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Tax audit effectiveness in Greek firms: Tax auditors' perceptions

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Changes in tax auditing procedures, tax administration and generally in tax policy have attracted the attention of researchers in recent years. The aim of this study is to examine the relationship between tax audit effectiveness, tax legislation and the use of specialized information system tools. We use the ability of public tax auditors to track tax infringements as a measure of tax audit effectiveness. Over two hundred structured questionnaires were constructed and distributed to tax auditors, who work in Greek public taxation agencies. Factor Analysis and multiple regression analysis were employed in order to examine our hypotheses. The results demonstrate that the use of information system tools can enable tax auditors to track properly tax infringements, thereby contributing to increased tax audit effectiveness. It is also suggested that constant changes in tax legislation inhibit tax auditors from being effective in their work. Our results call for direct policy intervention, including simplification of tax legislation and better training of tax auditors in the use of information systems.

Key words: Tax audit, auditing methods, tax infringements, information systems, tax legislation.

INTRODUCTION

During the last decade, states have been struggling to balance their budgets and eliminate their deficits, while at the same time looking for ways to increase their revenue (Leahy, 2006). Taxes have been acknowledged as a major source of public revenue (Gbadago and Awunyo-Vitor, 2015). For that reason, states have been trying to

implement and establish dynamic tax systems that will not only ensure the public revenues, necessary for the economic state functioning, but will also enhance citizens' trust towards governments in terms of fairness in the distribution of income tax burdens. Building on the above, tax compliance and tax accounting have been radically

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changing in most countries worldwide (Colon and Swagerman, 2015), while tax audit is currently at a crucial stage, as there is a growing demand for audit services (Carmichael et al., 1996; Karagiorgos et al., 2006). Auditing of taxpayers has been defined as “the activities conducted by the tax authorities in order to detect whether there is under reporting of tax basis” (Das-Gupta and Gang, 1996). Specifically, tax audit has been described as the procedure of examining the degree to which the taxpayer has properly prepared the financial statements according to the existing tax legislation (Pantelidis, 2009; Grampert, 2002) and whether he has correctly reported tax liabilities (Pantelidis, 2009; Arenas del Buey Torres, 2004). Finally, tax audit examines the accuracy of the submitted tax documents, so that the auditors can confirm the amount of tax due (Koromilas, 2013).

In Greece, authorities for many years have avoided a radical reform of the country’s tax system (Bronchi, 2001). On the other hand, a series of extensive amendments in tax legislation has taken place in the last twenty years, leading to “a nebulous system of conflicting laws, court and ministerial decisions, which clearly panders to special interests” (Ballas, 1994). Additionally, the complexity in the tax auditing procedures, as well as the perception that taxes are extremely high, has led to the increase of tax evasion in Greece (Baralexis, 2004). Panas (2011) conducted a survey in order to examine the behavior and the characteristics of taxpayers. The results revealed that 25% of respondents would hide part of their income from tax authorities, while 70% of the respondents believed that most people do not comply with tax laws because there is small possibility of being detected. Moreover, Artavanis et al. (2012), demonstrate that the existence of a semiformal economy as well as the lack of political power, willing to implement clear and effective tax legislation and tax procedures, are the reasons for a high tax evasion degree. Finally, a survey by Chatzipanagiotou (2010) suggests that tax authorities should implement simple and direct practices regarding tax auditing. Suggested public policy intervention should focus on four areas which include effective use of human resources, provision of education to public employees, positive change of the public opinion regarding tax payments and use of modern technology.

Regarding the use of modern technology, information systems (IS) can enhance the typical procedure of recording, processing and organizing accounting activities and accounting information and include a set of expanded opportunities to support effective tax audit. The valuable information generated by information systems is essential to the auditors in order to track any possible tax infringements and tax offenders. Moreover, the concept of tax audit also includes all the necessary actions for the collection of information that allow us to properly evaluate an enterprise’s financial statement (Sen and Bala, 2002). Therefore, in order to address the problem of tax evasion

it is essential for Greek authorities to design a flexible and effective tax audit system, with straight forward and efficient procedures, supported by easy-to-use control systems as well as educated and qualified auditors.

In this study, we examine the relationship between tax audit information system effectiveness and tax audit effectiveness. We propose that the use of a highly effective tax audit information system is positively related to increased tax audit effectiveness. In this study we will use a tax auditor’s ability to track tax infringements as a measure for tax audit effectiveness. To our knowledge, little empirical research on the tracking of tax infringements has been conducted within Greek context. Taking into account the fact that taxes contribute significantly to Greece’s revenue growth, the present paper aims to provide insights into the significant factors that are associated with tax infringements tracking.

Finally, complexity of tax legislation is examined as having a direct effect on tax infringements tracking. The complexity of tax legislation is difficult to measure objectively. Frequent amendments in tax legislation lead to increased ambiguity, regarding the decision of tax authorities for tax violation. This results in high uncertainty in a country’s tax system and negatively affects economic activity, since the lack of stability in tax legislation inhibits companies from making accurate revenue forecasts. In this study, we suggest that a high degree of tax law complexity negatively affects tax infringements tracking.

The remainder of this paper is organized in the following manner: the next section presents the relevant literature review and hypotheses are formulated. After that, the research method employed is outlined. Following this, the results of our study are presented. Finally, important theoretical and practical implications in the area of tax auditing are raised, along with limitations and suggestions for future research.

LITERATURE REVIEW

Relationship between information system and tax audit effectiveness

The impact of information technology on public administration has been the subject of extensive academic research. In their analysis of previous studies, Danziger and Andersen (2002) demonstrate that majority of academic research finds significant and positive relationship between IT and public administration effectiveness in terms of improved decision processes, planning and services. Additionally, Moon et al. (2014) claim that the adoption of IT in the public sector enhances organizational performance and productivity in terms of internal management functions. Regarding tax audit effectiveness, Ho and Lau (1999) discuss the changes concerning tax audit in Hong Kong. In June 1991 a new audit system, known as Field Audit was

introduced by Inland Revenue Department of Hong Kong. The staff of Field Audit was authorized to examine the validity of the reported information by companies, comparing their real profits with those reported in tax documents. The results show that the new audit system proved to be very useful in terms of detecting cases of tax evasion and ensuring revenues for the state, by collecting taxes and imposing penalties.

Finally, regarding the effectiveness of the Greek Taxation Information System (TAXIS), a research by Floropoulos et al. (2010) confirms the importance of information systems in effective tax audit. More specifically, the results indicate that tax agency employees believe that using information system has enhanced their job performance.

The above discussion leads to the first hypothesis for this study:

H1: The extent of Information System (IS) effectiveness has a positive effect on Tax Auditing Effectiveness.

Relationship between tax legislation and tax audit effectiveness

Effective tax administration has been widely associated with “good” tax policy (Aaron and Slemrad, 2004). Along those lines, simplicity is considered as an important attribute for a tax system (James et al., 2015). Richardson (2006) and Cox and Eger (2006) suggest that the complexity of tax legislation can be considered as one of the most important factors of non compliance. In that case, it is anticipated that audit effectiveness would be negatively affected by a highly complicated tax legislation, since there will be significant efforts for tax non-compliance.

This is the reason why many countries have been trying to simplify their tax legal system during the last decade. A recent survey, regarding taxation, was conducted by Deloitte (2014) with the participation of tax executives from 814 companies in 29 European countries. Findings about taxation in Europe revealed that the Netherlands and the United Kingdom stood out among the major economies of Europe as having the most favorable taxation legislation, while Italy stood out as having the least favorable, followed by France and Russia. It is also stated that stability and simplicity are the most important factors that make the tax system of a country favorable.

Regarding the main findings of the research on taxation in Greece, the majority of Greek participants (84.6%) responded that stability of the tax system has the greatest positive impact on the country's economic competitiveness. “Simplification of the Tax System” follows in second place (61.5%) and the factors “Predictable and Cooperative Tax Authority” and “Enhanced Tax Incentives” in third place (23.1%). Considering the chances for entrepreneurship in Greece

the vast majority (92.3%) of respondents believes that there is economic instability in the country. The two main causes of tax uncertainty are “Unclear or Deficient Instructions of Tax Authorities” (84.6%) and “Frequent Changes in Legislation” (76.9%).

According to this, we can formulate the second research hypothesis:

H2: The extent of Tax Legislation has a negative effect on Tax Audit Effectiveness.

METHODOLOGY

Sample

The research design is based on a questionnaire. Survey methodology is used as one of the most appropriate methods in the collection of primary data (Said and Khasharmeh, 2014). Structured questionnaire was used because of its ability to collect high quality data within shortest possible time (Gbadago, 2015).

Data collection proceeded in the following manner. First, we performed an initial literature review on tax audit. Then, a series of open-ended interviews were also conducted in order to identify themes that were important for our research. A selection of interviewees, who are considered to be experts in tax audits, was made. For reasons of confidentiality the names of the interviewees will not be publicly available. The interview questions varied according to the background of each interviewee, but they were generally focused on factors affecting tax audit effectiveness, the effectiveness of the Information System (IS) used in tax audit and the tax legislation. Regarding tax audit, factors associated with its effectiveness were focused on the types of tax infringements an auditor should be able to detect, Regarding Information System, factors associated with its effectiveness were examined in terms of the use of Elenxis, the new Information System developed for tax auditors in Greece.

Building on the information obtained from the above sources of evidence, we compiled a questionnaire which consisted of 19 items (Table 1). The questionnaire was structured in regard to the research hypotheses and was arranged in order of topic, so that the respondents could concentrate on each theme and provide focused answers (Tasios and Bekiaris, 2012). Our sample consists of employees, who work in public taxation agencies. More specifically, questionnaires were sent to 205 tax auditors, who perform audits in Greek firms. Our questionnaire was distributed via email. 93 complete questionnaires were returned, representing a response rate of 45.3 per cent. Our data were analyzed with the use of the SPSS software.

Dependent variable

Tax Infringements Tracking (TIT) forms our dependent variable. We include twelve questions in evaluating the tracking of tax infringement in terms of revenues, expenditures and other current taxes based on our review. Each item of Tax Infringements Tracking (TIT) is measured on a 5-point Likert scale ranging from (1) ‘not at all’ to (5) ‘to a large extent’.

Independent variables

Information Systems (IS) and Tax Legislation (TL) are examined as having a direct effect on Tax Infringement Tracking. In order to create an appropriate measure of Information Systems used for tax

Table 1. Measurement items for tax infringements tracking, IS and Tax legislation constructs.

Variables
Information Systems (IS)
IS1: Elenxis is easy to use and simple
IS2: Elenxis helps in audit procedures
IS3: Elenxis provides timeliness and accurate information
IS4: Elenxis is compatible with other tax information system (e.g. Taxis).
Tax Legislation (TL)
TL1: Tax legislation is complicated
TL2: Tax legislation can be interpreted in different ways
TL3: Tax legislation is not easily accessible
Tax Infringements Tracking (TIT)
TIT1: Tax auditor tracks differences between turnover submitted in tax documents and turnover reported on financial statements.
TIT2: Tax auditor tracks differences in the expenses submitted in tax documents.
TIT3: Tax auditor tracks differences in stock quantity.
TIT4: Tax auditor tracks differences in the inventory valuation methods.
TIT5: Tax auditor tracks differences in expenses which are not deducted from the total turnover.
TIT6: Tax auditor tracks fake invoices.
TIT7: Tax auditor tracks differences in customers and suppliers records.
TIT8: Tax auditor tracks differences in bad debt provision.
TIT9: Tax auditor tracks differences between the net profits submitted in tax documents and net profits reported on financial statements.
TIT10: Tax auditor tracks differences in VAT values.
TIT11: Tax auditor tracks differences in the transfer of amounts from book records to tax reporting system.
TIT12: Tax auditor tracks differences in other current taxes.

Source: Generated by the researcher, 2014.

auditing, we include four questions concerning the evaluation of Elenxis, the main tax auditing information system tool in Greece. Each item of Information Systems (IS) is measured on a 5-point Likert scale ranging from (1) "strongly disagree" to (5) "strongly agree".

Regarding Tax Legislation (TL), we set three questions: complexity, continuous updates on tax legislation and accessibility. Each item of Tax Legislation (TL) is measured on a 5-point Likert scale ranging from (1) "strongly disagree" to (5) "strongly agree". Table 1 presents the measurement items for the three variables.

Control variables

To avoid the bias caused by other variables that are omitted from our model, the effect of "Information Systems" and "Tax Legislation" on "Tax Infringements Tracking" is controlled by education (EDU), experience (EXP) and training of tax auditors (TR).

The level of education can play significant role in the tracing of tax infringements by auditors. The variable takes the value of '1' if the auditor does not hold a bachelor degree, '2' if auditor holds a bachelor degree, '3' if auditor holds a postgraduate degree and '4' if auditor holds a PhD.

Experience is vital for auditors in order to identify dysfunctions and misstatements. This variable takes the value of '1' if auditor has 1 to 5 years of experience '2' if auditor has 6 to 15 years of experience and '3' if auditor has 16 years of experience or above. Finally, constant changes in Greek tax legislation and rapid development in information system (IS) calls for continuous Training in auditing issues. This variable takes the value of '1' if auditor has

attended 0 to 3 seminars, '2' if auditor has attended 4 to 7 seminars and '3' if auditor has attended 8 seminars or more.

Model

Multiple regression analysis was performed to estimate the magnitude of the effect of the "Information Systems" and "Tax Legislation" on "Tax Infringements Tracking". Ordinary least squares (OLS) regression model was:

$$TIT = b_0 + b_1IS + b_2TL + b_3EDU + b_4EXP + b_5TR + e_i$$

where:

TI = tax infringements tracking;
 IS = information systems;
 TL = tax legislation;
 EDU = education;
 EXP = experience and
 TR = training.

RESULTS AND DISCUSSION

Demographic characteristics

Demographic characteristics of the regarding the gender, years of work experience in tax audit and the department of work experience are presented in Table 2.

Table 2. Respondents' profile

		F	(%)
Gender	Male	43	46.2
	Female	50	53.8
Years of work experience in tax audit	1 - 3	58	62.4
	4–8	13	14.0
	> 9	22	23.7
Department of work experience	Regional Tax Office	75	80.6
	Financial Crime Office	7	7.5
	General Auditing Office	7	7.5
	Other public Services	4	4.3

Source: Field Survey, 2015.

The 53.8% of our sample consists of female tax auditors. Concerning the work experience in the specific field of tax audit, the highest percentage of the sample (62.4%) has 1 to 3 years work experience in tax audit, while 14 per cent of respondents have 4 to 8 years experience in tax auditing. Another important fact derived from the demographic questions is that the vast majority of the auditors questioned (80.6%) belongs to regional taxation offices (D.O.Y.) and 15 per cent of the remaining participants are equally distributed between Financial Crime Office (7.5%) and General Auditing Office (7.5%). Overall, views of respondents were sought across the two genders and respondents' profiles indicate that survey tax auditors could provide useful information on tax infringements.

Descriptive statistics

Table 3 shows the descriptive statistics for the independent and dependent variables. Concerning the auditors' opinions about the information system's use it can be generally considered that these tools are not proved to be helpful in conducting tax audit. More specifically there are problems associated with the simplicity and the appropriate use of Elenxis and also difficulties in the exchange of information through these information systems. Tax auditors' responses regarding the tax legislation are worth to be mentioned. More specifically, from the responses it is argued the complexity of tax laws and the fact that tax laws are not clear and distinct. Generally all the means in this set of statements are very high, demonstrating tax legislation's complexity. Finally, regarding tax infringements, it is argued that the most common differences are associated with the expenses that are not deducted from the total turnover. On the contrary, it is very unlikely to be detected an error in bad debt provision.

Factor analysis

In order to examine construct validity of our instrument,

factor analysis was applied using principal component analysis for "Tax Infringements Tracking", "Information Systems" and "Tax Legislation" as multi-item constructs. Then, we had to evaluate whether this study is sufficient for this analysis. In this respect, Table 4 shows that values of Kaiser-Meyer-Olkin (KMO) measure are higher than 0.5 and results of Bartlett's test of sphericity are significant for both of two constructs (Kim and Mueller, 1978; Cavana et al., 2001; Hinton et al., 2004). To achieve higher uni-dimensionality and construct validity, items with factor loadings less than 0.60 (TIT5, TIT7, TIT12) are excluded from our final analysis, due to our sample size (Hair et al., 2009). After the elimination of these items, results confirmed that each of three variables can be treated as single measures, ended up with just one component.

Then, reliability analysis was conducted in order to test the internal consistency of each construct variable using Cronbach's alpha (Pallant, 2011). In this respect, Table 5 shows that Cronbach's alpha for "Tax Infringement Tracking" is 0.858, for "Information Systems" is 0.859 and for "Tax Legislation" is 0.865. Cronbach's alpha of 0.70 or more is considered significant and highly reliable, thus the results depict a great internal consistency for the three variables (Nunnally, 1978).

Regression analysis

Since multiple regressions are used, our variables have to satisfy the following assumptions: linearity, constant variance and normality (Hair et al., 2009). Therefore, Levene's test and Shapiro-Wilk test were undertaken respectively. A Pearson correlation matrix is provided for dependent, independent and control variables in Table 6. It is obvious that the correlation between our independent variables does not exceed the limit of 0.90 (Hair et al., 2009). From the Table, it is observed that there is a significant and positive correlation ($r=0.325$) between "Tax Infringements Tracking" and "Information Systems" at $p<0.05$ and also a significant and negative correlation ($r=-0.352$) between "Tax Infringements Tracking" and

Table 3. Descriptive statistics.

Variables	Mean	Std Dev.
Information Systems (IS)		
IS1: Elenxis is easy to use and simple	2.57	0.840
IS2: Elenxis helps in audit procedures	2.88	0.832
IS3: Elenxis provides timeliness and accurate information	2.87	0.863
IS4: Elenxis is compatible with other tax information system (e.g. Taxis).	3.03	0.914
Tax Legislation (TL)		
TL1: Tax legislationis complicated	4.36	0.855
TL2:Tax legislation can be interpreted in different ways	4.11	0.870
TL3: Tax legislation is not easily accessible	4.18	0.846
Tax Infringements Tracking (TIT)		
TIT1: Tax auditor tracks differences between the total turnovers submitted in tax documents and total turnovers reported on financial statements.	2.75	0.803
TIT2: Tax auditor tracks differences in the expenses submitted in tax documents.	3,07	0.791
TIT3: Tax auditor tracks differences in stock quantity.	2.83	0.855
TIT4: Tax auditor tracks differences in the inventory valuation methods.	2.74	0.896
TIT5: Tax auditor tracks differences in expenses which are not deducted from the total turnover.	3.10	0.922
TIT6: Tax auditor tracks fake invoices.	2.96	0.896
TIT7: Tax auditor tracks differences in customers and suppliers records.	3.10	0.933
TIT8: Tax auditor tracks differences in bad dept provision.	2.67	0.862
TIT9: Tax auditor tracks differences between the net profits submitted in tax documents and net profits reported on financial statements.	2.58	0.785
TIT10: Tax auditor tracks differences in VAT values.	2.57	0.826
TIT11: Tax auditor tracks differences in the transfer of amounts from book records to tax reporting system.	2.51	0.717
TIT12: Tax auditor tracks differences in other current taxes.	2.83	0.803

Source: Field Survey, 2015.

Table 4. Tests for factor analysis.

Construct	No of items	KMO	Bartlett's test of sphericity
Tax Infringements Tracking	12	0.841	Significant ($p < 0.001$)
Information Systems	4	0.795	Significant ($p < 0.001$)
Tax Legislation	3	0.668	Significant ($p < 0.001$)

Source: Field Survey, 2015.

“Tax Legislation” at $p < 0.01$.

In order to test H_1 and H_2 , regression analysis was conducted to test the significance of “Information Systems” and “Tax Legislation” on “Tax Infringements Tracking”. The results of regression for our model are presented in Table 7. There is a positive and significant relationship between “Information Systems” and “Tax Infringements Tracking” ($b_1 = 0.213$, $p = 0.003$), thus H_1 is strongly supported. In addition, “Tax Legislation” found to be negative and significant associated with “Tax Infringements Tracking” ($b_2 = -0.202$, $p = 0.004$), thus H_2 is strongly supported. Moreover, our model explained almost 35% ($R^2 = 0.349$, $p < 0.01$) of variance in “Tax

Infringements Tracking”. Finally, our control variables, “Education”, “Experience” and “Tax auditors training” have a positive and significant relationship with Tax Infringements Tracking ($b_3 = 0.115$, $p = 0.062$; $b_4 = 0.168$, $p = 0.013$; $b_5 = 0.193$, $p = 0.034$ respectively).

CONCLUSION AND RECOMMENDATIONS

The objective of this study is to highlight significant factors that contribute to increased tax auditing effectiveness. We specifically, outline the importance of technology and law legislation on tax auditors' performance. Our results

Table 5. Construct uni-dimensionality and reliability.

Construct	Instrument Items	No of items		Eigenvalue % of variance	Cronbach alpha
		Original	Deleted		
Tax infringements tracking	TIT1-TIT12	12	3	47.341	0.858
Information systems	IS1-IS4	4	0	70.803	0.859
Tax legislation	TL1-TL3	3	0	78.763	0.865

Source: Field Survey, 2015.

Table 6. Correlation matrix.

	TIT	IS	TL	EDU	EXP	TR
TIT	1					
IS	0,325*	1				
TL	-0.352**	-0.153	1			
EDU	0.327**	0.189	-0.267**	1		
EXP	0.331**	0.069	-0.083	0.105	1	
TR	0.168	-0.184	0.131	0.031	0.221*	1
Mean	2.742	2.839	4.219	2.946	2.269	1.280
Std. Dev.	0.566	0.723	0.761	0.852	0.768	0.578

** . Correlation is significant at the 0.01 level; * . Correlation is significant at the 0.05 level. Source: Field Survey, 2015.

Table 7. Regression analysis

Variables	Coeff.	Value	S.E.	t	p-value
Constant	b_0	2.024	0.449	4.507	0.000
IS	b_1	0.213	0.071	3.005	0.003
TL	b_2	-0.202	0.068	-2.973	0.004
EDU	b_3	0.115	0.061	1.892	0.062
EXP	b_4	0.168	0.066	2.534	0.013
TR	b_5	0.193	0.090	2.157	0.034

$Y = TI$; $R^2=0.349$; Adjusted $R^2=0.312$; $F=9.333$; $p=0.000$.
Source: Field Survey, 2015.

effective information systems helps tax auditors to track tax infringements. On the contrary, complexity and constant changes in tax legislation, makes it difficult for tax auditors to be effective in their work. Furthermore, level of education, work experience and training of tax auditors enhance their ability to track tax infringements. Our findings are of particular interest to Greek tax authorities, providing additional insight into the factors that affect "Tax Infringement Tracking" from the perspective of expert employees, who work in Greek public taxation agencies. Moreover, to the best of the authors' knowledge, it is the first time that "Tax Infringement Tracking" is quantitatively examined from the standpoint of taxation agency employees.

The fact that we detect a significant negative relation-

ship between tax legislation and tax infringement tracking, calls for direct policy intervention. Tax legislation should be simplified, so that tax auditors would not have to spend most of their time on law interpretation. Along those lines, the development of a tax auditing protocol, that would clearly define tax audit procedures, could also reduce the time a tax auditor spends on each audit. Regarding information systems, our study highlights the importance of designing and implementing an easy to use information system. Therefore, software developers should place particular attention to these factors when developing public sector software. Finally, our results suggest that tax auditors' training enhance their ability to perform audit controls. Consequently, continuous training in the form of educational seminars should also be

considered by tax authorities. The findings of the present study should be considered in light of a number of limitations. The first limitation is inherent in the use of a qualitative approach to collecting data, based on the perceptions of tax auditors. Therefore, a certain degree of bias should be taken into consideration. Furthermore, the research is based on tax auditors' perceptions regarding tax infringements in Greek firms. Thus, the results may be could not be generalized in every other country. Another limitation is that since our research is held during the Greek economic crisis period, hence it is possible that number of tax infringements has be increased. Future research should focus on examining tax audit from the point of view of different actors in the tax audit regime, not only public sector tax audit employee. Finally, a different approach, such as a case study methodology, could be used in order to capture the factors that inhibit tax auditors from detecting tax infringements.

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Conflict of Interests

The authors have not declared any conflict of interests.

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