NEEDS FOR TAX STAFF QUALIFICATIONS AND THE BENEFITS OF THIS PROCESS

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Abstract

The Tax Administration's activity and performance are important to be considered and studied to understand the factors that promote the performance improvement of this key institution in achieving the strategic objectives of the governance of each country. The objectives of the Tax Administration are the realization and administration of tax revenues for national taxes, public payments and collection of social security contributions. A majority activity of the Tax Administration has to do with the review of the data obtained from the financial statements and tax returns of the entities, and the use of this information to identify the highest risk subjects to carry out tax evasion.Initially, the study focuses on discovering the degree of recognition and use of financial ratios by tax inspectors in identifying high-risk tax evaders. Further, using statistical analysis, the paper identifies which are the most important financial ratios that can help tax inspectors in their daily work. From the analysis of the paper we find that a significant part of the tax evasion is revealed by the controls proposed by the tax inspectors and that the level of recognition and use of financial ratios on their part is neitherappropriate nor adequate. The study is of practical value because it is the first of its kind and is intended to provide valuable recommendations to related parties such as the extension of using financial analysis and ratios in determining tax risk of various subjects.

In this context, this paper focuses on identifying the impact that financial analysis may have on improving the performance of the tax administration.

Keywords:*Tax Administration, financial analysis, tax risk.*

JEL classification: M41

1. Introduction

The relationship between tax authorities and taxpayers is a relation which, like all relationships described in the theory of principal and agent (Jensen and Meckling, 1976), is characterized by conflict of interest, information asymmetry, and moral hazard problem. According to this theory, because taxpayers are responsible to pay taxes to tax authorities, the latter can almost be considered shareholders of the entities, either small or large. “The state, by virtue of the rights it enjoys over the cash flows of entities, is de facto the largest minority shareholder in almost all corporations” (Desai et al., 2007: 592).

The need to prepare financial statements for tax purposes arises from the obligations that the entity has to pay taxes to the tax authorities and the latter's need for information in order to determine, with a reasonable level of accuracy, the entities’ correct taxable annual income. In small entities that rely on little or no external financing, it is likely that the tax authorities will be the primary agents to whom the owner and / or administrator of the entity is responsible.

And indeed, for most small private enterprises, the primary function of financial reporting can actually be entirely fiscal. In such cases, the reliability and the accuracy of the financial information represents a major issue for tax authorities. However, it should be borne in mind that tax authorities do not have as a primary purpose of their activity and existence to improve the quality of financial reporting of the controlled entities per se. Indeed, the positive and improving effect on the quality of financial reporting is only a by-product of the tax authorities' interest in accurate reporting of taxable income (Hanlon et al., 2014: 138). However, the tax authorities' monitoring role and the factors related to the reliability of

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financial reporting from the tax authorities' perspective provide an opportunity to explore the behavior that entities demonstrate regarding financial and fiscal reporting.

On the other hand, in this reciprocal principal / agent relationship, it is also interesting to examine the behavior of tax authorities in relation to their approach to selecting entities that will be subject to tax audits. Tax audit procedures include the investigation, review and the audit of an entity's accounting records and other sources of information in order to determine whether tax liabilities calculation and tax payment on behalf of the audited company has been accurate and based on complete and accurate information.

Tax liabilities calculation is based on information provided and declared by taxpayers and other sources; therefore, if during the tax audit there are discrepancies between the reported information and the verified situation, the amount of tax liability should be adjusted, and so a probable tax evasion or avoidance the entity has made could be discovered. Tax avoidances are generally recognized as tax liabilities that are not accounted for or paid on a timely basis, due to reporting of false amounts. Because the entities in themselves either have strong incentives to evade taxes or simply are not able to accurately calculate the amount of tax payable, the Tax Administration regularly and systematically carries out tax audits on economic entities.

Tax audits are often costly and therefore tax authorities should carefully choose which entities will be subject to a tax audit. It is important to target those entities that actually have the highest risk of having significant tax evasion. Therefore, defining effective and efficient methods and models for selecting entities that will undergo a tax audit is an important and priority task for tax authorities and as such has recently attracted the interest of the academics and empirical research in general.

From the perspective of the situation in Albania, the reform of tax audit procedures is one of the aspects of the administrative reorganization of the Tax Authorities which has taken place systematically in the recent years. These administrative reforms have focused on tackling topics such as the responsibility and the accountability of the public administration in general, including the Tax Administration, and the purpose of achieving a reconciliation between expenditure responsibility and administration responsibility. To improve the performance and public accountability of the Tax Administration it is necessary to broaden the scope of research and engage in the analysis of both current work practices and recommendations for new practices and methods in the future.

A particular focus of the paper will be on the procedures followed by the Tax Authorities for the selection of entities that will be subject to tax audit. Currently, the selection protocol mainly relates to identifying the profile of those entities which are most likely to declare inaccurate data and to be involved in tax evasion. This is achieved by calculating the level of tax risk for each entity, based on the entity profile, industry, sector and other pre-determinedvariables. The selection protocol is initiated by the Intelligence System of the Tax Authorities, based on all the factors mentioned above and beyond that, and to a certain extent, also the tax inspectors have a role in selecting certain entities for control. They may select companies for control based on risk indicators and procedures as well as priorities decided internally in the Institution. It is in this context that this paper tries to make a contribution towards the most important risk indicators that tax inspectors may use during their work in order to better identify the riskiest entities. The tax inspector is a regular observer of the entity, so he reviews monthly VAT (Value Added Tax) statements, social security payments, income tax declaration and payments, etc., and he is also able to read and verify the Financial Statements. If the inspector, based on his experience and his familiarity with the company, notices certain deviances or suspectible activity on behalf of the monitored company, he may propose to perform an in depth operational control of that entity. But to perform this in a professional and objective manner, and to avoid the mistake of performing costly tax audits on companies which are not really risky or tax evading, a high degree of professional qualification is required on behalf of the tax inspector. If an entity is wrongly selected to be subject to a tax audit, that would be a waste of valuable audit resources, hours of work spent without productivity, increased dissatisfaction on the part of the audited entity and, what is the biggest risk, the probability that another entity which is really risky and tax evading, will not be subjected to tax audits, because "the system just did not selected it" to be audited.

2. Methodology of the Study

To analyze the current situation and the use of financial analysis by the Tax Authorities as well as to test its impact on improving the performance of the tax inspectors we have designed the methodology of this study around a main research question which is supported by three hypothesis. The general context and viewpoint of the following research question and hypothesis is that logically having a qualified tax staff increases disclosures and reporting quality on behalf of the reporting entities and consequently increases tax revenues. Increasing tax revenues directly has an impact on the state budget, state expenditures and probably future economic growth.

In general, there exists the belief that a qualified and trained Tax Administration staff is expected to reduce the tax evasion, as the audited subjects will be more exposed to qualitative and careful examinations from tax inspectors. Also, ethical and integrity of the tax auditors is highly evaluated. The qualities that a tax inspector must possess are; honesty, ethical conduct, fairness in law enforcement as well as professional competence and skills in the execution of duties. Tax inspectors should avoid any conflicts of interest when performing their tasks of tax auditing. They shall not offer advice, exhort influence nor have any other type of connections with the taxpayer and are required to declare in advance those cases where they are directly or indirectly related to the audited subject.

On the other hand employees of the Tax Administration, specifically the employees of the Operational Control and Back Office Control have the obligation to respect the rights of the taxpayers and subjects that they control. Every taxpaying company has the right to be subjected to reasonable controls; the right to confidentiality of his tax and financial records; the right to information; the right to be heard and the right to complain for the preliminary tax audit results. For failure to conduct their functional duties on a timely and reasonable manner, for unfair and / or biased treatment of taxpayers, as well as for other unlawful actions, employees of tax audit authority, are responsible according to law no. 9920 dt. 19.05.2008 "On Tax Procedures in the Republic of Albania" and Law no. 152/2013 "On the Civil Servant".

Back to our main research question and the hypothesis more specifically will focus on the adequacy of use and importance financial analysis ratios as risk indicators by the tax Administration to accurately select the tax audit subjects.

Research question: Are financial analysis ratios important for using by the Tax Administration? That is, do financial analysis ratios discriminate between risky and non-risky tax audit subjects?

Hypothesis 1: The training and education level of tax inspectors have an impact on their performance within the Tax Administration.

***Hypothesis 2*:**The comprehensive professional trainings of tax inspectors help them to correctly distinguish and select the tax audit risky subjects.

***Hypothesis 3*:**Use of financial analysis ratios by tax inspectors improves their performance by helping them to correctly focus on the more risky subjects.

The testing of the hypothesis and therefore having an answer for the main research question will be achieved through the analysis of the data collected from questionnaires. Questionnaires with closed and partially open questions were prepared and distributed to the tax inspectors in the Regional Directorates of Tax Authority in Albania via email. Contacts of these tax inspectors were provided by the author from internal resources. In total 460 questionnaires were sent to the targeted group of tax inspectors in the period from October to December of 2018 and 115 were received back, resulting in a 25 percent response rate, which is an acceptable response rate for questionnaires performed via electronic means.

The questionnaire is divided into 3 sections which are organized in such a way as to relate to each of the three hypotheses. The first section of thequestionnairewhich tests the first hypothesis(The training and education level of tax inspectors have an impact on their performance within the Tax Administration (focuses on gathering data related tosample characteristics (such as gender, age, education level, professional qualifications in Finance and/or Accounting, position in the Tax Authority Directorate, and job experience).

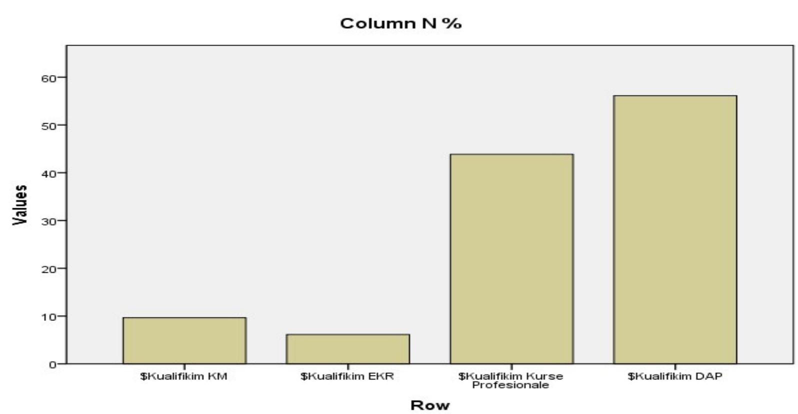
The data from the questionnaire showed that 45% of all respondents were female and 56% were male. Of the female inspectors, approximately 79% were *back office control* tax inspectors (that is, they monitor subjects via system from their offices, based on declarations and reports submitted by the companies themselves) and the rest were *operational control* tax inspectors (that is, they perform the tax audit on site and premises of the audited companies).

3. Analysis and main findings

In this section of the paper we will present the main findings and analysis derived from the data gathered through questionnaires conducted with Tax Inspectors in Albania.

One of the hypothesis of the study was that the level of qualifications and trainings of the tax inspectors had an impact on their performance. In the following chart no 1 we present the summarized findings on the analyzed respondents.

Chart No 1. The level of trainings and qualification of Tax Inspectors

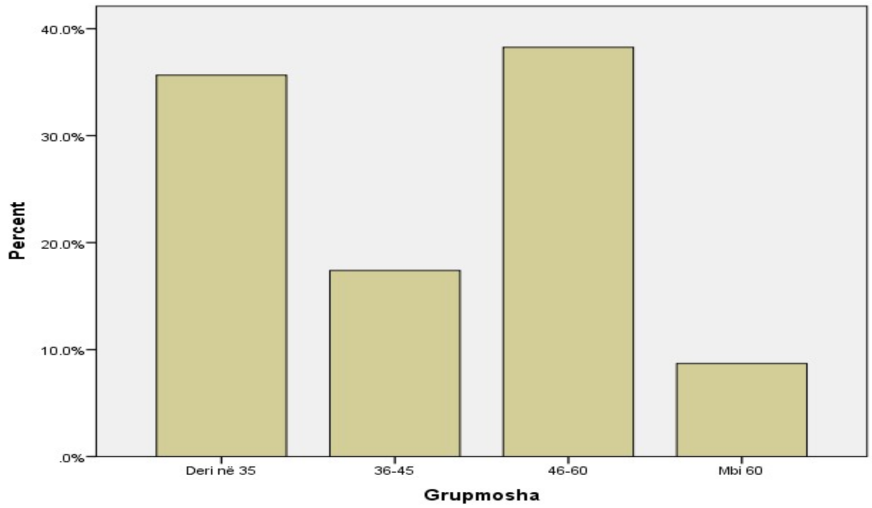


Source: Analysis of primary data gathered through questionnaires

Hat we see from chart 1 is that the majority of the inspectors do possess professional qualifications as well as qualifications and trainings undertaken by the Tax Authority where they are employed and the Department of Public Administration. Only a small fraction of the respondents possess the Auditor or Certified Accountant Certification (7 of the respondents are Auditors and 11 are Certified Accountants.

The next section of the questionnaire was focused on age of the respondents and the results are depicted in chart no 2.

Chart No 2. Age of Tax Inspectors

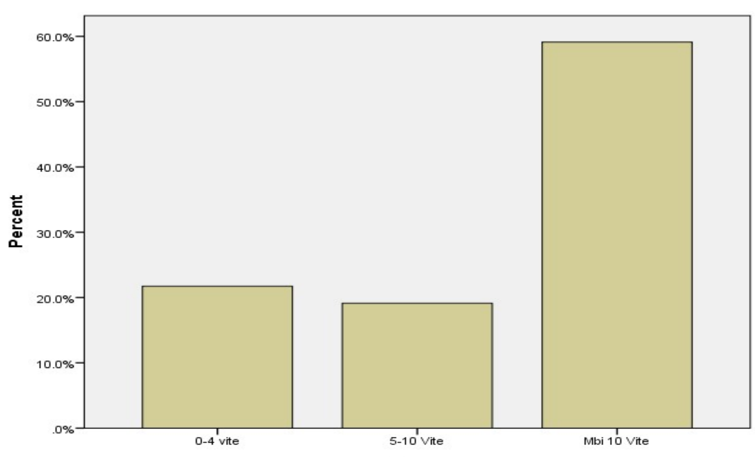


Source: Analysis of primary data gathered through questionnaires

As seen from chart 2, 36% of the respondents are younger than 35 years old, 18% of them are between 36 and 45 years old, 38% of them are between 46 and 60 years old and only 8% are older than 60 years. If we look at it in a deeper sub-categorization of data which relates the percentage of inspectors by position with the percentage by gender we see that approximately 71% of theback office control inspectors are female and the rest (29%) are male, whereas the operational control tax inspectors are categorized 19% female and 81% male. This is an interesting finding that may represent the common view point in Albania that operational control positions are widely considered to be “men job positions”.

Further analyzing of the data showed that about 22% of inspectors had up to 4 years of experience, 19% of them had 5-10 years of experience and the majority (59%) had over 10 years of experience (Chart 3). This indicates that in the recent years, the Taxation Authority has employed a lot of young staff (about 40% of the staff is recruited during the last 10 year) and therefore they have little experience in this area and lack qualification and trainings.

Chart No 3. Job Experience of Tax Inspectors



Source: Analysis of primary data gathered through questionnaires

Section 2 of the questionnaire focuses on revealing the professional aspects of the tax inspector's work. Section 2 is designed around the second hypothesis of this study, namely that: *The comprehensive professional trainings of tax inspectors help them to correctly distinguish and select the tax audit risky subjects*. In this section the interviewed tax auditors/tax inspectors are presented with a list of 11 statements and for each of them the inspectors should respond according a Likert scale from 1 to 5 (from totally contrary to the statement to fully agree with the statement). The purpose of this section is to ask for the tax inspectors' opinion as which were the main sources of information they usually rely upon and which informative signals they commonly take in consideration during their everyday job.

From the inspectors' responses, the factors that serve as a risk signal are widely found in the declared Financial Statements, so it is very important to read them carefully, analyze them and keep them incontinuous focus.In addition, the inspector considers that other factors, not included in the Financial Statements, but relevant to the Company's going concern are also relevant. One should not overlook an immediate decrease in the profit rate, an immediate decrease in the turnover of inventory, a continuous increase in the credit balance of VAT. The immediate suspension of the activity of the company constitutes a risk factor, and must be verified by physical on site controls.

The third section of the questionnaire developed with tax inspectors focuses on identifying those financial analysis ratios that are perceived as important by tax inspectors for use in their work. This section links to the third hypothesis: Use of financial analysis ratios by tax inspectors improves their performance by helping them to correctly focus on the more risky subjects. 16 financial ratios are listed in this section of the questionnaire and the tax inspectors were asked to declare if they had, or if they did not have prior knowledge about each specific ratio. The results (shown in table no 4) reveal that most of the tax auditors/inspectors do possessa somewhat thorough knowledge about these ratios and they are of the opinion that these ratioswould be useful if usedin their daily work. This suggests that according the tax auditors' opinion these financial ratios should be probably included in the protocols and the procedures they are asked to follow in their job description.

Table No 4. Knowledge of the financial ratios by Tax Inspectors

Financial Analysis Ratio	Possess knowledge of the ratio	Do not possess knowledge of the ratio
Current Ratio	97.4	2.6
Quick Ratio	85.2	14.8
Debt Ratio	92.2	7.8
Times interest earned Ratio	86.1	13.9
Return on Equity ROE	84.3	15.7
Return on Assets ROA	71.3	28.7
Net Marginal Profit Ratio	85.2	14.8
Profit Margin	98.3	1.7
Total Sales to Administrative Expenses Ratio	91.3	8.7
Fixed Assets to Total Assets Ratio(Investment ratio)	93.9	6.1
Total Inventory to Total Assets Ratio(Inventory ratio)	94.8	5.2
Operating profit (EBIT)	93.9	6.1
Change between reported profit and taxable profit to Total Sales Ratio	93.9	6.1
Salaries Expenses / Total Sales Ratio	78.3	21.7
Percentage of change of sales to percentage of change of accounts receivable Ratio	87	13
(Inventory + Accounts Receivable) / Total Assets Ratio	86.1	13.9

Source: Analysis of primary data gathered through questionnaires

The answers to the questionnaire show that most tax inspectors are knowledgeable about financial analysis ratios and consider them to be important in determining tax risk. In reality, what we observe in practice the use of financial ratios is almost negligible. In the tax audit documentation papers, these ratios are rarely analyzed in the Manual. Even in the proposals of back office tax inspectors, in case of risky subjects, the analysis performed to justify the selection of the companies to be audited we find to be very poor and not really using the financial ratios as risk indicators. In the majority of case the inspector is based in the low rates of payment of liabilities or the low rates of profitability and the fact that the company has been unchecked for years, when he proposes a certain company to be tax audited. In this situation we consider to be a gap that can be filled with using financial ratios as risk indicators, such as the liquidity ratios and financial leverage ratios, especially given the fact that tax inspectors are knowledgeable about these ratios. Only in this way can the tax inspector reach a fair and unbiased conclusion as to whether which are the companies that should be tax audited.

This avoids frequent controls and audits on entities that do not pose considerable risk, saving time and administrative costs, reducing the companies' dissatisfaction and frustration with unreasonable controls and, also recognizing and their accountability and transparency. Also the operational control tax inspector, during his in-depth audit of financial statements and reports declared from an entity, should use the financial analysis ratios to form a better opinion about the financial position of the company so that findings form tax audit may be increased.

4. Conclusions and recommendations

The main objective of this paper was to explain how the financial analysis ratios influence and guide the tax inspectors/auditors in identifying the tax evasion risk, which in turn, directly affects the performance of the individual tax auditors but also of the Tax Administration in Albania as a whole. This purpose was achieved by studying the opinion, knowledge and insights of the tax inspectors in Tax Authority about the financial analysis ratios, through a questionnaire.

Based on data collected from these questionnaires and their analysis, we found that the majority of the inspectors have sufficient knowledge of financial ratios, and according to them, these ratios are important to use in their daily work in identifying and detection of tax audit risk.

But based on the author's personal observations, the reality is quite different. In practice, these financial ratios are not used almost at all. The back office tax inspector is in constant contact with the entity, he verifies and controls the statements, reviews and accepts the financial reports which are periodically submitted to him. We think that it is the back office tax inspector who should be using the financial analysis ratios when verifying the Financial Statements and, where he finds that these ratio levels are inadequate, he should propose the company for in-depth audit.In a later phase, the operational control tax inspector who performs the in-depth tax audit function, should also use these financial ratios, not as risk indicators any more, but more like performance measures and through them he should try to form an opinion about the financial position and profitability and performance of the company.If the Financial Statements will be subject to a prudential analysis by the back office tax inspectors, who will identify the risky subjects, then these entities should be the focus of a more detailed audit. This avoids frequent controls on entities that do not pose a risk, saving time and administrative costs, reducing subjects 'dissatisfaction with unreasonable controls.

From the analysis of the answers to the questionnaire, we found that only a small fraction of the tax inspectors hold a professional certification or title; more specifically out of 115 tax inspectors in total who participated in the study, the title of Certified Accountant is hold by only 11 participants in the study, whereas Auditors we find to be only 7 of them. This is a negative indicator regarding the level of qualifications and trainings of the Tax Administration staff.

Almost all inspectors have participated in various trainings conducted mainly by Department of Public Administration. This fact indicates the importance of continuing training and qualifications for tax inspectors. Regarding the age of inspectors, 36% of employees are less than 35 years old, while the rest are older, a fact that is also related to the job position, which requires qualified and experienced staff. Further processing of the data showed that about 22% of inspectors had less than 4 years of job experience, 19% of them had 5-10 years of experience and 59% had more than 10 years of experience. This fact indicates that 41% of the Tax Administration staff has been hired during the past 10 years.

We may make a remark here regarding the initial job positions and tasks undertaken by tax inspectors. Usually a tax inspector will find it easier to work as a back office tax inspector rather than an operational control tax inspector, because she / he initially only possesses basic knowledge about the tax legislation and is familiar with only limited business issues, (each business sector has its own issues and topics of importance and focus, resulting either in differences in tax liabilities reported or differences in control and audit procedures that should be exerted practically). Also, based on the author's personal experience, it is very difficult for an inspector to start working as part of the Tax Administration if she / he does not have the necessary experience. The more qualified the Tax Administration employees are, the more professionally they will behave at identifying tax risk and preventing tax evasion.

Other data from the questionnaires showed that a better professional training background guidesthe inspectors more accurately towardsidentifying the risky subjects. The inspectors responded to 11 statements listed in the questionnaire based on a 5-Scale Likert classification. From the analysis of these results, 70% of tax inspectors think that the Financial Statements are useful in identification of the tax risk and that they should be subject to a rigorous verification by the back office tax inspector. The Inspector should base his opinion in the Financial Statements, to identify those entities that are risky. He should be careful in selecting them, as only 30% of the cases to be audited will be proposed by the regional directorates and not by the Risk Management directorate. Also, 63% of inspectors stated that they agree or completely agree that the tax inspectors have no freedom in selecting the subjects to be audited. In fact, only 30% of the companies that will be audited are selected by the regional directorates, more precisely by audit inspectors from the tax audit directorate offices.

Other risk factors that are also considered important by the inspectorinclude increased inventory, increased VAT credit reserve, abrupt reduction in turnover or immediate disruption of activities, frequent staff turnover, and reduced rates of payment of tax liabilities. If these factors cited above are thoroughly examined and carefully analyzed, the inspector will be more accurate in determining a company's tax risk. The inspector should be professional and reasonable about the risk factors, as the entity may in fact be presented with a lower VAT payment rate, but on the other hand it may result it has invested in the economy or may have imported as well as exported. In these cases, lowering the VAT payment rate is more than normal, this entity presents no tax risk and does not have to be selected for in-depth control.

In the third and final part of the questionnaire we listed 16 financial ratios, which resulted that most of them have complete knowledge about these reports and are of the opinion that they should be used in their daily work in identifying tax risk. But in reality this is not the case. The relevant manuals of the Tax Authority, only briefly mention some ratios, such as the rate of profitability, the rate of payment of VAT on realized turnover, the rate of inventory turnover. We think that usingonly these ratios, it is not enough toform an opinion about the financial situation of the company and to judge fairly about the tax risk that the entity has undertaken.

Recommendations

At the end of this research and in support of the results we obtained from the various tests we did, we have some modest recommendations, which we think that if taken into consideration by the Tax Administration, would be of assistance to the quality of its work and to achieving the objectives of this important institution.

First, we recommend that financial analysis through indicators and financial ratios be used as widely as possible during the daily work of the tax inspectors.

Second, as a general recommendation, we suggest that achieving more effective and efficient tax audits also requires aqualified and with integrity staffadministration. Two key elements are recommended in this regard: (1) occasional staff training, especially in the area of financial reporting and analysis. Although training efforts have been made by both the Tax Administration and locally and overseas funded projects, the reality remains that few tax inspectors are up to date with in-depth knowledge; (2) providing comfortable working conditions for inspectors and not unnecessarily political rotation and, above all, strengthening the role and improving the image of the tax inspector as an important factor in the fight against informality.

When completing the questionnaires, as well as during the frequent contacts with tax inspectors, a specific concern was raised by them (although not part of this study but directly affecting the performance of the inspectors), that there are frequent (and sometimes unnecessary) changes in tax legislation. Fiscal packages' requirements change each year(sometimes even several times during a year); for example the format of the sales and purchase books and the VAT return has changed four times since 2014. The minimum contribution pay has changed almost every year, the rent tax as well as many other changes, mainly tax rates of various taxes, such as the dividend with new changes to the fiscalpackage, which is effective in 2019. These frequent changes adversely affect both the performance of the Tax Administration and the quality of the Financial Statements, creating confusion among companies and tax inspectors and introducing possible gaps for tax evasion or abuse. As a final remark, we stress again that the selection and hiring of tax inspectors should be based on merit, not on political influence.

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