AFRICAN TAX ADMINISTRATION FORUM
FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

PLANNING AND EXECUTING TAX AUDIT

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9th September, 2021

Introduction

- Tax audit exercise is a veritable compliance enforcement mechanism

- Primarily designed to examine a taxpayer's financial affairs in order to ascertain the correct amount of taxes to be paid by the taxpayer and raise additional revenue from detected discrepancies

- An effective program of tax audit nudges taxpayers to voluntarily comply with the tax laws and guarantees retributive fairness.

- A properly planned and well executed tax audit activities can promote all round compliance risk management:
    - deterring tax evasion
    - correcting and educating taxpayers,
    - ensuring timely collection of tax arrears,
    - prosecuting tax offenders,
    - gathering intelligence on emerging tax compliance risks as well as
    - building confidence in the tax system and promoting voluntary compliance with the tax laws

Types of Tax Audit

1. Desk Audit

- Also known as desk review, desk examination or correspondence audit.
- Carried out at the tax administration's office without field visit to the taxpayer's office.
- Aims to ensure completeness and arithmetical accuracy of filed declarations.

2. Comprehensive Audit

- All the tax obligations of a taxpayer over some prior periods are selected for extensive examination.
- Requires having a pre-audit meeting with the taxpayer, field visit to the taxpayer's office and reconciliation meetings.
- Entails the use of a range of audit methodologies to carry out elaborate vetting and verification of the tax declarations, financials statements, the underlying records, books, and accounts of the taxpayer.

3. Single-Issue Audit

- Also known as specific issue audits, focusing on a single tax type or a single matter of interest.
- Quick response audits with a narrow focus but a thorough and exhaustive probe of a single matter.
- Examples are: Refund Audits, Mergers and Acquisitions Audits, Audit of Tax Incentives Schemes, registration audit, value added tax audit, withholding tax audit, capital allowance audit etc.

Audit Case Selection

- Audit case selection decisions should be based on clearly established methodology for identifying companies for tax audit.
- The methodology should assess the risk of every company in the tax administration's database by ranking all taxpayers using any number of factors and criteria to indicate and rate risks.
- Weights could be assigned each criterion based on a country's prevailing circumstances, and the criteria could then be weighed with the volume of transaction to generate a risk ranking for each taxpayer.
- The goal is to uniformly apply the risk assessment criteria to all companies so that the highest risk companies are selected for tax audit each year.
- The number of taxpayers that can be selected for audit from among the ranked/risk assessed database in any one year will be a function of the amount of audit resources available within the tax administration

Audit Case Selection (Cont'd)

- The following criteria among others could be used in an audit case selection risk assessment process:

SEGMENTATION	BUSINESS DECISIONS	FINANCIAL RATIOS	TRANSFER PRICING ARRANGEMENTS	SUNDRY CRITERIA
Taxpayer sector/industry	Liquidation/ Receivership	Tax burden ratios	Related party transactions	Stop filers
Volume of export	Public offer of shares	Debt to equity ratio	Transactions with companies in a tax haven or secrecy jurisdiction	Claims under double taxation agreements (DTA).
Volume of turnover	Change in accounting date	Profitability ratios	Complex group structures – foreign ownership	Fire/natural disasters
Volume of importation	Change in accounting software package	Tax adequacy ratio	Incorporation in a known tax haven	Nil returns or continuous loss situation.
Volume of staff turnover	Change in stocks valuation method	Ratio of contract to permanent workers	Thin capitalization	Claims under a tax incentive or waiver scheme.
Frequency of refund claims	Mergers or acquisitions or other business restructuring schemes	Ratios of specific items in the tax declarations i.e., capital allowances as a percent of total costs compared to the industry average.	Management fees, consulting fees, technical fees payment to a related company	Grossed up turnover from WHT data compared to turnover reported in the tax declaration

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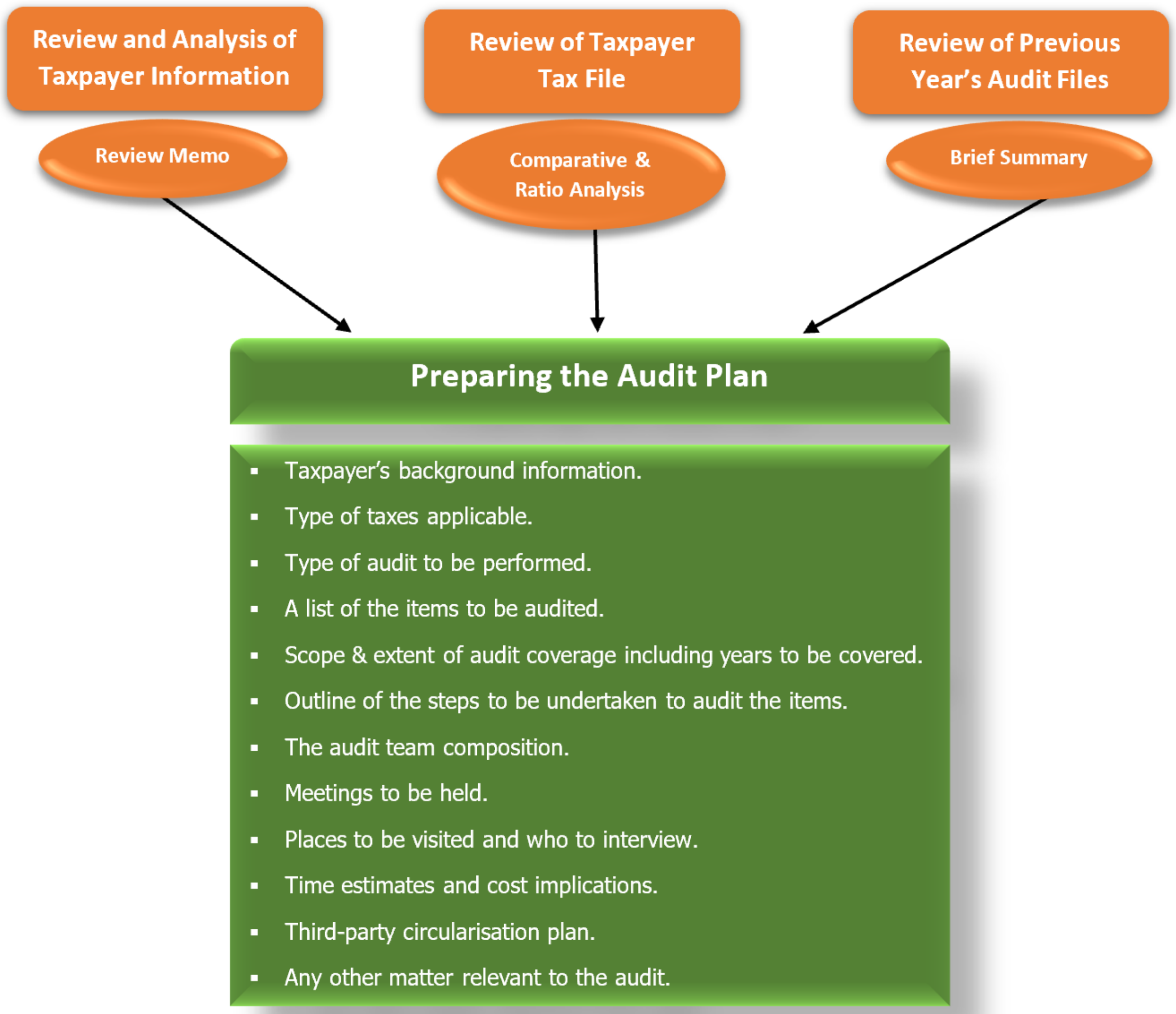
Pre-Audit Activities

- At the beginning of an audit process, certain pre-audit activities must be carried out before contacting the taxpayer:



Pre-Audit Meeting

- The pre-audit meeting should be held in accordance with the date and venue earlier arranged

- The essence of a pre-audit meeting is to:
  - gather detailed information about the taxpayer's business,
  - confirm the background information that have been accumulated during the file review, and
  - understand the taxpayer's specific circumstances based on accurate information.

Field Audit Process

This stage is where the principal activities of the tax audit exercise take place, and it is usually performed at the premises of the taxpayer.

It involves taking a detailed look at the taxpayer's books and the underlying accounting records in order to determine whether or not the correct amount of taxes have been paid for the income earned, taking into consideration the local accounting policies and the relevant tax legislations.

Field audit visit entails the use of a range of audit methodologies (e.g., direct, and indirect audit methodologies) to carry out elaborate vetting and verification of the tax returns, financial statements, the underlying accounting records, books, and source documents of the taxpayer.

Post Audit (Closeout) Meeting

Held at the conclusion of the field audit visit at the premises of the taxpayer or its authorized representative.

It marks the end of the field audit exercise and departure of the tax audit team from the taxpayer's premises

The purpose of a post-audit meeting is to:

- obtain any further outstanding information and documents that may be available only from the taxpayer's management ,

- get answers to outstanding question that arose during the field work, and

- provides an avenue for the audit team members to educate the taxpayer on areas where inadequate compliance to tax laws and policies have been observed during the course of the field audit.

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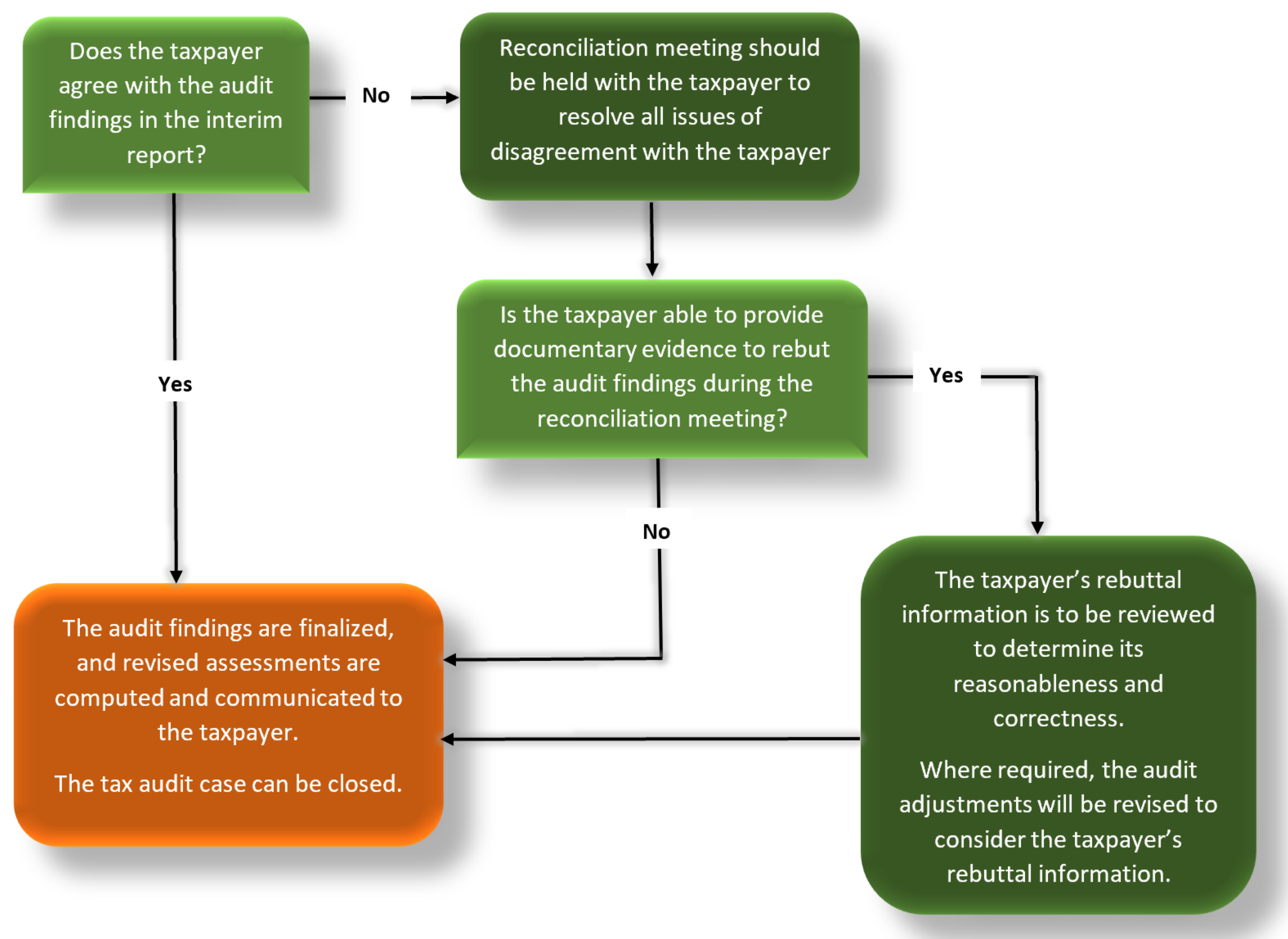
Interim Report & Reconciliation of Audit Findings

- Interim report highlights details of all findings during the audit exercise including those that may result in additional tax assessment, areas of possible dispute with the taxpayer and suggestions for resolution.

- After the field audit, a summary of the interim report and an invitation to a reconciliation meeting should be sent to the taxpayer.

- The purpose of the reconciliation meeting is to resolve all outstanding issues arising from the field exercise by giving the taxpayer the opportunity to provide further documents and information that might affect the final position of the audit exercise.



Closing an Audit

- An audit would be considered completed when the resulting issues from the field exercise have been resolved and revised assessments (if any) have been finalized.

- This is normally after all reconciliation meetings have been held and the only outstanding issue is collection of the additional assessments that emanated from the audit.

- Established policies and procedures in each tax administration will stipulate the specific processes that should be completed towards closing a tax audit case, nevertheless it normally requires performing some chain of activities including:
  - preparing and communicating the interim report to the taxpayer,
  - holding reconciliation meetings with the taxpayer,
  - processing revised assessments,
  - preparing the final audit report, and
  - obtaining the necessary approvals for case closure.

- Tax administrations are enjoined to put in place an appropriate level of control that will ensure that audit cases cannot be closed until there is an assurance that all of the information relevant to the audit is well documented in a single file, appropriately referenced and cross-referenced.

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- Thank you for your attention!