

**EFFECT OF TAX AUDIT ON EXCISE DUTY COLLECTION IN KENYA**

**(CASE STUDY OF NAIROBI REGION)**

**MICHAEL OKINYI OGUTU**

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**DECLARATION**

This project is my original work and has not been presented for a post graduate diploma in any other academic or non-institution.

**Michael Ogutu**

**Reg. No. HDB336/03/2299/2016**

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**Signature**

**Date**

This project has been submitted for examination with my approval as the supervisor.

**Dr. Marion Nekesa PhD**

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**Signature**

**Date**

## **ACKNOWLEDGEMENT**

All appreciation is to the Almighty God for enabling me to complete this project and for all the blessings in my life. Many thanks to my Supervisor Dr. Marion Nekesa who worked tirelessly through the entire research period. Finally, to my dear wife for according me the necessary support during this period.

## LIST OF ABBREVAITONS

<b>ANOVA</b>	Analysis of Variance
<b>EAC</b>	East African Community
<b>IRB</b>	Internal Revenue Board
<b>IRS</b>	Internal Revenue Service
<b>IT</b>	Information Technology
<b>ITMS</b>	Integrated Tax Management System
<b>KRA</b>	Kenya Revenue Authority
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>PIN</b>	Personal Identification Number
<b>PSC</b>	Public Service Commission
<b>SPSS</b>	Statistical Program for Social Sciences
<b>FIRS</b>	Federal Inland Revenue Service
<b>IRAS</b>	Inland Revenue Authority of Singapore
<b>ASK</b>	Assisted Self-help Kit
<b>GST</b>	Goods and Service Tax
<b>RRA</b>	Rwanda Revenue Authority

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## ABSTRACT

This study established the effects of the tax audit on excise duty tax in Nairobi, the study was guided by the following specific objectives: to determine the effect of tax audit on excise duty collection in Kenya, to determine the effect of the field audit on excise duty collection in Kenya and to determine the effectiveness of the desk audit on excise duty collection in Kenya. Review of current literature and sources related to the influence of excise tax audit on Excise duty collection in the Nairobi region. This included theoretical reviews, the empirical literature on the focus of past studies, and critical assessment of the gaps in the literature was identified. An effective conceptual framework was also outlined and all variables were conceptualized on the basis of the study objectives. Chapter three outlines the research methodology used in this study on the effects of the tax audit on the collection of excise duties in Kenya. The research covered the following research designs, target population, sampling frameworks, sampling and sampling techniques, data collection instruments, data collection tools and procedures and data collection tools and data. Chapter four addressed the analysis and interpretation of research findings on the impact of tax audits on excise duty collection. To determine the significance level, descriptive statistics and regression analysis were used. The study was conducted over a period of 5 years in which secondary data were used in the analysis for the period 2013 to 2018. The research study used to analyze of regression. The study found that the tax audit had a positive effect on the collection of excise duty. This can be demonstrated by the different figures shown which was the collection of excise duty within 5 years. This further implied that an increase in the excise duty collection was imperative when the Kenya Revenue Authority revamps the tax audit, especially in excisable goods and services. The study revealed that there was tax audit had an effect of 71.8 percent of the collection of excise duty. The study further revealed that the study variables had a strong positive relationship.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background of the study

Excise duties collection on excisable goods and services has improved tremendously over the last decade. This specific duty has gone up by over 25% for alcoholic beverages and 10% for fortified wine, brandy and spirits and liquor, from 2003 to 2013. These huge growth raises concern about the tax impact of such growths on goods and services that are excisable. OECD (2013) explains the meaning of excise duty as a tax levied on an act, occupation, privilege, manufacture, sale, or consumption. Excise taxes are discerning taxes on the sale or usage of selected goods and services, such alcohol products and tobacco as listed in the (Fifth Schedule to CAP, 472). Excise duty in Kenya is an intricate tax to administer in Kenya. Every single year in the Finance Act there are changes in excisable goods and services though the collections continue to improve each year but not to the level of the expectation. Additionally, KRA has not met the target for excise duty collection since 2016. The purpose of this research is therefore to examine the effect of tax audit on excise duty collection in Kenya.

Excisable goods have the meaning 'goods manufactured in Kenya or imported into Kenya on which an excise duty is imposed under the (Excise duty Act, 2015)'. Okonkwo (2014), defines tax audit as independent account, scrutiny of tax returns payments and any other taxpayer's records to check whether they comply with tax laws, rules and guidelines, and tax accuracy, payment and adherence to relevant procedures and accounting standards. While tax investigation and tax audit are often used interchangeably, tax investigation in practice is a

more detailed and thorough examination of the records of the taxpayer. It is usually caused by a lack of confidence, possibility of fraud, tax evasion and other related offences (Okonkwo, 2014).

### **1.1.1 Global perspective of tax audit practice**

Tax audit is a norm practiced globally to improve tax compliance. It is normally conducted by revenue administrations all over the world for instance Inland Revenue Service introduced an audit tool to detect tax evaders and formally enforce the Federal Inland Revenue Service (FIRS) audit unit on any organization. In an effort to determine tax evaders or taxpayers who are not compliant, audit mechanisms such as this risk engine tool were put into operation. Different companies detected by the tools were to undertake either a tax audit or a tax inspection under the statutory mandate and the provisions of Articles 58 and 60 of the Companies' Income Tax Act (Cap. 21 LFN 2004) and Articles 26 and 27 of the Federal Inland Revenue Service (Establishment Act, 2007). In Singapore, the Inland Revenue Authority of Singapore (IRAS) introduced an Assisted Self-Help Kit (ASK) for (Goods and Service Tax) GST-registered businesses. The exercise was intended to facilitate tax compliance amid Small and Medium Enterprises'. ASK is a comprehensive self-assessment compliance package for SMEs that encompasses guidelines and checklists with regards to a business 'internal processes and GST filings, to ensure the correctness of current and past GST submissions. Where the ASK review was used by a business to apply for or renew a GST scheme, the review was to be performed by or certified by tax practitioner with GST accreditation. The system was found more efficient and reliable when dealing with the SMEs (OECD, 2018).

Switzerland also was not left out in terms of implementing audit tools. The country adopted audit procedure which could integrate the personal appraisal of a general risk or their idea of the possible business risk in the risk selection model with the tax expert. Among the process

were coming up with ideas of which behaviors or business conducted could be risky and needed to be audited on frequently basis. Subsequent to that, the tax experts were to submit an indicator of the potential risk among others background information to support the risk indicators to the team which was responsible for evaluating the tax risks. The idea was analyzed by this devoted team and the result was positive, then the idea was demonstrated to be good for adoption. The idea was further subjected to test in a trial of field audits and assessed. If from the valuation the presentation of the idea yields higher than usual risk-oriented scenarios, the impression was to be combined as a new risk indicator (OECD 2018).

Iheanyi, (2014) explained in his study that tax officers were assigned with collection of tax decade ago in Egypt. At some moment they were instructed to tax cooking oil. To avoid evading taxes on cooking oil by their citizen they audited all the residential places to ensure that the citizen was declaring correct amount of oil used and that Egyptian citizen did substitute leftover oil from other food groundwork procedures as alternate to the taxed oil. This was a form of tax audit practiced decade ago by emperor of Egypt to curb the issue of tax evasion which was rampant during those days.

In Rwanda, they approached the whole scenario differently by putting in place various reforms of the revenue administration that include but not limited to knowledgeable and experienced officers and empowered them to increase the tax collection in Rwanda. This was necessary so that the country could handle the upward difficulty of businesses and tax avoidance strategies (Rwanda audited report, 2015). According to the same report the tax scope was faced with a lot of difficulties and challenges and majority were doubtful with the process. This contributed to minimal number of taxes assessed in 145 examples by RRA appeals committee (43% of all disputed cases). The process also revealed improper structures

of guarding revenue rather than evaluating outstanding discoveries already in existence to provide protective revenue security policies. The unsuccessful approach to collect all potential revenue could be attributed to weak tax Administration system. Which comprise of lack of suitable technology of registered taxpayers for both domestic taxes and import duty chargeable, gaps in tax system to authenticate taxpayers who were registered and those who were not registered. (Rwanda audited report, 2015).

### **1.1.2 Kenyan Perspectives**

Kenya Revenue Authority has been given legal authority to carry out tax audits and examination on taxpayers. This enables the authority to put in place legal requirement to ensure the tax are collected by the competent officers and to minimise the chances of tax evasion in Kenya. However, the powers have legal limits and more often the taxpayer are protected by the law, making tax collection more cumbersome in Kenya. Though Tax audits have set rules and regulations that should be well understood by the tax managers and their consultants so as to conduct the problematic and demanding procedures. In tax audit, tax payer is scrutinised to determine whether they have their precise tax liability and properly performed their duties. Tax audits related to other types of evaluation are more all-inclusive and wider, such as overall desk checks, compliance calls / assessments or related programs documentation (Adediran et al. 2013).

In Kenya Revenue Authority there are many types of audit normally carried out to improve tax compliance such as desk audit, field audit, correspondence audit, compliance audit, in-depth audit and risk profile audit. However, the researcher only concentrated on the three main audits normally carried out by officers in excise duty collection at KRA. Kenya Revenue Authority has legal authorities to carry out tax audit audits and taxpayer assessments to collect and safeguard income owing to its Kenyan government, but not without legal limitations. Tax audits are very intricate and tasking processes and as such, tax managers and their consultants

must comprehend the whole process A tax audit is a scrutiny to determine whether a taxpayer has properly assessed and stated their tax liability and other duties. Tax audits are widespread than other types of investigations on a regular basis, such as desk checks, visits to compliance appointments, reviewing relevant programs document (Adediran et al. 2013).

## **1.2 Statement of the problem**

Globally, comparative segment of excise duties in over-all tax revenue has been subjected to a long decline since 1975 when they accounted for average 10.5 to 7.8% in 2016. Apart from the OECD associated nations, other states vary with an excise duty collection of 2.6% of sum revenue in New Zealand and 18.2% in Turkey (OECD, 2018). Excise duty collections realised the poorest performance in the beginning of 2018, decreasing by 9% notwithstanding a growing number of alcohol distributors and manufacturers. Taxes from excisable goods such as beer, spirits and cigarettes only earned Kshs 4.09 billion a period of nine months of the current financial year compared to previous years, the current endorsed figures show. As Biber (2010) stated in the report of an audit program in a modern tax administration must spread beyond merely checking a taxpayer's reported duties and discovery of inconsistencies between a taxpayer's statement and supporting documentation.

Massive is the amount of tax lost through evasion. For example, in 2006, the IRS projected it to be US\$345 billion, adding up to 16.3% of the projected actual paid plus unpaid tax liability (Slemrod, 2007). A considerable past literature and best approach and current knowledge show that tax audit can be successful if there is good tax administration and taxpayer compliance. The findings however, were useful in developed countries but not currently applicable in developing country where tax payers always look for every opportunity to evade taxes. As a result, Policymakers from the developing countries always review their policy and tax law to curb the vice of tax evasion. This perennial problem of excise duty

collection can only be improved through effective tax audit practised. There is limited literature in Africa related to compliance and tax audit conducted in Ethiopia, Rwanda and Nigeria. The focus was on Tax audit in general and compliance in VAT. None of the study focused on excise duty collection.

The Kenya Revenue Authority collected Sh117.48 billion between July and March, 2018 compared with Sh121.57 billion, collected in 2017 in the same period as indicated in the data collected by the Central Bank of Kenya. The drop-in excise duty has been largely connected to upsurge in manufacture and sale of counterfeit and illicit products. Latest tax figures released by the KRA declares the drop is a departure from the past three years that posted an annual average progress of 16 per cent. Fake stamps and counterfeit goods caused a Sh7.35 billion falls in excise tax in the six months to December 31, 2018, instigating the taxman to recommence its war on illicit alcohol.

There has been limited studies on the effect of tax audit on excise duty collection in Kenya. The underlying gaps, however, were the area of focus, which was a general revenue collection compared to the study envisaged which focused on a more specific topic that is excise duty. Another study conducted by Olatunji (2018) on the tax audit effect on tax compliance and concluded that tax audit has no significant impact on tax compliance. Therefore, against this background, this study aims to evaluate the effects of the tax audit on the collection of excise duty in Kenya.

### **1.3 Objectives of the study**

The main objective of this study is to investigate the effect of tax audit on excise duty collection in Kenya.

### **1.3.1 Specific objectives**

This study will be guided by the following specific objectives; -

1. To determine the effect of compliance audit on excise duty collection in Kenya.
2. To find out the effect of field audit on excise duty collection in Kenya.
3. Examine the effect of In- depth audit on excise duty collection in Kenya.

### **1.4 Research Questions**

- i. What is the effect of compliance audit on excise collection in Kenya?
- ii. What is the effect of field audit on excise duty collection in Kenya?
- iii. Is there any effect of In -depth audit on excise duty collection in Kenya?

### **1.5 Justification of the study**

#### **1.5.1 Future Researchers**

Numerous past studies have concentrated on the effects of tax audit on other taxes such as Value Added Tax and Income Tax with none focusing on the effect of tax audit on excise duty collection.

#### **1.5.2 The Manufacturers**

This study was not only meant bridge this gap that exist to give a comparative analysis but also to understand why excise duty collection is low compared to other tax heads. There has been knowledge gap on the taxation especially on the study of tax audit and excise duty

#### **1.5.3 The Kenyan Government**

This study would be of great importance to many stakeholders in the Kenyan government especially in determining whether audit on excisable goods and services leads to high

revenue performance in excise duty tax. By establishing the effect of tax audit on excise duty revenue collection, KRA will understand the role tax audit has played in enhancing excise duty tax accountability and performance.

### **1.5.3 KRA Management**

The effects of excise duty tax audit on revenue collection will help in legislating appropriate laws to govern compliance in Kenya. Finding out how awareness of tax laws contributes to compliance level among those who deal with excisable goods and services among Kenyans in Nairobi region. It will also assist KRA to establish the level of awareness and to enhance its efforts aimed at promoting awareness of tax laws among Kenyan citizens making audit easier.

### **1.5.4 Policy Makers**

Lastly, finding out how tax audit on excisable products like tobacco and alcoholic products will help the government to identify where it has succeeded and the areas which require improvement in auditing the manufactures of these products.

## **1.6 Scope of the study**

Choice for audit cases within the authority is founded on risk profiles, this study the researcher focused on the type of audit carried out on excise duty collection which is currently being handled by the excise audit department office that resides within Times Towers building Nairobi. The process of audit includes, verification of consistency in tax payments determined by trend analysis, use of tools such as Electronic Goods Management System Intelligence collection including information provided by KRA's Information Reward Scheme, compliance records determined through previous audit results, nil and non-filer returns submitted among others. Hazardous categories (KRA website, 2019). The study

covered selected audited reports from KRA audit department and collection of revenue based on the past audits from the KRA statistics department.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The purpose of this chapter was to review existing literature and sources related to the effects of excise tax audit on Excise duty collection in the Nairobi region. It investigated theoretical reviews, empirical literature on past studies in this area, and provides a critical literature assessment to identify the gaps to be filled. Finally, this research used an effective conceptual framework.

#### **2.2 Theoretical framework**

The study was guided by the three theories that the researcher found relevant to the research topic: Classical Tax Compliance Theory, Economic Deterrence Theory and Crime Theory

##### **2.2.1 Classical theory of tax compliance**

Also known as A-S models, this theory is based on the theory of deterrence. Toggler (1997) formulated it. The theory states that the taxpayer is assumed to maximize the tax evasion gamble's expected utilities, balancing the benefits of successful tax cheating against the risky prospect of being caught and punished by tax authorities. Brook (2001) states that classical theory is only based on economic analysis but social and psychological variables are equally

important in understanding the issue of noncompliance to tax. Some of the important studies about the effects of deterrence on compliance include Hasseldine (2000), Torgler (2002) and Kirchler (2007). Elffers (2000) .Braithwaith (2003) reasoned that if Deterrence, that is the likelihood of discovery and sanction sternness, would be the substantial variable in explanation of taxpayer compliance. In most societies of the world, individuals would usually be non-compliant because the deterrence levels are low. The theory has contributed to the theory that revenue authorities should seek audited statements or conduct audits to determine compliance (Sandmo, 2005). The theory of deterrence mostly depends on tax audits and penalties (Alabede et al, 2011). The theory also stipulates and continue to urge the tax authorities to strengthen tax audit department to ensure the compliance level is kept at par and is relevant to research topic because it and will help the researcher to understand the effect of tax audit on excise duty collection.

### **2.2.2 Economic Deterrence Theory**

Becker's Theory of Economic Deterrence (1968) falls within criminology. The theory is based on the impression that it would be possible to prevent crime by individuals if the outcome of performing a crime outweighs the benefit of the crime itself. However, the overall effectiveness of prevention is difficult to prove, because only those who commit crime and not the deterred come into full force of legal enforcers Therefore, we may never know why others are not committing an offense. This theory implies that economic motivations and businesses encourage crime on the possibility of unnoticed their actions. Deterrence can be realized disciplinarily and persuasively in several ways. This means that deterrence can take the form of increased detection possibilities to increase the tax rate or by tax. Rate by imposing of tough penalties (Jackson & Milliron, 1986)

Most taxpayers will cite impartiality as key issues that impact tax compliance, according to Porschke and Witte (2011). Where taxpayers are willing to comply with the perception that taxation is impartial, and the opposite is also true. In such a situation, tax auditing is considered a mechanism for discouraging tax evasion. Taxpayers are constantly searching for opportunities to evade tax by exaggerating their expenditure while, on the other hand, reducing pre-tax turnover in order to pay less tax (Hanefah, Ariff&Kasipillahi, 2012), creating the impression that everyone can consciously distinguish between rights and wrongs and the penalties for wrongdoing or misconduct. Supporters of the theory of deterrence consider that after evaluating the rewards and penalties they engage in, people make choices to comply with or disregard the law. Taxpayers will tend to fake stamp in excise duty and sell counterfeit goods to ensure that they get the maximum benefit and lower their tax liability.

OECD (2016) reinforces this theory by stating that tax audit increases revenue collection by promoting taxpayers ' voluntary compliance that helps to increase revenue. It also ensures that proper taxes are submitted by determining the accuracy of returns. Tax liability can be easily reported with tax audit and issues requiring modifications to support a credible and convincing method of deterrence theory

### **2.2.3 Theory of Crime**

Crime theory affirms people's rationality as a way of acting in a manner that maximizes their predictable usefulness. Becker (1968), argued that authorities should balance properly between detecting non-compliers and statements to the extent that non-compliance is deemed irrational. In the beginning of 1970, Allingham and Sandmo (1972) extended Becker's work on crime economics to the tax context. They inspected the decision of taxpayers to evade taxes when their tax returns were filled out. They also investigated the connection between the rate of penalization for tax evasion at the time, the possibility of detection and the extent of tax

evasion carried out by individuals, significance of persuasion and collaboration as a regulatory mechanism to gain compliance. Their findings were that these variables had a connection. High rate of penalization and the ability to detect tax evasion rates among taxpayers. Therefore, in the 1980s, most researchers began to question the cost of dissuasion on their own to regulate behaviour. They began to reorient their research compliance rather than deterrence and began to realize the significance

Research has revealed that the use of threats and legal compulsion can generate undesirable behaviour, especially when perceived as illegal. These actions are most likely to increase non-compliance (Murphy and Harris 2007). Adediran, Alade & Oshode (2013) theory supported that taxpayers are evaders mostly on paying tax and therefore the need to motivate them by persuading them or ensuring they comply with the law. As a result, taxpayer often feel unenthusiastic in paying their tax obligation. The use of tax audit has nevertheless aided help in curtailing the tax scam practice by taxpayers trading with excisable goods and services.

Implementation of excisable goods management system will tend to curb the tax crime such as diversion of excisable goods on transit investigating and punishing tax offences, safeguarding the national revenue, protecting the tax order, supporting compliance and ensuring adoption of the tax regulations which are the elementary roles of tax audit. The tax audit practices must be founded on the facts and the tax laws, values and strategies trusting on the people and establishment the partnership with the jurisdictional provision and other related arm of the government to curb this vice of tax evasion. Tax audit if adopted fully will go a long way in reducing the chances of tax evasion in excise duty collection (KRA Website, 2016).

## **2.4 Empirical Review**

Bright et al. (2009) studied statistical sampling for tax audits in United States of America (USA), tried to review whether the use of statistical sampling for audit is a sufficient basis for determining the taxpayers' unpaid liability rather than reviewing all transactions to determine the exact amount of tax owed. The study used case studies, and relied on the cases and data from consumption taxes, primarily sales and use taxes of three agencies including Internal Revenue Service (IRS), the revenue departments in New York and Pennsylvania. The finding of the study indicated that audit assessment based on appropriately drawn and analysed statistical sample do not suffer from the defects that the courts have correctly concluded mar assessments based on non-statistical samples. Without sampling, it may be literally impossible for a tax examiner with a limited staff to audit an entire period especially when dealing with a taxpayer who conducts a large volume of transactions. The study further indicated that sampling techniques allow improved economies in the use of government resources in that tax administration can be more efficient, fairer, and less intrusive if the technologies used for identifying and measuring tax deficiencies are expanded to include controlled use of statistical sampling. The common interest of minimizing the duration of tax audit for both the tax administration and taxpayers can also be achieved with sampling techniques. However, statistical sampling cannot provide an exact determination of tax owed, and the uncertainty

Frank (2010) concludes that audit policy can have important effects on production decision by firms. The nature of such effects depends on whether firms compete or collude. Accordingly, an appropriate designed audit policy may not only achieve greater compliance and higher net revenue for given output and resources spend on audit but may also have other effects that would be normally considered desirable in a wider economic context. Yongzhi

(2005) concluded that this study does find a positive relationship between the audit and the voluntary compliance

Adediran, Alade and Oshode (2013) examine the impact of tax audit and investigations on revenue generation among tobacco manufacturers in Nigeria and concluded that Tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. He recommended that Tax audit and investigations should be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country. For many, wide price gap between the legal and tax evaded cigarettes is the key driver of demand for tax evaded cheap cigarettes widely available across the country and practicable steps need to be taken to address this situation which can be achieved by proper audit of all manufacturers.

Samuel (2014) did a study on how of taxpayers' financial statements audit impacted tax revenue growth. The research outcomes indicated that the tax audit increases the compliance rate which will in turn positively influence the tax revenues to be collected by RRA. The findings also revealed that tax audit deters and aids identifying evasion and fraud in taxation processes due to comprehensive review and examination of taxpayers' financial statements until they find out the taxpayers who underreport their income hence leading to tax revenues growth. The non-compliant taxpayers are tasked to pay penalties and fines in addition to the principal amount of taxes due. In addition, the research findings revealed that if there are the payments of penalties and fines in the case of noncompliance, all taxpayers in general try to conform to tax laws even those who are not audited.

Afubero and Okoye (2014) examined impact of taxation on revenue generation in Nigeria and recommends among others that Well-Equipped Data Base (WEDB) on all tax payers should be established by the Federal, State and Local Governments with the aim of identifying all possible sources of income of tax payers for tax purpose however the tax collection processes must be free and fair Ibrahim, Yusuf and Bello (2014) examined the contribution of tax audit and investigation to the sustainable development of the Nigerian economy and concluded that the practicing accountants should uphold the fundamental principles of professional ethics while rendering consultancy services since they often act for taxpayers in their dealing with the relevant tax authority.

According to Adan (2015) in encouraging signs for Pakistan's economy, the introduction of third tier tax slab on tobacco products and cigarettes has remarkably helped boosting revenue collection. This would improve further, by audit of tobacco sector is carried out with its extension to retail sector for effective enforcement of minimum price law.

However, this is not the case in Kenya, for example, according to the Kenya Revenue Authority (KRA), the tax category had its worst performance in the six months to December, with collections going down to nine percent. This means the taxman collected Sh74 billion during the first half of the 2017/18 financial year, compared to Sh81.6 billion over a similar half in 2016. KRA attributed the decline to a drop-in collection from the alcohol and tobacco industries, which are among the main targets of excise tax, also referred to as sin tax (Daily Standard February 14, 2018). This shows need to audit this manufacturer to establish why there is sudden drop in revenue while there is increase in consumption. Mebratu (2016) did a study on the impact of tax audit on tax compliance in Ethiopia, at federal level by using secondary macro data. The main objective of the study was to examine the impact of tax audit on tax compliance in Ethiopia, at federal level by using secondary macro data.

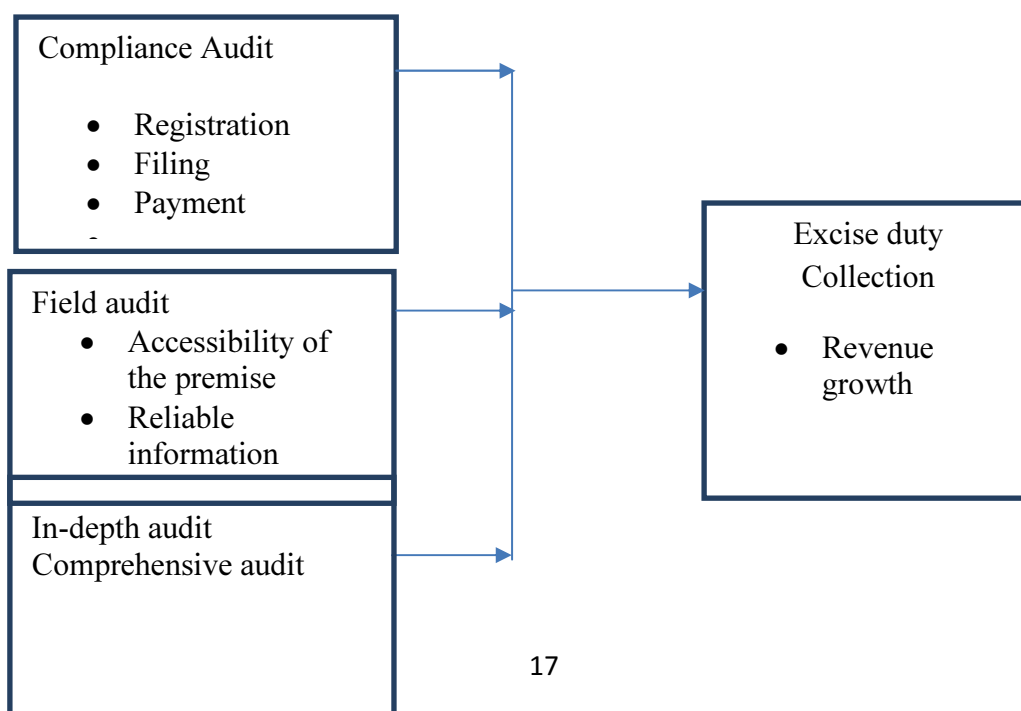
## 2.4 Conceptual Framework

This research study proposes a conceptual framework in which the independent variables are Compliance Audit, Field audit, In-depth audit and dependent variable is Excise duty collection

**Fig. 2.1 Conceptual Framework**

### Independent Variables

### Dependent Variable



### **2.4.1 Compliance Audit**

A compliance audit is different from an external audit since the auditor is not forming an opinion on the financial report but on the client's compliance with specified criteria.

The objective of a compliance engagement is to enable the auditor to express a conclusion on whether an entity has complied in all material respects, with requirements as measured by the suitable criteria. The responsibility for an entity's compliance with requirements as measured by the suitable criteria rests with the responsible party. A compliance engagement performed by an auditor does not relieve the responsible party of its obligations to ensure compliance with requirements as measured by the suitable criteria. The tax audits rely on the physical copies or electronic records and books of accounts that the taxpayer has submitted to the tax authority. In this type of tax audits, there is more reliance on technology. In-depth examination of the records and books may not be tenable in these type of tax audits. However, tax audits for compliance purposes are feasible in desk tax audits (TaxKenya.com). While they may involve the examination of documents and records, they frequently involve communication with the taxpayer via letter or phone to obtain explanations or information on issues of potential risk.

This category of audit tends to make up the bulk of audit interventions in most administrations. Although less deep, desk audits allow for a greater coverage at lower cost of potential errors in tax returns (deliberate or accidental). Increasingly such verification actions involve automatic cross-checking of returns against other data held by the tax administration, including identifying anomalies compared to returns of other taxpayers in similar situations. In all of these cases, where serious issues are found they can be escalated

to a limited scope or comprehensive audit. Devos (2014) states that in a self-assessment tax system, it is significant for tax audits to function efficiently because they drive compliance behavior of taxpayers. This in the end can be quantified by intensifying the possibility of being apprehended rather than enacting sanctions.

#### **2.4.2 Field audit**

Tax officers leave their offices and go to the premises of a taxpayer and from there conduct tax audits. The officers examine from the premises of the taxpayer both physical and electronic records and books. The officers may request physical or electronic format copies of the records. These types of tax audits are heavily dependent on what the taxpayer submitted to the tax authority and what the taxpayer paid. (Tax Kenya.com) Regular assessment officers, by the nature and scope of their work, may only conduct limited desk audits by reviewing accounts and returns. It is in the interest of the tax authorities to check this handicap and to improve tax compliance that they carry out field auditing.

Because of the nature and scope of their work, regular evaluation officers can only conduct a limited desk audit through account and return review. It is in a bid to check this disability as well as improve tax compliance that tax authorities perform field audit exercise on taxpayers by physically performing the exercise at the office of the taxpayer. (KRA Manual, 2015).

However, the taxpayers are formally notified of the auditor's arrival before the audit begins, and the auditors' requirements for documents to be audited will also be requested in advance.

Field audit involves physical verification at a taxpayer's premises of documentary evidence and materials to confirm the facts and figures of the tax returns filed. The scope or depth of verification depends on the outcome of the

audit work of the tax auditor and the audit risk factors. Special attention will normally be paid

to items that are likely to have high tax yield potential. The tax audit is usually carried out by means of the back duty (KRA manual, 2015). However, before the audit begins, the taxpayers are formally notified of the arrival of the auditor and the requirements of the auditors for documents to be audited are also requested in advance. Field audit involves physical verification of documentary evidence and materials at a taxpayer's premises to confirm the facts and figures of the field tax returns.

To help detect fake stamps during field enforcement, the authority implemented the electronic system in phases. The system helps to monitor the production of excisable products in real time from their production stages, giving their distribution the quantity and date of production. The system was initially launched with tobacco, wines and spirits under the EGMS regime. In accordance with Section 45 of the Excise Duty Act, the Cabinet Secretary, National Treasury introduced the Electronic Goods Management System (EGMS). The new regulations were intended to replace the 2013 Excise Duty (EGMS) Regulations and the primary objective was to improve efficiency in excisable goods management by addressing the shortcomings in the 2013 EGMS Regulations. Key amendments were the change in the pricing of excise stamps in which the inequity caused by the use of fixed stamp prices in all excisable products is expected to be alleviated. The new Regulations were introduced through 2017 Legal Notice 53 and entered into force on March 30, 2017. (KRA manual, 2015).

### **2.4.3 In Depth Audit**

The scope of in-depth audit is more detail and very comprehensive. It usually involves a thorough assessment of all document and detail information relating tax payers' details taxpayer's tax liability for a specified time. The essence of the audit provides a conclusive and accurate status of the tax liability for an entire tax return. Other nation conducts full

audits during random audit procedures. The type and precise aspects of tax compliance risks, for purpose of compliance research and/or the development of automated audit selection formulae. In-depth audits usually have high costs of undertaking since they are very comprehensive. A widespread program of in-depth audits comprise ofuse of considerablepossessions thus minimizes thescope of taxpayers in question to ascertained (OECD, 2006)

The methods of tax audits are thorough assessment that mostly cover all features of a tax and most tax types for many years of income. In-depth tax audits to normal tax audits but the examination of the records and books of accounts is deeper. Tax officers have different skills and experiences. Hence, the tax officers who conduct in-depth tax audits are more experienced and have a range of other skills including technological, forensic, psychology etc. In-depth tax audits are mostly a mixture of desk and field audits relying on the information provided by the taxpayers to the tax authority, information that the taxpayers may be holding and information from third party sources. The tax audits cover several years of income and all the tax systems administered by the tax authority. In many cases, substantive amounts of tax liabilities are generated.

In a bid to conduct a comprehensive audit, tax authorities in the taxpayer's office physically conduct full audit exercises on taxpayers. The requirement is that a formal notification is given to the taxpayers before the audit begins. All documents that auditors require are requested in advance This audit comprises of physically verifying documentary proof and data at the taxpayer's premise in order to authenticate the facts and figures of the tax returns filed by corporate taxpayers. The amount of authentication is reliant on the result of the desk audit work conducted by the tax auditor as well as the risk aspects of the audit process. Areas

with likelihood of producing high taxes are usually given more attention. (Ladi& Henry, 2015)

According to Ayalew (2014), the tax audit is effectively measured by allowing tax auditors to demonstrate the process of tax filing, enhance record custody and detect tax, recover more tax and penalize Isa and Pope (2011) conducted a study of the range of insights of taxpayers on the experience of tax audit. Their argument was that if an effective tax audit is carried out, it improves the administration of a tax system, thus increasing the compliance of volunteers.

## **2.5 Critique of the existing study**

Afubero and Okoye (2014) examined impact of taxation on revenue generation in Nigeria and recommends among others that Well-Equipped Data Base (WEDB) on all tax payers should be established by the Federal, State and Local Governments with the aim of identifying all possible sources of income of tax payers for tax purpose however the tax collection processes must be free and fair Ibrahim, Yusuf and Bello (2014) examined the contribution of tax audit and investigation to the sustainable development of the Nigerian economy and concluded that the practicing accountants should uphold the fundamental principles of professional ethics while rendering consultancy services since they often act for taxpayers in their dealing with the relevant tax authority.

According to Adan (2015) in encouraging signs for Pakistan's economy, the introduction of third tier tax slab on tobacco products and cigarettes has remarkably helped boosting revenue collection. This would improve further, by audit of tobacco sector is carried out with its extension to retail sector for effective enforcement of minimum price law.

Adediran, Alade and Oshode (2013) examine the impact of tax audit and investigations on revenue generation among tobacco manufacturers in Nigeria and concluded that Tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. He recommended that Tax audit and investigations should be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country.

However, this is not the case in Kenya, for example, according to the Kenya Revenue Authority (KRA), the tax category had its worst performance in the six months to December, with collections going down to nine percent. This means the taxman collected Sh74 billion during the first half of the 2017/18 financial year, compared to Sh81.6 billion over a similar half in 2016. KRA attributed the decline to a drop-in collection from the alcohol and tobacco industries, which are among the main targets of excise tax, also referred to as sin tax (Daily Standard February 14, 2018). This shows need to audit this manufacturer to establish why there is sudden drop in revenue while there is increase in consumption.

Mebratu(2016) did a study on the impact of tax audit on tax compliance in Ethiopia, at federal level by using secondary macrodata. The main objective of the study was to examine the impact of tax audit on tax compliance in Ethiopia, at federal level by using secondary macro data.

Several research studies have been conducted in Kenya, Rwanda, Ghana and Nigeria on the subject of tax audits and revenue collection and tax compliance. Harelimana (2018) did a study on the impact of tax audit on revenue collection in Rwanda. The key purpose of the study was mainly to establish the impact of tax audit on revenue collection in Rwanda. Olaoye& Ayodele (2018) did a study on effects of tax audit on tax compliance in Ekiti State,

Nigeria. The study employed primary data which where 60 questionnaires were randomly distributed to Federal Inland Revenue Service and Ekiti State Board of Internal Revenue Service Staff. The main objective was examining the effects of tax audit on tax compliance in Ekiti State, Nigeria. The glaring gap was the fact that this study was done in Nigeria and there was a need for a similar research to be carried out in a developing country.

Another study done by Opoku (2015) focused on the role of tax audit in revenue mobilization in Ghana Revenue Authority. The main objective of the study was to know whether tax audit practice plays a significant role in tax administration. Niu (2010) in a study found a positive association between the audit and the voluntary compliance. The finding suggests that the audit productivity may be under estimated in many studies in the literature.

## **2.5 Research gaps**

Studies that were conducted focused primarily on the impact of tax audits on tax compliance, and studies were mostly conducted in other African countries, not Kenya. Studies conducted in Kenya focused primarily on the impact on income collection of tax audits. Therefore, the current study should fill the disparity in expertise by focusing on the effect of tax audits on excise duty collection, particularly on manufacturing firms because excise duty collection performance is desirable. In order to increase tax compliance and income, more research on Tax audits and findings and recommendations should therefore be conducted to investigate the impact of tax audits on the collection of excise duty income in Kenya.

## **2.6 Summary**

Chapter two conducted a comprehensive study of relevant empirical studies prior to the impact of tax audits on income collection in jurisdictions other than Kenya. The three research goals and research questions steered the literature review in this chapter intensively. This chapter has reviewed the literature decisively aimed at establishing the

purpose of knowledge disparity to justify the current study of research. Once the disparities in knowledge have been recognized, the researcher has then established a conceptual framework to serve as the model for the research study in answering research questions. The next chapter will focus on the methodology that the researcher will use in answering the research questions and the research study objectives.

## **2.7 Research gaps**

Studies which have been done have mainly focused on the impact of tax audits on tax compliance and mostly these studies were done in other African countries and not Kenya. Studies that have been done in Kenya have focused primarily on the impact of tax audits on revenue collection. The current study should therefore, fill the expertise disparity by focusing on the effect of tax audits on excise duty collection especially on manufacturing firms because excise duty performance in terms of collection is wanting. For the country to enhance tax compliance and increase revenue more research should be carried out on tax audit and the findings and recommendations made available for public access. The research is therefore aimed to investigate the effect of tax audit on excise duty revenue collection in Kenya.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter outlines the research methodology used in this study on the effects of tax auditing on the collection of excise duty in Kenya. It provides the following subsections: research design, target population, sampling frame, sampling and sampling technique, data collection tools and procedures and data

#### **3.2 Research Design**

The study used a descriptive research design. Because of its concern to describe a population with regard to significant variables, the main emphasis being on establishing the relationship between variables (Kothari, 2006). Bryman & Bell (2011) defines research design as a plan to guide a researcher in organizing research activities and answering questions that are being studied.

Lavrakas,( 2008) stated in his thesis that descriptive research helps to determine the relationship between similar studies on how online systems such as iTax have contributed to the global and national success of tax compliance.Descriptive design is also appropriate in a study conducted by a large population such as Industrial Area Nairobi. A research study conducted by Wasao (2014) used the descriptive study design to analyze effectively the relationship between technology and tax compliance levels in terms of online tax return filing and online tax filing. In his research study, Odongo (2016) also used the descriptive study design approach to determine and analyze the possible relationship between the electronic filing system and the level of tax compliance.

The degree of compliance with the electronic filing of returns for different taxes and the tax due.

### **3.3 Target Population**

A population refers to a whole group of individuals, events or objects with a common observable, according to Kothari (2006). In this study, the type of data used was primarily secondary data. Evaluation of relevant documents from the research unit in the Department of Strategy Innovation and Risk Management and analysis using scientific software.

### **3.4 Sampling Frame**

A sampling frame, according to Schindler and Cooper (2001), consists of a list of people from which the researcher uses information about the study to be obtained. To assist in the analysis and to allow further frameworks to be divided for further analysis.

### **3.5 Sample size and sampling technique**

Sampling techniques are considered as strategies used in the statistical sampling process by researchers (Cooper and Schindler, 2001). The research used stratified random sampling techniques in each stratum. Stratified random sampling was preferred as it eliminated bias and gave equal opportunities for selection to the elements in the population. This was achieved by grouping the excise duty collection within the year of collection it was further broken down into various types of audit performed. The audit type includes compliance audit, desk audit and in-depth audit

### **3.6 Data Collection Methods**

Secondary data was collected two years before the audit two years after the audit through the review and detailed investigation of tax audit data from 2013/2014 to 2017/2018. The figures were then analyzed using SPSS data to show correlation, regression and coefficient significance.

### **3.7 Pilot test results**

The major purpose for pilot testing was to test whether the questionnaires could obtain the required results. The pilot study was used to find out the clarity and objectivity of the selected questions. The advantages of conducting the pilot test include enhancing the training of field staff, review of the instrument, prevention of wasteful expenditures on a full-blown survey whose results may not be applicable. Piloting involves testing the validity and reliability of the data collection instrument and in this case the questionnaires. Validity in qualitative research refers to credibility and trustworthiness of the data presented. Reliability in relation to qualitative research data is the measure that the data provided is consistent with what previous research literature has said or if similar research with a different group of participant's yields a similar set of data.

### **3.7.1 Reliability of the Research Instruments**

Reliability refers to the ability of a research instrument to consistently measure characteristics of interest over time. It is concerned with consistency, dependability or stability of a test (Nachmias&Nachmias, 1996). Reliability is measure of the degree to which a research instrument yields consistent result after repeated trials (Mugenda & Mugenda, 2003). According to Sekaran & Bougie (2010) the measurement of the reliability and the validity of a data instrument help the researcher to gauge the goodness of the variables of measurement. Reliability was measured using Cronbach's Alpha coefficient which is used to measure the internal consistency of the variable measures.

Reliability in research is influenced by random error. According to Zikmund (2010), errors may arise from inaccurate coding, ambiguous instruction to the subjects, fatigue, interview bias etc. These errors results to inconsistencies in the measurement, which ultimately affect the reliability of the data collected (Mugenda & Mugenda, 2003).

Cronbach's Alpha which measures how well a set of items or variables, measures a single un-dimensional latent construct that is a coefficient of reliability or consistency was used for this study. Cronbach's Alpha was adopted since it was used with continuous and non - dichotomous data. In particular, it was used for testing questionnaires using a Likert scale. The study employed test re-tests method to determine the reliability tool.

Cronbach's alpha general increase when the correlations between the items increase. The coefficient measures the internal consistency of the test. A commonly accepted rule of thumb is that an alpha of 0.7 indicates acceptable reliability and 0.8 or higher indicates good reliability (Gliem&Gliem, 2003). Very high reliability (0.95 or higher) is not necessary desirable, as this indicates that the items may be entirely redundant. The reliability of the

questionnaires was tested using the Cronbach's Alpha correlation coefficient with the aid of Statistical Package for Social Sciences (SPSS) software.

**Table 3.1: Reliability tests results**

<b>Constructs</b>	<b>Reliability Cronbach's alpha</b>	<b>Comment</b>
Compliance tax	0.863	Accepted
In depth audit	0.781	Accepted
Field audit	0.791	Accepted

Cronbach's Alpha was used to test the reliability of the proposed constructs. The findings indicated that compliance tax had a coefficient of 0.863, in depth audit had a coefficient of 0.781, field audit has a coefficient of 0.791. Reliability is expressed as a coefficient between 0 and 1.00. The higher the coefficient, the more reliable is the test. According to Cronbach (1951) a threshold of a Cronbach alpha of 0.7 and above is acceptable. For this study all constructs depicted a value of Cronbach's Alpha which were greater than 0.7, (Gliem & Gliem, 2003) asserts that Cronbach Alpha reliability coefficient value of 0.7 or higher is considered sufficient thus, all the study constructs were reliable.

### **3.8 Data collection procedure**

Procedures for collecting data began after approval of the proposal after its defence. For consent to collect data from the respondents, an introduction letter was issued to the sampled entities. Using the letter, the researcher went to the department of research to obtain secondary data used in data analysis.

### 3.9 Data analysis and Presentation

Using SPSS version 25, it was subjected to analysis once the secondary data had been obtained from the KRA report. To achieve analysis, inferential statistical methods of data analysis have been applied to the collected data. Using inferential analysis provides better insight into variables ' relationships. The data collected for the study's key variables were analyzed using regression and correlation

#### 3.8.1 Analytical Model

The following regression analysis was used to determine the effect tax audit on excise duty collection in Kenya. The research analytical model will be depicted by the linear equation given below:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \pi$$

Where:

$Y$  = Excise duty collection

$\beta_0 - \beta_3$  = Regression coefficient of independent variable

$X_1$  = Compliance audit

$X_2$  = In depth audit

$X_3$  = Field audit

$\pi$  = error term, it considers all the possible factors that would possibly influence the dependent variable though not captured in the model

## **CHAPTER FOUR**

### **DATA ANALYSIS AND PRESENTATION**

#### **4.1 Introduction**

This chapter addresses the data analysis and interpretation of the research findings on the effect of tax audit on excise duty collection. Descriptive statistics and regression analysis was used to determine the significant level. The study was conducted over a 5-year period where secondary data for the period 2013 to 2018 was used in the analysis. The research study made use of regression analysis to analyse. The data was collected from secondary sources, which were from KRA. The data was analysed using Microsoft Excel 2007 and SPSS 23 version.

**Table 4.1.1 Descriptive Statistics Total excise duty collected in billions as a result of tax audit**

<b>Total</b>	<b>2013/2014</b>	<b>2014/2015</b>	<b>2015/2016</b>	<b>2016/2017</b>	<b>2017 2018</b>
<b>collection</b>					
<b>Compliance</b>					
<b>audit</b>	35,855	38,246	48,986	55,499	53,011
<b>Field audit</b>	12,302	13,122	14,884	15,964	15,626
<b>In-depth</b>					
<b>audit</b>	4,973	5,722	9,013	12,575	15,898
<b>TOTAL</b>	<b>53,130</b>	<b>57,090</b>	<b>72,883</b>	<b>84,038</b>	<b>84,535</b>

**Source KRA report (2018)**

From the table below excise duty collection was measured by the gross excise collection trends over the study period of five years. Two years before tax audit and two years after the tax audit on excise duty collection. From the data represented above it is noticeable that the excise duty collection increased tremendously after the audit process. This indicates that effective tax audit such as compliance audit field and in-depth audit contributed to the increase of tax audit. The findings also revealed progressive steady increase from 2013 to 2018 excise duty collection majorly contributed by tax audit exercise. Other factor such as economic growth, inflation and expansion in excisable goods may also contributed to a certain degree.

**4.3 Correlation Analysis**

**Table 4.3.1 Correlation Coefficient**

	Excise duty collection	Compliance audit	Field audit	In-depth audit
<b>Pearson Correlation</b>	Excise duty collection	1.000		
	Compliance audit	.632	1.000	
<b>Sig. (1-tailed)</b>	Field audit	.876	.146	1.000
	In-depth Audit	.643	.427	.109
				1.000

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

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

Correlation analysis describes the relationship between excise duty collection and other independent variables such as Compliance audit, Field audit, in depth Audit as shown above. Pearson correlation coefficient was used to measure the strength of a linear relationship between two variables. Pearson correlation may take a variety of +1 and -1 and a score above zero shows that the relationship between the variables is significant and positive while where the score is zero portrays no association between the variables. However, where the score is below 0 it shows that the relationship between the variables is a negative one. Table 4.3.1 above shows a summary of correlation explain the relationship that exist between independent variables and dependent variable which as excise duty collection and other variables being compliant audit, in-depth audit and field audit. The correlation analysis also shows a strong positive correlation between field audit and excise duty collection at 0.876. This is an indication out of the three variables field audit has the highest significance value and should to adopted to increase the overall excise duty collection. In-

depth audit also shows a positive correlation of 0.643 that exist between in-depth audit and excise duty revenue collection. In conclusion all the three variables had a positive correlation and this prove that they all contributed to revenue collection within the period of study.

### 4.3 Regression Analysis

Multiple regression analysis was employed to determine the effect of tax audit on the tax compliance on excise duty collection. The determinant of the multiple regressions and the analysed data. R is the correlation coefficient which shows the relationship between the study variables. R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable.

Adjusted R squared was used to measure unbiased estimate of the population. Predators Compliance audit, Field audit and In-depth audit are constant.

**Table 4.3.2 Regression Model Summary**

<b>Model</b>	<b>R</b>	<b>R Squared</b>	<b>Adjusted R Squared</b>
<b>1</b>	.8479 <sup>a</sup>	.7188	.2399

From the findings in table 4.3 the value of R squared was 0.7188 which indicates that that there was a variation of 71.8% on excise duty collection at 95% confidence level. The interpretation of this is 71.8 % variations from excise duty are explained by the independent variables which is strong and has positive effect on excise duty collection. The remaining 29.2% could be explained by other variables not under this research study. This indicate a

positive significant of effect of tax audit on excise duty revenue. From the analysis it can be concluded that tax audit such as Compliance audit, field audit and in-depth audit does affect total excise collection as the taxpayers who transact excisable goods and services will be compliant during audit and thus will increase the excise revenue collection.

#### 4.4.1 Analysis of Variance

**Table 4.3: Analysis of Variance (ANOVA)**

Model		Sum of Squares	Df	Mean Square	F	Sig
1	Regression	3.312	5	1.107	2.548	.00274 <sup>b</sup>
	Residual	1.267	137	.04397		
	Total	4.579	142			

**Predictors: Compliance audit, Field audit, In depth audit**

From the ANOVA table in Table 4.34 indicates that the overall model was a good fit since (F-value=3.312 and p-value=0.00274<0.05).

Table 4.4.1 shows the overall significance of the regression estimation model. The analysis indicates that the model is significant in explaining the relationship between the mentioned modules at 5%level of significance. Analysis of variance shows that F- critical that is 3.312>0.00274. This implies that the regression equation was well specified and therefore the coefficient of the regression shows that there was a strong relationship between excise duty collection compliance audit and Field audit. The analysis of variance of the predictors and model has a significance of 0.02274 which is within the acceptable rangewhich is less than a p-value Of 0,05

**Table 4.37: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
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1	.488 <sup>a</sup>	.238	.225	.85449	1.989
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**a. Predictors: (Constant), compliance audit, in-depth audit and field audit**

**b. Dependent Variable: Excise Duty collection**

The R square value in Table 4.37 is 0.238 which clearly suggests that there is a strong relationship between compliance audit and field audit and in-depth audit as indicated in table above. Independent variables share a variation of 23.8% of dependent variable.

#### 4.5.1 Regression of Model Coefficient

**Table 4.4 Regression Model Coefficients**

Model	Unstandardized		Standardized	T	Sig
	Coefficients		Coefficients		
	B	Std Error	Beta		
Constant	2.481	1.178	1.243	0.745	0.040
Compliance audit	1.378	1.849	0.512	0.681	0.021
Field audit	1.435	0.728	0.065	.017	.0010

In-depth audit	1.217	2.069	0.032	1.894	.0017
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**Predictors: Compliance audit, Field audit, In depth audit**

**Dependent variable: Excise duty collection**

From the data in table 4.5, the established regression equation was;

$$Y = 2.481 + X + 1.378 \text{ Compliance audit} + 1.435 \text{ Filed audit} + 1.273 \text{ XIn-depth audit.}$$

On the table 4.4. above the regression coefficients of the predictors (factors) were presented.

Result indicate that filed audit was the most significant in explaining excise duty collection.

with Significant level of 0.010 which is less than a p-value Of 0,05. and beta of This therefore

means that the excise duty collection would be at 2.481 when the factors component with a

significant level of,0.04. With significant level of 0. 021.Compliance audit is positively

related to field audit and field audit is positively related in-depth audit. The analysis also

indicate that the level of field audit would lead to an increase in excise duty collection by a

factor of 1.378 with a significant level of 0.021. Lastly excise duty collection would be

1.217on in-depth audit with a significant level of 0.017

From the analysis, all the variables indicated positive significant levels with the field audit

portraying the highest level of significant. followed by in-depth audit. At third distance was

compliance audit. This indicates that the model is significant in explaining the relationship

between the different type of audit. This finding resonates with the findings of Adan (2015)

research which revealed the by improving the Pakistan's economy, the including a third-tier

tax slab on tobacco products and cigarettes has positively contributed in revenue collection.

This would improve further, by audit of tobacco sector is carried out with its extension to

retail sector for effective enforcement of minimum price law. The study also supported by a

study done by Okoye (2013) examine the impact of tax audit and investigations on revenue

generation among tobacco manufacturers in Nigeria and concluded that Tax audit and

investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter discusses the key findings of the study which was to establish effects of tax audit on excise duty collection, improvements and also outline suggestion for further research. It also recapitulates the findings of the study done with specific reference to the objectives and research questions of the study used as units of analysis. Data was interpreted and the results of the findings were correlated with both empirical and theoretical literature available. The conclusion relates directly to the specific objectives and research question which includes compliance audit, filed audit and in-depth audit. The recommendations were made based on the conclusions and discussion of the findings.

## **5.2 Summary of the Findings**

From the data analysis, the study found out that tax audit has a positive effect on excise duty collection. This can be proved by the different in figures depicted in the 4.1 above which outline the excise duty collection within a period of 5years. This further implies that when Kenya revenue Authority revamp tax audit especially in excisable goods and services then the increase on excise duty collection will be imperative. From the research findings on the R square, the study shows that there was a variation 71.8 % on excise duty collection. The study further revealed that there was a strong positive relationship between the study variables. From the findings of the ANOVA, the study found that compliance audit, field audit and in-depth audit positively influence on excise duty collection. These findings concur with the finding of Mebratu (2016) who conducted a study on the impact of tax audit on tax compliance in Ethiopia, at federal level by using secondary macro data and concluded in his study that tax audit has a positive effect on tax compliance. This therefore confirms that tax audit is very effective in enhancing compliance and increasing revenue collection.

### **5.2.1 Compliance audit**

From the regression analysis, the study found that there was a fairly positive relationship between Compliance audit and excise duty collection with a significant level of 0.0021. At 5% level of significance and 95% level of confidence, had the least among other variable. Furthermore, from the findings on correlation analysis, the study found that there was positive correlation between compliance audit and excise duty collection at .632, This resonates with the findings of Olaoye & Ayodele (2018) who investigated the effects of tax audit on tax compliance in Ekiti State, Nigeria and the study conclude that indeed tax audit has a positive effect on tax compliance .

### **5.2.2 Field audit**

From the regression analysis, the study found that there was strong positive relationship between field audit and excise duty collection with a significant level of 0.010. At 5% level of significance and 95% level of confidence, Field audit had the highest effect on excise duty which means field audit is where the officers visit taxpayers premises and when they find taxpayer not compliant, then there is principal amount and penalty is charged in this tends to increase duty collection. Field audit involves physical verification of documentary evidence and materials at the premises of a taxpayer so as to confirm the facts and figures of the tax returns filed by corporate taxpayers. Furthermore, from the findings on correlation analysis, the study found that there was a strong positive correlation between field audit and excise duty collection at 0.876 which was the highest. The findings corroborated with the findings of Harelimana (2018) who conducted a study on the impact of tax audit on revenue collection in Rwanda. The key finding was that field audit was more effective than other type of audit in Rwanda

### **5.2.3 In-depth audit**

From the regression analysis, the study found that there was a strong positive relationship between in-depth audit and excise duty revenue collection at 0.643. At 5% level of significance and 95% level of confidence, in-depth audit had the second greatest effect on excise duty collection. Furthermore, from the findings on correlation analysis, the study found that there was a strong positive correlation between in-depth audit and excise duty collection. In-depth audit involves a thorough investigation of all information applicable to the computation of a taxpayer's tax liability for a specified time. Though quite expensive.

#### **5.2.4 Excise duty collection**

The study confirms that tax audit has increased excise duty by almost doubling amount collected from 53,130 in the year 2013/2013 to 84,535. This was mainly contributed by the three types of audit which includes; compliance audit, desk audit and in-depth audit. The regression results also indicated 71.8 % variations from excise duty were explained by the independent variables which were all strong and had positive effect on excise duty collection. Significant level of all variables were less than a p-value of 0.05. This indication explained that tax audit process is very key in excise duty collection. The findings resonate with the study carried out by Niu (2010) which found a positive association between the audit and the voluntary compliance. The finding suggests that the audit productivity may be underestimated in many studies in the literature. Therefore, the tax audit is a very significant exercise which should be researched extensively and findings be made public for the scholar and revenue authority body.

### **5.3 Conclusion**

#### **5.3.1 Compliance Audit**

From the analysis, it can be concluded that a vigorous compliant audit increases excise duty collection. This was revealed from the regression and correlation analysis that there was a positive relationship between compliance audit, field audit and in-depth audit in relation to excise duty collection. The research found out that tax audit is a very effective mechanism of curbing those who are evading tax and especially in goods that are excisable with the frequent cases of a lot of counterfeit. With compliance audit the taxpayer is always engaged into payment of their taxes as per the law. This ensures flow of revenue.

### **5.3.2 Field Audit**

From the analysis, it can be concluded that a thorough field desk audit will increase excise duty collection. This affect excise duty collection positivelyby increase of revenue generation. The regression and correlation analysis revealed that there was a positive relationship between compliance audit, field audit and in-depth audit and excise duty collection. The research found out that field audit is the most effective mechanism of curbing those who are evading tax and especially in the manufacture of excisable goods.

### **5.3.3 In-depth Audit**

From the analysis, it can deduce that in-depth audit indeed increases excise duty collection. This can positively affect excise duty collection in the long run. This was revealed from the regression and correlation analysis that there was a positive relationship between compliance audit, field audit and in-depth audit in relation to excise duty collection. The research found out that tax audit is a very effective mechanism of curbing those who are evading tax and especially in goods that are excisable with the frequent cases of a lot of counterfeit. Without a proper audit the country will continue to lose a lot of excise duty collection revenue and in-depth audit is the most effective way to curb this.

## **5.4 Policy Recommendations**

### **5.4.1 Recommendation on compliance audit on excise duty collection**

From the research findings recommends a review audit policy which should govern the process of compliance audit stating the objective to achieved the structure governing the audit process and how frequent the audit process should be performed. The tax officials should be knowledgeable competent to carry out tax audit, in addition to this, they should understand the people they are dealing with and approach them in a manner that facilitate trust and mutual agreement A proper system which included proper management of excisable goods

management system should be properly monitored to improve compliance audit. The tax audit officer should be supervised by those who are professional. They should be monitored by other independent offices such as investigation department to minimize chances of corruption

#### **5.4.2 Recommendation on field audit on excise duty collection**

From the findings, it is highly recommended that the excise audit should be adopted and be done on a frequently basis to enable the government to monitor what the taxpayer's operation on the ground. The office currently dealing with the excisable goods do not have enough staff and therefore more staff should be recruited and proper training should be done to equip the department so as to carry out extensive field audit which will eventually improve revenue collection. The tax officials should be motivated to carry out tax audit. In addition, the government and the national treasury should put in proper system to monitor staff who might take advantage of the situation. The tax auditor should not be involved in corrupt practices that render the aim of the tax audit useless

#### **5.4.3 Recommendation on in-depth audit on excise duty collection**

From the research findings the study recommends the policy guiding in-depth audit. The policy should also stipulate how frequent it should be done. There is also need for the government and the national treasury to put in place proper systems to capture accurate data for purposes of monitoring and proper in-depth audit. Specialization should be adopted when it comes to in-depth audit. The cases should be grouped according to risk involved after carrying out a proper risk profiling. This will allow the tax audit staff to become a subject matter expert in specific field in which the audit is being carried out. The use of computer should also be adopted to minimize chances of corruption from manual as this will improve excise duty collection.

## **5.5 Suggestions for further study**

### **5.5.1 Compliance Audit**

The area of tax audit in research has not been given the seriousness it deserves from the review of the past studies. From the existing literature in Kenya very few researchers have done research in tax audit. From the literature available none has addressed the effect of tax audit on excise duty yet it is a grey area where scholars need to address the issue of tax evasion using counterfeit products. The study therefore recommends a study on the effect of tax compliance on excise duty using different methodology such as primary methods of data collection.

### **5.5.2 Field Audit**

From the available literature in Kenya very few researches have been done on tax audit. None has been focused on field audit only especially on excise duty collection. The study therefore recommends a study on the effect of field audit on revenue collection in Kenya.

### **5.5.3 In-depth Audit**

From the literature available none has addressed the effect of tax audit on excise duty yet it is a grey area where scholars need to address the issue of tax evasion using counterfeit products. The study therefore recommends the following studies to be done on in-depth audit. The study on the impact of excisable goods management system on excise duty collection.

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## **APPENDIX I: INTRODUCTION LETTER**

MichealOgutu

P.O Box 50976

Nairobi, Kenya

24<sup>th</sup> February, 2019.

Dear Respondent,

RE: **DATA COLLECTION**

I am a student at KESSRA currently undertaking a research study to fulfill the requirements of the Award of Post Graduate Diploma in Tax Administration on the **effects of tax audit on Excise duty collection in Kenya**: You have been selected to participate in this study and I

would highly appreciate if you assisted me by responding to all questions in the attached questionnaire as completely, correctly and honestly as possible. Your response will be treated with utmost confidentiality and will be used only for research purposes of this study only.

Kindly note that the study will be conducted as academic research and the information you provide will be treated as confidential. Your participation in the exercise is voluntary and so you are free to choose to or not to participate. But it would be helpful if you could participate fully. Kindly spare a few minutes from your busy schedule to complete the attached questionnaire.

Thank you in advance for your co-operation.

Yours Faithfully,

**MichealOgutu**

**APPENDIX 11: BUDGET**

DESCRIPTION	COST PER ITEM	TOTAL AMOUNT (Kshs)
<b>Stationery</b>		<b>20,000.00</b>
Photocopying papers	10 reams @600/=	
Pens, pencils, rubbers		
Ink cartridge (Printer)		
Files (12 rim binders)		
<b>Personnel</b>		<b>20,000.00</b>
Questionnaires administrators		
Stastician		

<b>Transport and subsistence</b>		<b>10,000.00</b>
Vehicles		
Subsistence allowance		
<b>Communication</b>		<b>20,000.00</b>
Telephone		
Internet		
<b>Other Services</b>		<b>20,000.00</b>
Library services		
Purchase of periodicals and books		
<b><u>Total expected cost</u></b>		<b><u>90,000.00</u></b>

**APPENDIX111: WORK PLAN (TIME SCHEDULE)**

<b>ACTIVITY (2018)</b>	<b>DECEMBER(2018)</b>	<b>FEBRUARY(2019)</b>	<b>APRIL (2019)</b>
Draft proposal			
Proposal presentation			
Designing the research instrument			
Proposal defense			
Field work & data Collection			
Data Entry / Analysis			
Report Writing			
Presentation of 1 <sup>st</sup> draft			

Presentation of 2 <sup>nd</sup> draft			
Submission of final report			