

## **CONTRIBUTION OF TAX AUDIT AND INVESTIGATION TO THE SUSTAINABLE DEVELOPMENT OF THE NIGERIAN ECONOMY**

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### **ABSTRACT**

The aim of this paper is to examine the Contribution of tax audit and investigation to the sustainable development of Nigerian economy. However, the study being a theoretical work used secondary sources of data collection method with the published and unpublished works of scholars in the field of social sciences in respect to tax Audit and Investigation. More so, the revealed that with an effective and efficient tax audit and investigation the cases of tax avoidance and tax evasion can be reduced, and also improve the Internally Generated Revenue (IGR) of the Nigerian government for sustainable growth and development. To achieve the objectives of tax audit and investigation, it was recommended that the practicing accountants should uphold the fundamental principles of professional ethics while rendering consultancy services since they often act for tax payers in their dealing with the relevant tax authority.

**Keywords:** Tax, Audit, Tax Audit, Investigation, Economy and Development

### **1. INTRODUCTION**

Prior to the introduction of self-assessment, there was no specific provision for tax audit and investigation under the company income tax Act. This was later introduced to assist in verifying the tax returns filed by tax payers through adequate tax audit process.

However, in terms of economic analysis, government taxation represents a withdrawal from the nation economy while its expenditure acts as an injection into it. So the government net position in term of taxation and expenditure, together with its public sector borrowing policies has an effect on the level of economic activity of within the Nigerian private and public sectors. This follows that in order to attain the desired level of economic growth and development by the Nigeria government, there is need to shift emphasis from crude oil revenue to improved sources of generating

revenue through taxes. The development of any nation depends on the amount of revenue generated and applied by the government on public infrastructure for the benefits of members of that society. No economy can grow without adequate resources for infrastructural development and provision of power and public utilities and services. Taxes, and tax systems, are fundamental components of any attempts to build nations, and this is particularly the case in developing or transitional nations. To this end compliance with the outcomes of tax audit will not only contribute to the Internally Generated Revenue (IGR) of the Federal Republic of Nigeria, but will also assist the government to provide the needed basic amenities to tax payers in return.

Therefore, the predetermined objective of tax audit is to minimize tax evasion on the one hand and also, to maximize the revenue base of the government as a result of compliance with the provision of the tax laws by the tax payer on the other.

## **2. LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK**

### **Concept of Tax Audit and Investigation**

Kircher (2008) in Agumas (2016) defined tax audit as an examination of an individual or organization's tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. He further reported that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return. In line with this notion, a tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. Ola (2001) stated that the process of tax audit involves tax returns that are selected for audit using some selection criteria. Subsequently, the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed. Tax audit is important because of its support to the government in collecting suitable tax revenue essential for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government (Agumas,2016).

Therefore, tax audit is a means of ensuring compliance with the tax laws whose primary objective is to maintain the confidence in the integrity of the self-assessment system. It helps to improve voluntary compliance by detecting and bringing to book those who do not pay the correct amount of tax. (Adediran,Alade & Oshode, 2013).Tax audit is a primary activity of the tax authorities under the Self-Assessment

System (SAS) in enhancing and encouraging voluntary compliance with the tax laws and regulations. It also ensures that a higher tax compliance rate is achieved under the SAS. A taxpayer can be selected for audit at any time to ascertain that the amount of tax reported and paid are in accordance with tax laws and regulations.

According to Association of National Accountants of Nigeria (2015), tax investigation is similar to any other form of investigation. It is not carried out on routine basis as that of an audit. It would be carried out when a tax payer is suspected to have committed fraud, and, cases of tax evasion could lead to tax investigation. Therefore, tax investigation is a more severe enforcement measure taken by the tax authorities to ensure compliance with the tax legislations by taxpayers. Tax Investigation is an In-depth investigation processed by a tax authority in order to recover tax undercharged in previous years of assessment (Wikipediawww.en.wikipedia.org).

Generally, tax investigation will be carried out should there be a suspicion - based on precise and definite evidence – that a taxpayer is deliberately trying to avoid paying tax or has committed an act of willful evasion under the tax laws. Often than not, both tax audit and tax investigation will result in additional taxes and penalties payable on under statement or omission of income.

### **Essential Audit Objectives in Tax Audit**

The application of the seven audit objectives (i.e. completeness, accuracy, existence, cut-off, valuation, right and obligation: and: presentation and disclosures) to the audit of taxation results in the specific objectives listed below. The auditor in the course of auditing taxpayer's record should obtain sufficient evidence to be satisfied that: Contentious matters are identified and their treatment is considered by a tax specialist (all objectives); The tax figures are generated from reliable accounting records (accuracy); The amount reported in the financial statements are in agreement with the accounting records (accuracy); The charge and provision for Current Corporation tax have been properly computed and accounted for (all objectives); Withholding tax and tax credits have been accounted for correctly (all objectives); The total potential deferred tax has been correctly computed and provided in the financial statements to the extent that is probable a liability will crystallize (all objectives); Tax charges and provisions are properly classified described and disclosed in the financial statements (<https://www.amazon.co.uk>)

## **The Need for an Ethical and Professional Approach In Tax Audit**

Under self-assessment, all taxpayers (whether individuals or companies) are responsible for disclosing their tax income and gains and the deductions and reliefs they are claiming against them. The practicing accountants often act for taxpayers in their dealing with the relevant tax authorities and situations can arise where accountants have concerns as to whether the taxpayers are being honest in providing information to the accountants for onward transmission.

How the accountants deal with such situations is a matter of professional judgment, but in deciding what to do, the accountants will be expected to uphold the fundamental principles of professional ethics while rendering consultancy services to the tax payers. They must act honestly and objectively with due care and diligence, and showing the highest standards of integrity since they often act for tax payers in their dealing with the relevant tax authorities.

## **Field Audit and Investigation**

The work of field auditor entails site visits to business premises and examination of accounting records of tax payers in order to ascertain whether correct returns of profits have been made. The field work activities are intended to encourage voluntary compliance with taxation requirements under the law. By giving these enforcement activities a more visible presence, it is hoped that tax payers will be reminded of the need to keep sufficient business records and lodge correct tax returns. Similarly, Investigation officers are responsible for conducting in-depth investigation when tax evasion is suspected, and taking action (including prosecution proceeding in appropriate cases) to create a deterrent to tax evasion. It is therefore, the responsibility of the field audit and investigation unit to conduct field audits and investigation on businesses and individuals with a view to combating tax evasion and avoidance (Annual Report, Inland Revenue Department (<http://www.ird.gov.hr/>)).

## **Skill Required By Field Audits and Tax Investigation Officers**

Field audits and tax investigation required not only the application of acting skills and taxation knowledge to different business environment, but also the extensive use of interviewing, negotiating and investigation techniques. Other Skills Required by Tax Audit and Investigation Officers for effective and efficient Service delivery are: Ability to gather information from multiple sources, understand and interpret complex tax law contract and documents and make adequate recommendations; ability to apply audit and investigation techniques to determine the appropriate tax liability and excellent written and verbal communication skills.(Karen, 2013).

## **Desk Audit**

This is an audit in which the whole activity of the audit takes place within the confines of the office of the tax officials. Under this the tax official may simply request the taxpayers to provide some additional documents to his office to enable him clear some issues in the returns submitted. In desk audit, no official note is given to the tax payer of the impending desk audit exercise. He only gets to know when letters are written to him requesting for certain documents or explanations. However, the essence of desk audit is to ensure some level of compliance with tax laws, rules and regulation as well as performing the administrative checks on returns submitted (Adediran, Alade & Oshode, 2013).

## **Documents Required For Tax Audits**

When the tax returns of business organizations are audited, the relevant tax authority will ask to see the specific records and documents that show how they came up with the amount reported on tax returns. Many deductible expenses will not be allowed unless there has been adequate recordkeeping and you can prove your eligibility for credits and deductions as contained in the tax laws. For certain business deductions the IRS requires records to be contemporaneous with the transactions and will often disallow expenses that are based on incomplete and re-created records. In addition, there must be suitable evidence to prove that the expenses were “ordinary and necessary but not lavish” in your business field. Proof of payment is not enough – each expense must have a valid business purpose that you can prove.

There are specific requirements for substantiating deductions for travel, meals and entertainment. As a business owner or employee, you are required to maintain an account book, diary, log, trip sheet or similar records, as well as documentary evidence, such as receipts and cancelled checks, to substantiate the amount, time, place, persons met with and the business purpose of your expenditures. Specific types of records may be needed for an audit of your business, including those that verify assets, gross receipts, purchases and expenses. All records should be timely and indicate what was received, from whom and for what business reason. Credit card or electronic banking statements alone may not be accepted if you are audited. The IRS requires receipts for the expenses you claim, as this is often the only way to prove what specific item or service was purchased for business purposes. (Karen, 2013)

## **Requirements for an Effective Tax Audits**

For the tax inspector to carry out a good audit exercise, the following conditions must be fulfilled

1. The tax auditor must be familiar with the environment in which he works. It is a condition which is highly critical that the tax inspector must be properly schooled in the political, economic, social, cultural and religious environment of the tax payer. A good knowledge of his environment will affect the decision made of him.
2. The tax officials should be motivated to carry out tax audit, he should be properly trained and have experience in his area. The tax inspector should not be carried away by corrupt practices that render the aim of the tax audit useless.
3. The tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.
4. Specialization should be encouraged. The cases should be grouped. This will allow the tax audit staff to become specialist in specific field.
5. The manner in which the audit is been carried out should be changed. The use of computer should replace the manual process as this will go a long way in facilitating the job and helping to preserve information for a long time. This will improve the efficiency of the exercise. (Ogundele, 1999).

### **Concepts of Sustainable Development**

Sustainable development has been defined in many ways, but the most frequently quoted definition is from Our Common Future, also known as the Brundtland Report:

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts: the concept of needs, in particular the essential needs of the world's poor, to which overriding priority should be given; and the idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs."

All definitions of sustainable development require that we see the world as a system—a system that connects space; and a system that connects time. When you think of the world as a system over space, you grow to understand that air pollution from North America affects air quality in Asia, and that pesticides sprayed in Argentina could harm fish stocks off the coast of Australia. And when you think of the world as a system over time, you start to realize that the decisions our grandparents made about how to farm the land continue to affect agricultural practice today; and the economic policies we endorse today will have an impact on urban poverty when our children are adults. We also understand that quality of life is a

system, too. It's good to be physically healthy, but what if you are poor and don't have access to education? It's good to have a secure income, but what if the air in your part of the world is unclean? And it's good to have freedom of religious expression, but what if you can't feed your family?

The concept of sustainable development is rooted in this sort of systems thinking. It helps us understand ourselves and our world. The problems we face are complex and serious—and we can't address them in the same way we created them. But we can address them. (International Institute for Sustainable Development <http://www.iisd.org/sd/#one>)

### **Managing Tax Gap for Sustainable Development**

Tax gap is the estimate of the difference produced by relevant tax authority between the income taxes actually paid and what should have been paid by all tax payers. It simply represents tax money that is never paid. Tax audit and investigation are one way that the tax authority seeks to reduce the tax gap in order to maximize the revenue generation of the government for sustainable growth and development of the Nigeria economy.

### **The Relevance of Tax Audit in Back Duty Assessment**

Tax audit is highly relevant in achieving the objective of back duty exercise carried out by the relevant tax authority to recover unpaid taxes through additional assessment as contained in the tax laws. Additional assessment will usually arise from a back duty assessment after the records of the taxpayers have been thoroughly audited (i.e. tax audit). The relevant tax authority, either under the provision of the Companies

Income Tax Act of 1990 or the Personal Tax Income Decree of 1993, may from time to time and as long as it wishes, carry out a back duty audit on a tax payer. The Law in fact allows the relevant tax authority to go back as far as six years before the year of examination.

During the course of a back duty audit, the records of the tax payer are audited to examine the truth in the information that was earlier provided in the annual returns or computations. It is confirmed that incomes has not been materially understated and the expenses have not been understated. It also seeks to determine whether the expenses included in the tax computations are allowable for tax purpose. During the course of the audit, the value of the qualifying capital expenditure will be confirmed. This is to check that the source of the capital allowance computation is reliable. The rate applied in capital allowance and tax computations are correct.

The tax computation is reviewed based on the findings from the audit exercise. This is subsequently compared to the tax computation earlier submitted and on which remittance was previously based. The shortfall on yearly is determined and this forms the basis of an additional assessment. An additional assessment arising from such an exercise is subject to the objection and appeal procedures. (Ojo, 2009)

### **Reasons for Instituting Back Duty Assessment**

Back duty audit may be instituted on the happening of one or more of the following events:

- (a) Errors or omissions in the assessment or collection of taxes due to deliberate intention of the taxpayer.
- (b) False or doubtful claim of allowances in respect of current or previous years.
- (c) Failure to disclose or include in full any income or earnings in the returns made available to the tax office.
- (d) Decrease in revenue or profit in the returns made available to the tax office.
- (e) Tax has not been charged and assessed or has been charged or assessed at less than that which ought to have been charged or assessed. (Ojo, 2009)

### **Non-Filers and Methods of Tracing Them**

A Non-Filer is a person who has earning income which is chargeable to income tax but do not fill return and try to escape what is normally called the “tax net”. In developing countries especially those with predominantly cash-based economic like Nigeria, A very large number of people earning income which is chargeable to tax do not file their returns. If ever they are caught instead of becoming a tax payer, they try to buy themselves out of the situation. Most of the time they believe that once they are in the tax net, whether their income increases or not, their tax is going to increase. Very often, they end up paying much more than they would have paid had, they embraced the tax net.

Non-filers just like the filers fall into two categories; these are who have a fixed place of business or profession and those who have no such fixed place e.g. brokers, insurance agents, itinerant vendors etc. Persons deriving income only from property, dividends, income from securities, income from bank deposits, income from money lending etc. also do not have any fixed place of business.

The only way to trace non-filers is an institutionalized arrangement for survey. In some of the tax administrations, there is an independent survey organization exclusively for survey, while in others the task is performed by the local tax office. (This is the case in the Nigerian system of tax administration). Whatever the setup, there must be arrangement for field surveys.

- Survey of The Commercial Areas: Every commercial market should be surveyed to identify the persons doing business there, whether they are earning taxable income or not. The survey should not only note the existence but also the extent of business. Further, in addition to survey of person doing business there, the survey should also cover the owners of the shops and offices and the rent received from them.

Commercial markets usually have market associations which have the names and business addresses of their members. This source of information is also very useful. In most of the markets, there are a number of people who exercise their professions there without having a fixed place business, such as agents, brokers, and transporters etc. The market committees either registered them or at least have their names and addresses.

- Survey of The Residential Areas: Likewise, the physical survey of the residential areas is also essential. The survey should aim at obtaining the names of the owners and tenants of the houses, and rents paid by the tenants. Very often, offices are also established in residential areas. The survey should cover them as well. (CATA-Commonwealth Association of the Tax Administrators, 2005)

### **Risk Based Tax Audit – Prospect and Benefits**

In most cases, the tax authorities at both federal and state level under-utilize the audit process in ensuring sanity within the tax system. They still adopt an audit approach which the rest of the world had left behind ages ago. The approach, being the “Full audit”, is “risk-based audit” approach. The full-audit approach is an audit approach that allows the auditor to carry out substantive audit procedure on all items in the financial records of the tax payer without specifically focusing on any area which has the potential of causing material misstatement. In other words, the auditors are expected to do a close to 100% examination of the records of the tax payer. This as we all know is neither feasible nor specific to any area of audit risk. The risk-based audit approach on the other hand is more specific. It aims at identifying the risk factors, assessing these factors and conducting audit procedures on the risk variables to form an audit opinion. Auditing standard favors this approach. The tax authorities

need to re-examine their audit process and adopt the risk-base audit approach to achieve better result. The era of full tax audit of taxpayers which is wide and far in-between is over.

To guarantee efficient tax system, the tax authorities need to focus on key areas of audit risk by profiling their tax payers to establish areas in their operation which could result in material misstatement. This approach could be projected to industries/sectarian classification of the tax payers to enable better risk profiling. A typical example is carrying out a risk profile by Oil and gas sector, banking and financial institutions, SMEs, etc. To enable them carry out this risk profiling, efficient and effective collection of tax data must be devised.

Risk based audit thrives where there is adequate tax data available for analysis. This could be achieved in the first instance by embracing electronic filing of tax returns into a central data base which is then analyzed by the tax authorities. The current practice of manual tax return makes risk profiling more tedious as the manual tax data needs to be inputted into a form that could be analyzed using robust data analysis software. Other information such as non-filing of tax return, late filing of tax return, delayed payment of assessed tax liability, results of previous audits, etc. are information that could aid risk profiling of a tax payer. Then again, where this information is not readily available in a coordinated fashion; any attempt at risk based audit would be at futility.

Conclusively, the tax system could be better managed to be more efficient and effective if risk-based tax audit collaborate with information technology. Tax revenue would soar, tax evasion is minimized and overall tax compliance improved. (Ogunbiyi- <http://www.academia.edu>)

### **Prior Studies on Tax Audit and Investigation**

Numerous studies have attempted to explain the contribution of tax audit and investigation to check mate tax evasion, avoidance as well as ensuring tax compliance in improving government revenue worldwide.

Collins and Plumlee (1991) studied the effect of tax audit schemes on the taxpayer's labor and reporting decision. The study also examined the impact of alternative tax rates and penalty levels on earned and underreported income. Experimental design was adopted, and laboratory labor setting was used to test the effects of audit schemes, tax rates, and penalty levels on underreported income and work effort. The experimental results of the study indicated that audit schemes that incorporate some preliminary information signal sent by the taxpayer might be more successful in

curbing underreporting than purely random audit models. Nonrandom schemes are most effective when tax rates are low and penalty levels are rather high. Further, reported income and actual income do vary at the same time in that electing to underreport also earn more actual income.

In USA, Smith and Stalans (1994) also studied the negotiating strategies preferred by taxpayers and auditors for dealing with tax audit disputes. The study adopted a pre-audit open-ended interview conducted with a randomly selected sample of taxpayers and state tax auditors that drawn from four field offices of the Oregon Department of Revenue (DOR). The results of this study revealed that the strategic preferences of both taxpayers and auditors is influenced by the nature of the dispute, general taxpayer's attitudes toward taxpaying and tax administration, the difference in formal power, and the perceived role obligations of auditors. As the study results showed, tax auditors are more likely to include holding firm as one of their strategic choices.

Whereas taxpayers who has an objective to minimize the time and effort they devote to the audit are more likely to prefer the cooperative strategies, but those taxpayers who believe that they can influence the decision making of the auditor are more likely to prefer the assertive strategies. The study further indicated that taxpayers who support taking advantage of loopholes and ambiguities in the tax law tend to prefer the assertive strategies, and those who want to minimize their involvement are more likely to prefer cooperative strategies.

Mittone (2006) examines that early experience of audits in taxpayers' "tax life" is a more effective way to increase compliance than later audits. Also Kastlunger, Kirchler, Mittone, and Pitters (2009) study of experimental research also suggests that, although the effectiveness of audits and fines cannot be completely confirmed, early audits in taxpayers' "tax life" have a positive impact on compliance. Badara, (2012), Questionnaire based research by using descriptive statistics, result shows that the relevant tax authority (RTA) employed tax audit towards achieving target revenue, that tax audit reduce the problems of tax evasion, that tax payers do not usually cooperated with tax audit personnel during the exercise. Niu (2010)

Historical population data of a New York State economic sector was used .The results of both

Ordinary Least Squares (OLS) and Time Series Cross Section (TSCS) autoregressive modeling methods suggest that after an audit, a firm would report a higher sales growth rate.

### **3. CONCLUSION AND RECOMMENDATIONS**

This study being a content analysis revealed that there is the need to add value to the Nigeria tax practices by changing the mind-set of some tax payers who prefer to deliberately or ignorantly misapply the tax law to gain undue advantages. The study also discovers that since an average Nigerian tax payer often may not voluntarily comply with the tax laws in filing returns, tax audit and investigation can assist in providing solutions to this problem. Also revealed in this paper is that tax audit and investigation can help the tax payers to get use to the applicable tax laws thereby making the Nigeria tax system to be more efficient. Above all a routine tax audit exercise will not only assist in minimizing revenue leakages but will also strengthen the overall tax system in Nigeria.

One of the overall objectives of tax policies in a modern economy is to achieve social justice. This lies at the heart of politics since what some think of as just is regarded by others completely unjust in term of attitudes to re-distributions of wealth. Tax audit and investigation should be regularly carried out by the government to ensure social justice and equitable distribution of income. Tax audit and investigation should be employed as one of the tools used to checkmate the activities of tax evaders. It will also provide an opportunity to increase its revenue generation base used in providing the required basic amenities for the well-being of its citizenry. In totality, it serves as a holistic approach to strengthen the overall tax system if properly adopted.

The study recommended that: the practicing accountants (i.e. the tax consultants) should act honestly and objectively with due care and diligence and showing the highest standards of integrity when acting for the tax payers in their dealing with the relevant tax authority; Back duty assessments should be thoroughly carried out more often to reduce cases of tax avoidance and tax evasion to a bearable level; the relevant tax authority should device means of tracing non-filers in order to increase the revenue base of the government; the government should encourage and motivate the tax payers through an effective and efficient utilization of tax revenue in providing the required basic amenities and the government should sensitize the general public on the importance and benefits of taxes as well as the consequences of tax avoidance and tax evasion.

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