA and the taxpayer leading to mistrust by the taxpayers. The risk factors inherent in customer behavior, accounting systems and business sectors and industry specific norm remains under developed within ERCA. Taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant.

2.5. Conclusions

The implementation and deployment of Standard Integrated Government Tax Administration System (SIGTAS), ASYCUDA++, Biometric based TIN, Cash Register System, bank payment system, parametrical risk based auditing system, voluntary compliance and self assessment practices have to be practiced and generally be a central and critical path of the reform package in order to tackle tax avoidance, tax evasion, and commercial fraud at all levels in ERCA.

Thus, ERCA planed to develop automated risk based tax-auditing system using IT infrastructure systems. Currently ERCA already started the implementation of desk Audit Project to clean up taxpayer data and create an auditable, that enables and reliable database. This will enable ERCA to implement a range of audit products according to the nature of the taxpayer's risk and the issues of Data Management Policy and Strategy, Risk Management Policy and Strategy and Compliance Management policy and Strategy had covered to support the successful delivery compliance approach and guide the Tax Audit and Post Clearance Audit based on risk.

PCA is new concept in ERCA it needs grate attention and capacity building to practice the audit based on the legal framework as it is stated on Custom Proclamation No 622 Article 64-66 and The Post Clearance Audit activity should be guide by HQ or centralized.

The existing tax audit manuals namely assessment and audit operating manual ,Value added tax audit manual and investigation audit Manual, should be revised and integrated based on this policy principles as well it is true in post clearance audit manual.

3. Audit Policy Framework

Audit is defined as the structured examination of a business' relevant commercial systems, financial and non-financial records, physical stock and other assets, internally generated data and that produced independently of the business. The main purposes of Tax and Post-Clearance audit in ERCA are to:

- Establish the extent of a risk or risks and quantify any errors which may have arisen as a result;
- Improve future compliance;
- Support those who wish to comply; and
- Deter non-compliance.

A by-product of the above may be the detection of material and deliberate error and fraud.

3.1. What is a tax audit?

A tax audit in ERCA's context is defined as:

an activity or a set of activities performed by Tax auditors to determine at taxpayer's correct tax liabilities for a particular accounting or tax period, by examine of a taxpayer's organization procedures and financial records in order to assess compliance to tax laws and verifying the true, fair, reliable, and accuracy of tax returns, and financial statements.

Conducting an audit, various types of information will be reviewed namely, tax returns, financial statements, accounting records, customs declaration and other source documents. Generally, an audit will examine different issues identified as most significant in achieving an accurate assessment of a taxpayer's tax liability. Some of the typical issues will include any indications of unreported income, or potentially over claimed deductions, over /under valuation, smuggling and illegal activities.

Tax audits usually focus on areas where there is a high risk with regard to the amount of tax paid and/or payable. Depending on the specific factors relating to a taxpayer, the scope of tax auditing will often vary. However, it is important to remember that the primary objective of an audit is to determine the correct amount of tax that ought to be paid. The above stated objective is very important to tax payers as well as to tax authorities and it helps ensure that taxpayers have

confidence in the fairness of the audit process such that an audit could result in either an **increase** or a **decrease** of a taxpayer's tax liability.

3.2. What is Customs audit?

Post Clearance Audit (PCA) is a process, which enables the Authority, after the release of goods, to verify the accuracy of customs declaration of books, records, business system and other relevant customs commercial data held by persons directly or indirectly involved in the import or export of goods.

In Ethiopia, legal framework Proclamation Number 622 Articles 64-66 this custom control or audit may be carried out in a defined period or only within 10 years from the date of custom declaration has been accepted.

According to this proclamation such control may be performed after the release of goods from custom custody:

- Surprise inspection to ascertain the accuracy of customs declaration.
- For the purpose of ascertaining the accuracy of particular contained in custom declaration.
- At the premises of a person who is directly or indirectly involved in the business operation of the import or export of the goods or at the premises of any person in possession of the data and document subject to inspection

In conclusion, Tax Audit and Post clearance Audit play an important role to the extent that it provides a tool to ensure that taxes are assessed and declared based on the established laws and thus helps to build and maintain public confidence in the integrity of the tax system by ensuring that all taxpayers are subject to the same laws and standards.

3.3. Audit Policy Statement

- a. The major objective of conducting tax and customs auditing is to improve compliance through effective audit, programs based on risks, executed by a robust range of audit types and directed at a wide range of taxpayers and tax types. ERCA's mission is to promote voluntary compliance through achieving an audit program that is driven by risk, which guides the allocation of its limited audit resource towards the non-compliant and support those taxpayers who want to be complaint. In addition, strikes a balance between coverage, quality and overall deterrent considerations. As such, ERCA aims to ensure that customs & tax audits are administered in a timely, responsible, fair and professional manner.

- b. The current change being undertaken on the auditing practices is shift from random selection of taxpayer for audit to risk based approach, which shall be tailored to specific sectors and taxpayer segments. The compliance and risk-based audit strategy shall be driven by the objective verifying the true, fair, reliable, and accuracy of tax returns, or declaration and financial statements.

- c. Through audit ERCA aims to determine whether: The right tax or duty declaration is presented at the right time; Commercial systems properly address ERCA requirements; Procedures, supported by commercial records are in place to ensure Timely and accurate declaration, payment, repayment or deferment of duty or taxes; internal controls, including physical checks as appropriate, are in place to combat weaknesses in commercial systems, minimizing the risk of error and maximizing the businesses' ability to comply; and adequate management controls are in place to minimize the risk of tax evasion ,tax fraud or malpractice.

3.4 Policy Principles

The main principles of ERCA tax audit policy and strategy are Facilitation vs. Control, Taxpayer Relationship, Improved Tax Audit Management and Auditor Professionalism.

3.4.1. Facilitation vs. Control

Facilitation

The audit will be driven by risk management techniques to identify ERCA's compliance priorities and opportunities for facilitation. This will enable ERCA to simplify the custom control, shift the audit resources to areas of high risk and support taxpayers in discharging their tax obligation. By simplifying the audit procedures and treating the taxpayer according to the nature of the risk associated with.

Control

Detection of the non-compliant taxpayers and sending appropriate warning in order to keep-up compliant taxpayer being comply or to keep-up fair competing plain land and prevent the compliant taxpayer the illegal acts by non compliant. The audit program design appropriate control measures or range of audit product that enable ERCA treat the taxpayer based on identified risk and level of compliance. Such program could be exemplified by help and support (Education kind of audit for example Advisory Visit, Record Keeping and Registration Check), deterrence by detection and by an effective application of enforcement of tax and customs laws.

Therefore, striking the balance between an effective control through tax and customs audit and facilitation of trade and investment is a crucial issue to be maintained in ERCA. Tax audit is one of the tools of compliance risk management strategy that is to promote voluntary compliance concept. Taxpayers will voluntarily comply when ERCA achieves the correct balance of facilitation, fairness and enforcement (control).

Ethiopia's revenue administration system relies on taxpayers assessing their liability under the law and paying the correct amount of tax. However, unless it is systematically administered such system of self-assessment has inherent risks. ERCA tax audit systems manage these potential risks by balancing the resources and structuring the range of audit products accordingly to ensure that people meet their obligations through education, quality and fair audit service and support, and enforcement in a way that is acceptable to the community and sustainable in the long term.

3.4.2 ERCA-Taxpayer Relationship: ERCA will:

- Believe that a taxpayer is honest and willing to comply unless there is good reason to believe otherwise.
- Treat taxpayers with a good compliance history with a light-touch approach.
- Ensure that the taxpayer is fully aware of their rights and obligations before, during and after a tax and post clearance audit.
- Provide taxpayers with education and recommendations to help mitigate any risks or poor performing controls, working together with taxpayers to help them accurately comply with their tax obligations.
- Use the full powers of the law to challenge taxpayers who are deliberately evading or avoiding their tax obligations.

3.4.3 Improved Tax Audit Management: ERCA will:

- Use a transparent and robust risk based system as per ERCA's risk management policy to identify taxpayers for enhanced tax audit activities.
- Use a diverse and proportionate range of audit approach to target our activities to those areas of highest risk to the revenue.

- Fully exploit data available e.g., third party data, SIGTAS and ASYCUDA++ risk selection modules and functionality to select cases for audit effectively and efficiently.
- Demonstrate a consistent approach to audit operations across all ERCA branches.
- Share experiences and new approaches, within and across branches, to develop common audit best practices and to avoid negative inconsistencies in the treatment of taxpayers.
- The selection of audit cases practice based on risk management system as per ERCA Risk Policy.
- Automate the selection of audit cases to support the customs and tax compliance management with the use of dedicated tools like Interactive Data Extraction and Analysis software (IDEA) and Computer Assisted Audit Tools (CAAT)

3.4.4. Auditor Professionalism: ERCA auditors will:

- Demonstrate ERCA's ethical standards and audit professionalism to gain taxpayers confidence and respect.
- Be provided with the necessary training and skills (at list 40 hours per year for each auditor) required to conduct professional and efficient audit.
- Adopt an investigative approach during audit to establish what have not been recorded in the accounting system.
- Conduct quality assurance checks to ensure auditors act in accordance with law and principles outlined in the taxpayer charter.
- Be flexible so that ERCA is able to respond in a timely manner to emerging and changing threats as well as to meet the demands of the current /potential economic global dynamism.

3.4.5. Segmentation Approach

For the sake of taxpayer segmentation in Ethiopia, taxpayers have been segmented into Large Taxpayers Office (LTO), Medium, Small and Micro Size Taxpayers groups. Thus according to such segmentation the tax and PCA audit resources primarily deployed to LTO and Addis Ababa Commercial Goods Facilitation Branch Offices respectively. However, other ERCA branch offices according to the significance of risks need attention to be audited in line with this policy.

3.5. Audit Responsibilities

3.5.1. Headquarter Division Responsibilities

3.5.1.1. Tasking and Co-Ordination

In order to become a risk-driven organization, ERCA's tax audit directorate will adopt a tasking and co-ordination framework to implement the tax audit policy and strategy. This is a process, which takes account of business planning needs in the context of the federal government, ERCA and local branches tax audit objectives. The centerpiece of "tasking and co-ordination" process is a regular high-level strategic Virtual Team, which is chaired by a senior manager (Director Level) with the authority to deploy necessary tax audit resources to risk. This Virtual Team will work closely with the Risk Committee - currently chaired by the Enforcement Deputy Director General. The tasking and co-ordination committee will normally meet on a monthly/quarterly basis and usually consists of:

- Presentations of strategic intelligence products like emerging trends & threats to revenue,
- Scoring of specific risks against a standardized risk-scoring matrix,
- Re-calibration of weighting of risk scores as corporate priorities/ resources change,
- Quick allocation of tax audit resources to mitigate highest risks identified in intelligence and risk products,
- Commissioning of campaigns, and
- Effective and efficient co-ordination of resources across the various tax audit branches.

The benefits of this approach are:

- A consistent and objective assessment of risks to revenue,
- A clear audit trail for decision making,
- Effective and efficient use of resources – quick deployment to newly emerging risks, and
- Allocation of resources to areas of greatest corporate, government or fiscal risk.

Within the tax audit arena, participants for the operationally focused committee would be: Tax audit Director (Chair), Audit Process Owners from Addis Ababa Branch Offices, senior officers from Risk and Intelligence Compliance Campaigns Project Manager. To maximize the impact of this committee, it would need to link closely with the pre-sift approach at the branch level outlined below.

3.5.1.2. Other Activities

Other activities of the Tax and Post Clearance Audit team in Head Quarters will be:

- a) Developing the Authority's Audit Plan;

- b) Setting objectives, priorities and strategies for the audit program;
- c) Making policy decisions on the nature of audits (e.g. single issue or comprehensive audits);
- d) Establishing national audit targets, including types of audits and taxpayer groups to be audited;
- e) Allocating audit targets to the operational tax offices;
- f) Monitoring performance against budgets and targets;
- g) Setting criteria to be used by operational offices in selecting taxpayers to be audited;
- h) Developing and maintaining computer systems to aid audit selection and reporting;
- i) Providing training materials, manuals, legal assistance, forms and documentation, and other support to auditors;
- j) Analyzing and evaluating audit results and other data to be used in future planning;
- k) Communicating legislative changes, policy decisions and procedures to operational offices;
- l) Conducting quality assurance checks of operational offices to ensure that audit policies and procedures are applied professionally and consistently;
- m) Provide coaching, redesigning and advocacy services;
- n) Conducting Special audit operations depending up on its level of complexity; and
- o) Lead and coordinate field audit of post clearance audit (PCA) operation.

3.5.2. Branch Delivery Responsibilities

The roles and responsibilities of the tax audit and post clearance audit teams in the branch offices will be:

- a) Carrying out taxpayer audits in accordance with the audit program established by headquarter,
- b) Selecting cases based on approved risk-based criteria;
- c) Providing input to headquarter in the development of plans and performance targets;
- d) Monitoring progress of individual audits and auditors, including the quality of audits;
- e) Identifying training needs and, where appropriate, conducting training or arranging with headquarter for training to be provided;
- f) Monitoring achievement of plans, and providing regular reports to headquarter; and
- g) Maintaining data on taxpayer profiles, and undertaking research and analysis of compliance behavior.

3.6. Policy objective and strategy

Objective

The primary objective for conducting a tax and post clearance audit will be to improve the overall level of taxpayer compliance both voluntarily and involuntarily. This will be achieved through the implementation of effective and efficient audit programs among others.

Strategy

To attain these policy objectives Major strategies or our approach will:

- a) Be based on a robust and transparent assessment of risk;
- b) Use a diverse range of audit products, which are tailored to respond to the risks in a specific sector and/or taxpayer segment;
- c) Adopt an investigatory approach to establish the completeness, accuracy, timeliness, credibility and validity of a taxpayer's declarations, disclosures and other financial arrangement will be designed to encourage compliance and will strike a balance between interventions that are proportionate, fair, consistent and transparent and interventions which act as a deterrent
- d) Encouraging voluntary compliance through effective and efficient tax audit programs;
- e) Deterring non-compliance by providing meaningful incentives for compliance and applying effective and objective penalties on non-compliant taxpayers. The audit approach will always therefore be corrective, deterrent and preventative;

✚ **Corrective:** - for those taxpayers who try to comply but always not succeed the audit programs will provide information and assistance to enable them assess themselves.

✚ **Deterrent:** - for those taxpayers who don't want to comply, but will if we pay attention. The audit program will influence the behavior of such taxpayers or sending warning signals by making detection to be compliant in the future.

✚ **Preventive:** - for those taxpayers who have decided not comply the audit program will make detection and use an effective enforcement of the tax and customs laws. The leverage affects initiate the potential non-compliant taxpayers to be compliant in the future.

- f) Maximize the educational opportunities of the audit e.g. use the audit to educate and foster good customer relations;

- g) Strengthen Customs supervision and control, normalize import, export order, and promote foreign trade; e.g., compliance audit (AEO);
- h) Fully utilize the audit and risk functionality of SIGTAS and ASYCUDA++ to improve audit planning and to demonstrate all audit activity based on risk. Apart from the optimum utilization of the in-placed tax audit module within SIGTAS, Develop computer software as enabler to enhance the audit productivity, quality, efficiency and coverage such as IDEA/CAATs that helps audit activity.

3.7. Risk Based Audit Selection: Operating Models

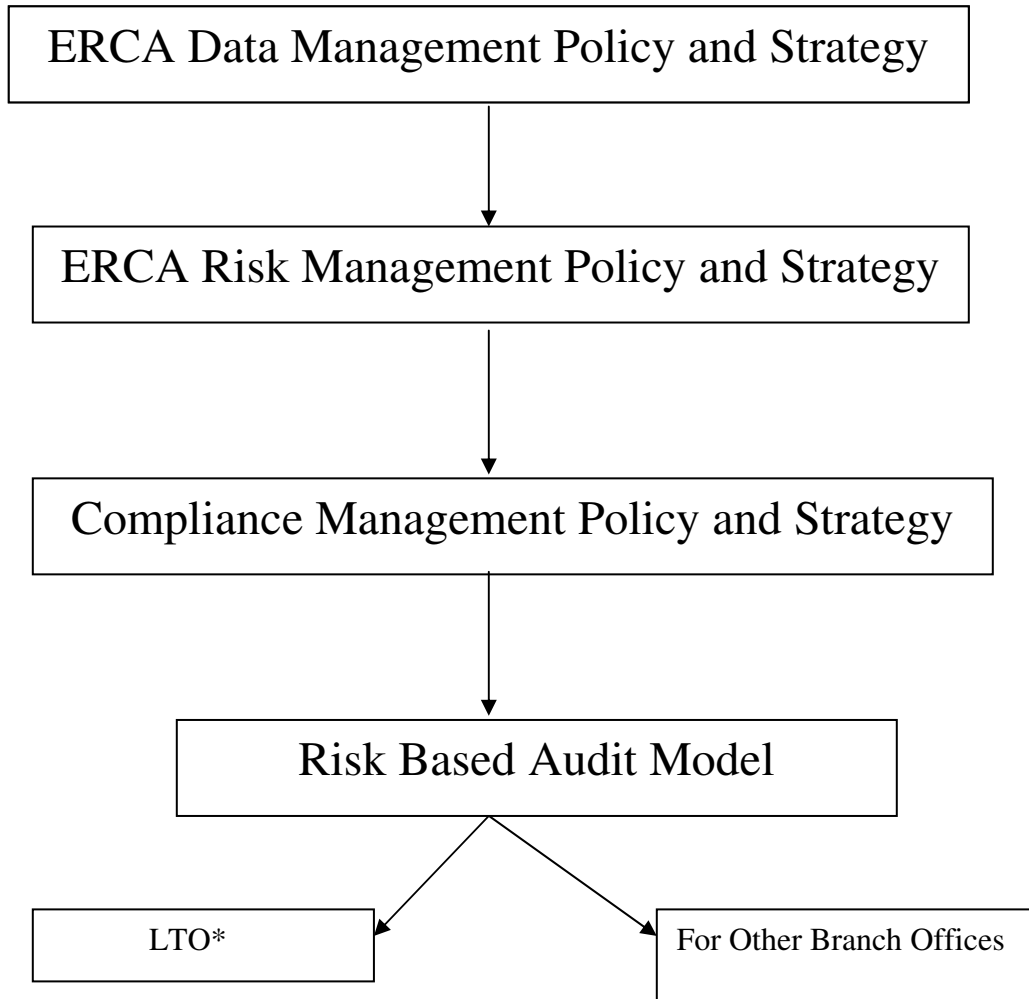
ERCA is required to audit some or all its taxpayers to verify if customers are paying the right tax at the right time. Conducting audits involves costs to the tax department as well as to the taxpayer. To make audit more efficient and effective and to maximize resources, audit selection based on establish risk criteria will be used to select a particular taxpayer for a mandatory audit.

The proposed operating models introduce some new roles such as Client/Customer Relationship Manager (CRM), Branch Audit Selection Team and PCA Risk Team. Their purpose is to use risk criteria to further sift taxpayers for audit, choose the most appropriate audit type and to allocate the audit to the most qualified team.

The CRM role is specific to Large Taxpayers. A person has a named CRM whose role is to manage Taxpayers relationship with ERCA. It does not mean that the largest businesses are necessarily the most risky but they are those with the most complex tax affairs who need and want a more regular and tailored relationship with ERCA. Many such customers manage their tax affairs in a way that presents low tax risk. The CRMs work with their customers gaining a deeper understanding of tax risk from this direct engagement to draw up initial risk assessments for each business and begin to plan ERCA activities more explicitly in response to risk. Large Taxpayers Office controls 800 to 1,000 taxpayers in ERCA. This is risk assessment approach that will benefit ERCA in delivering its four key major strategic issues and other future prospective.

The following diagrams demonstrate how tax and Post-Clearance audit will be managed in ERCA:

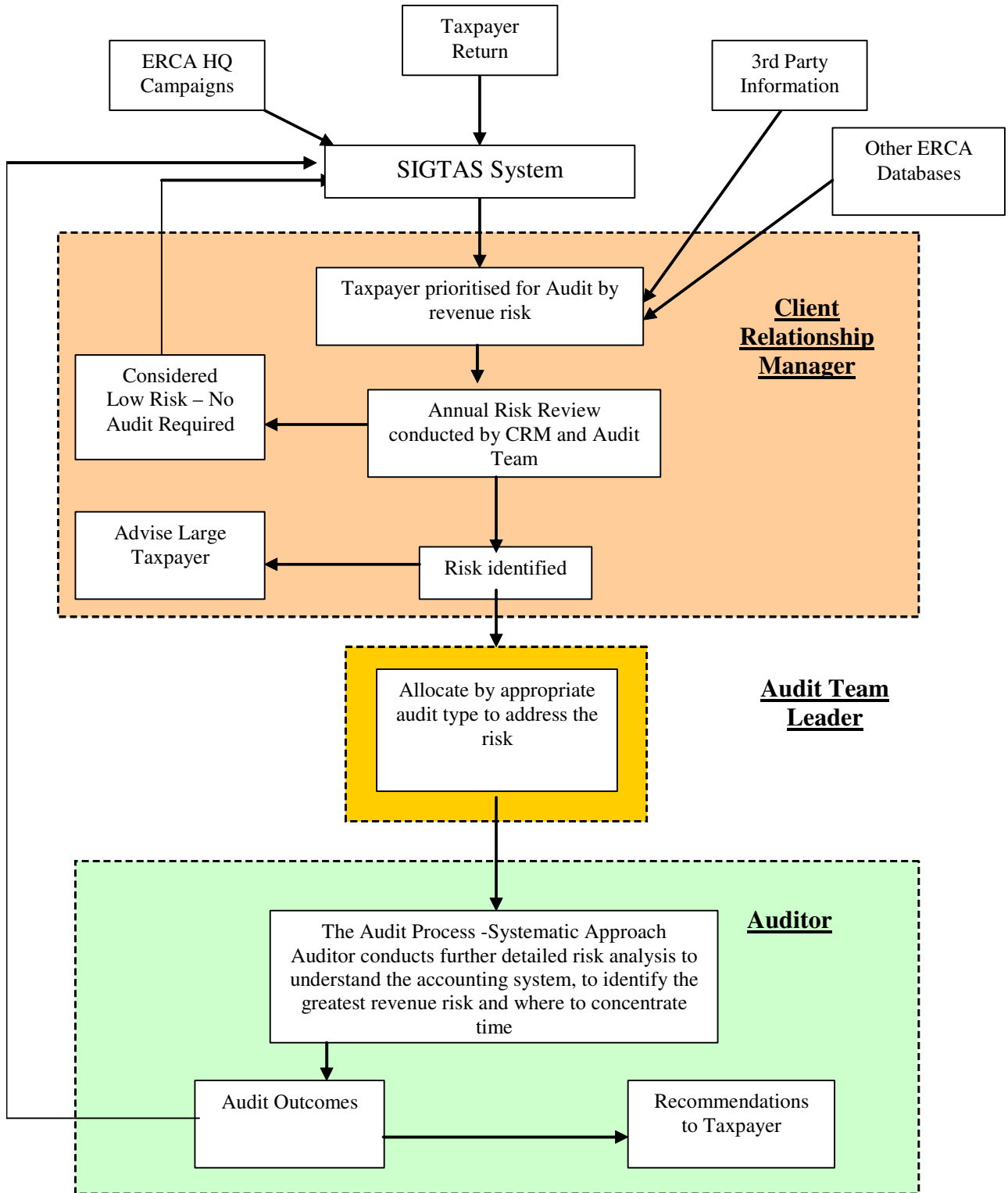
The Risk Based Audit Model



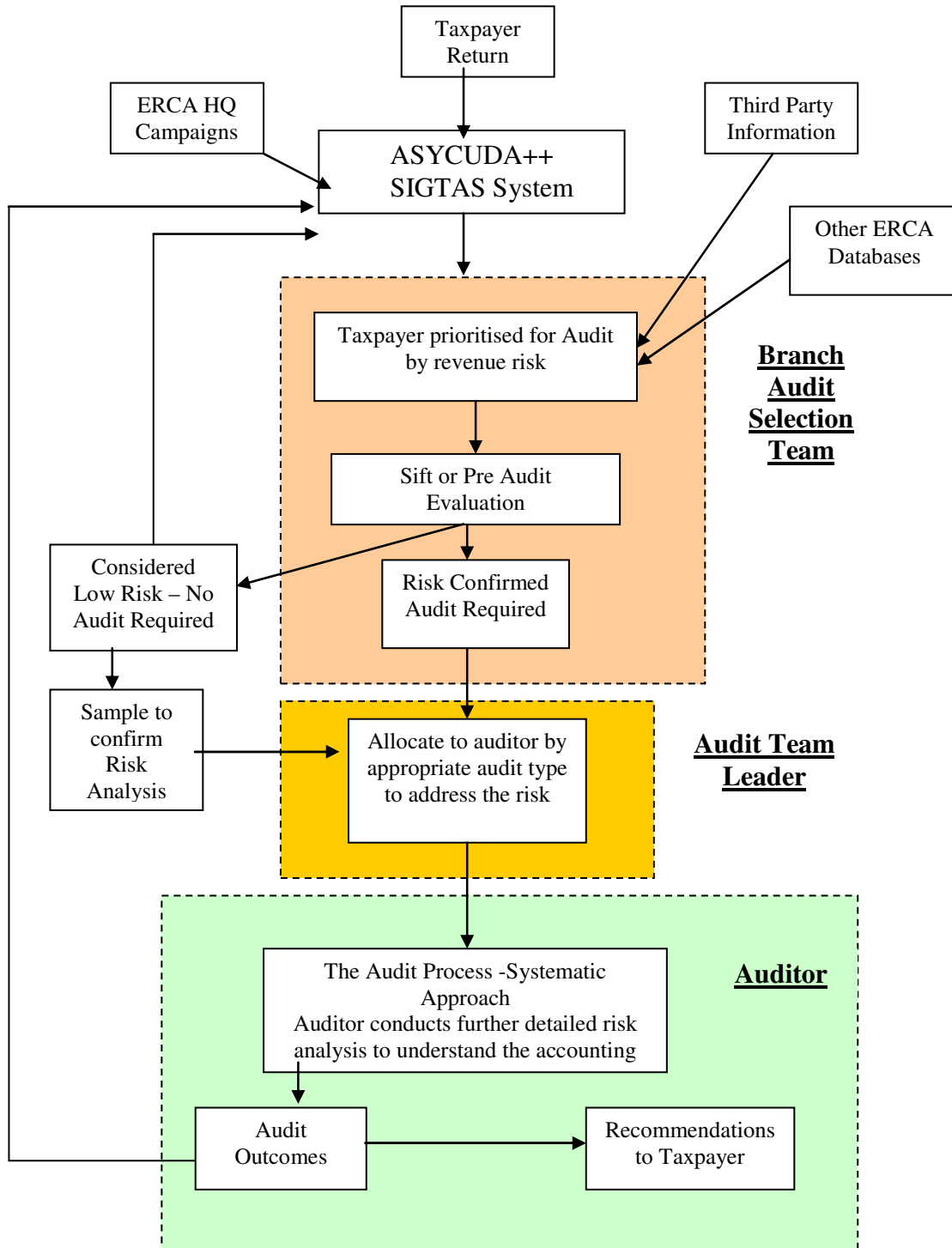
Note:-

** In a similar fashion the Audit selection model for A.A.C.G.F.B.O. could be designed & implemented.*

ERCA LTO Branch - Audit Selection Model



ERCA other Branch - Audit Selection Model 2



The following diagrams demonstrate how tax audit will be managed in ERCA:

3.8. Sources of information for risk assessment

The suggested risk based selecting model used wide range of taxpayer's information sources from-Whilst it is impossible to cite an exhaustive list of sources of information which ERCA will routinely use to inform is risk assessment process, the following provide an overview of the key sources of information used by ERCA's auditors:

3.8.1. SIGTAS

ERCA has recognized that in modern tax administration, it is necessary to computerize the tax collection procedure. This produces benefits, which satisfy both the tax administration and the tax payer. On 24th February 2004, the Federal Inland Revenue Authority (legacy department of ERCA) announced the development of new software which would be used to collect information through the Standard Integrated Government Tax Administration System (SIGTAS). SIGTAS is an integrated package with all modules necessary to manage all taxes and licenses including a risk selectivity module.

3.8.2. ASYCUDA⁺⁺

Before the ASYCUDA⁺⁺ system was introduced in Ethiopia, the completions of duties were done manually using desk calculators. Combined with this was the fact that annual external trade statistics were not up to date (usually lag 2 years) and the fact that revenue collection was done by manual receipt. This meant that the administration and compliance with tax law was time consuming and cumbersome. However, after the introduction of ASYCUDA⁺⁺ the above problems were highly reduced and are a key tool used to identify high-risk consignments, importers, transporters and customers.

3.8.3. Other external sources

Within strict legislative frameworks, ERCA works closely with other private and public institutions as well as individuals such as informants (whistle-blowers) and collaborating in order to gather relevant information in order to set risk criteria and establish the compliance history of a taxpayer.

3.9. Auditing standards

Auditing standards guidelines: - ERCA and its Tax and Post-Clearance auditors must meet the tax and custom auditing standards in order to achieve its objectives. Auditors should keep in mind that as public servants they are subject to public scrutiny and criticism. They should at all times strive to maintain high standard of professional and personal conduct while discharging the duty for ERCA Auditors are only able to

successfully undertake their duty with full confidence of our customers. The standards that serve as guidelines for appropriate professional conduct of a tax and custom auditor are: *ERCA Code of Conduct, Independency, Due Professional Care, Confidentiality, and Standards of Field Work, Supervision, Training, Professionalism, Quality Customer Service and Collectibles.*

In addition to this, the audit plan standard in ERCA will be as follows:-

1. Desk audit 20 %;
2. Spot or Issue audit 50-60 %;
3. Comprehensive audit 5-10 % and
4. Other or Special type of audit 10-25 %.

Notice: - Regarding other special audit see annex A Glossary of some audit term

4. Working Environment

Creating safe and healthy working environment where tax audit staff feel valued, safe, empowered and well looked after has a significant impact on the motivation and overall performance of the Tax Audit and post clearance audit in ERCA. It is the policy of the ERCA to pro-actively manage these issues according to the federal civil servant percolation No 515/2007 and collaboration with other concerned body.

4.1. HEALTH AND SAFETY

Tax Auditors might be exposed to health hazards that affect their personal safety health will discharge their duties. These health hazards can be reduced as minimum exposure by integration of tax audit directorate with concerned body. These include:

4.1.1. Ergonomic hazards

- **Display Screen Equipment and Office:** the nature of the work of a tax auditor can often result in long periods being spent at an office desk using a computer or reviewing documents. If not managed properly, this can result in a range of physical impairments or injuries, which can influence the ability of the tax auditor to perform at the optimal level.
- **Chemical hazards management:** our staffs might have some expose to chemical hazard and this may have health effects to prevent the health effects of chemicals we have to implement chemical safety measures.

4.1.2. Psychosocial hazards

- **Interaction with the General Public:** tax auditors are often required to visit customers at their place of business. If not managed properly, this can result in a range of physical impairments or injuries, which can influence the ability of the tax auditor to perform at the optimal level. In particular,
 - **Customer Business Premises:** some customers business premises may be potentially dangerous places e.g. presence of chemicals, fast moving vehicles, etc. which may pose potential Health and Safety risks to tax auditors.
 - **Intimidation and Aggression:** it is acknowledged that the majority of ERCA's customers are honest and do not pose a risk to the health and safety of ERCA's tax

auditors. However, some customers, particularly those engaged in tax fraud and evasion, may try to use a range of physical and psychological tactics to intimidate ERCA's tax auditors in order to dissuade them from carrying out their duties properly. This can have an immediate impact in terms of physical injuries reducing tax collections as well as longer-term impacts resulting from mental stress.

- **Prevention and control of Environmental sanitation problems:** like bad office keeping, improper wasted disposal system and unsafe water.

It is the policy of ERCA's tax audit function that it will take all reasonable steps to manage and mitigate the Health and Safety risks that its staff may face in the course of their duties. It is acknowledged that this will have a positive impact in terms of employer-employee relations and employee-customer relationship as well as on individual performance.

4.2. DIVERSITY

Getting the right person, in the right job, with the right skills at the right time regardless of gender, HIV status, age, disability, language and/or regional identity has a direct positive impact on the performance and functioning of ERCA. Managing diversity can have a positive impact at both an internal and external level:

External: a diverse workforce within the tax audit directorate will create a tax audit service, which meets and is responsive to the needs of its diverse customer base.

Internal: Staff who feels that they have an equality of opportunity in terms of access to good quality work, training and promotion is more likely to be motivated to perform well.

Recognizing the positive impact on performance that comes from managing diversity, it is the policy of ERCA's tax audit function that it will take all reasonable steps to provide its staff with an equality of opportunity. It is acknowledged that implementing this policy strategy may require additional investment in a particular diversity group to provide them with an equality of opportunity.

4.3. INTEGRITY & ETHICS

All employees of ERCA are in a privileged position and are quite rightly, held to a higher standard of professionalism and ethical behavior than other members of society are. Additionally, tax Audit is an internationally recognized profession, which has established standards of conduct. All tax auditors in ERCA must comply with these standards if ERCA is to maintain its customer's confidence in ERCA's ability to do our job properly and their faith in the impartiality and fairness of ERCA's tax audit programs. ERCA tax

auditors are only to complete their roles properly with the confidence of the public at large. Integrity in tax audit is particularly important as tax auditors have regular access to privileged and commercially sensitive information, have close contact with customers and enjoy a high degree of discretion and autonomy. These can be key enablers to unethical behavior. In order to maintain our Customer's confidence in ERCA, it is the policy of the ERCA that the risks of unethical behavior will be pro-actively managed and that all tax audit staff has a role to play.

5. Next Steps

When ERCA's top management approves this policy and strategy, the Tax Audit directorate will convene a project team to develop a detailed 3-year implementation plan. This plan will be submitted to top management for approval. If approved, the project team will then be empowered to deliver the implementation plan and, it is hoped, deliver real change in the management and administration of tax audit in Ethiopia.

Annexes

Annex A: Glossary of some audit terms

Registration checks: - This type of audit is a quick check on businesses to establish that they are correctly registered for all their taxpaying obligations. Information from the business license office, customs, third parties or other audit activities may alert the administration that a check is necessary.

Advisory audits: - A visit to newly established businesses advising them of their obligations in terms of tax types, filing of declarations, payment of amounts due, and records to be maintained may be appropriate. This is particularly necessary when introducing new laws.

Record keeping audits: - A check on enterprises that may have a reputation of not keeping adequate records. The visit would point out the obligations of the taxpayer with regard to keeping of records and the consequences of failing to do so. These audits should be followed up and penalties imposed if the taxpayer continues to disregard record keeping requirements.

Desk audits: - Audits will generally require field visits; however, it may be possible to undertake some basic checks from the tax office. These can be conducted in relation to specific issue audits of a small enterprise or employee when the auditor is confident that all necessary information can be ascertained by conducting the examination in the office. They can also be used as a preliminary examination of declarations, analyzing ratios and cross checking information to determine if further investigation is warranted.

Single-issue audits: - Focusing on a single tax type, single aspect or a single period. For instance, the auditor may be only examining whether the taxpayer has met obligations in respect of employment tax, VAT, or examining a specific expense claim.

VAT refund audits: - Verifying the taxpayer is right to a refund prior to processing the refund. Usually undertaken for first refund claims as well as where the refund claim varies significantly from established patterns and trends.

Audit projects: - Audits can be organized as a separate project for specific groups of taxpayers. These audit projects may cover an industry (e.g., construction) or a line of business (e.g., retail) and/ or certain items from the declaration or profit and loss account (e.g., depreciation). They will consist of specific checks and are used to address a particular risk or to establish the degree of non-compliance in a particular sector.

Comprehensive (or full) audits: - An examination of all tax obligations over a number of tax periods is preferred when major discrepancies are uncovered during single-issue audits. Comprehensive audits are usually time consuming and therefore should only be

applied to taxpayers where there is evidence of under reporting that influences across taxes.

Fraud Investigations: - Involve the most serious cases of non-compliance with Criminal implications. Require special skills in investigation and evidentiary requirements as they often involve seizure of records, taking testimonies from witnesses and preparing briefs for courts.

Computer Systems Audit: An approach that examines the computer system using sampling and computer assisted audit techniques.

Compliance audit (AEO): It is a system audit that examines the company level of compliance the business system whether able to meet AEO requirement or not or it is process rating the company reliability for tax a purpose with a view to the concessions of special benefits. It is a tool to assured tax payers business system quality with regarding customs and tax law.

Business Lifecycle: - Certain events arise during the course of an individuals' lifetime or a businesses' lifespan where the obligations for reporting information to ERCA change. At the times of such changes, there is the risk that the individual and collective failures to meet these new obligations pose a significant risk to the Exchequer. There are also times when becomes aware of facts that are able to provide us with a pointer to the attitudes of certain individuals regarding their fiscal obligations. The life events campaign will look to identify the populations that are subject to these types of circumstances, and will look to design, develop and implement a programmed of tailored activity to reinforce compliant behavior and to tackle and deter non-compliant behavior in certain such populations. A number of initial populations are under consideration.

Campaigns: - The home repair, maintenance and improvement sector includes a large variety of activities. MoFED may estimates that some 600,000 people operate in this sector legally below the VAT threshold or in the hidden economy. Campaigns will look to design, develop and implement a programmed of tailored activity to reinforce compliant behaviors and to tackle and deter non-compliant behavior in certain populations within this sector, seeking to create a level playing field for businesses. The first population of individuals under consideration are plumbing / heating engineers.

Annex B: Characteristics of taxpayer sectors and audit approaches

Business Size	Small and Micro	Medium	Large
Number of Taxpayers	Large	Moderate	Small
Revenue at risk per taxpayer	Tens of thousands of birr	Hundreds of thousands of birr	Millions of birr
Areas of non compliance	Receiving cash without tax withheld, poor records, not registering, not filing	Understating sales, overstating purchases and expenses, falsification of documents, “creative” Accounting. Diversion of income to wealthy Owners.	<ul style="list-style-type: none"> – Tax treated as an expense to be minimized through: – complex and dynamic structures, involving financial products, – Global and local non –arms length and non Commercial transactions; and aggressive interpretation of the law.
Audit Treatment	Selective, simple auditing using education and penalties as a leverage tool to gain compliance through the broader community	Single issue audits focusing on areas of non-compliance and using sampling and computer audit techniques	Tailored audits by teams comprising specialists in specific taxes, industry sectors, international and computerized audit.

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