

**ANALYSIS OF RISKS THAT AFFECT VALUE ADDED TAX REVENUE
COLLECTION BY KENYA REVENUE AUTHORITY.**

By

JAMES OWUOR

**A research project submitted in partial fulfillment of the requirements for the award of
the degree of Master of Business Administration in the School of Business.**

UNIVERSITY OF NAIROBI

NOVEMBER 2010

DECLARATION

This research project is my original work and has not been presented in either the same or different form to this or any other University for any academic qualification

.....

Date.....

Owuor, James

D61/9004/2006

This research project has been submitted for examination with my approval as the University Supervisor.

.....

Date.....

Mr. Nicholas T.T Simiyu

Accounting and Finance Department

School of Business

ACKNOWLEDGEMENT

First and certainly most important, I am most grateful to God Almighty for making it possible for me to undertake this study.

I am also sincerely thankful to my supervisor Mr. N.T.T Simiyu for his guidance, commitment, time, patience and invaluable support throughout the study period and during this project.

Many thanks also go Mrs. Nyamute who was my moderator, Mr. Lishenga, Mr. Marie, Mr. Odipo and many other lecturers who supported and encouraged me even when things seemed to be tougher.

Sincere gratitude goes to all my MBA colleagues for the critiques, moral support and encouragement during the difficult times of compiling this research proposal and report.

Finally to all who assisted me in different ways to make this work successful. May God bless you all.

Special thanks go Kenya Revenue Authority management and staff who participated in this research through research questions and giving the much needed information to make this work a success.

DEDICATION

I dedicate this project to my daughter Sheila and sons Paul and Silas who continually prayed for me. Special dedication goes to my loving wife Judith who supported me during my studies. May the Lord Almighty bless them abundantly.

ABSTRACT

The purpose of the study was to analyse the risks that impact on Value Added Tax (VAT) revenue collection by the Kenya Revenue Authority (KRA). The study was necessitated by the declining VAT revenue despite KRA implementing several collection strategies to maximise revenue collection. The study was to identify the risks that affect revenue collection and secondly to analyze the impact of those risks as to whether they are high, moderate or low.

The study has also covered broadly what other researchers have done in this area. The research gaps have also been identified regarding risk analysis in revenue collection.

The research design used is cross sectional as the study tried to establish factors associated with the declining revenue at KRA. The sampling technique applied was probability sampling which used stratified sampling. This was important as all elements responsible for identifying risks at every level was captured. The semi structured questionnaires has been administered to the staff. As this is a policy oriented research, the qualitative data analysis method has been used.

The study found out that the risks are well understood and identified by the tax managers and some tax auditors. However, the revenue officers who are the majority did not identify the risks adequately as the other groups. The risks do affect revenue collection. The study found out the most of the identified when analysed have high rate occurrence and high impact on the revenue receivable by the Authority.

Finally the study recommends that the Authority needs to adopt the bottom-top approach to risk identification and analysis. This will need the Authority to train the revenue officers in risk identification and analysis skills to make the more involved and effective in this process.

TABLE OF CONTENTS

	Page
Declaration	ii
Acknowledgement	iii
Dedication	iv
Abstract	v
Table of contents	vii
List of Tables	xi
List of figures	xii
References	xii
Appendices	xii
Abbreviations and Acronyms	xiii
CHAPTER ONE: INTRODUCTION	1
1.1 Background of the study	1
1.1.1 Profile: Kenya Revenue Authority	4
1.1.2 The Value Added Tax in Kenya	4
1.1.3 Scope and Rates of Value Added Tax in Kenya	4
1.2 Statement of the problem	5
1.3.1 Purpose of the Study	6
1.3.2 Objectives of the study	6
1.3 .3 Research questions	6
1.4 Importance of the Study	7

1.4.1 Scholars	7
1.4.2 Tax Policy Implementers	7
1.4.3 Employees	7
1.4.4 Tax Policy Makers	7
1.4.5 Members of the Public	8
CHAPTER TWO: LITERATURE REVIEW	9
2.1 Introduction	9
2.2 Definition of Risk and Risk Analysis	9
2.3 Risk Identification	10
2.4.0 Probable Threats that affect VAT Revenue Collection	11
2.4.1 Tax Evasion	11
2.4.2 Informal Economy	11
2.4.3 Corruption	12
2.4.4 High Cost of Revenue Collection	12
2.4.5 Complex Legal Systems	13
2.4.6 Inadequate Internal Audit	13
2.4.7 High Penalties	14
2.4.8 High Inflation	14
2.4.9 Inadequate Training	14
2.5 Critical Analysis of the Risk Sources	15

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY	20
3.1 Introduction	18
3.1.1 Research Design	18
3.1.2 Study Location	18
3.2 Population	18
3.3 Sampling Techniques and Sample Size	19
3.3.1 Sampling Technique	19
3.3.2 Sample Size	19
3.3.2.1 Tax Managers	20
3.3.2.2 Tax Auditors	20
3.3.2.3 Revenue Officers	20
3.3.3 Research instruments	21
3.4 Data Collection Techniques	21
3.5 Data Analysis	21
3.6 Ethics and Confidentiality	22
CHAPTER FOUR: DATA ANALYSIS, PRESENTATION AND INTERPRETATION	23
4.1 Introduction	23
4.2 Response Rate	23
4.3 Response by Category	24
4.4 Risk Awareness	24

4.5 Risk Identification and Profiling	25
4.6 Measurability of the Identified Risks	26
4.7 Cataloguing of Risks	26
4.8 Effects of Risks on VAT Revenue	27
4.9 Risk Analysis Reduces the Impact of Risks on Revenue Collection	27
4.10 Risk Analysis and Authority's Policies and Principles	28
4.11 Employees' Participation in Risk Analysis	28
4.12 Existence of Organ Analyzing Risk Exposure of the Authority	29
4.13 Impact of the Principles of Risk Analysis to the Authority	30
4.14 Risk Analysis and Revenue Shortfall	30
4.15 Risk Analysis and Respondents' Expectations	31
4.16 Risk Analysis and Achievement of Revenue Targets	31
4.17 Perceived Likelihood and Impact of the Identified Risks on Revenue Collection	32
4.18 Risk Analysis and Achievement of Revenue Targets	34
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS	37
5.1 Introduction	37
5.2 Summary of Research Findings	37
5.3 Conclusion	39
5.4 Recommendations	39
5.5 Limitations of the Study	40
5.6 Suggestions for Further Research	41

List of Tables

Table 3.1 Sample Frame	20
Table 4.1 Risk Awareness	25
Table 4.2 Risk Identification and Profiling	25
Table 4.3 Measurability of Risks	26
Table 4.4 Risk Cataloguing	27
Table 4.5 Identified Risks as Major Cause of Revenue Decline	27
Table 4.6 How Risk Analysis Impacts on Risks	28
Table 4.7 Consistency of Authority's Policies and Principles on Risk Analysis	28
Table 4.8 Frequency of Reporting the Identified Risks	29
Table 4.9 Existence of Organ Analyzing Identified Risks	30
Table 4.10 View on Application of Risks Analysis Principles	30
Table 4.11 Analysis of Risks after Revenue Shortfall	31

List of Figures

Figure 4.1 Response Rate	23
Figure 4.2 Responses by Category	24
Figure 4.3 Risk Analysis processes necessary for the Achievement of Revenue Targets	32
Figure 4.4 The Likelihood of occurrence of the Risks Identified to Revenue Collection	34
Figure 4.5 The Level of Impact of Risks Identified to Revenue Collection	36

REFERENCES	44
-------------------	-----------

QUESTIONNAIRE	48
----------------------	-----------

APPENDICES

Appendix 1.1 Trends in Revenue Performance	57
Appendix 1.2 Cumulative Revenue Performances	58
Appendix 1.3 VAT as a Percentage of Total Taxes (1998/99 – 2007/08)	59
Appendix 1.4 Growth in VAT on Domestic Products (1998/99 – 2007/08)	60

Abbreviations and Acronyms

CG	Commissioner General
ETR	Electronic Tax Registers
FY	Fiscal Year/ Financial Year
IMF	International Monetary Fund
KPMG	Keat Peat Marwick Group
KRA	Kenya Revenue Authority
Kshs.	Kenya Shillings
PWC	Pricewaterhouse Coopers
SARS	South Africa Revenue Services
SME's	Small and Medium Scale Enterprises
SRM	Sales Receipt Machine
VAT	Value Added Tax