



# RISK-BASED TAX AUDIT REVENUE GENERATION IN NIGERIA

**A Presentation at the CITN 2018 Lagos MPTP**

**December 4, 2018**

**Venue:**

**Tax Professionals' House  
CITN Secretariat Alausa, Ikeja-Lagos**

**Seyi Katola, FCTI**



# Presentation Outline



- **Course Objectives**
- **Audit and Auditing**
- **Relevance of Audit to Taxation**
- **Tax Audit Approaches**
- **Tax Audit Triggers**
- **Risk, Uncertainty and Certainty**
- **Risk-Based Audit**
- **Risk-Based Audit: Application to Tax Audit**
- **Risk –Based Auditing: Impact on Revenue Generation**
- **The Challenges & Remedy**
- **Conclusion**



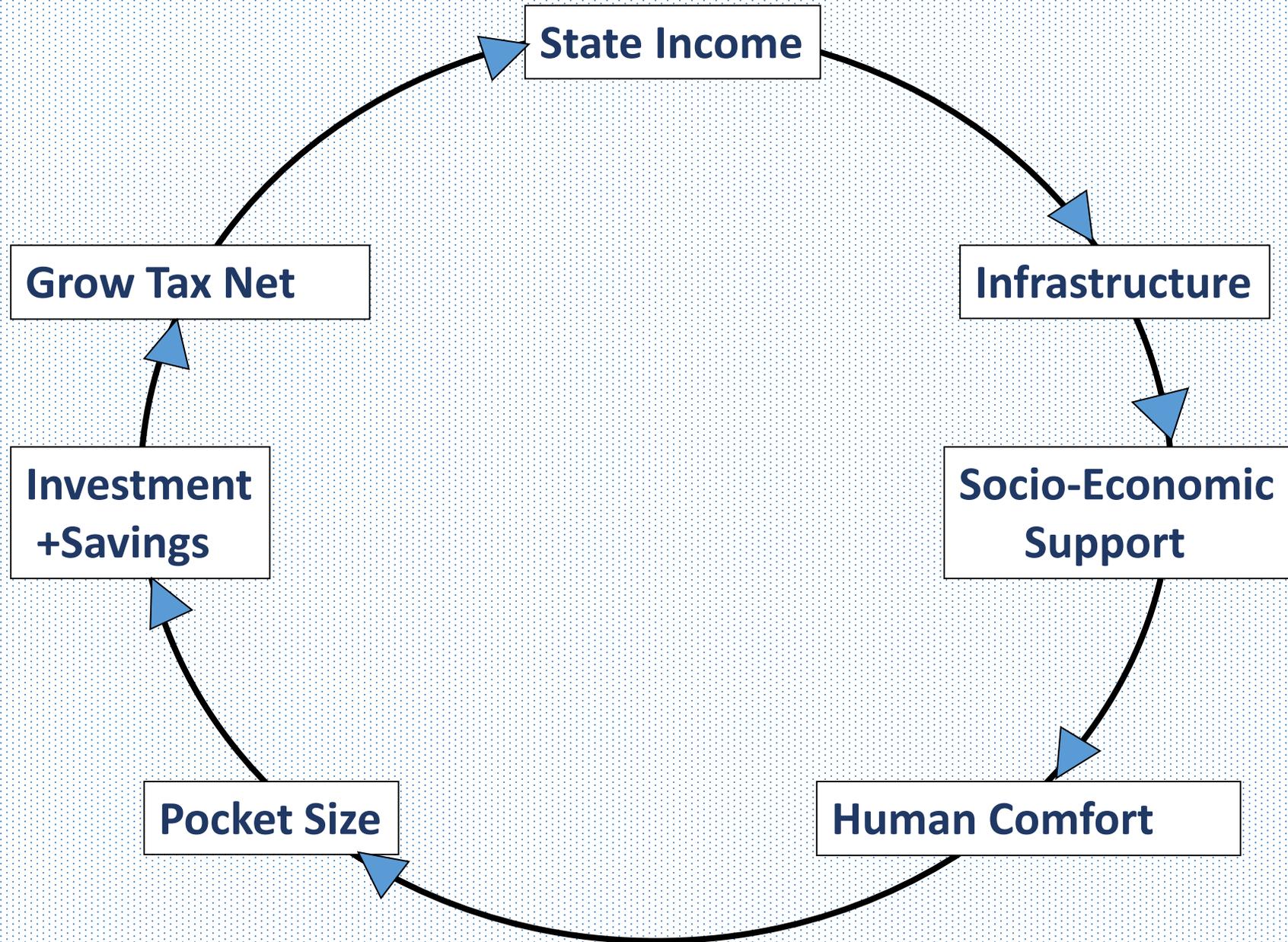
# Course Objectives



- **At the end of this session, participants should be able to:**
  - ✓ **recognize the fundamental principles of risk-based audit**
  - ✓ **recognize the analytical techniques used in risk-based audit strategies**
  - ✓ **identify the institutional challenges and relevance to taxation**
  - ✓ **appreciate the incremental import of risk-based approach to tax audit**
  - ✓ **appreciate the benefits of risk-based tax audit to tax ecosystem**
  - ✓ **understand the positive impact of risk-based tax audit on revenue generation**



# Circular Advantage of Taxation





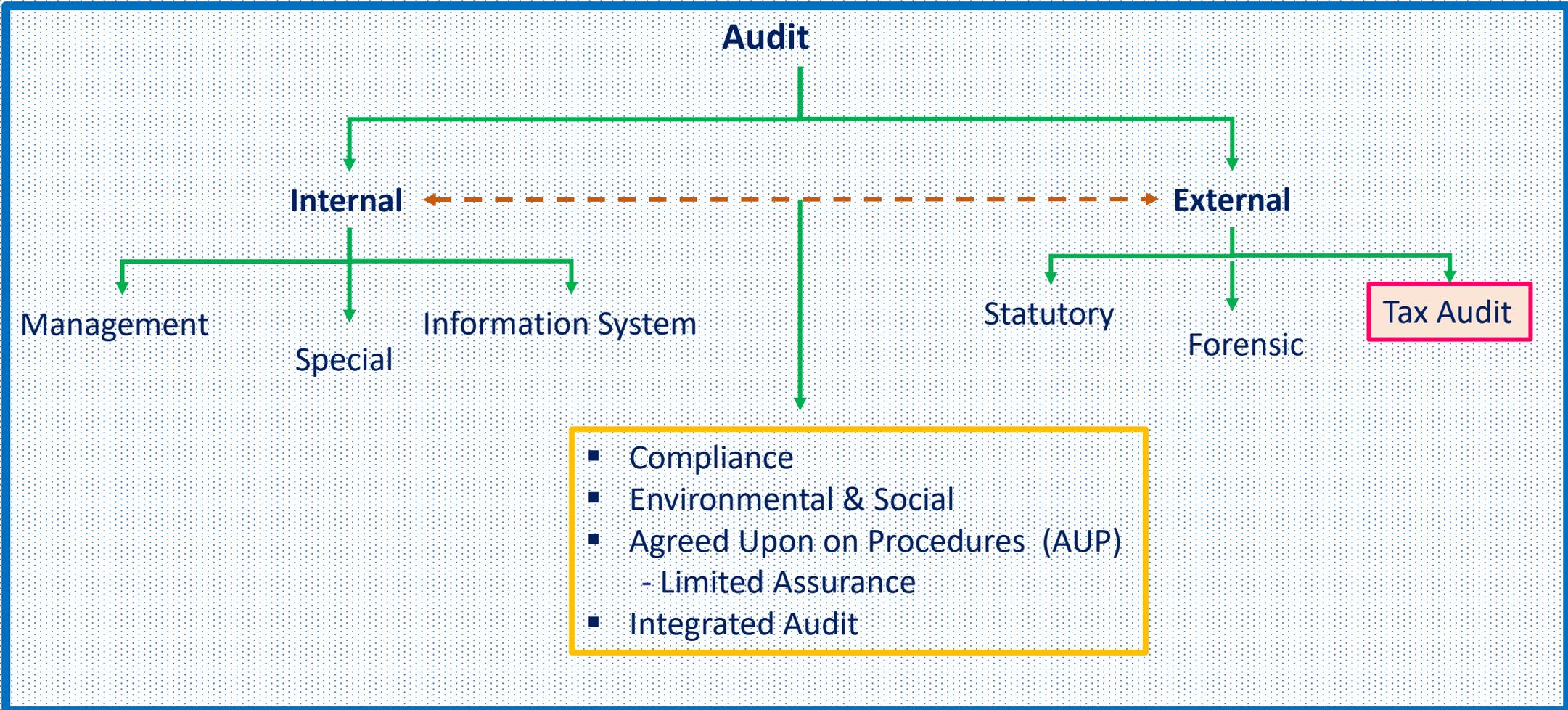
# Audit & Auditing



- **What you don't inspect you don't expect**
  
- **Inspection ensures that activities are conducted to accommodate the interest of all stakeholders**
  
- **Audit transcends inspection:**
  - examination of activities – operation, processes and systems
  - ensure conduct of activities in line with the established (agreed) standards and regulations
  - Obtain relevant evidence
  - expression of independent and objective opinion, relative to the audit objective
  - losses of all kinds are minimized or eliminated
  - helps in achieving the operation and corporate objectives
  
- **Actions (processes) and the motion for delivering audit = AUDITING**
  
- **Audit without expression of objective Opinion = diagnosis without prescription**
  
- **No Audit, no meaningful living**
  - beneficial to all stakeholders



# Audit Variants





# Audit Relevance To Taxation



- Ecology of taxation includes the Tax Authority, Taxpayer, the Government, Community, Tax Practitioners, Accountants, Lawyers, Professional Valuers and other related parties.
- The Taxpayer's responsibilities in the ecosystem includes submission of Returns, at defined intervals for the consideration and assessment by the Tax Authority
- The Tax Authority would need to review and examine the submitted Returns for completeness and accuracy within the purview of the extant tax laws, regulations/guidelines and practice.
- The demand for the review demands that the Returns – items and figures – are verified
- This verification and validation calls for specific audit. Specific audit relevant to taxation, in this circumstance, TAX AUDIT, evolved and has helped in providing comfort to all stakeholders



# Tax Audit: Introduction



## ■ Meaning

- An examination of Tax Returns, conducted by the Tax Authority, to verify the completeness and accuracy of Income, Tax Deductibles, Tax Liabilities and Tax Payments of a Taxpayer, and that all of these were done as and when due.

## ■ Object

- Primarily, to ensure completeness and accuracy of declarations (Tax Returns) and payments
- Secondly, to prevent **tax evasion**; and also to increase State Revenue
- Others: resolve conflict between tax authority assessment and taxpayers assertion



# Tax Audit: Legislative Provisions



- Tax Legislation, whilst prodding taxpayers to file returns to the relevant tax authorities at specified times, gives discretionary power to the tax authorities for the conduct of tax audit
  
- Relevant sections for tax audit provision in the tax laws start with common preface, viz:
  - “Nothing in the foregoing provisions of this section or in any other provisions of this Act shall be construed as precluding the relevant authority from verifying by tax audit any matter...”
  
- Examples of this empowering sections are:
  - CITA – Section 60 (4)
  - PITA – Section 47 (4)
  - FIRS Act – Section 26 (4)



# Types of Tax Audit



## Desk Audit



May be the first line of audit at the tax office. Tax Officer reviewing the Returns filed by the Taxpayer for completeness and accuracy

## Mail or Correspondence Audit



Following a Desk Audit, the Tax Officer may, on the discovery of incompleteness or inaccuracies, send a letter via any of the mailing systems (email, fax, courier or post office box) to request for additional documents and/or information

## Office Audit



The Tax Officer writes, inviting the Taxpayer to visit the office, with some requested documents and may also be asked to provide oral explanations to substantiate some declarations in the Returns or new info-request about him/her

## Field Audit



Here, the Tax Officers visits the office or home of the Taxpayer to verify some declaration in the latter's Returns. Enquiries may not be limited to the Returns filed and may include any other information considered necessary by the Tax Officers

## Taxpayer Compliance Measurement Program (TCMP) Audit



The Tax Officer selects a sample from a group of taxpayers for audit, with a view to assessing the compliance level of the Group. The selection may be random or sectorial, depending still, on the audit objective



# Tax Audit Triggers



Taxman

Beckons



Taxpayer

- Non-filing of Returns
- Inconsistency in Filing Returns
- Unusual rise or fall in Revenue
- Seemingly deliberate omission of income
- Unusual increase in tax deductibles

- Reinstatement of income as franked
- Business expansion with disproportionate and lower revenue
- Sudden foreign investment
- Elaborate life-style relative to declared income stream
- Whistle Blower Report



# Risk: Meaning & Description



## ■ Risk

- potential of loss occurrence
- describes a situation in which there is a chance of loss or danger happening
- outcome of an action taken or not taken
- a chance or loss of exposure to danger, arising out of internal or external factors that may be minimized through preventive measures



## Risk: Likelihood and Consequence Interplay

Likelihood	Consequence				
	Insignificant	Minor	Moderate	Major	Catastrophic
Almost certain	Medium	High	Critical	Critical	Critical
Likely	Medium	High	High	Critical	Critical
Possible	Low	Medium	High	Critical	Critical
Unlikely	Low	Low	Medium	High	Critical
Rare	Low	Low	Medium	High	High



# Uncertainty: Meaning & Description



## Uncertainty

- Absence of certainty of certainty of the outcome in a given situation
  - Not sure about the future outcome
  - A situation where there are multiple alternatives, resulting in a specific outcome, but the probability of the outcome is unknown
- Uncertainty occurs because of insufficient information or knowledge about the present condition



# Certainty: Meaning & Description



## Certainty

- mental state of being without doubt
  - assurance of an event and/or outcome
  - Perfect knowledge of event, occurrence and consequences
- 
- Is an ideal situation that never occurs and absolutely, unattainable
  - The lower the risk of occurrence the nearer the outcome towards certainty
  - In all human endeavours, risk or uncertainty exists



# Risk Vs Uncertainty



<b>BASIS</b>	<b>RISK</b>	<b>UNCERTAINTY</b>
Meaning	Probability of winning or losing something worthy	Situation, where the future events are unknown
Future Events	Probabilities are known	Unknown
Measurability	Possible, and may be ascertained	Impossible – can't be measured
Outcome	Chances of outcomes are known	Chances of, and the outcome are not known
Controllability	Controllable	Uncontrollable
Minimization of Occurrence	Possible	Impossible
Probabilities	Are Assigned	Not assignable
Insurability	Yes – risks may be insured against	No
Auditability	Possible	Impossible – waste exercise



# Broad Audit Approaches



## Meaning

- are the methods or techniques used in carrying out audit assignment towards expression of independent opinion, relative to the audit objective

## Broad Classification

- Control Based; and
- **Risk Based**

## Control Based Audit Approach

- The auditor first focuses on testing the strength of the internal control system in order to ascertain the degree of reliance he will place on the system and processes of the organization.
- Outcome of the internal control assessment influences subsequent audit steps – compliance and/or substantive tests



# Risk-Based Audit



## Meaning

- An independent and objective examination, using disciplined and evidence-based approach to assessing the effectiveness of risk management in the conduct of an audit
- Audit planning is dependent on the measure of risks associated with the audit assignment relative to the audit objective, including
  - Auditable elements being prioritized based on inherent risks and past and future assurance engagement
  - Provide comprehensive base for selecting the engagement to be included



# Risk Level Assessment

- The outcome of objective analysis of risks associated with the audit engagement

<b>RISK LEVEL</b>	<b>DESCRIPTION</b>
Very High	Major event that will require management to make large scale, long-term realignment to its operation, objectives and finance
High	Critical event, which with proper management, can be resolved by the management
Medium	Significant event that may be managed, under normal circumstances. The consequences means that the activity may be subjected to significant review or changed ways of operations
Low	An event, the consequences of which may be absorbed through normal activity or minimal management effort

Source: Government of Canada Publication on Risk-Based Audit Plan 2017-18



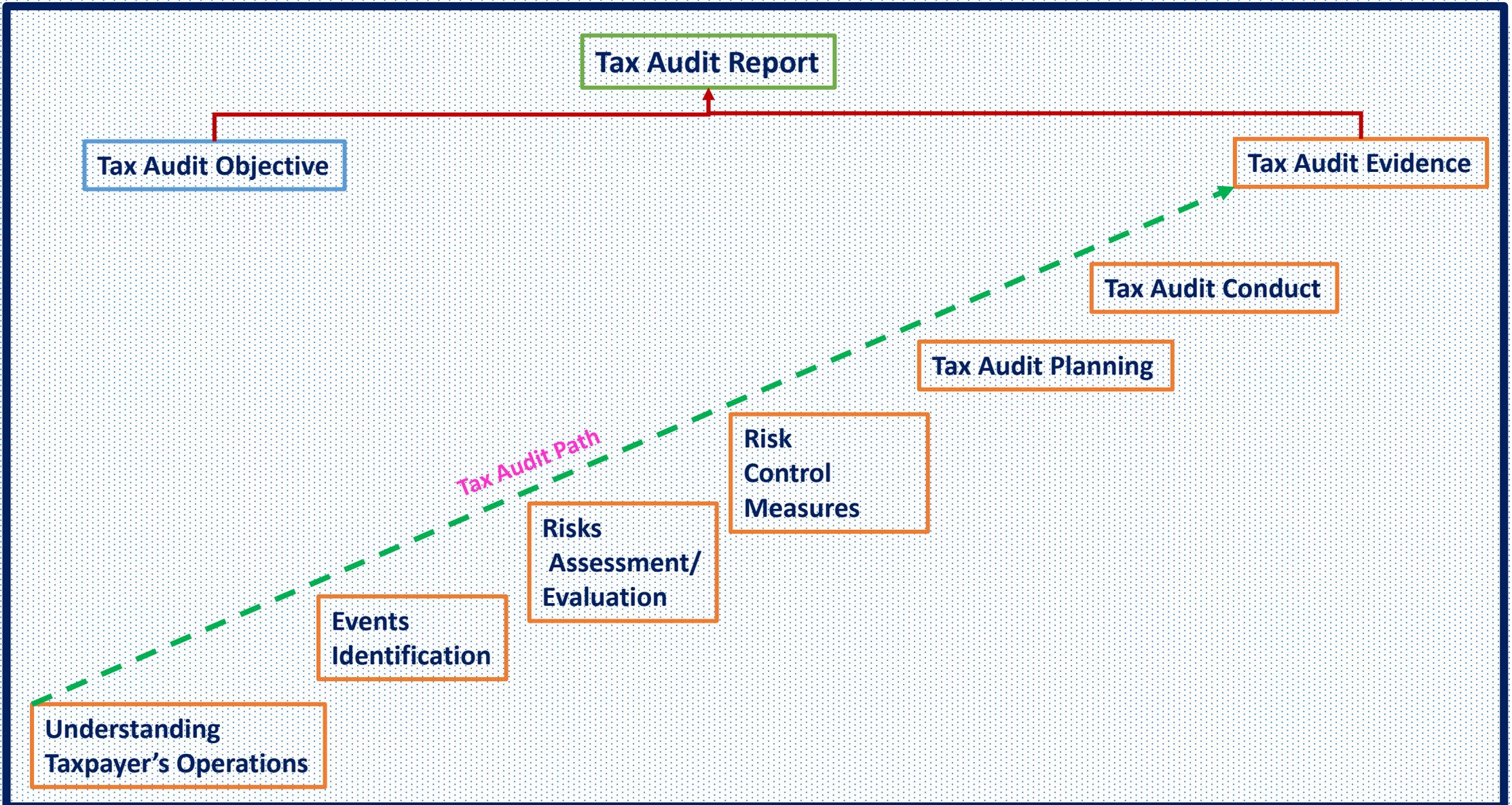
# Risk-Based Audit: Relevance to Tax Audit



- Unlike the typical financial audit, Tax Audit, is specific and conducted with a view to obtaining audit evidence that may support resolution of conflict and sometimes, litigation.
- Control-based audit is unsuitable as an assessment of the internal control activity of the target taxpayer with a view to sampling in audit may undermine the substance of the resultant audit evidence and report
- It involves full examination, without room for doubts in the audit evidences obtained
- There are inherent risks associated with all audit and the tax authority must recognize same in its audit planning, for minimization, if not eliminated:
  - Optimize audit resources
  - Best use of time allotted
  - Achieve the audit objectives



# Risk Based Tax Audit Approach





# Risk Based Tax Audit: Impact on Revenue Generation



## Circler Benefits

### Tax Authority

- Efficient use of both human and material resources
- Adequately hedge against all influencing risks
- Assurance of sufficient evidence to support assessment
- Raise reputation and credibility profile of the Revenue
- Increase voluntary compliance of Taxpayers – Return Filing and Tax Revenue

### Taxpayer

- Minimizes supply of irrelevant documents
- Saves time and engagement of productive personnel
- Contentions are relatively reduced
- Provides good learning for improvement in tax obligations
- Reduces incidence of avoidable tax penalty



# Challenges and Mitigants



CHALLENGES	MITIGANTS
<b>Tax Authority</b> <ul style="list-style-type: none"><li>▪ Application of Risk-Based to tax Audit</li><li>▪ Inadequate Technically-proficient Manpower</li><li>▪ Uncooperative attitude of taxpayer</li></ul>	<b>Tax Authority</b> <ul style="list-style-type: none"><li>▪ Policy Adoption and education of tax officers</li><li>▪ Redirect and improve staff training program</li><li>▪ Continuous stakeholders' engagement and communication of the obvious mutual benefits</li></ul>
<b>Taxpayer</b> <ul style="list-style-type: none"><li>▪ Unaware of consequential benefits</li><li>▪ Activity Disruption</li><li>▪ Fear of additional assessment</li></ul>	<b>Taxpayer</b> <ul style="list-style-type: none"><li>▪ Continuous stakeholders' engagement by the tax authority</li><li>▪ Adequate notice and improved human relations (toning down communication expressions)</li><li>▪ Continuous education of taxpayers of the mutual benefits</li></ul>



# Conclusions



- Tax audit is not a punitive engagement but an approach to improving the taxation system
- Continuous education of both the tax officers and the public is most crucial for tax-audit success
- With the risk-based approach, tax audit is made more scientific, purposeful and rewarding to all
- Circular benefits of taxation becomes more assuring with the adoption of risk-based approach to tax examination, review and audit by the tax authorities



Thank You