

Investigation of Iranian Tax Audit Deficiencies and Challenges: Case Study from Iranian Audit Firms and Institutions Perspective

Arefeh Mohaghegh

Department of Accounting, Semnan branch, Islamic Azad University, Semnan, Iran

E-mail: mohaghegh.arefeh@yahoo.com

Abstract

Tax gathering as one of the government tasks is highly affected by financial reporting such that tax affairs organization in charge of tax collection considers financial reports based on rules and regulations in order to tax recognition in the form of survey groups and claims tax from economic units. In this research, we practiced administrative problems related to article 272 direct tax regulations (DTR) from auditing institutes perspective to offer proper strategies for providing a reasonable executing basis of these two fields. On the other hand after analyzing statistic results, we conclude that clarifying tax rules, observing accounting standards, compiling audit & tax standards, and fully performing the article 272 of direct tax regulations play an important role in the tax audit improvement and can reduce challenges and problems facing tax audit.

Keywords: auditing, tax audit (article 272 direct taxes regulations), auditing institutes

Introduction

The goal of financial reports within economic entities is to provide common data needs of users including investors, facility providers, goods and services suppliers, customers, government and governmental institutes. Thus, the objective of financial statements is to offer data which may be practical for extensive range of users in decision making. In spite of growing role of government within Iranian economics during last decades, our tax system not only failed to play a considerable role to determine government financial supplies but also lost its authority as time passed because this system couldn't apply efficiently the tax potentials due to inabilities and deficiencies. In this regard following state economic, social, and cultural development plans in order to modify state tax system by parliament approval and government suggestion there have been major reforms in direct taxes system and amongst them is providing legal base to use official accountants and audit organization services in the form of article 272.

Assigning a part of this task in the form of article 277 D.T.R to official accountants society provided a basis to use accountants professional forces an potentials and official accountants started their activities as a colleague for tax affairs organization to recognize tax from 1381, this article proper performing and reinforcing provided bases for cooperation however requires executive problems and the article weak and strong points based on scientific researches and documentations. In this research we practiced executive problems of the article D.T.R from audit entities perspective providing proper strategies make a suitable basis to perform these two fields more desirable. Although the article has been performed for a long time, seems that there is no proper basis to apply legal capacities optimally. In this research, we try to provide an appropriate basis to apply efficiently their services in reporting and express executive problems of official accountants provided services application.

Research background and literature

Tax

Economists believe that tax is the most common and appropriate way of state incomes and moreover is considered as the most significant instrument to assign monetary policy. It's also used

as the most important market to transfer income from one group of society (mostly high earned) to another (mostly low earned). Hence, the tax is believed as most efficient instrument of the state (government).

Regarding states objectives about tax imposition, financial and economic experts have suggested followings:

- a. Society income and wealth distribution
- b. Expenses and costs control and conduct within economy
- c. Supply part of democratic state costs
- d. Imports and exports value control

Various definitions have been offered to tax along with different nation's development and evolution from among which some are as follow:

- a. Tax includes distribution of listed costs within budget among people based on their payment abilities
- b. Tax includes a kind of payment and financial approval which is performed gratuitously by people due to legal requirement regarding state expenses provision
- c. Tax is a contribution that based on national balance and according to regulations everybody is required to pay a part of his/her income or assets to state treasure in order to provide public costs and preserve economic, political and social interests of the state based on his/her ability

Tax features

English economist, Adam Smith following the classic school has characterized tax via four features which are confirmed by most of financial experts around the world and are well known as Smith's quadruplet regulations. They are:

A. Justice

Taxes need to be determined in justice and fitted to tax payers' potency, in other words all payers in same condition should be treated similarly that is policy makers ought to consider ones in same positions regarding their income level equally. Therefore, justice will be realized about tax when all members of a society participate to pay and people in same conditions and considering their income rate treated equally without any difference as well as charged properly when distributing.

B. precision and necessity

Tax should be specified and certain as well as its amount and time of payment and never leave these items to tax collectors decisions. In other words the way of payment, amount and amount of indemnity shall be clear and tax payer learns his/her relation with the law.

C. Simplicity

The tax should be taken from payers in most appropriate time and based on most relevant time and bother them less.

D. Thriftiness

The tax collection should take the least cost and has the most income for the state. In other words, expenses paid for tax collection must be a little share of original tax.

Types of tax (Iranian tax system)

Types of tax based on direct tax system in Iran are as following:

A. Direct taxes:

In general, two kinds of direct tax are collected from people's income assets:

1. Tax on assets that includes tax on heritage and stamp fee.

2. Tax on assets that includes tax on properties, agricultural income, salary, machinery income, legal persons and casual income.

B. Indirect tax

This type of tax is posed on consumer in goods price and added services.

1. Auditing implication

Promotion in application fields and number of users of economic units' financial information has increased accounting objectives to remove limited needs of capital owner to response to data requirements of certain groups that financial statements and explanatory notes accompanying them in this case is the most prevalent data transfer instruments out of economic units.

Users of financial statements can rely on financial data reflected within them when an independent person has provided his/her professional idea about credibility of this data. Independent auditors are responsible to provide their comments about financial statements within today's socio-economic systems. The preliminary meaning of auditor in English has been "hearer" and related to a period when state accounts have been approving after being recited in a public session. The auditing has been performed to determine honesty of reporting and function of people from medieval to the industrial revolution. The industry owners started to hire managers during industrial revolution and synchronous with promotion of production departments. By having this separation between managers and owners, the absent owners started to hire auditors to prevent managers and personnel defraud. Defraud detection was the main objective of auditing in years prior to 1900. This objective became pale within first half of 20th century and moved to a new objective that is to determine whether financial statements provides a proper picture of a financial statement, operations outputs and changes of a statement. One of the effective controlling and validating instruments serving organizations and managements is auditing. Following definitions are provided to specify the audit concept:

First definition: consideration or pursuing a bunch of financial statements, accounting documents and other supporting evidences including internal and external of Owner Company via independent auditors.

Second definition: audit includes independent consideration of financial reports for any kind of business & non-business department either benefit or non-benefit and regardless of legal size or form provided that commenting on said statements is the goal of such consideration.

Types of audit

Audit often is classified in three categories:

1. Financial statement audit
2. Operational audit
3. Observation audit

Financial statement audit

This type of audit includes balance sheet, loss and profit statement, precise loss and profit statement, cash flow statement and its goal is to determine compatibility of the way of providing financial statements through accounting principles and standards that leads eventually to professional statement and reports regarding their favorability.

Operational audit:

This kind of audit includes investigating a certain part of an organization to assess their performance while evaluating the level of effectiveness of that part, in other words its success to achieve goals and responsibilities assigned. The performance of the part can be assessed through efficiency criterion that is the level of success to use available resources in the best way. Due to opacity of efficiency and effectiveness criterion operational audit requires more judgments comparing to two others. Its final product is a report to management containing suggestions to improve operations.

Observation audit:

Implementation of this kind of audit depends on availability of demonstrable information and criterion or well-known standards which are established by legal authorities. A known one in this type is tax audit which is the subject of this research.

1. Concept of tax (article 272 of code of direct taxes)

Taxable income recognition is performed based on article 272 of direct tax code by official auditors, audit organization or member institutes of official auditors' society and through considering accounting books, documents and deeds and financial statements. The accountant should explicitly comment on rule observation and trading regulations and other codes related to the exact department. He/ she should also do so on statements provision, notes accompanying them, and the way of statement presentation and result of operation within statements. Relying on article 272, audit organization, official accountants and member institutes of accounting society, who are responsible for legal auditing and investigation or individuals auditing, upon the request of individuals are supposed to set auditing reports provided according to sample of state tax organization and deliver to tax payer to submit to tax affairs department.

History of auditing in Iran:

It's a short time that auditing appeared as a profession, expertise and a discipline and covers hardly 100 years. It was trading code approved in 1311 that pointed to audit in Iran. According to this code general assembly of each joint stock company may select one or more warden from among its shareholders or outsiders to deliver a report to general assembly of shareholders on general conditions during coming year of company and management provided statements considering accounts, documents and deeds. Although general assembly of these seemingly joint stock established after this code have essentially been selecting warden or wardens who investigated also company accounts, there was no such like auditing one expects commonly. Direct tax code have recently seen major modifications through aforementioned direction approval after many years of fluctuations and the ground to use services of audit organization, official accountants and member institutes of audit society was provided.

Executive problems of financial audit:

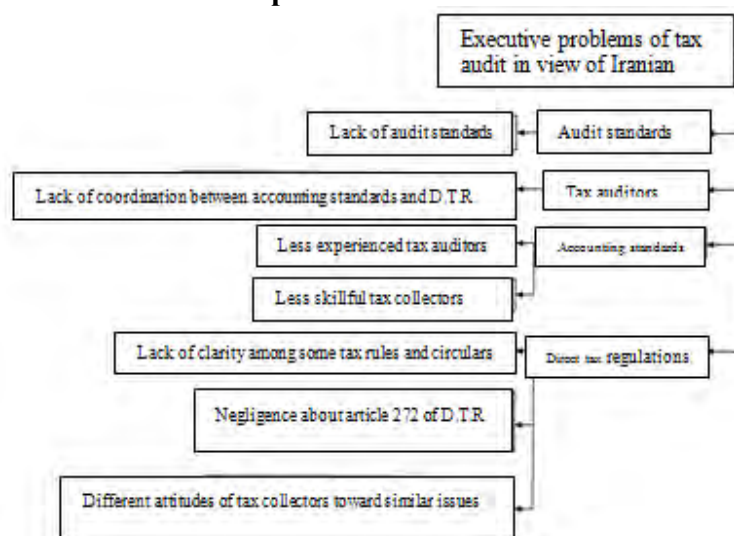
1. Negligence about article 272 of direct tax code by state tax organization
2. Lack of auditing standard
3. Opacity of some of rules within tax circulars
4. Lack of coordination between accounting principles & standards and direct tax regulations and / or related bylaws
5. Unknowledgeable tax expertise versus less experienced official accountants
6. Different attitudes of tax auditors with different topics and similar opacities

Research hypotheses

1. Negligence about article 272 of direct tax code by state tax organization is one of executive problems faced by financial auditors.
2. Lack of auditing standard is one of executive problems for financial auditors.
3. Lack of coordination between accounting standards and direct tax regulations is one of executive problems faced by financial auditors.
4. Opacity of some of rules within tax circulars is one of executive problems faced by financial auditors.
5. Unknowledgeable tax expertise versus less experienced official accountants is one of executive problems faced by financial auditors.

6. Less experience and unknowledgeable tax collectors with similar topics and opacity is one of the executive problems for financial auditing in view of audit institutes.
 7. Tax collectors' different attitudes toward similar topics and opacity are one of the executive problems for financial auditing in view of audit institutes.
- Implicit model for research hypothesis

Conceptual model of research



Research variables

Financial audit standard, coordination between accounting standards and direct tax regulations, clarity of tax regulations and circulars, tax auditor's essential experience and knowledge, provisions of article 272 of direct tax regulations, different attitudes of tax auditors with similar topics are independent variables and executive problems is dependent one.

Research method and population:

After the questionnaire being designed, auditing institutes comments on executive problems of financial audit were collected and used to obtain required information to test hypotheses. Publications, related magazines, tax organization circulars and theses were also used when needed. Sampling method was random.

Does the coordination between accounting standards and direct tax regulations affect auditing institute's performance?

Are opaque issues around tax in companies treated similarly in view of tax auditors?

This research is of explanatory type. Within this type of research, researchers are required to observation technique to collect data. The observation method consists of questionnaire and applies statistic method is explanatory and perceptive. Population of this study is auditing institutes.

Remarks:

1. Population of this study is from a homogeneous context or interrelated coherent population.
2. All population (N) lists should be available.
3. All population should enjoy similar opportunities to be selected in n persons.
4. Sampling is performed via random method.

Sample volume

Since large sampling results in facility dissipation and on the other hand small sampling is not sufficiently accurate, thus, providing 200 auditing institute with questionnaire regarding time limitation of the study isn't seemed justifiable. Therefore, the number of institutes should be decreased at anyway.

Based on following equation, we determined sampling number equal to 66. Since we wanted to generalize findings with 95% to whole population, therefore, error for first kind) α (of test was determined 5% which decrease second kind) β (to the least.

$$n = \frac{N * U^2 * p * q}{N * E^2 + \frac{U^2}{2} * p * q}$$

Where: n indicates sample number, N population number, occurrence expectancy of first kind error, P ratio of success demonstrating hypotheses, q ratio of failure demonstrating hypotheses.

Questionnaire justifiability and reliability

Validity and confidence of measurement are evaluated by justifiability and reliability, respectively. Justifiability and reliability features are considered essential for research effectiveness and usefulness as well as for data collection methods. Justifiability actually points to logic relation between test questions and materials to be tested. Questionnaire reliability was tested using Cronbach's Alpha.

$$\alpha = K / (K - 1) (1 - \sum_{i=1}^k s^2 I / s^2)$$

Where: k indicates questionnaire items, s^2_i questions variance, and s^2 total questions variance.

While the value of Cronbach's Alpha approaches 1 the questionnaire reliability increases. Obtained value for Cronbach's Alpha was 0.87 for the questionnaire of this study indicating its reliability.

Reliability

Table1: Case processing summary

	N	%
Cass Valid	66	100.0
Excluded	0	0
Total	66	100.0

a.Listwise deletion based on all variables in the procedure

Table 2. Reliability Statistics

Cronbach's Alpha	N of items
0.872	30

Applied statistic methods:

Single sample mean comparison test

t- Student test may be used when the goal is to compare the mean of a sample or variable with a fixed value. The normality assumption is necessary (although the number of sample is higher than 30, the distribution would be normal based on central limit proposition). Null and opposite hypotheses will be as following:

$$\begin{cases} H_0: \mu = \mu_0 \\ H_1: \mu \neq \mu_0 \end{cases}$$

In which test statistic are described as:

$$t = \frac{\bar{x} - \mu_0}{S/\sqrt{n}}$$

Within above test statistic \bar{x} and s indicate sample mean and standard deviation, respectively. μ Indicates value of tested object and n number of sample. It's established that the test statistic will be normal distributed when the sample volume is higher ($n > 30$). H_0 may be described (for confidence level 95%)

The null hypothesis may be rejected when t is placed in rejection section of H_0 .

Rank mean comparison with Friedman test

Effective factors can be compared using Friedman test. The answers can be compared through this method regarding their ranks when they are independent of each other. Null and opposite hypotheses are written as follow:

H_0 : variables are distributed similarly.

H_1 : at least one couple of variables has different distributions.

Variables

	X_1	X_2	...	X_k
1	X^{11}	X^{12}	...	X^{1k}
2	X^{21}	X^{22}	...	X^{2k}
.
.
.
n	X_n^1	X_n^2	...	X_n^k

$$R_j = \sum_{i=1}^b R(X_{ij})$$

Test statistic is as follow:

$$T = \frac{(K-1)[bB - b^2k(k+1)^2/4]}{A - bk(k+1)^2/4}$$

$$A = \sum_{i=1}^b \sum_{j=1}^k [R(X_{ij})]^2 \quad B = \frac{1}{b} \sum_{j=1}^k R_j^2$$

The freedom degree of statistic distribution is K^2 and $K-1$. Rejection and non-rejection region of null hypothesis is as follow. When the value of statistic is in the rejection region, the null hypothesis is rejected.

Results

Research hypotheses are explained as follow considering results from statistic data:

H1: Negligence about article 272 of direct tax code by state tax organization is one of executive problems faced by financial auditors.

Regarding this negligence and considering results originating from data analysis it was became clear that tax organization neglects about provisions of article 272.

H2. Lack of auditing standard is one of executive problems for financial auditors. Regarding this problem, results of data analysis showed that lack of auditing standard, in view of auditing institutes, is one of executive problems for financial auditing.

H3. Lack of coordination between accounting standards and direct tax regulations is one of executive problems for financial auditors.

Regarding this problem the analysis results indicated that accounting standards and direct tax code provisions aren't in some cases matched each other.

H4. Opacity existing in some of tax rules and circulars is one of executive problems faced by financial auditors. Regarding this opacity, the analysis results showed that the number of recessed circulars by tax organization compared by issued ones and the number of issued circulars compared by direct tax codes provisions is higher. In some cases, legal provisions and issued circulars are containing opacity.

H5. Unknowledgeable versus less experienced financial auditors is one of executive problems for financial auditing.

The analysis results showed that auditing institute believes the experience and knowledge of auditing team on tax regulations and circulars is considered within financial audit. Therefore, the hypothesis that lack of knowledge and experience is one of executive problems for tax auditing was rejected.

H6. Less experienced and unknowledgeable tax collectors is one of the executive problems for financial auditing in Iran.

Regarding this problem, the analysis results showed that less dominant tax collectors on tax regulations and circulars is one of executive problems of tax auditing.

H7. Tax collectors' Different attitudes toward similar topics and opacity are one of the executive problems for financial auditing in view of audit institutes.

Regarding this problem the analysis results showed that tax collectors in some cases treat similar topics and opacity differently.

Research suggestions

1. Full performance of article 272 of direct tax code
2. Although the tax organization, issuing and announcing different circulars, is seeking to preserve monitoring right on tax reporting method via official accountants, clarity of article 272 implies that adjusted tax reports of official accountants is accepted by tax organization. Therefore, whole provisions of said article should be observed by tax affairs organization and prevented any circular attachment anomalous to its provisions.
3. Tax regulations transparency
4. Tax regulation clarifying preserves it against any kind of paraphrase and interpretation and also no need to circular issuance to explain more. Through this the tax regulations are out of any personal influence of executives.
5. Observing accounting standards while legal texts compiling
6. This study specifies that difference between official accountants and tax collectors is related to tax legal texts and accounting standards mismatch. The areas for mismatch can be depreciation costs, long term contracts loss, uncommon wastage, investment value decrease reserve, intangible assets value decrease reserves, balance value decrease reserve, and reserves of skeptical credits and etc. therefor economic activists are required to observe accounting standards when providing financial statements, revision statements and correcting construct of direct tax regulations texts. They should pose their comments on accounting standards to remove existing challenges.
7. Hold training workshops and seminars
8. Training workshops and seminars regularly for auditors are suggested on subjects like the way of statement preparing and learning last tax regulations. In case of tax collectors these seminars

and workshops can be around the way of applying auditors financial reports as well as introduction to auditing and accounting standards to perform article 272 and remove executive problems as possible.

9. Tax audit standard complying
10. This is performed by cooperation between the committee for audit standard compilation and tax affairs organization. This cooperation prohibits any kind of personal inclined auditing that result in discrepancy between official accountants and tax organization.
11. Tax regulations specification and explanation as the first preference of tax audit
12. Although accounting standards and tax regulations match is a necessity, specifying and explaining this issue that within financial audit observation of base rules and regulations is the first criterion and preference of financial reports for official accountants and auditors improves financial reports qualitatively.
13. Iranian auditors society supervision
14. It's proposed that to establish quality control committee within auditor's society to investigate tax audit reports in order to match with ones issued with tax regulations.
15. Based on results following suggestion can be effective:
 - Firms internal construct promotion or establishment in an effective way to be able to prevent common error in financial statements.
 - Suitable executive directions regarding the way of financial statement provision and presentation for liquidating economic entities shall be issued by standard compilation authorities.
 - Efficient authorities shall accurately define indices related to firm's current assets value determination and regarding economic changes revised within specific time intervals.
 - The appropriate type of confirmation shall be selected at the time of application by auditor based on conditions.
 - Providing age tables for receivable accounts in suitable intervals to be applied by board of directors to decide for skeptical credits reserves reflecting.
 - Applying appraisal policies to provide fast payment received as a cash discount granting.
 - Chronologic methods to determine unused capacity costs in economic entities
 - Regular and irregular wastage definition to separate and set a price
 - Hold training courses for financial staff to familiarize with standards and their way of application as well as to require economic entities to apply compiled standards.
 - Legal requirements to remove reports paragraphs to improve the ways of statement providing by authorized officials and consequently to improve ways of audit reports.
 - Consideration of financial issues and audit reports for economic entities by general assembly as well as auditors' solutions and suggestions by trade entities.
 - Rulemaking in order to treat offending managers and rejecting financial statements and balancing of firms containing major deficiencies as well as to pursue assembly tasks to be done completely.

References

- Accounting Standards (2009). Auditing Organization Publication, Tenth Edition, Tehran
- Arbab Soleimani, Abbas; and Nafari, Mahmoud (2009). Principles of Accounting, Auditing Organization Publication No. 87, Sixth Edition, Tehran
- Arbab Soleimani, Abbas and Ali-Madad, Mostafa, An introduction to International
- Arab Mazar, Ali-Akbar (2002). Tax Journal, I, Serial Number 36.
- Auditing Guidelines, Publication No. 60 of Auditing Organization.

- Auditing Standards (2009). Auditing Organization Publication, Tenth Edition, Tehran
- Bostanian, Javad (2005). Status of tax auditing in tax system, Quarterly Journal of Official Accountant.
- Davani, Gholam-Hosseini (2006). Tax accounting, Kiomars publications, Sixth Edition, Tehran
- Direct Taxation Act enacted in 1966
- Direct Taxation Act enacted in 1987
- Direct Taxation Act enacted in 2001
- Hanifeh, Masoud; and Mahmoudi, Shahnaz (2007). Tax Accounting, Kiomars Publications. First Edition, Tehran
- Hashi, Abbas(2009). The need for tax law or elimination of tax audit, world economy newspaper, 11/11.
- Hashi, Abbas (2007). The barriers to implementation of tax audit and strategies to overcome them, world economy newspaper, 25/02.
- Iran-Nejad Parizi, Mehdi (2006) Research methods in social sciences, Modiran Publications, third edition
- Madani, Ali (1999). Fundamental concepts and methods of statistics.
- Shams Ahmadi, Mansour (2006). Tax auditing and auditing standards, Quarterly Journal of Accounting Science and research.
- Movassaghi, Mohammad-Ali (2009). Ambiguous terms in tax code, Quarterly Journal of Official Accountant.
- Masihi, Mohammad (2006). Performance Evaluation of Auditing organization and Association of certified public accountants for improved quality of tax reporting in implementation of Article 272 of Direct Taxation Act, master's thesis on accounting, Islamic Azad University, Central Tehran branch.
- Mahmoudi, Mohammad (2005). Evaluation of difference between the Iranian accounting standards and tax laws and regulations and disclosure practices, Master's Thesis on Accounting, Islamic Azad University, Science and Research Branch.
- Nikkhah Bahrami, Hossein (2006). Comparison of Tax Efficiency before and after implementing the Article 272 of Direct Taxation Act in Office of Tax on Tehran Companies, Master's thesis on public administration, Islamic Azad University, Science and Research Branch.
- Pournazar, Mahmoud (2007). The impact of tax audit conducted under Article 272 of Direct Taxation Act on tax break, Master's Thesis on Accounting, Islamic Azad University, Science and Research Branch.
- Sadeh, Mehdi (1996). Research methods with an emphasis on applied aspects, Moalef publication, first edition, Tehran.
- Sanford Labovits (1967). Some Observations on Measurement and Statistics, Social Forces, 46, 151-160.
- Sanford Labovits (1970).The Assignment of Numbers to Rank Order Categories”, American Sociological Review, 35, 515-524
- Set of Law and regulations of Iranian Society of CPAs (2003). Hesab publications, third edition, Tehran
- Trotabas ,Louis and Mary Kotter, Jean (1997). Tax law, Translation and summarization by Mohammad-Ali Yazdanbakhsh, Khatoon publishing center, first edition, Tehran
- Vahidi, Hossein (1967). History of economic thought from the beginning to socialism, Sanaei Library Publications, Tehran.
- Zandi Haghghi, Manouchehr (1966). Public Finance Economics, Azar publications, third edition, Tehran.