
Title: Tax Auditing as a Tool for the Early Detection of Tax Risks in Algerian Enterprises

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Abstract

This research aims to examine the role of tax auditing as an effective tool for the early detection of tax risks within Algerian enterprises. It explores the concept of tax risk, its types, and sources, while also addressing the various forms and methodologies of tax auditing. The study emphasizes the importance of adopting tax audit mechanisms as a means of preventing disputes with tax authorities and avoiding penalties resulting from errors or irregularities. The findings suggest that when applied systematically and professionally, tax auditing becomes a strategic tool to ensure tax compliance and transparency. It also contributes to the legal reduction of the tax burden, thereby improving institutional performance and enhancing financial stability.

Keywords: Tax auditing, Tax Risks, Tax Compliance

Introduction:

The contemporary economic environment is witnessing rapid developments and successive transformations, particularly in the tax domain, which has become characterized by complex regulations and a variety of oversight procedures. These factors have led enterprises to face increasing challenges in fulfilling their tax obligations. In this context, tax risks have emerged as a serious concern for businesses due to their potential financial and legal consequences that can negatively impact an enterprise's stability and continuity.

Given this reality, tax auditing has emerged as an effective tool for analyzing and evaluating the tax status of a business, identifying shortcomings or violations before they are detected by tax authorities. Tax auditing does not only focus on verifying the compliance of tax transactions with existing laws but extends to the early detection of sources of tax risks, thereby serving as a preventive measure that supports decision-makers within the organization.

Building on the importance of this preventive role, this research seeks to highlight how tax auditing can be employed as a tool for the early detection of tax risks in Algerian enterprises, shedding light on current practices and the challenges faced in its implementation within the local context.

Research Problem

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The main question of the study is: **Is tax auditing an effective tool for the early detection of tax risks within Algerian enterprises?**

Research Objective:

This research aims to explore the role of tax auditing in the early detection of tax risks within Algerian enterprises by analyzing the mechanisms of tax auditing and evaluating its effectiveness in identifying potential tax risks before they materialize. The goal is to enhance tax compliance and improve the financial and legal performance of businesses. Additionally, the study seeks to provide a methodological approach on how to utilize tax auditing as a preventive regulatory tool within the Algerian business environment.

Significance of the Study:

The significance of this study stems from the growing need for Algerian enterprises to adopt effective regulatory tools that assist them in adapting to continuous changes in tax regulations and avoiding the costs associated with tax errors or fraud. In this context, tax auditing holds special importance as it allows for the early detection of tax risks, contributing to the protection of enterprises from penalties and fines, while also enhancing their transparency and credibility before tax authorities. The study's importance is further underscored by its focus on an often-overlooked aspect of accounting practice—the preventive role of tax auditing—which adds value both academically and practically.

The Nature of Tax Risk:

Risk is an essential element in any business, and its presence cannot be disputed. The establishment of a company inherently involves bearing risks, and there is no guarantee of its continued existence. Even large corporations do not have any assurance of permanence. Examples of multinational companies that have disappeared or faced difficulties in survival include Enron, Arthur Andersen, Alstom, and Parmalat.

In a business context, risk refers to any event or situation that can negatively impact the organization's objectives and future performance. Risks can arise from various aspects, including the external environment and internal operations, and may have financial, administrative, operational, legal, or other consequences.

Several definitions of risk have been proposed:

1. Definition of Risk:

Risk is any process, phenomenon, or human activity that can lead to losses of life, injuries, health impacts, property damage, social and economic disturbances, or environmental degradation. (<https://www.undrr.org/ar/terminology/alkhtr>)

From an economic perspective, the classical concept of risk was almost absent from economic theory, where humans were seen as responsible for their fate. The economic system, as designed by the founders of economic theory, was based on the complete rationality of economic agents, who were considered highly competent, either successful or unsuccessful, based on their rational strategic choices, good intentions, and caution—values that Adam Smith elevated to a virtue. (Varmav, 2014, p. 35)

2. Types of Risks:

Based on a study by Jean-David Darsa, business risks are represented in a hierarchical pyramid, ranging from macroeconomic risks to microeconomic ones, and from individual to collective risks. Darsa classified the primary risk categories as follows:

- Geopolitical risks
- Economic risks
- Strategic risks
- Financial risks
- Operational risks (core to business operations)
- Industrial risks (a subset of operational risks)

- Legal risks (a subset of operational risks)
- Informational risks (a specific subset of operational risks)
- Social and psychological risks (including operational risks)
- Reputation risks
- Knowledge management risks
- Other risks (e.g., environmental risks, quality increases, system failures)
- Integrity risks (the ultimate individual risks)(Drasa, 2013, p. 34)

Tax Risk in Enterprises:

Studying tax risk within a company is vital to ensuring the business's compliance with tax regulations and minimizing the potential risks of tax obligations. Identifying weaknesses in tax procedures and assessing the company's current compliance with tax laws is essential. By studying tax risk, businesses can identify potential risks and develop strategies to mitigate them, ensuring full compliance with tax laws.

1. Definition of Tax Risk:

Tax risk refers to the potential for incurring a tax cost that is higher or lower than the amount legally required or the amount that the taxpayer is prepared or able to pay. (Njabou, 2020, p. 24)

According to Ernst & Young (2008), tax risk is defined as "any event, action, or inaction in the areas of tax strategy, operations, financial reporting, and compliance that negatively impacts the tax situation or business of a company, or leads to an unexpected level of penalties, corrections, additional taxes, reputational damage, loss of opportunities, or compromise of financial integrity." (Revue de Contrôle de Comptabilité et de l'Audit, 2023, p. 251)

Some view tax risk as encompassing two perspectives: the first is the classical view, which concerns intentional or unintentional non-compliance with tax rules, while the second is equally significant and concerns neglect or lack of awareness of tax privileges that could lead to significant tax savings. (KHELASSI, 2013, p. 143)

Sources of Tax Risk:

The sources of tax risk are varied and can be classified into internal and external sources:

• **Internal Sources:**

Internal tax risk sources can be grouped into two categories:

○ **Process-related sources:**

The process of identifying tax risks is a preventive measure based on applying regular procedures within the organization. However, some of these procedures may be inadequate and exacerbate risks. Therefore, it is advisable to establish effective tax procedures (e.g., preparing tax returns and withholding tax) and verify their effectiveness through control tools. These procedures aim to reduce the likelihood and impact of risks, as their absence leads to an increase in residual risks, which must be measured to evaluate the effectiveness of risk management.

○ **Individual-related sources:**

Risks arising from individuals result from negligence, lack of competence, or lack of cooperation. Therefore, fostering a culture of tax compliance within the organization is crucial, along with educating employees on the importance of managing tax risks. Reducing these risks requires hiring qualified professionals and providing initial and ongoing training to ensure effective performance. (KHELASSI, 2013, pp. 147-148)

• **Procedure-related sources:**

The process of identifying tax risks is a preventive measure based on the application of regular methods and procedures within the enterprise. However, some of these procedures may be inadequate and may increase the

severity of risks. Therefore, it is advisable to establish effective tax procedures (such as the preparation of declarations and withholdings at source) and verify their effectiveness through control tools. These procedures aim to reduce the probability and impact of risks, as their absence leads to a higher level of residual risks, necessitating their measurement to assess the effectiveness of risk management. The more limited these risks are, the more effective the adopted system is considered.

- **Personnel-related sources:**

Risks associated with personnel arise from negligence, lack of competence, or absence of cooperation. Therefore, the culture of tax compliance within the enterprise must be strengthened, and employees must be made aware of the importance of managing tax risks. Reducing these risks requires employing qualified personnel, in addition to providing initial and ongoing training to ensure effective performance.

External sources of tax risk:

External tax risk sources can be summarized in the following points:

- **The complex nature of tax texts:**

The complexity of the tax system contributes to its difficult application, leading to poor compliance and pushing some taxpayers toward tax evasion, in a tense relationship with the tax administration, which highlights the need for a simplified system that enhances voluntary compliance.

(BEN HADJ SAAD, 2009, p. 21)

The complexity of tax texts can be measured through the following criteria:

(KHELASSI, 2013, p. 145)

- Legal productivity
- Uncertainty in texts and lack of security
- Differences between accounting and taxation

2. Classifications of tax risk

According to the work of Price Waterhouse Coopers, tax risks can be divided into seven types, which together form the tax risk portfolio of the enterprise: (Yaiche, 2007, p. 16)

- Transfer risks
- Position risks
- Operational risks
- Non-compliance or legal non-conformity risks
- Accounting-related risks
- Reputation risks
- The enterprise's tax risk portfolio

3.1 The nature of tax auditing

This section addresses the various definitions of tax auditing in addition to its types.

First: The concept of tax auditing:

Although there is no consensus among experts on a specific definition of tax auditing, several definitions attempt to explain it:

- Tax auditing is: "A process aimed at validating the tax burden of the enterprise and determining the qualitative and quantitative nature of tax risk to which the enterprise may be exposed due to non-compliance with tax laws."

(Pinard-Fabro, 2008, p. 13)

- Tax auditing is: "A tool for making decisions regarding all the tax structures of the company; it is a critical examination of the company's tax status in order to obtain an impression of the enterprise's tax aspect."

(Abdelkader, 2018, pp. 56-58)

- As defined by the **Association technique d'harmonisation des cabinets d'audit et conseil (ATIC)**:

"Tax auditing involves expressing an opinion on a set of tax structures of the unit (enterprise) and their application method. Thus, taxation in all its forms is the subject of audit within the enterprise."

(Hamidatou, 2019, p. 91)

- Professor **M.P. Colin** defined tax auditing as follows:

"Tax auditing is the accounting examination by the tax administration."
(P. Colin, 1985, p. 35)

- Professor **KHELASSI Reda** in his book *précis d'audit fiscal de l'entreprise* defined tax auditing as follows:

"Tax auditing is an examination of the tax status of the enterprise to form an impression. Its purpose is to prepare a diagnosis or enable the enterprise to make good use of taxation, thus allowing it to use it to its advantage. It contributes to the enterprise's tax security (increased regularity) and helps improve tax management (increased efficiency)."

(KHELASSI, 2013, p. 94)

- Professors **P. Bougon and Vallée** defined it as:

"Tax auditing measures the enterprise's ability to utilize its resources according to tax law, within the framework of its managerial policies, to achieve the set objectives."
(IM. Vallée, 1986, p. 53)

From the above, tax auditing can be defined as:

"A critical and contractual examination of the enterprise's tax situation in order to form an impression of the enterprise's ability to comply with and exploit tax laws."

3.2 Types of Tax Auditing:

Since tax auditing is not legally mandatory, it can be distinguished based on the party conducting it—whether internal or external:

- **Internal Tax Auditing:**

The internal auditor ensures compliance with accounting and tax legislation.
(Seau, 2018, p. 22)

This is within the framework of the control function defined by the COSO committee as an internal control process carried out by the board of directors, managers, and employees of an organization to provide reasonable assurance capable of achieving the following objectives:

(Seau, 2018, p. 23)

- Implementation and improvement of operations
- Reliability of financial information
- Compliance with applicable laws and regulations

This process, which necessarily affects all applicable laws, results in a report on the tax aspect of the enterprise addressed primarily to the board of directors.

- **External Tax Auditing:**

This is a contractual mission that may be continuous or occasional, assigned to an external party presumed to have competence, independence, and professionalism. Its goal is to make the tax management of the enterprise more efficient, in order to reduce tax costs by focusing on the tax aspect during the examination of financial statements. These tasks may complement internal audit functions. This party carries out the following actions:

(Hamidatou, 2019, pp. 96-97)

- Ensuring the tax burden is low
- Studying the tax options adopted by the enterprise
- Verifying the level of tax risk in the enterprise

This preventive procedure, like internal tax auditing, results in a report and a neutral technical opinion on the tax status of the enterprise.

3. Tax auditing as a tool for detecting tax risks within the enterprise:

Tax auditing within the enterprise relies on several procedures aimed at identifying errors, violations, or gaps in the internal control system to improve the management function within the enterprise.

The activities and procedures carried out by the tax auditor focus on:

Assessing the tax management function in the enterprise:

The tax auditor evaluates the tax management function based on:

4.1 Examining the existence of a tax department in the enterprise:

Tax regularity or compliance involves analyzing how tax issues are handled within the enterprise. The tax auditor inquires about the existence of a tax department, the presence of specialists in accounting entries with tax implications, and whether the enterprise consults tax advisors and the methods of tax treatment for transactions.

(KHELASSI, 2013, p. 334)

4.2 Verifying the existence of an effective information system:

The tax auditor follows these steps:

(Drissi, 2016, p. 245)

- Ensuring the existence of an effective information system and that taxation is integrated into enterprise management
- Verifying the presence of a management program integrated into sales tracking operations over a period based on physical inventory results and accounting data
- Verifying that this system allows calculation of the following formula for each inventory item:

Final inventory = Initial inventory + Purchases - Consumed or lost inventory

- Ensuring the existence of a tax file and verifying that it includes three sub-files:
 - The annual tax file
 - The permanent tax file
 - The tax dispute file

4.3 Ensuring the existence of documents that make up these files and verifying they are regularly updated and well-organized:

For this purpose, the auditor should request these files and verify that they include the following elements:

- A list of marketed products or activities carried out by the enterprise
- The specific tax system for each product or activity
- Copies of tax returns filed during the last four years
- Financial statements and tax notes (schedule of tax result determination)
- A detailed breakdown of depreciations
- A detailed list of donations and gifts
- A breakdown of provisions and impairment losses for non-doubtful receivables
- Details on provisions and impairment losses for inventory devaluation
- A description of the company's tax system concerning the various taxes and duties it is subject to (e.g., income tax, VAT, etc.), in addition to the tax policy followed

4.4 Ensuring that Procedures Do Not Suffer from Tax Deficiencies

(Drissi, 2016, p. 247)

- Study and review procedures to identify tax deficiencies and provide guidance to account for the tax factor.
- Examine the management and commercial operations procedures manual. This examination pertains to all procedures specific to the enterprise (such as procurement, sales, treasury processes, etc.).
- Ensure that the supplier selection process takes into account the tax system applicable to the goods or services concerned.
- Verify that the procurement department sends the request to the financial department for analysis of the product's tax regime (purchase with tax and fee suspension or exemption from duties and taxes, etc.).
- In supplier consultations, verify that subcontracting service quotations include requirements relating to the enterprise's tax status.
- Request bidding procedures and verify the aforementioned point.
- In case of deficiencies, obtain the necessary clarifications.
- Ensure that procedures do not suffer from tax deficiencies:
 - Study and review procedures to identify tax deficiencies and provide guidance to account for the tax factor.
 - Examine the management and commercial operations procedures manual. This examination pertains to all procedures specific to the enterprise (such as procurement, sales, treasury processes, etc.).
 - Ensure that sales procedures incorporate legislation relating to turnover tax (prices, taxable base, other measures, etc.). Accordingly:
 - Request sales procedures and verify that they incorporate value-added tax legislation.
 - Obtain clarifications in case of noticeable deficiencies.

4.5 Ensuring that the Examination and Control Procedures Used by the Enterprise Allow for Accurate, Complete, and Clear Declarations to Be Submitted on Time

For this purpose, it is necessary to:

- Verify that the enterprise applies the tax rules governing the determination of the tax base and the calculation of taxes and fees due.

- Request declarations for the period under audit and verify that they were submitted with great care.
- Request declarations for the period under audit and verify that they are accompanied by all documents required to be submitted to the tax administration.
- Request declarations for the period under audit and verify that all of them are sent to the competent authority on time in accordance with the applicable tax legislation.

4.6 Ensuring that Declarations Are Prepared Under the Effective Supervision of the Responsible Person

To do this, the auditor should:

- Request declarations for the period under audit and verify that they were all prepared under the effective supervision of the direct responsible person.
- Verify the physical presence of this supervision (signature and date) by the responsible person.

4.7 Ensuring that the Preparation of Tax Declarations Is Based on Accounting

Here, the tax auditor should:

(Drissi, 2016, p. 250)

- Request the declarations for the period under audit and verify that a consistent reconciliation has been made between accounting and the declared tax bases and rules.
- Physically verify the execution of this reconciliation.

4.8 Evaluating Document Management

As part of verifying the existence of a process followed for document archiving, the auditor should: (Drissi, 2016, p. 251)

- Ensure that the enterprise has a tax database containing a summary of taxes and fees declared over at least the last ten years.
- Request documents justifying the existence of a tax database as defined in the previous point.
- Ensure that documents are preserved in their original state.
- Request archived documents and verify that they are preserved in their original form.

4.9 Analyzing the Enterprise's Tax History

Regarding the enterprise's tax history, the tax auditor examines: (KHELASSI, 2013, p. 381)

- Whether the tax administration has sent the enterprise a request for information regarding non-prescribed periods.
- Whether the enterprise has submitted complaints, disputes, or requests for reductions and cancellations to the tax administration.
- Whether the enterprise has received notices of accounting audits and for which years.
- Whether the enterprise was informed of adjustments and in which area (direct taxes – value-added tax).

5. Audit of Tax Declarations

These declarations include:

- Occasional declarations
- Monthly declarations
- Annual declarations

The tax auditor must audit compliance with the formal rules and legal aspects of tax declarations.

5.1 Formal Rules

The auditor may examine, in particular, the stages of preparation of the various declarations and study the procedures used for verification and control within the enterprise, in order to ensure that there are no computational inconsistencies. Therefore, attention should be given to the following points:

(KHELASSI, 2013, p. 378)

- Has the enterprise submitted the mandatory declarations?
- Does the enterprise use the required forms?
- Does the enterprise have supporting documents for the submitted declarations?
- Does the enterprise retain the supporting documents?
- Are the declarations correctly prepared?
- Does the enterprise have the necessary means to justify the content of the various declarations it has filed?

5.2 Due Date

This type of review aims to reduce penalties and sanctions due to delays in submitting tax declarations and paying taxes. The most appropriate tool for the company is the **tax schedule** (a document that records all the company's tax obligations, including the dates for filing declarations and paying various taxes and fees).

(KHELASSI, 2013, p. 378)

To achieve this, the auditor should:

- Verify the existence of a tax schedule.
- Verify the quality and reliability of the schedule.
- Verify the proper use of this schedule.

5.3 Verifying the Existence of a Tax Schedule

- Ensure that a tax schedule is prepared by the relevant entity within the company.
- Request the company's tax schedule and verify that it is actually being followed.

5.4 Verifying the Quality and Reliability of the Schedule

Ensure that the tax schedule is of good quality and reliability by:

(Drissi, 2016, p. 255)

- Requesting the company's tax schedule and verifying that it correctly displays the dates for submitting declarations and paying various taxes and fees.
- Also verifying that the schedule is complete and contains reliable, clear, verifiable, and understandable information.

5.6 Verifying the Proper Use of the Schedule

- Ensure that the tax schedule has been disseminated to all relevant persons.
- Request documentation proving the dissemination of the tax schedule: a copy of the dissemination notice to the concerned individuals.
- Ensure that there are no late penalties in the accounts due to delays in submitting declarations.
- Request records of payments for such penalties due to declaration delays.
- Obtain explanations in case any questions arise.

5.7 Examining the Adaptation of the Accounting System to Tax Needs and Compliance with Accounting and Tax Rules

✓ Examining the Adaptation of the Accounting System to Tax Needs:

(KHELASSI, 2013, p. 255)

The tax auditor focuses on conducting comparisons between accounting data and tax declarations, such as turnover, payroll base, and withholdings at source, to ensure consistency and reliability. Declarations based on accounting data are more secure due to ease of traceability and auditing, whereas non-accounting-based declarations raise doubts about their accuracy and completeness and often lead to discrepancies that are difficult to justify.

• Examining Compliance with Accounting and Tax Rules:

The tax auditor must examine accounting and tax compliance through:

Compliance with accounting rules:

Compliance with accounting rules is examined by:

(Drissi, 2016, p. 290)

- Ensuring that the accounting is maintained in accordance with the applicable accounting system (Article 2 of Law No. 07-11 dated 15 Dhu al-Qi'dah 1428 corresponding to November 25, 2007, related to the financial accounting system).
- During the review of accounting records, verify whether the concepts underlying the preparation and presentation of financial statements, such as accounting principles and standards, are respected, along with the qualitative characteristics of financial information.
- Verifying the accounting's ability to justify the accuracy of declared results.
- Also verifying that the company has effective procedures for data entry, posting, analysis, and accounting justification, and for comparing accounting to tax data.
- Verifying that the preparation of tax declarations is based on accounting elements.
- Verifying that the accounting is up to date.
- Ensuring that, for expenses to be deductible from taxable profits, they must have been incurred for the benefit of the enterprise.
- During the audit of balance sheet and income accounts, verify whether this aspect has been reviewed.
- Ensuring that the company complies with tax rules regarding the deduction of value-added tax.
- During the review of balance sheet and income accounts, verify that the company's compliance with tax rules has been included in the audit program.

6- Examination of Efficiency and Credibility:

This examination is based on the internal consistency of accounting documents and supporting documents. It aims to form an impression regarding the regularity in the form of the accounting documents. (KHELASSI, 2013, p. 408)

Examination of Efficiency and Reliability:

The tax auditor performs the following (Drissi, 2016, p. 291):

- Ensuring the presence of all the following mandatory accounting documents:
 - Account extracts of accounting operations as defined in applicable laws and regulations, particularly a summary of the income statement.

- A copy of the balance sheet.
- A statement of the nature of general expenses.
- A statement of the nature of depreciations and reserves established from profits, with precise identification of the purpose of these depreciations and reserves.
- The income statement that allows the determination of taxable profit.
- A statement of payments related to the professional activity tax concerned.
- Legal records (inventory of investments and legal records related to employees, etc.).
- The balance sheet and auxiliary journals for each accounting account.
- Ensuring that the operations and entries under review comply with reliability standards:
 - Verifying that the operations and entries made and recorded in the accounting books correspond to reality.
 - Verifying that the operations and entries recorded in the accounting are objective and comprehensive.
 - Verifying that all operations are recorded in the accounting based on reliable supporting documents.

Examination of Accounting Document Preservation:

- Ensuring that the books, records, documents, and files usually requested and reviewed by the tax administration are preserved for 10 years, in accordance with the provisions of Article 12 of the Commercial Code.
- Requesting the financial statements for the last ten financial cycles and verifying they are properly preserved.
- Requesting the trial balances (general and subsidiary) for the last ten financial cycles and verifying that they were issued, classified, and stored in secure locations.
- Requesting auxiliary journals for the last ten financial cycles and verifying that they were issued, classified, and stored in secure locations.
- Requesting files extracted from computer software that allow for accounting recovery for the last ten financial cycles and verifying that they are saved on CDs (or any other electronic means) and stored securely.
- Requesting computer files used in the preparation of financial statements and verifying that they are saved on CDs (or any other electronic means) and stored securely.
- Requesting a second copy of these magnetic disks and verifying that they are stored in another secure location.
- In case of insufficient procedures for document preservation, requesting the necessary clarifications from the responsible party.

Compliance with Tax Rules:

The necessity to examine this aspect is due to the diversity of tax legislation and rules, resulting in the development of two types of obligations in this examination:

Invoice Preparation:

Invoices must be prepared in accordance with the provisions of Article 18 of the Value Added Tax Law and must contain:

- The nature of the original transaction as well as the name and address of the person with whom the deal was concluded.
- The date of execution of the transaction.

- The page of the accounting register where the transaction is recorded or the special register stipulated in Article 72.
- The value of the amount paid or not yet collected.

The tax auditor must verify the presence of all this data on the invoices, in addition to a continuous numbering sequence. In the event of a breach, potential penalties due to lack of data should be estimated.

When the institution engages in multiple activities or branches, it must be ensured that the invoice includes the tax identification of the location providing the service. On the other hand, if the company chooses to make a single declaration under the name of the headquarters, it must be verified that the invoice bears the tax identity of the main office and not the branches.

Conclusion

Tax auditing is a strategic tool that enables Algerian institutions to face increasing tax challenges, especially in light of the complexity of the tax environment and the diversity of risk sources. Based on the discussion in this research, it becomes clear that tax auditing is not limited to verifying the accuracy of tax declarations but goes beyond that to serve as a tool for early detection of tax risks that may negatively affect the financial and legal position of the institution.

Adopting a precise methodology in tax auditing, based on the analysis of information systems and internal control, allows for the identification of deficiencies and deviations before they worsen, thereby contributing to reducing the tax burden and achieving voluntary compliance. Tax auditing also enhances the institution's ability to make informed decisions and avoid disputes with the tax administration.

In light of the above, it can be said that the effectiveness of tax auditing as a tool for early detection of tax risk depends on the institution's awareness of the importance of this type of control, the competence of tax auditors, and the necessity of updating and simplifying tax legislation to facilitate both the auditing and compliance process simultaneously.

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