Transparency of Value-Added Tax System and Audit Risk:
A Case of the Retail Sector in Masvingo Urban, Zimbabwe

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The paper aims to evaluate the relationship between transparency of Value-Added Tax (VAT) and audit risk in the retail sector in Masvingo urban. The paper used a descriptive survey approach. A likert scale questionnaire and face to face interviews were employed. Record keeping is poor and VAT fraud is high. It was concluded that, audit risk is high where there is lack of transparency in the VAT system. The possible implication is to assist the Zimbabwe Revenue Authority and the retail sector to realise their role in championing recent technology to broadening government revenue base.

INTRODUCTION AND BACKGROUND

“The Value-Added Tax (VAT) was implemented in France in 1954. The VAT’s expansion was limited to less than 10 countries in the late 1960s.” (Charlet& Owens, 2010:2). Its original coverage was limited, and France did not move to a full VAT that reached the broader retail sector until 1968. The first full VAT in Europe was enacted in Denmark in 1967, although the country did not join the European Economic Community until 1973.” (James, 2001). Bulk & Fischer (2015:9) citing OECD, reported that, a total of 164 countries across the globe have implemented VAT by year 2014. The statistics breakdown is as follows: 46 in Africa; 1 in North America; 18 in Central America and the Caribbean; 12 in South America; 28 in Asia; 51 in Europe and 8 in Oceanic.

Lee, Kim &Borcherding (2013:2), came to the conclusion that, VAT has become the source of revenue for many countries contributing on average about 32 percent of the total revenue for OECD member countries. De Swardt & Oberholzer (2006), in their paper, presents that, South Africa collected an average of 25 percent of its total tax revenues from VAT and this suggests high ratio of VAT to total revenue collected.

VAT is seen as complex, non-transparent, relatively costly to collect and with rapidly changing rates, as reflected by Mikesell (2014:18). Mikesell substantiates that VAT is not easier to enforce since collection is done at all stages of production meaning to say retail stage evasion still leaves much tax collected in earlier stages.

In Zimbabwe, the government introduced VAT law in January 2004 to replace the sales tax, (VAT ACT Chapter 23:12, Section 6). The Zimbabwe Revenue Authority (ZIMRA) was established on 19 January 2001 (ZIMRA 2014). “The Zimbabwe Revenue Authority is a government department which is responsible for the collection of state revenue in form of excise duty, customs duty, road tolls, corporate and civil taxes. In addition, it also facilitates trade, offers fiscal advice to the government as well as civil protection to the public.” (ZIMRA 2014). To foster effective performance the organization is divided into various departments, which include: Domestic Taxes; Customs and Excise; Legal and Corporate Services;
Investigations and International Affairs; Human Resource and Administration, Finance; Corporate Planning and Modernisation; Loss Control, Internal Audit; and Infrastructure and Information and Communication Technology (ICT) Development as outlined by ZIMRA (2014)

Kloeden, (2011:35) argued that the introduction of VAT has seen the emergence of a new approach to tax audit in Africa. The concept of Self-assessment allowed the audit of all VAT returns not necessary for a previously compliant taxpayer unless there is suspicion for non-compliance.

In 2008, many retail shops in Zimbabwe closed business due to hard economic conditions. The introduction of the multi-currency system in 2009, saw the sprouting of many Retail firms. In this regard a new firm could be perceived as high risk owing to the auditor's inexperience of the firm. Firms which operate in a high technology industry like those which use the electronic system could be regarded as risky owing to the impact of technical advances on inventory values and trading base. According to Docherty & Stein, (2001) generally the view by the taxpayer concerning tax payment has a serious implication upon the level of compliance. Some taxpayers may not agree with the amounts they pay but consider themselves powerless to change the system and some taxpayers are unfaithful, seek ways by all means necessary to evade tax. Despite all these premonitions, not paying tax remains illegal hence the need to closely scrutinize the level of audit risk in the payment of VAT in the Retail Sector.

This research is unique in that VAT system has more demanding accounting, transparency and compliance obligations. The paper aims to move upwards to look at how the visibility of VAT has on audit risk. Most of the researches are failing to appreciate the fact that ZIMRA has a critical role to play in stimulating and putting up structures which reveal a clear picture in the processing of VAT returns. The research is going to concentrate on transparency in the system, ZIMRA’s tracking process of the system to reflect the invisibility of VAT. Furthermore, the research focus on the adequacy of the procedures undertaken by the ZIMRA internal Audit department in detecting material errors and misstatements in the Retail sector.

LITERATURE REVIEW

The efficiency of a VAT adoption is measured by the tax to GDP ratio (Lee, Kim & Borcherding, 2013:5-5). They point out that designing of VAT rates have an influence on the taxpayer. The authors support this view by mentioning that broad base and flat tax rate may bring less incentive for VAT taxpayers, and this lowers the marginal tax rate. On electronic transactions, De Swart & Oberholzer (2006:12), in their paper on how compliant is South African value added tax payers dealing in digitised products, present that it is imperative for the VAT Act to provide clarity as to whether a vendor-registration or self-assessment collection mechanism is to be applied in collecting VAT on the supply of digitised products by a foreign supplier. They further argued that, a VAT Act should make a specific reference to the imposition of VAT on the supply of digitised products, hence apply to e-commerce transactions. Most VAT systems implies that goods and services are taxed where the consumer is situated hence there is need for clarity to the public on what can be classified as digital products for VAT purposes (De Swardt & Oberrholzer, 2006:4-6).

Value-Added Tax Registration

Thersby (2006), proclaim that VAT registration is voluntary as well as compulsory. Compulsory registration starts where a certain threshold has been reached by an operator for example R300 000 in a year. Thersby (ibid) underlines that a business should file VAT returns on a monthly basis, bi-monthly, quarterly, bi-annually or annually depending on the turnover pattern. The author further mentions that returns have to be submitted to the Revenue Authority on a specified date a month after the tax period and deregistration can also be voluntary or compulsory as is the case with initial registration. However, Moneyweb’s TAX BREAKS (2006), underline that it is important to keep proper documentation for managing VAT risk.

Focusing on Zimbabwe, operators who are registered for VAT may charge VAT on the supply of goods and services (ZIMRA, 2014). A trader is required to register for VAT if the value of taxable
supplies exceeds $60000 within a period of 12 months. ZIMRA (2014) further prescribe that, in any case
where the operator has reached or exceeded a turnover of $60000 but failed to register, the Commissioner
General of ZIMRA may compulsorily register the operator. The operator would be required to pay the
VAT due, interest and penalties on the computed debt. Failure to register for VAT constitutes an offence
in terms of the VAT ACT Chapter 23:12.

The following are not required to register for VAT: traders only dealing in exempt supplies; any
person conducting private or recreational activities or hobby, small traders whose taxable turnover is
below US$60000 per annum.

**Procedures to Register for VAT**

According to ZIMRA (2014), the following are the procedures followed by traders to register for
VAT: for individual traders form REV 1 which is fully completed should be submitted to ZIMRA; for
companies, they should submit current bank account, certificate of incorporation, memorandum and
articles of association, CR 6, CR 14, copy of identity documents for at least two directors, letter
appointing public officer who has signing powers of bank account, proof of residence of directors and
public officer. Finally, upon registration every registered operator will be issued with a certificate of
registration and such certificate shall be displayed prominently.

**Responsibilities of a Registered Person**

As outlined by ZIMRA (2014), a registered person should comply with the following requirements as
stated in the VAT ACT: keep accounting records for at least six years after the tax period; complete and
submit VAT returns as per requirement; calculate and remit the VAT due to the Commissioner General of
ZIMRA on or before the due date; issue tax or fiscal invoices debit notes or credit notes; account for VAT
if one sells or retains stock or assets; advise the Commissioner General on any changes in business details
or when one ceases trade.

**Cancellation of Registration**

Deregistration can be done upon voluntary application; on cessation of trade and notice being given
within 21 days of the date of such cessation of trade (ZIMRA, 2014). Notice and application should be
made to the Commissioner General. VAT 5 form should be completed and submitted to the
Commissioner General of ZIMRA. The operator can be deregistered if the Commissioner General is
satisfied that all obligations have been met.

**Registration for Fiscalised Recording of Taxable Transactions**

With effect from 1st October 2011, all VAT registered operators under category C whose annual value
of taxable supplies exceeds US$240000 are required to record transactions electronically in terms of

**Transparency**

I respectfully offer the following words of Mikesell (2014:7): “democratic choice requires that the
public knows its tax liability. It is not acceptable for the public to be unaware of what it pays for the
government services. The pricing tradition is that shelf prices include VAT or is added at purchase in
some instances or embedded in vending machine prices. Sales receipts in many countries include the
amount and the rate of the tax on the transaction and price of the purchase before tax. VAT is 100%
passed on to the consumers despite consumers’ belief that VAT partially falls on firms. Many consumers
see tax applied or reported on the tax register but not embedded from earlier transactions. VAT receipt
with tax paid on the transaction gives a visible and accurate indication of household tax burden”.

Naibei, Odondo, Siringi (2011:18-20), stresses the fact that electronic tax registers (ERT) improve
VAT compliance. They argued this should be supported by frequent inspection by the Revenue Auditors.
The businesses should be encouraged to regularly use ERT for every transaction to reduce the temptation
for tax evasion. Naibei, Odondo, and Siringi (2011) supports that customers should be educated on the
need to insist on being issued with ERT receipts for each transaction. The businessman should obtain refunds for input VAT with much easy and timeously to minimise the burden of paying tax by the taxpayer.

In Zimbabwe, VAT is invoice based and is accounted for on both cash and credit terms (ZIMRA, 2014). ZIMRA (2014), prescribes that a supplier who is a registered operator who supplies taxable goods or services is required to issue the recipient with a tax invoice or fiscal tax invoice within 30 days from the date of such supply. It is unlawful to issue more than one tax invoice for each taxable supply. ZIMRA (2014) warns that input tax maybe disallowed if the tax invoice do not contain all the necessary features. The features of a valid tax invoice include: the word ‘tax invoice’ or fiscal tax invoice should be in a prominent place; the name, address and VAT registration number of the supplier; the name and address of the recipient, serialised number and date on which the invoice is issued; description of the goods or services supplied; value of supply, price charged or consideration of the supply; any other words or phrases employed under the fiscal recording regulations denoting an invoice used to account for taxable supplies. ZIMRA also states that it is an offence for an unregistered operator to charge VAT in respect of supplies made. The VAT Act of Zimbabwe, chapter 23:12 stipulates that VAT is levied on the supply of goods and services as well as on the importation and exportation of goods and services. The VAT act provides different rates that are charged to traders. Taxable supplies attract VAT at specified rates of zero percent (zero rated), fifteen percent (standard rated), and traders are not required to register for VAT if providing exempt supplies.

Audit Risk

Daniel (2015:65-74), suggests that audit risk combines the risk of material misstatement, due to fraud or error within the financial statements, with both the risk of failure of internal control system to detect and correct them and with the risk the auditor will not detect such distortions. In the paper by Daniel (ibid), the auditor uses the audit risk model to estimate the degree of assurance required for important tests when it takes into account the level of audit risk and the assessment of both inherent and control risks. Many auditors use an audit scheme with high, medium or low risk allocation within the model. The audit risk model requires the auditor to consider each component of risk and to document every decision. The audit risk model as presented by Daniel (2015) is as follows:

\[ AR = IR \times CR \times DR \]

Where AR is audit risk; IR is inherent risk; CR is control risk; DR is detection risk.

If traders only file and make payments without self-assessment, this would require the taxpayers to take several steps in the tax office and at the bank and call for complicated tax return forms and supporting documents (Ebrill et al as cited by Walpole, 2014). Self-assessment VAT system simplifies the compliance processes to the taxpayers and will make the tax administration work easy by simply making checks on the taxpayer VAT liability without relying much on existing records. Ebrill et al as cited by Walpole (2014:3) opine that VAT operates effectively with self-assessment at its core.

Mechanics of VAT

ZIMRA (2014) writes, input tax arise when one registered operator supplies another registered operator with goods or services, thus the supplier of the goods or services will levy VAT. On the other hand, output tax arise when the registered operator in turn supplies goods or services to other persons. VAT must be included in the price charged for those goods or services. The VAT formula as stated on ZIMRA website is as follows:

\[ \text{VAT due/refundable} = \text{output tax} - \text{input tax} \]
Revenue Performance

<table>
<thead>
<tr>
<th>Revenue head</th>
<th>Target</th>
<th>Actual</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT on local 2014 year sales</td>
<td>748755000</td>
<td>509399000</td>
<td>-32%</td>
</tr>
<tr>
<td>VAT on 2014 year imports</td>
<td>486245000</td>
<td>480916400</td>
<td>-0.01%</td>
</tr>
<tr>
<td>VAT on local sales-1st half of 2015</td>
<td>316300000</td>
<td>212764492</td>
<td>-33%</td>
</tr>
<tr>
<td>VAT on imports-1st half of 2015</td>
<td>195700000</td>
<td>215244943</td>
<td>+10%</td>
</tr>
<tr>
<td>VAT on local sales-3rd quarter of 2015</td>
<td>161100000</td>
<td>136236297</td>
<td>-15.43%</td>
</tr>
<tr>
<td>VAT on imports-3rd quarter of 2015</td>
<td>104900000</td>
<td>116016935</td>
<td>+10.60%</td>
</tr>
</tbody>
</table>

Source: www.zimra.co.zw revenue performance reports

The above results were extracted from the revenue performance reports published on ZMRA’s website. For 2014 year, annual actual revenue head contribution, VAT on imports constitute 14% and VAT on local sales 14% respectively of the total actual revenue collected. For the VAT on local sales, gross collections for the year amounted to US$735,800,000 and net cumulative collections of US$509,400,000 against a target of US$748,800,000, resulting in a negative variance of 32%. VAT on local sales contributed up to 51% of total VAT revenue. However, VAT on imports amounted to US$480,000,000 against a target of US$486,200,000 resulting in a negative variance of 1%. VAT on imports contributed 49% of VAT revenue during the year 2014.

For the first half of 2015, VAT on local sales, net collections amounted to US$212,800,000 against a target of US$316,300,000, resulting in a negative variance of 33%. Net VAT on local sales contributed 13% to total revenue and 49.7% to total VAT revenue. The other category of VAT, VAT on imports collections amounted to US$215,200,000 against a target of US$195,700,000. This translates to a positive variance 10%. VAT on imports contributed to 13% to total revenue and 50.3% to total VAT revenue.

Lastly for the third quarter of 2015, the ZIMRA board chairperson reported that, VAT on local sales, net collections of US$136,240,000 against a target of US$161,100,000. Net VAT on local collections were 84.57% of the target. VAT on local sales contributed 54.01% to total VAT revenue. VAT on imports, revenue collections from VAT on imports for the quarter were US$116,020,000 which is 110.60% of the target US$104,900,000. The revenue head contributed 45.99% to total VAT revenue.

METHODOLOGY

The research explores the relationship between VAT transparency and audit risk in the retail sector in Masvingo urban, Zimbabwe. A mixed method was followed that embrace qualitative and quantitative methods. The mixed methods approach was deemed most suitable as participants were able to quickly complete the structured questionnaire and also express their views openly during the interviews. The main rationale to use a mixed methods was that this allows the research to combine the methods in a way that achieves complementary strengths and non-overlapping weaknesses (Johnson & Ownuegbuzie, 2004). This combines the strengths and at the same time compensate for weaknesses of each method. Participants were divided into two groups: retail operators and ZIMRA internal auditors. A likert scale questionnaire was used to collect data and face to face interviews were conducted. The sample size consist of 30 retail operators and 10 ZIMRA audit staff. A pilot test was conducted for the survey to identify weaknesses and complexity in questions before the final survey was conducted. Participation was voluntary and no financial incentives were provided to participants. The results were presented and analyzed using SPSS.
FINDINGS AND DISCUSSION

70 percent of the participants indicated that there is an inadequate training on the use of electronic system to process VAT. However, of note was that the majority of retail operators are currently using both the computerized and manual systems to maintain and process VAT returns. 30 percent of the participants stresses the fact that they were not aware of how input tax and output tax are calculated. This was mostly highlighted by small retail operators who do not have full time bookkeepers and accountants. Operators that use an online electronic system to file VAT returns tend to meet their VAT obligations.

From a question directed to ZIMRA auditors only, 80 percent perceived that electronic system is efficient and reduces VAT fraud and compliance costs by the taxpayer.

The majority of the owners of the retail shops insists that the tax officers are corrupt and sometimes demand bribes to lessen the liability of VAT offenders. This was supported by a study done in Bangladesh by Faridy, Copp, Freudenberg and Sarker (2014:19) who discovered that VAT officials are unfriendly, unfair and corrupt. They also mentioned that VAT officials give more co-operation to large entities than small business operators. However, ZIMRA auditors claim that most of the retailers are now operating in the informal sector where they are hard to tax and in some instances some are earning well above the minimum threshold required for compulsory registration of US$ 60000 per annum. ZIMRA auditors maintain that they frequently visit the premises of retail operators to verify their transactions records for VAT purposes.

Some retail operators maintains both electronic and manual systems to conceal their records so as to reduce their output tax. It was discovered that some shop owners have a tendency of maintaining two different set of books, a genuine and a fake one for similar transactions so as to defraud the taxman. This might remain invisible and the revenue collection fall short of its target.

Another interesting observation was that, the ZIMRA auditors are constituted of both experienced and inexperienced officers. This together with acceptance of bribes and corruption practices by the taxmen may increase audit risk. 30% of the retail owners emphasize that at times ZIMRA auditors do not disclose their conflict of interest as they may directly or indirectly own some retail operations. This is common these days as many are fighting economic hardships for survival and they engage themselves in supplementary income projects to feed their families. Failure to disclose conflict of interest compromise the independence of the auditors when doing their work.

The research found out that there is a lot of smuggling of goods and services into and out of the country through the country, borders. This leads to evading VAT and other indirect taxes such as customs and excise duties. As a result the country is also losing a lot of revenue. Currently the operators who are registered for VAT employ a self-assessment method where they prepare VAT returns and submit them to ZIMRA at prescribed dates. The auditors would then visit the retail operators’ premises for verification of records against the returns. Mikesell (2014:17) citing (Johnson 2013) accentuates the importance of VAT as it provides a special audit trail because each business pays the tax on its purchases and receives an invoice to support reimbursement.

The research found that large retailers maintain their accounting records for VAT purposes than small retailers. Keeping of purchases records and sales records makes the work of tax auditor much easier since the transaction trails are visible. Mikesell (2014:17) supports that by pointing out that the control over evasion in VAT is the prospect of being audited and the main practical use of maintained invoices is to make the audit trail easier to follow. This means that keeping records is very important as this allows accurate and timely processing of VAT returns. Thus adding more transparency to the system as they would be required for verification by auditors.

“Sometimes the law itself, the rules, office orders, and Statutory Regulatory Orders are inconsistent and contradictory. With enough educational support, the VAT law appears to be easy to understand,” as concluded by Faridy et al (2014:19). 40 percent of the owners of retail operators feels that the current VAT law is complex and non-transparent. This was mentioned by owners of small retail shops arguing that VAT law is designed by the government and ZIMRA officers without their participation. Evidence support that as the interpretation is difficult without consistent education from the policy makers. The
other reason was that small firms rely on hiring the bookkeepers and accountants to assist them in preparing returns which appears to be an extra cost to them. This is supported by Faridy el al (2014:18) who offers that small taxpayers mainly rely on themselves, their tax advisors, professional bookkeepers and accountants. Revenue authorities do not provide sufficient induction or educational programs for small retailers to raise awareness and inform them of changes in VAT law.

The ZIMRA auditors argued that VAT is visible to them where the trader maintains all transaction records, employ a fiscalised system, employ full time bookkeepers and accountants, traders’ visit the ZIMRA website for VAT changes and updates, the taxpayer being friendly to the tax officials, and the law is written or translated in a language understood by the taxpayer. Constraints for transparency include frequent relocations of the trader without notifying the tax office, failure to declare goods or services by traders, attitude of traders to the taxman (hostile), misrepresentation of accounting records, misinterpretation of the VAT law by firms (taxman), frequent changes to the VAT law, poor background knowledge of the VAT law, and inability to interpret VAT Act by tax officers. Narayanan (2014:10) expressed that when VAT rates tend to rise overtime and there is a tendency to move from a single rate to multiple rates, this results in VAT becoming more complex overtime. From a study done by Faridy et al (2014:18), it showed that VAT transparency is compromised by multiple rates of VAT, highly complicated language, and frequent changes in the VAT law.

60% of the participants disclose that they are aware of the VAT liability per period. However a study done by Faridy, Copp, Freudenberg and Sarker (2014:17) in Bangladesh, when the VAT rates are high, taxpayers do not comply despite their awareness of VAT that they are obliged to pay.

**TABLE 2**

| RETAIL FIRMS ARE AWARE OF THE PROCEDURES TO MANAGE AND PROCESS VAT |
|----------------------|---------------------|---------------------|---------------------|
|                     | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid Strongly disagree | 3         | 10.0    | 10.0          | 10.0               |
| Disagree            | 7         | 23.3    | 23.3          | 33.3               |
| Not sure            | 2         | 6.7     | 6.7           | 40.0               |
| Agree               | 8         | 26.7    | 26.7          | 66.7               |
| Strongly agree      | 10        | 33.3    | 33.3          | 100.0              |
| Total               | 30        | 100.0   | 100.0         |                    |

ZIMRA publicise its VAT law and any changes made through its website, the print media, pamphlets, and even though the national television and radios. Most retailers admitted that they rarely visit the ZIMRA website, access pamphlets or attend ZIMRA workshops to keep them abreast with latest VAT information. ZIMRA auditors concurred that the likelihood of audits, surprise check-ups, fines and penalties improves compliance by the retail firms.

One of the key findings was that 70 percent of retail owners opposes the perception that there is selective application of the VAT law by the ZIMRA auditors. On the other hand, 70 percent of ZIMRA auditors view that regular check-ups or audits may result in a low detection risk as retail operators would be encouraged to comply.
### TABLE 3
**CORRELATION BETWEEN TRANSACTION RECORD KEEPING AND AUDIT RISK**

<table>
<thead>
<tr>
<th>The likelihood of VAT transaction record keeping reduces audit risk</th>
<th>Audit risk is low where the VAT law is understandable by the taxpayer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>0.000</td>
</tr>
<tr>
<td>N</td>
<td>10</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed).

The questions were directed to ten ZIMRA auditors. The Pearson’s correlation between transaction record keeping and audit risk is 0.953. This is close to 1. This means that there is a strong relationship between transaction record keeping and audit risk. This means that changes in transaction record keeping are correlated with changes in audit risk level. One can conclude that when record keeping by retailers increase, the audit risk is going to be very low. The significant (2-Tailed) value is 0.000. This value is less than 0.05. One can conclude that there is a statistically significant correlation between quantity of transaction records and lower audit risk.

### CONCLUSION

Given the above findings, it can be concluded that lack of transparency due to poor records keeping, corruption by the tax official, lack of educational workshops about VAT, misinterpretation of the VAT legislation, complex language in the VAT Act, these obscure visibility of VAT and consequently compromise the work of ZIMRA audit department resulting in high audit risk. VAT system in the retail sector is not effective, some are still using outdated technology gadgets and software which is not compatible with the present business transactions. The use of the manual system is associated with poor record keeping, inaccuracy, lack of transparency and inefficient which lead to high audit risk.

VAT audit procedures and investigations are not strictly followed evidenced by some errors which are not detected, due to existence of inappropriate management control system, problem of recruiting and maintaining well-trained and experienced personnel in the audit division were also noted. VAT is still not transparent on some sections of the retail sector due to challenges such as falsification of records, failure to register for VAT, tax evasion, lack of technology to install the electronic system which is faster and accurate, VAT fraud involving management and corrupt tendencies. VAT can be more transparent, if
ZIMRA’s internal audit department becomes semi-autonomous department with its sufficient budgetary allocation to attract competent staff, retain staff and purchase state of the art technology, educate retailers various aspects of VAT, keeping proper records and desist from fraud activities.

It can be concluded that transparency of VAT affect audit risk. An increase in invisibility, result in high audit risk. On the other hand a move towards more visibility and transparency reduce audit risk and consequently high revenue flows to the government.

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ACKNOWLEDGEMENTS

Writing up of this research was made possible by the support the researcher got from ZIMRA staff and owners of retail firms through their participation in the survey. The researcher would like also to thank the editors of the Journal of Accounting and Finance and the reviewers for the comments and suggestions they will make to this paper. Most of all, I am thankful to my workmates at Great Zimbabwe University, in the department of accounting and information systems for their encouragement and moral support.