FACTORS AFFECTING TAX AUDIT EFFECTIVENESS IN KENYA REVENUE AUTHORITY: A CASE OF SOUTH RIFT-VALLEY REGION

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A Research Project Presented to the Institute of Postgraduate Studies of Kabarak University in Partial Fulfillment of the Requirements for the Award of Master of Business Administration (Finance)

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DECLARATION

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The research project entitled **"Factors Affecting Tax Audit Effectiveness In Kenya Revenue Authority: A case of South Rift-Valley Region"** and written by Catherine Chebet Rotich is presented to the Institute of Postgraduate Studies of Kabarak University. We have reviewed the research project and recommended it to be accepted in partial fulfillment of the requirement for the award of degree of Master of Business Administration (Finance Option).

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DEDICATION

This work is dedicated to my husband (Cornelius), my son (Hesed), and my daughter (Hokmah) for their emotional and moral support.

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ABSTRACT

Tax income forms a very significant portion of government revenue. Taxation is geared towards generating revenue for the government to cater for its expenditure. In spite of recording remarkable revenue growth and implementing many initiatives such as carrying out an audit of taxpayers to improve tax collection, Kenya Revenue Authority did not achieve its revenue targets over the period under study. An ineffective tax audit has been considered as one of the many reasons behind non-compliance to tax laws and revenue loss. The audit of taxpayers plays an important role in the administration of tax laws. Its primary role is detecting and preventing non-compliance. The taxpayers, both large and small pose a risk that their reported taxable income is not correct due to under declaration of business income or overstating the expenses against business income. All these risks lead to a reduction or loss of tax revenue to the government. Therefore, the present study sought to evaluate the selected factors affecting tax audit effectiveness in Kenya. Specifically, it sought to examine the effect of audit case selection, staff capacity, tax dispute resolution mechanism, and Interpretation of tax laws on tax audit effectiveness in Kenya Revenue Authority-South rift valley region. The study was premised on the Theory of Inspired Confidence, Policy Learning Theory, Optimal Theory of Taxation, and Hoffman's Tax Planning Theory. The study used a descriptive research design targeting a population of 80 respondents, consisting of tax officers in South Rift Valley Region; therefore, it adopted a census method. Questionnaires were used to collect data after being subjected to the tests for validity by pre-testing the instruments, engaging independent experts to evaluate it, and doing a pilot test which assists in the restructuring of the questionnaire to suit the information required from respondents. The reliability of the research instrument was checked by doing a Test-retest of the same. Data were analyzed using descriptive statistics and inferential statistics. The study has added new knowledge to the existing literature on taxpayer audits and also provided a recommendation on how tax compliance can be enhanced through tax audit initiative. The findings revealed that audit case selection ($\beta = 0.479$, $p < 0.05$) and tax audit staff capacity ($\beta = 0.136$, $p < 0.05$) are directly related to tax audit effectiveness in South Rift Valley Region. However, the tax disputes resolution mechanisms ($\beta = -0.009$, $p > 0.05$) and interpretation of tax laws ($\beta = -0.042$, $p > 0.05$) are inversely related to tax audit effectiveness in the area as per the joint regression model. The study recommends that there is need to improve on the audit case selection procedures. There is also need for KRA to organize regular training for all its staff to enable them to be more competent in their work. The study also recommends that additional policy interventions be made on the tax dispute resolution mechanisms to enable the expedition of tax disputes and prevent accrual of dues and unresolved disputes. Finally, tax laws need to be simplified to improve the application and administration of the tax laws and procedures.

Keywords: *Kenya Revenue Authority, Tax audit, Tax officer, Tax, Tax returns*

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ABBREVIATIONS AND ACRONYMS

IEA	-	Institute of Economic Affairs
IMF	-	International Monetary Fund
IT1	-	Income Tax Return for Individual
IT2	-	Income Tax Return for Company
KRA	-	Kenya Revenue Authority

NACOSTI	-	National Commission for Science, Technology, and Innovation
OECD	-	Organization for Economic Co-operation and Development
PAYE	-	Pay As You Earn
U.K	-	United Kingdom
UN	-	United Nations
U.S.A	-	United States of America
VAT	-	Value Added Tax
WHT	-	Withholding Taxes

CONCEPTUAL AND OPERATIONAL DEFINITION OF TERMS

Tax Revenue: Under this study, tax revenue will mean government income due to taxation which is income gained by governments through taxation (Thuronyi, 2003).

Tax Returns: A tax return is defined as a document file with Kenya Revenue Authority showing the income, expenses, and other relevant financial information from which the tax due is determined. This includes monthly returns

such as VAT returns, Monthly Rental income return, Excise tax return, and Annual income tax returns for both individuals and firms (KRA,2012).

Tax Compliance: Under this study tax compliance will refer to activities ranging from taxpayers registration, timely and correctly filing of returns, reporting of correct income, and payment of taxes due on time to a revenue collecting body (OECD, 2006).

Tax Audits: Under this study, a tax audit will mean an examination of the taxpayers' tax return and financial records a little more closely to verify whether the income and deductions to determine if a taxpayer has submitted correct taxable income in the Self-assessment return and paid the correct amount of tax payable, by the tax authority (KRA, 2012).

Tax Disputes: Tax disputes in this study will refer to a situation where the taxpayers disagree with the audit findings provided by tax officers about their tax liability and take some actions such as objecting to tax demanded, appealing to tax tribunals, and even going to court regarding the disagreement (IMF, 2014).

Revenue/Tax officers: A revenue officer is a trained individual who collects revenues such as taxes and duties on behalf of the government through the administration of tax laws and procedures (OECD, 2016).

Transfer Pricing: Pricing of products and services between a parent company and its subsidiary(s) (ICPAK, 2017)

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Taxes are considered to be a mandatory payment to the government, a definition differentiating it from other government actions that have an equivalent economic effect,

thus it is neither inclusive nor exclusive (Thuronyi, 2003). Therefore, taxation is not only the compulsory payment but also the conveying of funds from citizens to the government charged as per the tax laws to facilitate the government in delivering its public goods and services. Revenue tax is a major source of finances to the nation. It is solely used to fund the governments' development and recurrent expenditure (Badara, 2012). In fact, according to Gbadago and Awunyo-Vitor (2015), tax revenue has been recognized as the main source of finance for the government. Consequently, modern economies have established robust tax systems that assist the inefficient collection of taxes to ensure that the supply of public goods and services and also boost public confidence in the government, while guaranteeing that the tax-burden administration is fair and equitable.

In developed Nations like the USA and Canada, tax collection systems employed are not only effective but efficient resulting in an optimal collection of expected tax revenues (Beekes and Brown, 2008). In contrast, a study by Edward (2009) depicted that the difficulties in collecting tax revenue in developing countries were more pronounced as compared with the developed countries. According to the IMF (2011), extensive tax evasion and avoidance is the main challenge to domestic tax base expansion in many African nations.

Even though poor tax compliance is becoming a major problem in nations around the world (McKerchar & Evans, 2009), developing states especially those in Sub-Saharan Africa are mostly affected (Fuest & Riedel, 2009). The explanations behind tax revenue losses are many, although most authors tend to agree that system inadequacy, corruption, poor internal control systems, and corporate governance among others are to blame for the state of affairs. For example, Fati's (2014) study in Ghana revealed that the tax revenue performance has been unstable due to the lack of an all-inclusive register for all

the business activities that are subjected to taxes. Also, they use the manual system to record the transactions and make it difficult to track all business activities from invoicing to payment. Moreover, the manual system of record-keeping not only resulted in huge revenue loss but also led to exposure to corrupt practices. To increase the transparency and responsibility of tax officers and state officers, measures to control tax loss have to be put in place and implemented (Fjeldstad and Haggstad, 2012).

Revenue collecting bodies have insufficient resources to come up with the taxes owed by the taxpayers and thus they implement a Self Assessment system to foster voluntary compliance, where taxpayers declare their income and expenses for tax purposes since they have all the information of their business transactions and financial activities. In a Self Assessment system, the taxpayers compute the taxes payable and remit them without the help of tax officers. Where the Self Assessment returns are done inappropriately or are not filed on time then penalties and interest are administered by tax laws. The revenue collecting institutions that adopts the self-assessment systems employs selective and target-based forms of verification, such as risk-based audits, third-party information, or intelligence to scrutinize the information in the tax returns, and thus it minimizes the administration cost (IMF, 2014). The self-assessment system was first implemented in Kenya in 1992, as an initiative to increase the tax base and as a tax administrative function. This system improves compliance to tax laws and procedures since the taxpayer files the return, assesses him, and pays the taxes due thus resulting in savings in administrative cost (IEA, 2006).

1.1.1 Tax Audit

The tax compliance activities range from taxpayers registration, return filing, income reporting, and payment of taxes to a revenue collecting body. The main objective of a revenue body is to increase the rate of compliance with tax legislation and regulations

and thus build trust and confidence in the public and society through a fair and equitable tax administrative system in place. Cases of non-compliance with the tax procedures are quite unavoidable due to lack of tax knowledge, negligence, tax planning, and tax fraud by the taxpayers or lack of a strong tax administration system. Noncompliance to tax laws denies the government funds they require to provide goods and services to their citizens. In the past non-compliance has been exclusively addressed by enforcing the regulation procedure in place through risk-based audits. Therefore, taxpayer audits have remained a key measure for dealing with compliance risk. In many revenue collecting bodies, audit forms the biggest initiative in terms of resources deployed to administer tax laws and regulations. The main objective of revenue bodies is to optimize revenue collected under the tax laws and improve the rates of compliance while maintaining public trust (OECD, 2006).

Poor tax audit has been cited as being among one of the many reasons behind non-compliance and revenue loss. The financial reporting systems for most business enterprises are sub-standard and, hence, this poses a significant challenge to the tax auditor. Furthermore, the intricacy of tax auditing procedures and the impression that the tax rates are high has contributed greatly to an upsurge in non-compliance (Kiabel & Nwokah, 2009). The strength of audits differs from one country to another. Germany and Japan have the most intensive field audits, and then followed by the U.S, but the potency of audits in the U.K. is low. Also, the nature of the tax audit procedures varies from one country to another, such that Common law countries tend to have a fairly informal procedure for assessment of tax (Thuronyi, 2003).

A tax audit can be termed as a verification of a tax return by tax officers to check and confirm that the income reported and expenditure claimed from the same are correct. It involves the examination of tax returns about the taxpayer's records and books of

accounts. Tax returns in Kenya consist of Income-tax return-IT1 & IT2, VAT Return, Excise Return, PAYE Return, WHT Return, and Agency tax Return. Taxpayers' audits are statutory audits and thus the right to audit taxpayer's records is governed by the various Acts administered by the Commissioner of Domestic Taxes and Customs. Therefore, tax auditors operate within the framework of the tax statutes. For instance, the power to access taxpayers premises, books, records, and other information is stipulated under Sections 56, 69, 119, and 120 of the Income Tax Act CAP 476, Section 31 of the VAT Act CAP 470 and Sections 58E, 58F (5), 58G (2), 80, 89, 95, 169, 170, 174 and 177 of the Customs and Excise Duty Act CAP 472 (KRA, 2012).

Many taxpayers, especially those in the Small and Medium Enterprises sector, have high chances of under-declaring taxable profit, and claiming huge and incorrect expenditure and thus reducing the income to be subjected to taxes. Also, they have poor bookkeeping skills, inconsistent accounting books, and financial statements. The identified techniques that have been employed and have transformed over time in carrying out tax audits in many countries are analysis of bank and cash transactions, cost profits and margin ratios, Net worth, Source and application of funds. The auditor will analyze the results from the application of these procedures; they consolidate the facts and gather evidence to build a case to support the tax position of a taxpayer after comparing the same with the information in the tax return (OECD, 2006).

Transfer pricing is an emerging international taxation issue faced by Multi-National Enterprises today. It a complicated and dynamic issue that no country should overlook. From a national leader's point of view, the pricing of goods and services between related business entities are geared towards minimizing the taxable income and eventually tax payable in a country where taxes are perceived to be high. Due to increase economic integrations and dynamic business environment among countries the loss of taxes due to

transfer pricing is quite huge. Multi-National Enterprises are characterized by the globalization of business and unified management function at one location. United Nations Conference on Trade and Development noted that integration of business by Multi-National Enterprises poses challenges to policy-makers in coming up with the methods of apportioning turnover and expenditures for Multi-National Enterprises among various countries to ascertain the correct taxes due (UN,2013). The audit of related Multi-National Corporations with arranged pricing procedures requires a lot of resources in terms of time, labor, skills, and finances. However, it results in huge tax revenue that can be recovered over a longer period such as two to three years (OECD, 2010).

In summary tax audit investigates the correctness of tax returns submitted to revenue institutions and books of account about other financial documents to determine the unpaid taxes (Koromilas, 2013). According to Kulshreshtha (2011) audit is a science or art of studying deviations. Generally, an audit can be termed as an organized and documented activity done by a professional to find out through investigation, examination, and analysis of the evidence the compliance with procedures in place and guidelines and the effectiveness of their application (Stamatis, 2002).

1.1.2 Audit Case Selection

Due to meager resources and a huge number of taxpayers especially in Small and Medium Enterprises to administer, revenue collecting institutions require a well-programmed risk-based framework to identify the taxpayers for audit. Additionally, an effective and efficient methodology is required to examine the returns and records so

that each audit case results in a fairly correct assessment of the taxpayer's true tax position (OECD, 2006).

Audit Case Selection is randomly done or based on taxpayer's risk profile, by considering factors such as time and consistency in tax remittance, deviations from sector or industry statistics, third party information, and sector's specific features such as huge transactions in cash and businesses with related parties in tax haven countries. The other factors include frequent and large capital allowances claims, transfer pricing arrangements in Multi-National corporations, compliance trends, nil or late filing of returns, and continuous reporting of losses. (KRA, 2012).

It is paramount to commit enough resources such as time to assess risk before selecting a taxpayer for audit besides allocating required resources for carrying out an audit case. Risk assessment is continuously done at all stages during the actual audit to ensure that there is the optimal utilization of time and other resources. Assessment of risk is incorporated in the entire audit process since audits deals with changing tax regimes which are characterized by comprehensive and complicated tax matters with both local and international perspective. Audit cases should be risk profiled by identifying audit risks and assessing them through listing according to the likelihood and the effect of their occurrence as well as finding out the strategies that can be adopted to avoid and mitigate their negative impact where they are impossible to avoid (UN, 2013).

The success of scrutinizing tax assessments to check compliance with tax laws about payment of taxes and reporting of income and expenses is greatly dependent on audit case selection. The use of the approach which is guided by data in selecting an audit case reduces the chances of selecting a compliant taxpayer as opposed to a non-compliant taxpayer (Chepkwony, 2017).

The main role of Revenue Authorities is to check and increased compliance with tax laws and procedures by managing risk with limited resources through measures such as monitoring of taxpayers, education, and enforcement. Therefore, audit Case selection is important as it leads to effective use of the audit resource since it guides tax Audits to most risky taxpayers (Cotton, 2006)

1.1.3 Audit Staff Capacity

Staff competence, proficiency, and due professional care are key elements in effective internal audit activity (IIA, 2006). A study on tax regime difficulties was carried out in Uganda-a developing country. The findings revealed that employing new technology in tax administration and having competent and skilled revenue officers can assist the government to overcome the challenges in tax administration (Kayaga, 2010).

OECD (2004), cited factors that directly affect the compliance risk management decision making to not only include changes in financial resource allocation to a revenue collecting body, position of the government on particular tax legislation variations for instance increased powers for revenue officers but also lack of enough staff and skills. According to Alzeban and Gwilliam (2014), the effectiveness of audit staff is determined by the level of their competence. Mihret *et al*. (2010), also posited that the tenets for an effective and efficient audit program require the staff who are not only technically competent but well train on dynamic and emerging tax issues.

1.1.4 Tax Dispute Resolution Mechanism

The general audit procedures followed in undertaking an audit involve; notifying the taxpayer on a date, scope in terms of period and tax areas to be covered and all the primary-source records and secondary documents required. An audit commences by inspection of taxpayer premises and an interview to assist in building rapport with the

taxpayer. Thereafter the revenue officers will start an in-depth examination of records availed, then the presentation of findings to the taxpayer, and finally issuing of demand notice and assessments and recovery of the tax due if the taxpayer agrees with the audit findings. In situations where the taxpayer is not in agreement then he undertakes a dispute resolution process as provided in the tax laws like objecting to taxes in writing and appealing to tax appeal tribunal or court (KRA, 2012).

A tax dispute normally emerges when KRA assesses a taxpayer based on the findings of a tax audit. A dispute can also arise from a wrong interpretation of facts in an audit case or the applicable law. The taxpayer can object to the assessed taxes as per the provisions of the Revenue Acts to the Commissioner. Where the taxpayer cannot agree to the resulting decision of the commissioner, he can appeal the decision to the Tax Appeals Tribunal. He may also make further appeals to the High Court of Kenya and the Court of Appeal if he disagrees with Tax Appeal Tribunal's decision. The taxpayer or commissioner can also request the dispute, to be handled through Alternative Dispute Resolution mechanisms, especially when the case is in Tax Appeal Tribunal or court. (Rödl & Partner, 2018).

1.1.5 Interpretation of Tax Laws

Tax audit involves clarification and interpretation of complex laws, thorough examinations of taxpayers' books and records, and associating with taxpayers thus functioning much like a "public image" of revenue collecting institutions. Accuracy is one of the key principles to the quality of the individual audits since it points out that a lack of compliance through a proper interpretation and application of the tax legislation, and consequently resulting in an appropriate evaluation of tax liability (OECD, 2006). Simplified, consistent, and integrated tax laws and procedures are understandable for the taxpayers to apply to their situation and thus enabling them to file the tax returns,

calculate and remit the taxes due on time. This will eventually result in a reduction of the compliance cost to the revenue collecting institutions (IMF, 2014).

Majority of contentious matters in tax law interpretation results from tax avoidance transactions. The normal tax cases don't turn into a dispute over the definition of the tax law. Depending on the systems, judges can be creative to some extent in evaluating the facts and the relevant aspects of tax law, application of private law, and synthesizing the precedent. In situations where the economic issues of tax affairs are paramount for tax procedures, then the judges will take technical iterative procedures of ascertaining the facts about legal rules in determining and deciding the case. There are different maxims and approaches to the interpretation of tax laws in various countries. These include but not limited to the literal meaning, in *dubio* contra *fisc*al-in doubt against the revenue, legislative intent, teleological, decision-based on the facts, true legal nature, economic substance, deference to an administrative agency, constitutional construction, re-enactment doctrine, taxpayer's reliance on administrative interpretation and procedural errors in assessment (Thuronyi, 2003).

The taxpayer can be declared as compliant when the total taxes due is determined and paid. Establishing correct taxes due is difficult due to the ambiguous nature of the tax system and variations in interpreting tax legislation by taxpayers, tax agents, tax auditors, and in courts. On the other hand, a taxpayer may have met their normal tax obligations but non-compliance could arise where the tax legislation is not clear in the meaning and intent. Therefore, clarity of the taxation laws becomes a risk to be addressed by revenue bodies. High rates of compliance are achieved through clear and unambiguous tax laws. Good tax legislation is a solid foundation to build a tax administrative audit program and to create an effective tool to manage compliance risk. On contrary, ambivalent tax law creates loopholes for taxpayers to evade and avoid taxes (OECD, 2004).

1.1.6 Penalties and Interest

Revenue bodies impose penalties for failure to provide relevant documents to a tax auditor and without legal sanction, it will be difficult to undertake an examination of records of the taxpayer effectively. Penalties can also be imposed where the taxpayer has under-declared tax liability as a result of errors, misinterpretation of facts or law, carelessness, and fraudulent actions. In all OECD member countries, tax evasion or avoidance offenders can be prosecuted under criminal laws and may lead to imprisonment or huge fines which are normally more than the tax liability (OECD, 2006).

Penalties and Interest are imposed to make the taxpayers aware of their tax obligations in complying with tax laws and procedures. Penalties are administered as sanctions for tax offenses, while interest is applied on taxes that were not paid on time thus reimbursing the government for the time taxes remains overdue and the use of that money (IMF, 2014).

Small enterprises need more attention as far as tax compliance is a concern since they find it difficult to accomplish their obligations about taxes. Also, these businesses are greatly exposed to external factors such as economic dynamics, steep competition, and lack of regulations that promote transparency and accountability and even illegal actions, thus resulting in poor or noncompliance to tax procedures. Small businesses are majorly family businesses or rather operated by the owner and thus are highly affected by such risks like personality, social interactions, and emotions. Owing to their nature, tax penalties are one of the initiatives that have been adopted to foster tax compliance issues. Tax penalties stimulate fairness and assists in achieving the desired social standards that affect the choices of the taxpayers, thus playing a vital role in formalizing the businesses

and improving tax compliance. The legislators and tax administrators should understand the challenges and nature of tax penalties when designing them to achieve their intended objectives. First, they should be aware that tax penalties are paramount and required, especially to prevent non-compliance through enforcement and revenue collection. Secondly, those high tax penalties may pose a challenge in the formalization of small businesses and may not improve tax compliance. Also, tax penalty regimes should not be used as a means of collecting revenue collection itself. Finally, they should note that that are other initiatives that can best enhance compliance other than tax penalties. Also, they should utilize noncompliance preventive tools such as good monitoring controls, sending reminders, and incentives where applicable (Swistak, 2015).

1.1.7 Kenya Revenue Authority

Kenya Revenue Authority was instituted through an Act of Parliament, CAP 469 of the laws of Kenya, in the year 1995. The Authority is tasked to collect tax revenue for the Government of Kenya, and it accounts for over 95% of Government Ordinary revenues (VAT, Income taxes, Customs duties, and levies). The vision of KRA is to facilitate transformation in Kenya by innovation, Professionalism, and appreciating Customer-Focused in Tax Administration (KRA, 2016). Kenya Revenue Authority has developed innovative and co-operative approaches to enhance revenue collection and improve compliance to tax laws, regulations, and procedures. These approaches include designing an organizational structure which is composed of the Office of the commissioner-general, Domestic Taxes Department (Large Taxpayers Office, Medium Taxpayers Office, and Small Taxpayer Office), Customs Department, Investigation and Enforcement Department, and Support Services Department. Under Domestic tax departments, KRA has further developed programs/initiatives such as Audit, Taxpayer services, and registration, Policy Unit Technical, Compliance Monitoring, and Debt

program. Also, KRA has open approximately 30 regional offices for domestic taxes throughout the country and also satellite stations to facilitate the implementation of revenue initiatives and thus tax administration as a whole (KRA,2015).

The East African Community facts and figures 2016 report on revenue trends depict that KRA is leading in total revenue collected for years 2010/11 to 2015/16 amongst other revenue authorities of the community states. Kenya's tax revenue trend analysis from 2010 to 2015 shows revenue has been increasing every year from 7,760 million US dollars in year 2010/11 and to 11,343.1 million US dollars in year 2015/16. The percentage tax revenue on total government expenditure has however been decreasing over the same period. In the year 2010/11, the percentage of tax revenue on total government expenditure is 73.83 while in the year 2015/16 the percentage is 57.9 %, as per the data in Table 1 (EAC, 2016). This analysis shows that the government is far from being a self-financed government, and thus there is a need to improve/review tax initiatives.

Table 1: Kenya's Tax Revenue and Government Expenditure for Year 2010/11 to 2015/16

Year	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Tax Revenue (Million USD)	7,760	7,923	9,201	10,976	10,487	11,343
Government Expenditure (Million USD)	10,510	12,041	12,623	15,198	17,940	19,600.

% Tax Revenue On Gov't Expenditure	73.8	65.8	72.9	72.2	58.5	57.9

Source: http://www.eac.int/about/key-documents

In addition, KRA did not meet the set revenue targets for the year 2010/11 to 2015/16 as depicted in the analysis of annual performance reports in the table below.

Table 2: Revenue Performance

Year	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Revenue Targets(billions)	641.212	733.354	863.300	972.800	1,108.800	1,212.600
Revenue Collected(billions)	634.903	707.360	800.500	963.800	1,069.600	1,200.200
Shortfall	6.309	25.994	62.800	9.000	39.200	12.400

Source: KRA 2015, KRA 2018

1.2 Statement of the Problem

The tax compliance in Kenya is estimated at 65% being the weighted average of registration-60% of the citizens, filing-55.5% of the taxpayers registered, and payment rates at 79.9 percent of the taxpayers who are filing returns, respectively (KRA, 2015). The cases of non-compliance results from low risk of detection and inefficient preventive measures such as tax audit. In a bid to improve tax compliance KRA has over time come up with revenue enforcement and preventive measures such as taxpayer audit. It has also allocated resources necessary to implement its revenue initiatives but tax audit has never been given enough resources and attention it requires. An ineffective tax audit has been considered one of the many reasons behind non-compliance. The taxpayers that were audited during the year 2010-2015 in Kenya Revenue Authority Specifically in South Rift valley region about the total number of taxpayers mapped to the region is very low. There is scant research on factors that affect the effectiveness of the tax audit function as

a tax administrative tool especially in Kenya. Therefore, the present study sought to examine how to audit case selection, staff capacity, tax dispute resolution mechanism, and interpretation of tax laws affect the effectiveness of tax audit function in revenue collection in South Rift Valley Region.

1.3 Purpose of the Study

The objectives of the study are composed of the general objective and specific objective as detailed below.

1.3.1 General Objective

The general objective of the study was to evaluate the factors affecting tax audit effectiveness in the Kenya Revenue Authority.

1.3.2 Specific Objectives

i. To assess the effect of audit case selection on tax audit effectiveness in South Rift Valley Region.

ii. To investigate the effect of audit staff capacity on tax audit effectiveness in South Rift Valley Region.

iii. To evaluate the effect of tax disputes resolution mechanisms on tax audit effectiveness in South Rift Valley Region.

iv. To analyze the effect of the interpretation of tax laws on tax audit effectiveness in South Rift Valley Region.

1.4 Research Hypotheses

The following hypotheses were tested:

H0$_1$: Audit case selection has no statistically significant effect on tax audit effectiveness in South Rift Valley Region.

H0$_2$: Audit staff capacity has no statistically significant effect on tax audit effectiveness in South Rift Valley Region.

H0$_3$: Tax disputes resolution mechanism has no statistically significant effect on tax audit effectiveness in South Rift Valley Region**.**

H0$_4$: Interpretation of tax laws has no statistically significant effect on tax audit effectiveness in South Rift Valley Region.

1.5 Significance of the Study

The findings of the study are vital to South Rift valley Region management as it will provide them with more information in planning and allocating the necessary resources to audit programs. It will also help them to improve the audit function as maximized on it to collect more taxes from hidden and undeclared income. The outcome of the study may also be important to other revenue collection agencies as it provides them with more knowledge about tax audits. Tax consultants provide advice on technical issues of tax to their clients especially in interpreting the complex tax laws and its application as far as tax compliance is concerned. This research will therefore help tax agents to understand the objectives of tax audits as a strategy to prevent and deter non-compliance, tax evasion, and tax avoidance. The study is also anticipated to bring on board crucial findings that will be invaluable to policymakers in relevant sectors in their policy decisions. In this regard, the government may also benefit from the findings of the study in terms of understanding the relevance of taxpayer audit as a strategy to not only monitor compliance to tax laws despite changing the environment. Furthermore, the research study will be a reliable source of reference to scholars and academicians in the fields of audit, tax management, and revenue collection systems at large.

1.6 Scope of the Study

This study was confined to selected factors affecting tax audit effectiveness in Kenya over the periods 2010 to 2015 because over this period Kenya Revenue Authority did not achieve the set tax revenue and the level of tax compliance was very low. The selected factors are audit case selection, audit staff capacity, tax disputes resolution mechanism, and interpretation of tax laws. These factors have been selected for this study since they are the backbone of the audit procedure. The study obtained primary data from 80 revenue officers in KRA.

1.7 Limitations

The limitations of the study were obtaining respondents' attention to respond to issues about the topic and the accessibility to the revenue officers.

1.8 Delimitation of the Study

This problem was overcome by assuring them that the information was going to be used for academic reasons only. Also, the challenge of accessing the officers was overcome by seeking approval from relevant institutions concerned while emphasizing that the study is very significant to them, and the information shared was held with high confidentiality.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the underlying concepts of tax revenue collection and tax audit function. The aim is to underpin factors related to the effectiveness of the audit function through theoretical examination and empirical evidence. The discussions will be anchored on the study objectives after which a conceptual framework depicting the hypothesized relationships will be explained.

2.2 Theoretical Literature Review

The theoretical discussion in this section currently advances main theories purporting to explain the audit function of tax revenue collection. As such, the theories reviewed here are the Theory of Inspired Confidence, The Policy Learning Theory, The Optimal Theory of Taxation, and Hoffman's Tax Planning Theory.

2.2.1 Theory of Inspired Confidence

This theory was developed by Professor Theodore Limperg in year between 1879 and 1961 at the University of Amsterdam. This theory links the society expectations and needs for reliable financial information and the capacity of auditing methods and tools to match those expectations, and it also emphasizes the improvement of the community needs and the auditing techniques over some time (Limperg Institute, 1985). Limperg concluded that the duty of the accountants to undertake their work professionally and with due diligence in such a way that society's needs are dully met. In this theory, an accountant is supposed to determine the expectations he triggers in every special audit case and understand the weight of the trust and confidence he awakens in with the performance of each particular function (Limperg Institute, 1985).

The analysis of this theory points out that auditors are required evidence while carrying out his work so as assure the community that their desires are dully going to be met. It also appreciated the fact that when the trust of the community in the importance of audit and its objectives is lost then the social importance of audit is destroyed as observed by Limperg. The principles of Limperg's theory are relevant in devising the audit initiative and also in appreciating the social importance of auditing and the impact of how the audit is to be carried out (Carmichael (2004). Taxpayer audits are vital in the administration of tax laws since it diagnoses tax avoidance and evasion and also acts as a preventive tool to the taxpayers who participate in non-compliant activities. Therefore, all audits in the overall audit program are geared towards arriving at a correct assessment as far as tax liabilities are a concern.

This theory is important to this study since the success of a tax audit like any another audit is to present the findings with evidence to support it, and that all the taxes unpaid can be accounted for to satisfy all the stakeholders; that is tax agents, taxpayers, and the government.

2.2.2 Policy Learning Theory

The policy learning theory was introduced by Heclo in 1993. This theory refers to continuous changes of thoughts and behavioral desires which emerge as a result of experiences and are the determinant factors to the achievement of the objectives of the policy (Heclo, 1974). Policy learning theory forms a critical aspect of the changes in the policy that can eventually distort the secondary aspects of the entity's culture. The policy change also causes a shift in macro-economic conditions and other external factors as well as governance structures of an organization. Understanding the change in policy processes takes a long period like 10 years of more (Sabatier, 1988). The three complex processes of the policy learning theory know about organizations, programs, and

policies. There is a need to understand the differences between the three processes (Bennett and Howlett, 1992).

Policy learning is demonstrated when changes in the same policy come as an outcome of the same process' (Hall, 1993: 78) like in the case of tax policies in the present study. In the case of the Kenyan tax regime, for example, changes in patterns of taxation are mostly anchored in government policy and it is important for both the government and the organizations charged with collecting taxes, the taxpayers and their agents need to learn the changes in the policy regime. This theory will be used in the present study to shed light on how tax policy changes brought about by changes in public finance laws affect the auditing of taxpayers.

2.2.3 Optimal Theory of Taxation

The Optimal Theory of Taxation is an outgrowth of the foundational work of Ramsey (1927) and Mirrlees (1971) and has been very instrumental for economists when deciding on optimum tax policy. In the accepted optimal theory a tax administration system should the one that maximizes the social welfare of the stakeholders.

The written works on optimal taxation specifically consider the government to be utilitarian, where the utilities of the society members determine the social welfare purposes and plan The main objective of the social planner is to come up with a tax system which maximizes the welfare of the consumers putting into consideration that the same consumers will benefit from tax incentives provided by the tax system. Developments in recent decades concerning optimal tax theory have led to certain postulates: That the best marginal tax rates can be achieved through its distribution capacity, that it should be able to decline as the income increase, and that a flat tax rate should have a uniform transfer of lump-sum, that its redistribution extent should increase

in wage differences, should be based on income besides other personal features, should consider only the finished products for taxation and that should have universal taxation, should exclude taxation of capital income and finally, it should be robust and comprehensive since economies are complicated and subject to change. Essentially, the best taxation is concerned with maximizing revenue collection to economically feasible limits as advised by Adam Smith while also minimizing the costs of taxation. The costs noted are the efficiency costs (Barro 1986).

The Costs incurred in raising taxes can either be administrative (Kinyua, 2014) that leads to governments to invest in more efficient systems, such as, technology-based systems to avoid revenue leakages, and social costs which are generally concerned with the distributive ability of the population.

The current study is also concerned with the problem of the revenue envelope. Governments primarily derive their revenues from taxes and these taxes in the budget are often designated as revenue estimates, therefore, a theory that undergirds the taxation process as a means of achieving the budget objectives is important. The Optimal Theory of Taxation theory will thus be instrumental in explaining how auditing optimizes tax for the revenue collector.

2.2.4 Hoffman's Tax Planning Theory

Hoffman's Tax Planning Theory was first proposed by Hoffman in 1961. According to Hoffman (1961). Tax planning by the taxpayers is often geared towards a diversion of income to other related corporate entities that would have been tax and remitted to the government. Tax planning transactions are done objectively to reduce income to be subjected to taxes to the lowest levels, with little or no change in accounting income, since the taxes due depends on the taxable profit and not accounting profit. Therefore,

the key issue is increasing the transactions which bring down the profits to be subjected to tax and does not relate directly to the accounting profit. This theory acknowledges the fact that the transactions which are plan to tax planning activities are directly affecting the financial performance of a business entity. Hoffman (1961) noted that the tax cost plays a role during tax planning transactions. This theory thus explains that tax planning benefits are more than the tax cost such since there is a positive relationship between a firm's performance and planning of tax. However, the extent of this theory does not take into account the ever-changing characteristics of tax planning and the performance of the market. Due to changes in capital markets and globalization issues and detachment of firms' control and ownership, robust tax planning theories are inevitable, even though the challenge can be dealt with using an empirical point of view rather than a theoretical position (Inger, 2012).

The present study recognizes that from the taxpayer's perspective tax planning is imperative while from the taxman point of view, good auditing techniques are instrumental in uncovering the tax planning strategies. Therefore, in the context of the present study, the theory will be instrumental in providing insight into how understanding tax planning strategies leads to effective auditing by the tax auditors.

2.3 Empirical Literature Review

2.3.1 Tax Audit

Mirera (2013) studied the effects of tax audit on tax revenue in Kenya Revenue Authority (Nairobi West Tax station). The study used a descriptive approach and secondary data for the period 2008 to 2012 from Kenya Revenue Authority audit reports. The data evaluation was done and the results showed that there was an increase in the tax paid after the audit, especially for a random tax audit, cut-off tax audit, and conditional tax audit. The analysis of the tax revenue from a specific firm a few years

before the audit and two years after the audit depicted an increase in tax collected after the audit. The study pointed out that there is a direct relationship between tax audit and tax revenue collected.

Harelimana (2018) did a study in Rwanda to investigate the relationship between Tax audit and revenue collection in Rwanda. The study adopted a descriptive research design and utilized both primary data collected from 110 respondents in the Rwanda Revenue Authority and secondary data. He found out that as the tax audits increase the revenue collected also increases. Therefore, the audit of taxpayers is positively related to the revenue collected in a particular year

Nurebo et al. (2019) carried out a study in Kembata Tembaro Zone –Southern Ethiopia to assess factors affecting tax audit effectiveness. The study employed qualitative and quantitative research methods with a Sample size of 146 respondents composing of tax officials of tax authority only. They found out that the support from the management, quality of the audit, awareness of taxpayers, and the system of tax administration is directly related to audit effectiveness, whereas the complexity of tax law and accounting/reporting of taxes are inversely related to tax audit effectiveness.

Badara (2012) in his study evaluated the impact of Tax audit on tax compliance, in Nigeria-Bauchi State of Internal revenue using primary data from 48 respondents who were the revenue staff and some selected individual taxpayers and forms. The findings revealed that the Tax Authority uses tax audits to achieve target revenue, that tax audit mitigates tax evasion, and that there is a lack of cooperation of taxpayers with tax audit staff during the audit process.

Chalu and Mzee (2017) researched the factor affecting the effectiveness of tax audits in Tanzania. They group the factors into four categories that are factors associated with the

organization, factors relating to tax auditors, taxpayers related factors, and regulatory factors. The study adopted an explanatory approach and collected data from 225 tax auditors in 23 tax regions in Tanzania using questionnaires. Data were analyzed using both descriptive and inferential statistics. They found out that: implementation of tax auditors' recommendations by management, adequacy of resources in tax audit unit, taxpayers' attitude, availability and application of regulation/ audit standards, and leadership in place and tax regimes for tax audit are vital factors for tax audit effectiveness.

2.3.2 Audit Case Selection and Tax Audit

Chepkwony (2017) assessed the factors that the Kenya Revenue Authority considers to determine the possibility of a taxpayer being audited and found that there are many such as nature and type of business, type of projects the company undertakes, whether the business sector has a regulatory body, the taxpayer representation, Accountant /tax agent profile, the frequency of change of the tax agents, nil/late/non-filling of tax returns, Variances in tax assessed and tax paid, the taxpayer profitability/liquidity ratio trends, firms group structure, taxpayers sector performance, the investment deduction claims, variation in import/export declarations and Taxpayer's huge refund claims.

Gupta and Nagadevara (2007) in their study found out that data mining algorithms are the most effective and efficient tax audit case selection methods that the revenue institutions can employ to check the evasion and improve compliance. They further supported their findings by pointing out that the auditing of taxpayers is costly to both taxpayer and revenue institutions, and thus there is a need to minimize the cost of auditing while maximizing compliance.

Alm, et al. (2005) examined the factors of state audit selection and the ensuing compliance with a sales tax by the firm in New Mexico, using secondary data. They adopted a type of selection with two stages to approximate the factors of the State's audit case selection criteria and the entities' subsequent declaration results for the entities selected for an audit. The results from the first-stage audit selection process depicted that tax returns are selected methodologically by the state for audit, by considering the income and expense items reported by the corporate taxpayers on their returns for taxes. On the other hand, the second-stage corporate taxpayer's tax return's declarations findings revealed that business entities that show significant deviation in tax deductions, the service sector firms, firms that file late returns, and the ones that the mailing address outside the state have low levels of compliance.

2.3.3 Tax Dispute Resolution Mechanism and Tax Audit

A study was carried out by Tran-Nam and Walpole (2016) in Australia to examine the feasibility of external tax dispute resolution and the effects of unbiased tax dispute resolution on social justice. The research discovered that the studies on tax administration complexity did not consider the implication of laws and regulation intricacy on tax justice. Secondly, they didn't differentiate between tax disputes from civil and commercial disputes; thirdly, the compliance costs are an impediment to easy access and impartiality of tax dispute resolution techniques; and finally, they did not note that inaccessibility and unbiased tax dispute resolution procedures may result to a breach of both social and distributive justice. The research points out that the Australian Tax Office has recently developed an Alternative Dispute Resolution approach as a tax dispute resolution mechanism that can reduce the compliance costs, pressure and it results in socially unbiased outcomes for taxpayers.

Wardhana (2016) evaluated decisions made by the court on transfer pricing tax disputes from 2002 to 2013 in Indonesia. The paper pointed out that the disputes prompted the Indonesian Tax Authority to review its transfer pricing procedures, and subsequently enacted a Regulation that arrogated the arm's-length principles in line with the OECD procedures about transfer pricing. The study finally justifies the reason as to why 76% of transfer pricing disputes in Indonesia were in the favour of the taxpayer by noting that it is due to variability of the legal basis of the existing legislation, lack of transfer pricing audit regime, lack of expertise in transfer pricing issues and a weak transfer pricing system.

2.3.4 Tax Audit Staff Capacity and Tax Audit

OECD (2004) cited factors that directly affect the compliance risk management decision-making to not only include changes in financial resource allocation to a revenue collecting body, the position of the government on particular tax legislation variations for instance increased powers for revenue officers, but also lack of enough staff and skills.

Al-Twaijry *et al*., (2004) posited that skills and competencies determine the internal audit work can be trusted by the auditors from independent entities. In Studies by Ali *et al*. (2007) and Ahmad *et al.* (2009) in analyzing the importance of domestic audits to the public sector in Malaysia and they discovered that inadequate staff and incompetence due to lack of training, requisite knowledge and experience in handing work hurts the internal audit functions. They, therefore, recommended that frequent training of staff is imperative and paramount in improving the work of internal audit.

Schyf (2000) highlighted factors that are adversely affecting the performance of the internal audit program in South Africa's public sector. The variables were inadequate competencies and skills among the audit staff. Puteh (2016) carried out a study of the

critical competencies considered by top management in the service industry in Malaysia. She found that cognitive competencies, functional, leadership, and communication is considered vital for organizational excellence in performance and professional employees are supposed to have the best delivery of their services. Professionals are therefore expected to equip themselves with those competencies and to pursue the development of the same so they can increase their capacities in carrying out their daily duties, enable them to interact with their colleagues of all cadres in their respective organization, and also make them have a competitive advantage in the job market.

Toroitich (2017) posited that staff ought to be trained on how to use e-procurement tools to improve the application of those tools. Therefore, the organizations are supposed to train their employees so they can acquire requisite skills in operating the e-procurement system. Additionally, recruiting staff that is qualified and providing the user manual procurement systems facilitate faster implementation of the procurement system. However, no empirical studies have been done so far about the effects of tax auditors' competence on tax audit effectiveness in the KRA South Rift valley Region in Kenya.

2.3.5 Interpretation of Tax Laws and Tax Audit

The penalties and tax audits are implemented to improve compliance with tax laws but not necessarily as a deterrence measure. Also, audit improves the tax knowledge of the taxpayers and thus streamlining the application of tax laws (Çelikkaya 2002). Slemrod (2012) in his study noted that the simplicity of tax laws, efficiency, and equity must be considered when policies are being made at every time the tax revenue is being increased. He further gave examples of taxes that have low-efficiency costs such as Ramsey tax and the poll tax. Poll taxes on the hand are a bit simple while Ramsey tax is quite complex since every category of commodities and transaction has different tax rates but both can quite inequitable. The integration of both poll tax and Ramsey tax as

applied in many countries can result in maximum tax collection at a lower cost, considering that there exists a nonlinear relationship between simplicity and equity.

According to Pantelidis, (2009), the concepts that are used to denote or describe accounting, legal and tax terms and its prescribed rules can make the taxpayers not to easily understand their obligations and rights and thus fail to pay the rightful share to the government. Therefore, in most cases, the taxpayers engage professionals such as lawyers and accountants to assist them in complying with tax laws, or they may choose not to declare income and pay taxes. Additionally, the tax legislation can be ambiguous in interpretation and application thus resulting in tax evasion and huge loss of revenue arising from tax planning activities. He also noted that an inconsistent definition of tax terms brings complexity in tax laws and the impact on the cost of compliance to the taxpayers when designing those laws and tax administrative systems. He also observed that another factor that affects the complexity of the tax system in reducing tax liabilities is personal interest.

Policymakers encounter a lot of checks and balances in designing and application of tax laws and administrative procedures in that besides the significance of simplicity, due diligence needs to be observed when exercising discretion to balance the policy objectives and simplicity (Shome, 2004). The main policy objectives are transparency, fairness, optimal, social impact, predictability, and the ability to protect revenue.

Complex tax laws and administrative systems hurt the incidental cost of carrying out business, investment decisions, production, and productivity. The complexity of the tax system is a result of the effects of internal and external factors surrounding its development and application. The cost arising due to the complexity of the tax system equates to the taxes to be paid. The complexity of tax by itself can harm the economy of

a country and even taxpayers who are trying to comply with the tax code. (Olowookere & Fasina, 2013). The tax law complexity denies the country the ability to compete with other countries economically in the globe, especially by denying the government the needed revenue and increasing the burden of tax on the taxpayers. Frey and Torgler (2007) in their study of tax morale and conditional cooperation established that the perceived tax injustice, the lack of institutional quality- complex tax laws & changing of them frequently was responsible for poor compliance to tax collection.

Atawodi and Ojeka (2012) studied the impact of variables on compliance to tax code on small and medium enterprises and they discovered the most crucial determinants of poor tax compliance complicated procedures especially on the filing of tax returns and extremely high rates of taxes. Also, lack of taxpayer awareness and education on tax code and many taxes hurt compliance among the small and medium enterprises in North Central Nigeria as per their study.

A study by Mwangi (2014) revealed that the low accessibility to as far as taxes are concern contributes to a large extent to poor compliance to tax laws and procedure, as per his discussion on variables that affect tax compliance among small and medium business in Nairobi. The poor access to relevant information is the main reason as to why the taxpayers compute taxes payable wrongly and thus leading to low tax compliance levels. The small and medium businesses opined that improvement of the accessibility of the needed tax information through media, education, and training can assist in simplifying the tax legislation and eventually motivates them to comply.

Muiru (2012), studied the barriers that complicate the laws and procedures of doing business in Kenya found out that comprehensiveness of business activities results in challenges in the overall tax administration. The taxpayers who desire to cooperate and

comply with the tax code encounter challenges especially in making a vital decision in their business where the tax laws are unclear as far as the treatment of multiplex business activities. Kenya's tax code does not have provisions where the taxpayer can seek tax rulings in advance during business decision-making point, but it allows them to seek a ruling on the interpretation of tax laws and its impact on specific business activity. A private ruling is normally done without any publicity to maintain confidentiality.

2.4 Research Gap

The foregoing literature review has underscored the impact of tax audit on revenue and compliance; factors affecting tax audit effectiveness in Ethiopia and Tanzania; Importance of case selection system to a revenue collecting body; Cost verse benefits of an external tax dispute resolution and the importance of training staff in the empirical perspective. It is, however, important to appreciate that a comprehensive theoretical framework for tax auditing is lacking and, hence, the theories co-opted from compliance, public policy, and taxation are ones that provide basic insight into the variables under investigation in the study. Further, the foregoing discussions have brought quite many empirical issues concerning taxation and audit to the forefront. The need to ensure high tax compliance to ensure the delivery of service to the public is enhanced. The role of the tax audit function and its associated variables has also been examined. However, local studies focusing on the KRA have not focused on the effect of audit case selection, tax audit staff capacity, tax dispute resolution mechanism, and interpretation of tax laws on tax audit effectiveness in the KRA South Rift Station in Kenya.

2.5 Conceptual Framework

According to Orodho (2005), the conceptual framework covers the main features of a study and their presumed relationship. This study tests the conceptual framework presented in Figure 1.

```
┌─────────────────────────┐
│ Audit case selection    │
│   • Profiling           │───────┐
│   • Risk assessment     │       │
└─────────────────────────┘       ▼
┌─────────────────────────┐    ┌──────────────────────────────┐
│ Audit staff capacity    │    │ Tax audit effectiveness      │
│   • Training            │───▶│   • Number of taxpayers      │
│   • Experience          │    │     audited                  │
│   • Staff adequacy      │    │   • Revenue/Compliance       │
└─────────────────────────┘    │     rates                    │
┌─────────────────────────┐    └──────────────────────────────┘
│ Tax dispute resolution  │             ▲
│ mechanism               │───▶         │
│   • Cases completion    │             │
│     time                │             │
│   • Tax recovery efficacy│            │
│   • Alternative resolution│           │
└─────────────────────────┘    ┌──────────────────────┐
┌─────────────────────────┐    │ • Tax penalties and  │
│ Interpretation of tax laws│──▶│   interests          │
│   • Scope               │    └──────────────────────┘
│   • Complexity          │      **Intervening variable**
└─────────────────────────┘
```

Figure 1: Conceptual Framework

Source: Researcher (2020)

The conceptual framework in Figure 1 shows the expected relationships existing between the independent factors and the dependent factor. This study conceptualizes that the increase in tax compliance which leads to an increase in tax revenue collected every year could be affected by the tax dispute resolution process on audit cases, Audit case selection, staff capacity, and Interpretation of tax laws, as administered through taxpayer audits. This study is therefore geared towards analyzing the type, nature, and strength of these relationships.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter gives detailed information on the research design used. It begins with the location the study was done, the population of the study, research instrument, data collection, and analysis.

3.2 Location of the Study

The study was conducted in Kenya Revenue Authority-South Rift Valley Region consisting of Nyahururu, Naivasha, Nakuru, Narok, Maralal, and Kericho. The selection of this area of study has been informed by the fact that the region is expansive and diverse and as such is likely to be information-rich for the study.

3.3 Research Design

Paul et al. (2009), in defining a research design said that it is a framework for collecting data to be used to get the information required. This research study employed a descriptive research design. Descriptive research describes a condition qualitatively (Trevor, 2010). Descriptive research assists in providing answers to such questions such as what, who, where, when, and how about specific problems of research though it does not fully give answers to why question. Descriptive research is preferred since it gives current information on the subject under study and illustrates the conditions in a situation. A descriptive research design is normally used as a predecessor to quantitative research designs to give an outline of the variables that can be quantitatively tested.

3.4 Target Population

A target population is defined as the researches of a group of people with common features obtained from the general population (Mugenda & Mugenda, 2009). The study, therefore, targets, the Kenya Revenue Authority- South Rift Valley Region based in Nakuru County. The station has 80 tax officers in both the Nakuru Station and the satellite stations. Therefore, the entire accessible population under consideration in this study comprises 80 persons. This population was chosen due to their conversance with the tax audit process and is expected to be familiar with the variables being investigated in this study.

Table 3:Population Distribution

Respondents/ Location	Population
Nakuru	70
Naivasha	3
Nyahururu	2
Narok	2
Kericho	3
Total	**80**

Census method was used for the present study because the respondents are specific persons in the organizations that are involved in the tax audit operation, control, and management of the audit functions in South Rift Valley Region- KRA. Furthermore, the population is composed of only 80 respondents.

3.5 Research Instrumentation

Data was obtained primarily through the questionnaires. The questionnaires used were structured to capture the respondents' views on the research problem.

3.5.1 Pilot Study

Piloting was undertaken in KRA Eldoret-North Rift Valley Region before the questionnaires were used to check accuracy and correctness using 10 respondents who were purposively selected; however, this population was not included in the actual study.

3.6 Validity and Reliability of the Research Instruments

3.6.1 Validity

Validity was tested by reviewing the research instrument design about the objectives of the study to ensure that it is up to the standards. Validity is considered to measure the preciseness and importance of inferences, which are dependent on the results. It is also used to ascertain if the test is good enough to measure what it was intended to measure as well as determining if it represents the factors being studied accurately. It is normally affected by a systematic error in data (Sekeran, 2003). The questionnaire was also given to independent experts to verify the validity of its contents and ensure that their clarity of all items and that is no biasness in examining the variables. The findings from the pilot test assisted in checking if there were information missing, correcting the errors, and questions that were unclear to the respondents (Hair, Black, Babin & Anderson, 2009). These corrections helped in improving the validity of the questionnaires to be used for the actual study.

3.6.2 Reliability of the Instrument

Reliability refers to the estimate of the stability of the study findings from the test of the research instrument. It is a measure used to determine the extent and ability of the instrument to give uniform results from several tests. It is affected by random error. Test-retest of the instruments was done on the instruments. The responses from the two administrations were correlated using Pearson's moment correlation formulary.

According to Fraenkel and Wallen (2000), a value of 0.70 or higher from the correlation formula should be attained for a questionnaire to be used.

3.7 Data Collection Procedures

The researcher obtained a letter of introduction from Kabarak University administration and afterward a permit to collect data from the Kenya Revenue Authority-South Rift Valley Region and NACOSTI. The researcher requested permission to undertake the research study and collect data from the head of KRA South Rift Valley Region, after explaining the importance and purpose of the research study. The researcher then proceeded to collect data after being granted permission. The respondents were assured of their confidentiality of any information they gave. The questionnaires were administered using the dropping and picking later technique. This gave the respondents ample time to respond to the questions being asked in the instrument.

3.8 Data Analysis

The data analysis was done using descriptive and inferential statistical techniques. Descriptive statistics is important since it explains the basic features of the population by specifically computing the standard deviations, mode and means; inferential statistics were employed to determine the kind of influence among the variables using the multiple regression models. Data collected from the research instruments was verified, cleaned, and edited before coding and carrying out data analysis. The closed-ended questions from the Likert scale in the research instrument were transformed to numerical codes ranging from one to five points accordingly, and then the data was transferred to the Statistical tool. The multiple regression model was assumed to hold under the equation;

$$y_{ij} = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \varepsilon$$

The linear regression model was assumed as per the equations below:

$$y_{ij} = \beta_0 + \beta_1 x_1 + \varepsilon$$

$$y_{ij} = \beta_0 + \beta_2 x_2 + \varepsilon$$

$$y_{ij} = \beta_0 + \beta_3 x_3 + \varepsilon$$

$$y_{ij} = \beta_0 + \beta_4 x_4 + \varepsilon$$

Where;

y = Tax Audit Effectiveness

β_0 = Constant

X_1 = Audit Case Selection

X_2 = Audit Staff Capacity

X_3 = Tax Dispute Resolution Mechanism

X_4 = Interpretation and application of Tax Laws

β_1 to β_4, are the coefficients of the variables determine by the model

ε = the estimated error of the regression model.

The results will then be presented in tables, interpreted, and discussed.

3.9 Ethical Consideration

There are certain ethical protocols that the researcher followed. The first was informing respondents of their rights and confidentiality of the information they are providing and also soliciting their consent. This served to ensure that their participation in filling the instruments is not out of coercion or influence. The researcher also treated the respondents with respect and courtesy (Cooper & Schindler, 2003). This was done to ensure that the respondents feel free and provide the right responses to the questionnaire. The ethical measures that the researcher followed in analyzing data to ensure the integrity of data was encoding accuracy of all the responses provided to make sure that

statistics generated and correct and verifiable (Cooper & Schindler, 2003). The researcher sought permits to research the area. This was done to ensure compliance with the laws of Kenya regarding research. The respondents were first informed on the importance of the information to be gathered and its intended use and beneficiaries. The respondents were not allowed to indicate their identity and contacts in the research instrument to ensure that there are privacy and confidentiality.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION, AND DISCUSSION

4.1 Introduction

This chapter contains the findings from data analysis and information collected using the research instrument. The analysis of data was done using descriptive and inferential statistics for all variables and the results summarized in the tables, and their impact was discussed in detail.

4.1.1 Reliability Results

Data were first checked to ascertain its fitness in the analysis. This was done by computing Cronbach's Alpha value using a statistical tool. The results are presented in Table 4. A reliability coefficient measures if the items are good enough to carry out statistical analysis.

Table: 4: Reliability Statistics

Cronbach's Alpha	N of Items
.833	32

The Cronbach's alpha coefficient was .833. According to Bhattacherjee (2012), the correlation coefficient above 0.7 is adequate and indicates that the data is reliably good to carry out the study.

4.1.2 Response Rate

Table 5 shows the response rate of the questionnaires.

Table 5: Rate of Response

Target No. of respondents	No. of Questionnaires Returned	Response Rate (%)
80	70	87.5

The high questionnaire response rate (87.5%) shown in Table 5 resulted from the method of administration of the instrument, which was this self-administered. This was acceptable according to the recommendations of Mugenda and Mugenda (2003). The other questionnaires were either not returned or found to be unusable for the study; hence, their results could not be included in the findings.

4.2 Background Characteristics of the Respondents

The background characteristics of the respondents were first established to give some basic insight into the respondents who participated in the study. The characteristics considered in the study were; gender and highest level of education attained by them and work experience in the tax revenue sector in terms of years. The findings are summarized in Tables 6 and 7.

Table 6: Demographic Characteristics of the Respondents

Variable	Category	Frequency	Percentage (%)
Gender	Male	40	59
	Female	30	41
Level of study	Undergraduate degree	45	66
	Postgraduate degree & Others	23	34

The results also indicate that majority (59%) of the tax officers were male although there was a significant proportion of females (41%) which was more than the constitutionally stipulated 30% gender representation threshold for the public sector in Kenya.

The results also indicate that most (66%) of the tax officers had an undergraduate degree level of education as their highest academic qualifications, while 34% of the tax officers have a postgraduate degree as the highest degree and trained and conversant with the tax audit.

Table 7: Years Worked in KRA

Years worked in the KRA	Frequency	Percentage	Mean	Std. Dev
1 - 5yrs	11	15.8	11.93	7.327
6 - 10 yrs	23	32.9		
11 - 15 yrs	20	28.6		
16 - 20yrs	9	12.8		
Above 20yrs	7	9.9		
Total	**70**	**100**		

The findings also suggest that majority (43%) of the respondents had worked in the tax revenue sector for between 6 – 10 years. The findings also indicate that on average majority of the tax officers had worked in the revenue sector an average of 11.93 years and a standard deviation of 7.327 years. The general implication of these findings is that the respondents had reasonable levels of education and experience in the tax revenue sector and as such, the study could rely on them to provide dependable information for the study purposes.

4.3 Descriptive Statistics

4.3.1 Audit Case Selection and Tax Audit Effectiveness in South Rift Valley, Region

The first objective of the study was to establish the effect of audit case selection on tax audit effectiveness in South Rift Valley, Kenya. This objective was measured base on taxpayer profiling and risk assessment. The responses were rated on a Likert 5 point scale ranging from; 1 = strongly disagree to 5 = strongly agree. The results are summarized in Table 8.

Table 8: Audit Case Selection and Tax Audit Effectiveness in South Rift Valley

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	Mean	Std. Dev
The audit case selection is important in carrying out tax audit.	46(65.7)	23(32.9)	1(1.4)	0	0	4.64	0.512
The case selection methods are well understood by tax officers.	13(18.6)	31(44.3)	20(28.6)	6(8.6)	0	3.73	0.867
There are 100% implementation of risk-based tax audit case selection procedures over the last five years.	3(4.3)	29(41.4)	18(25.7)	19(27.1)	1(1.4)	3.2	0.942
The parameters in risk-based case selection procedures are enough to determine the level of risk of tax loss.	2(2.9)	33(47.1)	20(28.6)	14(20.0)	1(1.4)	3.3	0.874
Audit case selection procedures can be applied to both individual and corporate taxpayers.	18(25.7)	44(62.9)	6(8.6)	2(2.9)	0	4.11	0.671
Audit case selection procedures can be applied to both Large taxpayer's informal sector and small taxpayers in the informal sector e.g Jua Kali sector.	9(12.9)	31(44.3)	6(8.6)	22(31.4)	2(2.9)	3.33	1.139
Average						**3.718**	**0.834**

The results in Table 8 shows that the percentage of the respondents who strongly agreed is (Mean = 4.64; SD = 0.512) that the audit case selection was important in carrying out a tax audit. The findings also depicted that the audit case selection methods were fairly understood by tax officers as indicated by the percentage of respondents who agreed (Mean = 3.73; SD = 0.867). Also, the was a 100% implementation of risk-based tax audit

case selection procedures over the last five years as suggested by the percentage of the respondents who agreed (Mean = 3.2; SD = 0.942). Most respondents were of the view that the parameters in risk-based case selection procedures were enough to determine the level of risk of a tax loss (Mean = 3.3; SD = 0.874). The majority also agreed that audit case selection procedures can be applied to both individual and corporate taxpayers (Mean = 4.11; SD = 0.671). The audit case selection procedures were reported to be highly flexible as they could be fairly applied on both Large taxpayer's informal sector and small taxpayers in the informal sector e.g Jua Kali sector (Mean = 3.33; SD = 1.139). These findings generally underscore the importance of tax audit case selection has on tax audit effectiveness. Particularly, the finding showing that the audit case selection procedures were highly flexible and could be applied on both large taxpayers' informal sector and small taxpayers in the informal sector e.g Jua Kali reinforces the effect of the audit case selection process. This is consistent with Gupta and Nagadevara (2007) who noted that feasible tax audit case selection tools are supposed to be employed by tax administration bodies to minimize the cost of audits and maximize revenue collection and compliance by reducing the cases of tax evasion and avoidance.

4.3.2 Audit Staff Capacity on Tax Audit Effectiveness in South Rift Valley, Region

The second objective of the research study was to find out the effect of audit staff capacity on tax audit effectiveness in South Rift Valley Region. This objective was assessed based on training, experience, and staff adequacy. The responses were rated on a 5 point Likert scale ranging from; 1 = strongly disagree to 5 = strongly agree. The results are summarized in Table 9.

Table 9: Audit Staff Capacity on Tax Audit Effectiveness in South Rift Valley

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	Mean	Std. Dev
Tax auditors are well trained and capable of carrying out their work.	16(22.9)	46(65.7)	5(7.1)	2(2.9)	1(1.4)	4.06	0.74
All tax auditors in our organization receive regular training to enable them to be more competent in their work.	4(5.7)	24(34.3)	16(22.9)	22(31.4)	4(5.7)	3.03	1.063
Tax auditors demonstrate conversance with tax laws in carrying out an audit.	10(14.3)	47(67.1)	10(14.3)	3(4.3)	0	3.91	0.676
Tax audit staff are enough to audit more than half of taxpayers in a given year.	2(2.9)	3(4.3)	15(21.4)	36(51.4)	14(20.0)	2.19	0.906
Tax audit staff are fully facilitated to carry out the audit.	0	23(32.9)	21(30.0)	20(28.6)	6(8.6)	2.87	0.977
Tax audit staff adheres to KRA core values	15(21.4)	41(58.6)	12(17.1)	2(2.9)	0	3.99	0.712
Audit staff have been achieving their revenue targets in the last 5 years.	7(10.0)	29(41.4)	21(30.0)	11(15.7)	2(2.9)	3.4	0.969
Average						**3.35**	**0863**

The findings in Table 9 show that majority of the respondents were of the view that the Tax auditors were well trained and capable of carrying out their work as indicated by the majority who strongly agreed (Mean = 4.06; SD = 0.74). Further, all tax auditors in the area received regular training to enable them to be more competent in their work as indicated by the majority of the respondents who agreed (Mean = 3.03; SD = 1.063). The

findings also indicate that majority of the tax auditors demonstrate conversance with tax laws in carrying out audits (Mean = 3.91; SD = 0.676). However, most respondents disagreed that there was enough tax audit staff to audit more than half of taxpayers in a given year (Mean = 2.19; SD = 0.906). Further, the tax audit staff were not fully facilitated to carry out the audit as indicated by the majority of the respondents who disagreed (Mean = 2.87; SD = 0.977). Other findings indicate that the tax audit staff adheres to KRA core values as indicated by most of the respondents who agreed (Mean = 3.99; SD = 0.712). Also, the audit staff has been achieving its revenue targets in the last 5 years (Mean = 3.4; SD = 0.969).

It is evident from these results that staff capacity was an essential element in a tax audit. However, the near-parity in different opinions on staff training, that is, all tax auditors in the area received regular training to enable them to be more competent in their work is in contrast to the Mihret et al. (2010) noted frequent training of audit staff and technical competence is necessary for an effective tax audit. Indeed, Schyf (2000) pointed out the barriers that affecting the performance of internal audits in South African public sector to include a lack of relevant competencies among others.

4.3.3 Tax Disputes Resolution Mechanisms on Tax Audit Effectiveness in South Rift Valley Region

The third objective of the study was to evaluate the effect of tax disputes resolution mechanisms on tax audit effectiveness in South Rift Valley Region. This objective was examined using several indicators namely; case completion time, tax recovery efficacy, and alternative resolution. The responses were rated on a 5 point Likert scale ranging from; 1 = strongly disagree to 5 = strongly agree. The results are summarized in Table 10.

Table 10: Tax Disputes Resolution Mechanisms on Tax Audit Effectiveness in Kenya

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	Mean	Std. Dev
The tax dispute resolution mechanism in place is effective and efficient in resolving disputes	7(10.0)	44(62.9)	13(18.6)	6(8.6)	0	3.74	0.755
Over 50% of tax disputes cases have been resolved within 3 months	5(7.1)	10(14.3)	25(35.7)	24(34.3)	6(8.6)	2.77	1.038
KRA has won over 50% of tax disputes in the past 5 years.	3(4.3)	18(25.7)	32(45.7)	15(21.4)	2(2.9)	3.07	0.873
The tax dispute resolution mechanism procedures are well understood by both parties(KRA staff and taxpayers)	4(5.7)	31(44.3)	14(20.0)	20(28.6)	1(1.4)	3.24	0.984
Over 50% of tax liabilities arising from taxpayer audits cases end up in disputes	4(5.7)	15(21.4)	23(32.9)	23(32.9)	5(7.1)	2.86	1.026
Over 50% of tax disputes are resolved at the Tax Appeal Tribunal.	5(7.1)	13(18.6)	29(41.4)	19(27.1)	4(5.7)	2.94	0.991
Average						**3.103**	**0.945**

It is evident from the findings in Table 10 that the tax dispute resolution mechanisms in place were effective and efficient in resolving disputes as indicated by the majority of the respondents who agreed (Mean = 3.74; SD = 0.755). However, there was uncertainty on

whether more than 50% of tax disputes cases have been resolved within 3 months as indicated by the majority of the respondents who were neutral (Mean = 2.77; SD = 1.038). Consequently, there was also uncertainty on whether KRA has won over 50% of tax disputes in the past 5 years (Mean = 3.07; SD = 0.873). Further, the tax dispute resolution mechanism procedures were well understood by both parties(KRA staff and taxpayers) as suggested by the majority of the respondents who agreed (Mean = 3.24; SD = 0.984). However, the majority of the respondents disagreed (Mean = 2.86; SD = 1.026) while 7.1% strongly disagreed with the view that over 50% of tax liabilities arising from taxpayer audits cases end up in disputes. There was also uncertainty as to whether over 50% of tax disputes were resolved at the Tax Appeal Tribunal (Mean = 2.94; SD = 0.991).These findings suggest that the tax dispute resolution mechanisms were not adequate and underscore the need for having a robust dispute resolution mechanism. According to Wardhana (2016), disputes prompted the Indonesian Tax Authority to review its transfer pricing procedures and subsequently enacted a Regulation that arrogated the arm's-length principles in line with the OECD transfer pricing guidelines.

4.3.4 Interpretation of Tax Laws on Tax Audit Effectiveness in South Rift Valley Region

The fourth objective of the study was to analyze the effect of the interpretation of tax laws on tax audit effectiveness in South Rift Valley Region. This objective was assessed based on Scope and Complexity. The responses were rated on a 5 point Likert scale ranging from; 1= strongly disagree to 5= strongly agree. The results are summarized in Table 11.

Table 11: Interpretation of Tax Laws on Tax Audit Effectiveness

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	Mean	Std. Dev
All tax audit arrears results from mistakes due to poor interpretation of the tax legislation	7(10.0)	7(10.0)	13(18.6)	39(55.7)	4(5.7)	2.63	1.079
Over 50% of audit cases every year end up to objection due to technicalities of tax laws	4(5.7)	19(27.1)	20(28.6)	26(37.1)	1(1.4)	2.99	0.97
Taxpayers representatives are aware of the non-clarity of tax laws and help taxpayers to evade taxes	2(2.9)	28(40.0)	26(37.1)	14(20.0)	0	3.26	0.811
The complexity of the taxation system makes taxpayers not to fulfill there tax obligation	6(8.6)	31(44.3)	11(15.7)	22(31.4)	0	3.3	1.012
Previous rulings on tax cases are being used to clarify the tax matters arising due to dispute in interpretation	11(15.7)	49(70.0)	8(11.4)	2(2.9)	0	3.97	0.625
All the tax officers and taxpayers have access to guidelines on the interpretation of tax legislation	7(10.0)	30(42.9)	19(27.1)	13(18.6)	1(1.4)	3.41	0.955
Average						**3.263**	**0.909**

From the results in Table 11, it is evident that most of the respondents disagreed that all tax audit arrears results from mistakes due to poor interpretation of the tax legislation (Mean = 2.63; SD = 1.079). However, the majority of the respondents disagreed that over 50% of audit cases every year end up objection due to technicalities of tax laws (Mean = 2.99; SD = 0.97). The findings also indicate that the taxpayers' representatives were aware of the non-clarity of tax laws and helped taxpayers to evade taxes (Mean =

3.26; SD = 0.811). Further, most respondents agreed that the complexity of the taxation system makes taxpayers not fulfill their tax obligations (Mean = 3.3; SD = 1.012). Also, previous rulings on tax cases are being used to clarify the tax matters arising due to disputes in interpretation (Mean = 3.97; SD = 0.625). Besides, most of the respondents were of the view that all the tax officers and taxpayers have access to guidelines on the interpretation of tax legislation (Mean = 3.41; SD = 0.955).

Overall, these findings suggest that the tax officers were fairly conversant with the tax procedures in the country, though the taxpayers' point of view was not considered in the study. According to Olowookere and Fasina (2013), the complexity of the tax code by itself is harmful to the economy of the country and taxpayers who are willing to comply. Additionally, tax code complication denies the country the ability to compete globally as far as the economy is concerned; increases the tax burden, and does not increase tax revenue to the government.

4.3.5 Tax Audit Effectiveness in South Rift Valley Region

Finally, the study sought to determine the levels of tax audit effectiveness in South Rift Valley Region. This dependent variable was determined by asking the respondents the question surrounding the number of taxpayer audits that have been done, rates of compliance, and revenue collected. A 5 point Likert scale ranging from; 1 = strongly agree to 5 = strongly disagree was used to measure the responses to the statements posed. These results are presented in Table 12.

Table 12: Tax Audit Effectiveness in South Rift Valley Region

Statement	SA Freq(%)	A Freq(%)	N Freq(%)	D Freq(%)	SD Freq(%)	Mean	Std. Dev
Tax audits have contributed to high revenue collection over the period 2010 – 2015	13(18.6)	43(61.4)	11(15.7)	3(4.3)	0	3.94	0.72
Tax audit contributed significantly to an increase in tax compliance rate over the period 2010 – 2015	10(14.3)	48(68.6)	10(14.3)	2(2.9)	0	3.96	0.634
Tax audit is an important enforcement initiative in revenue collection	18(25.7)	47(67.1)	4(5.7)	1(1.4)	0	4.17	0.589
More than 50% of taxpayers in South Rift Valley Region were audited in 2010 – 2015	1(1.4)	8(11.4)	30(42.9)	25(35.7)	6(8.6)	2.61	0.856
Both corporate and individual business were audited in 2010 – 2015 in South Rift Valley Region	4(5.7)	41(58.6)	10(14.3)	11(15.7)	4(5.7)	3.37	0.783
Over 50% of taxpayers audited have complied with tax legislation	1(1.4)	36(51.4)	21(30.0)	12(17.1)	0	3.43	1.015
All the taxpayer audits carried out in 2010 – 2015 resulted in high tax yield in South Rift Region	5(7.1)	36(51.4)	24(34.3)	5(7.1)	0	3.59	0.732
Average						**3.579**	**0.761**

The results in Table 12 suggest that tax audits have contributed to high revenue collection over the period 2010 – 2015 as confirmed by the percentage of the respondents who agreed (Mean = 3.94; SD = 0.72. Further, tax audit contributed significantly to increase in tax compliance rate over the period 2010 – 2015 (Mean = 3.96; SD = 0.634). The findings also indicate that most respondents were of the view that

tax audit is an important enforcement initiative in revenue collection (Mean = 4.17; SD = 0.589). However, the results also suggest that there was uncertainty on whether more than 50% of taxpayers in South Rift Valley Region were audited in 2010 − 2015 as revealed by most of the neutral respondents (Mean = 2.61; SD = 0.856) regarding this statement. Nevertheless, both corporate and individual businesses were audited in 2010 − 2015 in South Rift Valley Region (Mean = 3.37; SD = 0.783). Most respondents, however, agreed that over 50% of taxpayers audited have complied with tax legislation (Mean = 3.43; SD = 1.015). The findings also indicate that all the taxpayer audits carried out in 2010 − 2015 resulted in high tax yield in South Rift Region (Mean = 3.59; SD = 0.732).

These findings agree with Nurebo et al. (2019) who found out that support from the management, quality of the audit, awareness of the taxpayers, and system of tax administration is directly related to audit effectiveness, whereas the complexity of tax law and accounting/reporting of taxes are inversely related to tax audit effectiveness. The findings also agree with Badara (2012) who found that the Tax collection body uses tax audits to optimize revenue collection, that tax audit mitigates tax evasion, and that there is a lack of cooperation of taxpayers with tax audit staff during the audit process.

4.4 Correlation

4.4.1 Correlation Analysis

Correlation analysis was done to establish the significance and level of association between the independent variables and the dependent variable. The resulting figure of correlation analysis is termed as the correlation coefficient (or "r"). It ranges from -1.0 to +1.0. The closer r is to +1 or -1, the closer the association of the two variables. If " r" is positive, it means that as one variable increases the other also increases. If the correlation coefficient is negative then it means that as one variable increases then the other variable

decreases and thus there is an inverse relationship between the variables. The results of the correlation analysis are summarized in Table 13.

Table 13: Summary of Correlation Results

		Audit Case Selection	Audit Staff Capacity	Dispute Resolution Mechanism	Tax Laws Interpretation	Tax Audit Effectiveness
Audit Case Selection	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	70				
Audit Staff Capacity	Pearson Correlation	.586**	1			
	Sig. (2-tailed)	0				
	N	70	70			
Dispute Resolution Mechanism	Pearson Correlation	.329**	.358**	1		
	Sig. (2-tailed)	0.005	0.002			
	N	70	70	70		
Tax Laws Interpretation	Pearson Correlation	.241*	0.083	0.125	1	
	Sig. (2-tailed)	0.044	0.496	0.303		
	N	70	70	70	70	
Tax Audit Effectiveness	Pearson Correlation	.487**	.310**	0.156	0.075	1
	Sig. (2-tailed)	0.000	0.009	0.016	0.535	
	N	70	70	70	70	70

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

The correlation summary above in Table 13 indicates significant positive relationship exists between audit case selection and tax audit effectiveness in South Rift region ($r = 0.487$; $p < 0.05$). Moreover, the relationship was moderate and positive implying that the implementers had put considerable emphasis on audit case selection to ensure that all high-risk taxpayers were well audited to give better tax yields. These findings concur with Mirera (2013) who found that there was a positive relationship between tax audit and tax revenue collected.

A correlation analysis was also done to determine whether there was a significant relationship between tax audit staff capacity and tax audit effectiveness. The results showed a significant relationship existed (r = 0.310, p < 0.05) between the two variables. The degree of the association of the two variables was positive suggesting that the capacity of the tax audit staff was instrumental in improving tax audit effectiveness. These results support those of Gwilliam (2014) who established that greater audit effectiveness is directly related to the competence of audit staff.

The study also sought to determine whether tax disputes resolution mechanisms significantly affected tax audit effectiveness in South Rift Valley Region. The correlation analysis showed that there was a significant relationship existing between the two variables (r = 0.156, p < 0.05). The results, however, suggest that the relationship between the variables was weak implying that the dispute relationship mechanisms were weak and as such were not having much impact on tax audit effectiveness. These findings disagree with Tran-Nam and Walpole (2016) who had established that a significant relationship existed between tax dispute resolution mechanism and tax compliance.

Finally, the correlation analysis to determine whether the interpretation of tax laws significantly affects tax audit effectiveness in South Rift Valley Region. indicates that the relationship was not significant (r = 0.075, p > 0.05). This finding suggests that the interpretation of the tax laws did not substantially contribute to tax audit effectiveness in the area. These findings are in contrast to Frey and Torgler (2007) who discovered that complexity of tax code and its continuous variation is the main cause of non-compliance and tax revenue collection in their study and Ojeka (2012) who noted that extremely high tax rates and complicated tax legislation are the most critical factors causing poor compliance among Small and Medium Enterprises.

4.5 Inferential Statistics

Multiple regression was carried out to establish the association between the predictor variables and a dependent variable. The analysis was also done to determine the extent to which all independent variable relates to the dependent variable collectively. The finding has summarized in Table 14 below.

Table 14: Multiple Linear Regression Analysis Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.490a	0.24	0.193	2.61244

a Predictors: (Constant), Tax Laws Interpretation, Audit Staff Capacity, Dispute Resolution Mechanism, Audit Case Selection

The results in Table 14 show that the model correlation coefficient r = 0.490 was higher than any zero-order value in the table. The coefficient of determination r² = 0.24 also indicates that all the independent variables combined in the model could explain for approximately 24 % of the variations in tax audit effectiveness in South Rift Valley Region. This suggested that the model could improve when more variables were incorporated into it when analyzing the factors affecting tax audit effectiveness in Kenya.

4.6 Analysis of Variances

There was also a need to determine the appropriateness of the multivariate regression model, therefore, an ANOVA test was carried out consistent with the recommendations of Modugno and Giannerini (2015). The results are given in Table 15.

Table 15: Summary of ANOVA results

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	140.155	4	35.039	5.134	.001
Residual	443.616	65	6.825		
Total	**583.771**	**69**			

a Dependent Variable: Tax Audit Effectiveness
b Predictors: (Constant), Tax Laws Interpretation, Audit Staff Capacity, Dispute Resolution Mechanism, Audit Case Selection

The results of the ANOVA performed on the independent and dependent variables summarized in Table 15 indicate that there was a significant difference between means of the independent variables and depend on variable describing tax audit effectiveness in Kenya (F_o = 5.134> F_c = 2.39; α < 0.05; df = 4, 69; p < 0.05). This finding confirms the appropriateness of the regression model suggested in Table 13. The Variance Influencing Factor (VIF) for each independent variable was also carried out to determine the presence of Multicollinearity and the result showed that there was no multicollinearity since the values lied between the recommended values 1 and 10 ($1 \leq x \leq 10$). Hence, it was possible to find out which were the most significant factors affecting tax audit effectiveness in Kenya using the standardized beta value. The results are as shown in Table 16.

Table 16: Summary of Multiple Regression Analysis

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	15.062	3.072		4.903	0.000		
Audit Case Selection	0.461	0.133	0.479	3.454	0.001	0.607	1.646
Audit Staff Capacity	0.178	0.088	0.136	2.023	0.005	0.621	1.611
Dispute Resolution Mechanism	-0.008	0.104	-0.009	-0.075	0.941	0.846	1.182
Tax Laws Interpretation	-0.041	0.11	-0.042	-0.374	0.710	0.932	1.072

Dependent Variable: Tax Audit Effectiveness

The results in Table 16, it is evident that the most significant factor affecting tax audit effectiveness in South Rift Valley, Kenya was Audit Case Selection ($\beta = 0.479$, $p < 0.05$). This was followed by Audit Staff Capacity ($\beta = 0.136$, $p < 0.05$) suggesting that the dependent variable would change by a corresponding number of standard deviations when the respective independent variables changed by one standard deviation. However, looking at the table, it is evident that the other two independent variables in the model Dispute Resolution Mechanism ($\beta = -0.009$, $p > 0.05$) and Tax Laws Interpretation ($\beta = -0.042$, $p > 0.05$) did not significantly influence tax audit effectiveness as per the joint model. The equation for the model is as shown below:

$$TAE = 15.062 + 0.461ACS + 0.178ASC - 0.008DRM - 0.041TLI + 2.61$$

4.7 Hypothesis Testing

Based on these findings the hypotheses of the study were tested. The first hypothesis of the study was:

H0$_1$: Audit case selection has no statistically significant effect on tax audit effectiveness in South Rift Valley Region.

The results from the regression model in Table 4.11 indicate that Audit case selection has a statistically significant effect on tax audit effectiveness in South Rift Valley Region (β = 0.479, p <0.05). This led to the rejection of the null hypothesis **H0₁.** These findings support those of Mirera (2013) whose study on the effects of tax audit on tax revenue in Kenya Revenue Authority (Nairobi West Tax station) revealed that there was an increase in the tax paid after an audit, especially for a random tax audit, cut-off tax audit and conditional tax audit. The analysis of the tax revenue from a specific firm a few years before the audit and two years after the audit depicted an increase in tax collected after the audit.

The second hypothesis of the study was:

H0₂: Audit staff capacity has no statistically significant effect on tax audit effectiveness in South Rift Valley Region.

According to the results in the multiple regression model in Table 4.11, Audit staff capacity had a statistically significant effect on tax audit effectiveness in South Rift Valley Region ($\beta_2 = 0.136$, p < 0.05). Consequently, the null hypothesis **H0₂** was rejected. These findings agree with Chalu and Mzee (2017) whose study on the variables affecting the tax audit effectiveness in Tanzania revealed that adequacy of the tax audit unit influenced the effectiveness of tax audit. Further, Alzeban and Gwilliam (2014) in his findings found out that staff competence is directly associated with tax audit effectiveness. It also concurs with Cohen and Sayag (2010) who argued that the proficiency of employees in audit is critical for effective audits.

The third hypothesis of the study was:

H0₃: Tax disputes resolution mechanism has no statistically significant effect on tax audit effectiveness in South Rift Valley Region**.**

It is evident from the results from the regression model in Table 4.11 that Tax disputes resolution mechanism has no statistically significant effect on tax audit effectiveness in South Rift Valley Region (β = -0.009, $p > 0.05$). As such, the null hypothesis **H0₃** was accepted and the view that adopted Tax disputes resolution mechanism was not a factor of tax audit effectiveness in the area. According to a study by Tran-Nam and Walpole (2016) in Australia on the feasibility of external tax dispute resolution and the effects of unbiased tax dispute resolution on social justice, a tax dispute resolution mechanism that can reduce the compliance costs, pressure and it results in a socially unbiased outcome for taxpayers.

The fourth hypothesis of the study was:

H0₄: Interpretation of tax laws has no statistically significant effect on tax audit effectiveness in South Rift Valley Region.

The results from the regression model in Table 4.11 indicate that the Interpretation of tax laws has no statistically significant effect on tax audit effectiveness in South Rift Valley Region (β = -0.042, $p > 0.05$). Hence, the null hypothesis **H0₁** was accepted**.** These findings fail to support those of Muiru (2012) whose study on the obstacles brought about by complex tax code in doing business, established that the application of tax procedures on comprehensive business activities is quite a challenge even for the taxpayers who are more than willing to comply.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides summaries of the results from the research study; its conclusions and recommendations and suggestions on areas of future studies.

5.2 Summary of the Findings

The overall aim of this study was to evaluate the selected factors affecting tax audit effectiveness in South Rift Valley, Kenya. It specifically sought to determine the role of audit case selection, audit staff capacity, tax disputes resolution mechanism, and interpretation of tax laws on tax audit effectiveness. The findings on these are summarized as follows.

5.2.1 Audit Case Selection and Tax Audit Effectiveness in South Rift Valley, Region

The findings on this objective revealed that audit case selection was important in carrying out tax audit. The findings also revealed that the audit case selection methods were well understood by tax officers. Besides, there was a full implementation of tax audit case selection based on taxpayer risk profile over the last five years. Most tax officers were of the view that the parameters in risk-based case selection procedures were enough to determine the level of risk of tax loss. The majority of the tax officers agreed that audit case selection procedures can be applied to both individual and corporate taxpayers. The audit case selection procedures were reported to be highly flexible as they could be applied to both large taxpayer's informal sector and small taxpayers in the informal sector, such as the *Jua Kali* sector. Results from the multiple regression analysis also revealed that audit case selection has a statistically significant effect on tax audit effectiveness in South Rift Valley Region ($\beta = 0.479$, $p < 0.05$). As such, the null hypothesis $H0_1$ was rejected.

5.2.2 Audit Staff Capacity on Tax Audit Effectiveness in South Rift Valley Region

The findings on this objective revealed that most tax auditors were well trained and capable of carrying out their work. However, there was uncertainty about whether all tax auditors in the area received regular training to enable them to be more competent in their work. The findings also revealed that the majority of the tax auditors demonstrate conversance with tax laws in carrying out an audit. However, the tax audit staff was inadequate to audit more than half of taxpayers in a given year. Further, the tax audit staff were fully facilitated to carry out the audit. Other findings indicate that the tax audit staff adheres to KRA core values. Also, the audit staff has been achieving its revenue targets in the last 5 years. The results from the multiple regression analysis further revealed that tax audit staff capacity had a statistically significant effect on tax audit effectiveness in South Rift Valley Region ($\beta_2 = 0.136$, p < 0.05). Consequently, the null hypothesis **H0$_2$** was rejected.

5.2.3 Tax Disputes Resolution Mechanisms on Tax Audit Effectiveness in South Rift Valley Region

It is evident from the results on this objective that the tax dispute resolution mechanisms in place were effective and efficient in resolving disputes. However, there was uncertainty on whether more than 50% of tax disputes cases have been resolved within 3 months. Consequently, there was also uncertainty on whether KRA has won over 50% of tax disputes in the past 5 years. Further, the tax dispute resolution mechanism procedures were well understood by both parties(KRA staff and taxpayers). However, the majority were of the view that over 50% of tax liabilities arising from taxpayer audits cases end up in disputes. There was also uncertainty as to whether over 50% of tax disputes were resolved at the Tax Appeal Tribunal. However, it emerged from the regression analysis that tax disputes resolution mechanisms had no statistically significant effect on tax audit

effectiveness in South Rift Valley Region (β = -0.009, p > 0.05). Hence, the null hypothesis **H0₃** was accepted.

5.2.4 Interpretation of Tax Laws on Tax Audit Effectiveness in South Rift Valley Region

The findings on this objective revealed that most of the tax officers were of the view that all tax audit arrears results from mistakes due to poor interpretation of the tax legislation. However, the tax officers disagreed that over 50% of audit cases every year end up objection due to technicalities of tax laws. The findings also indicate that the taxpayers' representatives were aware of the non-clarity of tax laws and helped taxpayers to evade taxes. Further, most tax officers felt that the complexity of the taxation system makes taxpayers not fulfill their tax obligations. Also, previous rulings on tax cases are being used to clarify the tax matters arising due to disputes in interpretation. Besides, most of the tax officers were of the view that all the tax officers and taxpayers have access to guidelines on the interpretation of tax legislation. Nevertheless, it emerged from the regression results that that interpretation of tax laws has no statistically significant effect on tax audit effectiveness in South Rift Valley Region (β = -0.042, p > 0.05). Consequently, the null hypothesis **H0₁** was accepted**.**

5.3 Conclusions

Based on the findings of the research study, it was established that audit case selection was a factor of tax audit effectiveness in South Rift Valley Region. Imperatively, audit case selection was important in carrying out tax audit and was well understood by tax officers. Further, the parameters in risk-based case selection procedures were enough to determine the level of risk of tax loss. Also, the audit case selection procedures can be applied to both individual and corporate taxpayers.

Concerning the audit staff capacity, the study concludes that it was a significant factor in tax audit effectiveness in South Rift Valley Region. It was established that most tax auditors were well trained and capable of carrying out their work and demonstrated conversance with tax laws in carrying out an audit. However, there was uncertainty about whether all tax auditors in the area received regular training to enable them to be more competent in their work. It was further established that the tax audit staff was inadequate to audit more than half of taxpayers in a given year.

Concerning tax dispute mechanisms, it can be concluded that that tax dispute resolution mechanism was not a factor of tax audit effectiveness in South Rift Valley Region. The tax dispute resolution mechanisms in place were effective and efficient in resolving disputes. However, there was uncertainty on whether more than 50% of tax disputes cases have been resolved within 3 months. Further, over 50% of tax liabilities arising from taxpayer audits cases end up in disputes.

Finally, it emerged from the regression results that that interpretation of tax laws has no statistically significant effect on tax audit effectiveness in South Rift Valley Region. Therefore, the study concludes that it was not a factor of tax audit effectiveness. It was also established that all tax audit arrears result from mistakes due to poor interpretation of the tax legislation. However, less than 50% of audit cases every year end up objection due to the technicalities of tax laws. However, the complexity of the taxation system makes taxpayers not comply with their tax obligation.

5.4 Recommendations

Concerning tax audit case selection, it was revealed that audit case selection was a factor of tax audit effectiveness in South Rift Valley Region. The study, however, recommends

that there is a need to improve on the audit case selection procedures that can be applied to both large taxpayers' informal sector and small taxpayers in the informal sector.

Concerning tax audit staff capacity, the study recommends that KRA organizes regular training for all its staff to enable them to be more competent in their work. Besides, it should also ensure that more tax audit staff is recruited proportional to the projected taxpayer base to increase tax audit efficiency.

The study, further, recommends about tax disputes resolution mechanisms that there is a need to make policy interventions on the tax dispute resolution mechanisms to enable the expedition of tax disputes and prevent the accrual of dues and unresolved disputes. The interventions should also aim to ensure that fewer tax liabilities arising from taxpayer audits cases end up in disputes

Regarding the interpretation of tax laws, it was also established that all tax audit arrears result from mistakes due to poor interpretation of the tax legislation arising from technicalities of tax laws. It is on the strength of this evidence that the study recommends that legal interventions be made with tax liabilities disclosures to improve the application of the tax procedures.

5.5 Limitations of the Study and Recommendations for Future Studies

The study covered the areas in the main objective which were not exhaustive in assessing the effectiveness of tax audit. The other limitations of the research study are that it only used questionnaires as a research instrument. Kothari (2004) noted that questionnaires can have ambiguous replies. Besides, the respondents in the study were tax officers only, and it employed inferential statistics in analyzing data.

Future research studies should explore other variables that could affect the effectiveness of the audit. It should also incorporate guides for an interview and secondary data as well

as using questionnaires to overcome the ambiguity of replies and also to improve the reliability of research findings. Additionally, future research studies should incorporate taxpayers and also use other data analysis tools like time series models in analyzing data.

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APPENDICES

Appendix I: Questionnaire

Factors Affecting the Effectiveness of Tax Audit Function in Revenue Collection Focusing on Kenya Revenue Authority- South Rift Valley Region

Dear Participant,

My name is Catherine Chebet. I am a student at Kabarak University, pursuing a Master of Business Administration, Finance option. I am researching **Factors affecting the effectiveness of tax audit function in revenue collection focusing on Kenya Revenue Authority- South Rift Valley Region.**

I am requesting you to honestly and sincerely fill this questionnaire. The information provided will be handled with the utmost confidentiality and shall be used for research purposes only. Kindly tick the relevant answer in the boxes and also give the answers that suit your opinion to the questions. Do not indicate your name on the questionnaire.

Section A: Background Information

1. Gender

    Male ☐   Female ☐

2. Highest Level of education

    Certificate ☐   Diploma ☐   Bachelor's degree ☐

    Master Degree ☐   Other...

3. Experience in the tax revenue sector in terms of years..

Section B: Audit Case Selection

In this section, the study requires your views concerning the taxpayer audit case selection in the Kenya Revenue Authority- South Rift Valley Region. Answer by putting the mark appropriately to suit your point of view. The categories are:1-Strongly Disagree, 2-Disagree, 3-Neutral, 4-Agree, 5-Strongly Agree

Statements	SA	A	N	D	SD
The audit case selection is important in carrying out tax audit					
The case selection methods are well understood by tax officers					
There are 100% implementation of risk-based tax audit case selection procedures over the last five years					
The parameters in risk-based case selection procedures are enough to determine the level of risk of tax loss.					
Audit case selection procedures can be applied to both individual and corporate taxpayers.					
Audit case selection procedures can be applied to both Large taxpayer's informal sector and small taxpayers in the informal sector e.g Jua Kali sector.					

Section C: Tax Audit Staff Capacity

In this section, the study requires your best opinion concerning the tax audit staff capacity in Kenya Revenue Authority- South Rift Valley Region. Mark the appropriate answer according to your views. The categories are:

1-Strongly Disagree, 2-Disagree, 3-Neutral, 4-Agree, 5-Strongly Agree

Statements	SA	A	N	D	SD
Tax auditors are well trained and capable of carrying out their work					
All tax auditors in our organization receive regular training to enable them to be more competent in their work					
Tax auditors demonstrate conversance with tax laws in carrying out an audit					
Tax audit staff are enough to audit more than half of taxpayers in a given year.					
Tax audit staff are fully facilitated to carry out an audit.					
Tax audit staff adheres to KRA core values					
Audit staff have been achieving their revenue targets in the last 5 years					

Section D: Tax Dispute Resolution Mechanism

In this section, the study requires information concerning the tax dispute resolution mechanism in Kenya Revenue Authority-South Rift Valley Region. Read each of the statements and tick the appropriate answer based on your best point of you. The categories are:

1-Strongly Disagrees, 2-Disagree, 3-Neutral, 4-Agree, 5-Strongly Agree

Statements	SA	A	N	D	SD
The tax dispute resolution mechanism in place is effective and efficient in resolving disputes					
Over 50% of tax disputes cases have been resolved within 3 months					
KRA has won over 50% of tax disputes in the past 5 years.					
The tax dispute resolution mechanism procedures are well understood by both parties(KRA staff and taxpayers)					
Over 50% of tax liabilities arising from taxpayer audits cases end up in disputes					
Over 50% of tax disputes are resolved at the Tax Appeal Tribunal.					

Section E: Interpretation of Tax Laws

In this section, the research study requires information on the taxpayers' and tax auditors' interpretation of tax legislation. Give your best answer by ticking the category that suits your observation. The categories are:

1-Strongly Disagree, 2-Disagree, 3-Neutral, 4-Agree, 5-Strongly Agree

Statements	SA	A	N	D	SD
All tax audit arrears results from mistakes due to poor interpretation of the tax legislation					
Over 50% of audit cases every year end up to objection due to technicalities of tax laws					
Taxpayers and their representative are aware of the non-clarity of tax laws and help taxpayers to evade taxes					

The complexity of the taxation system makes taxpayers not to fulfill there tax obligation				
Previous rulings on tax cases are being used to clarify the tax matters arising due to dispute in interpretation				
All the tax officers and taxpayers have access to guidelines on the interpretation of tax legislation				

Section F: Tax Audit

In this section, the study requires your opinion about tax audits in the South Rift Valley Region. Kindly answer by ticking the category that suits your view. The categories are: 1-Strongly Disagree, 2-Disagree, 3-Neutral, 4-Agree, 5-Strongly Agree

Statements	SA	A	N	D	SD
Tax audits have contributed to high revenue collection over the period 2010-2015.					
Tax audit contributed significantly to the increase in tax compliance rate over the period 2010 to 2015					
Tax audit is an important enforcement initiative in revenue collection					
More than 50% of taxpayers in South Rift valley region were audited from 2010 to 2015					
Over 50% of taxpayers audited have complied with tax legislation					
Both corporate and Individual businesses were audited in 2010-2015 in South Rift Valley Region.					
All the taxpayer audits carried out in 2010-2015 resulted in high tax yield in South Rift Region					

Thank You For Your Time And Cooperation

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The Grant of Research Licenses is Guided by the Science, Technology and Innovation (Research Licensing) Regulations, 2014

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