

**NIGERIA
GOVERNORS'
FORUM**



HelpDesk

A Practical Approach to Conducting Effective

Tax Audit and

Investigation

for State Internal Revenue Services



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Foreword

The Nigeria Governors' Forum (NGF) has continued to play an active role in strengthening institutional and governance systems at the sub-national level. This support has been through the provision of evidence to influence policy formulation and implementation; the development of knowledge resources to strengthen the implementation of reforms; and the delivery of platforms for peer learning; in areas such as economic development, public financial management, health, human resource management and citizens engagement amongst others.

To strengthen the reform environment and fast track full domestication of commendable practices across the 36 States, the NGF Secretariat also develops guides for implementing various reforms based on extensive experience in peer reviewing the 36 States in the last 10 years. This has significantly improved the way State governments run and the overall governance climate in the country.

We encourage States to adopt the approaches documented in this guide given that they have worked in many States. The guide is also used by the NGF Secretariat to build the capacity of State governments in strengthening domestic revenue mobilisation. It has served as a functional tool at different administrative levels, in the design, implementation and monitoring of sub-national tax reforms.

We express our profound gratitude to our development partners for the support provided in the production of this guide.

Asishana Bayo Okauru Esq.

Director General

Nigeria Governors' Forum



Prelude and Acknowledgement

The HelpDesk is a technical support programme instituted by the Nigeria Governors' Forum (NGF) to support States in improving their development performance, by providing demand-based advice, knowledge resources and technical support in the areas of Public Financial Management (PFM) and Domestic Financing (Internally Generated Revenue). This publication is a compendium of resources designed to guide State Internal Revenue Services (SIRS) in conducting effective tax audits and investigations.

The tax audit guide was prepared by a team led by Olanrewaju Ajogbasile supported by Dr. Mark Abani, Zubaida Abiola and David Nabena.

Acronyms and Abbreviations

BoJA	Best of Judgment Assessment
CAC	Corporate Affairs Commission
CBN	Central Bank of Nigeria
FIRS	Federal Inland Revenue Service
IRS	Internal Revenue Service
JTB	Joint Tax Board
PAYE	Pay as You Earn
PITA	Personal Income Tax
SIRS	State Internal Revenue Service
TIN	Taxpayer Identification Number
VAT	Value Added Tax
WHT	With Holding Tax

Section One:

Introduction

An audit is an official inspection of an entity's (Person or organization) account, systems or process typically by an authorized and independent body or person to ascertain inherent risks, compliance with set standards and obligations. Where such an assessment is focused on the review of financial records, books and accounts, it is referred to as a financial audit while any focused on existing systems or processes is called a system audit. Financial audits are done to check if there are irregularities in an entity's accounting operations and to ascertain its financial standing while a system audit is conducted to ascertain inherent risks that might affect an entity's operation.

Audits are also conducted as part of the tax assessment process especially where taxpayer compliance is considered poor. More specifically, they are conducted for the following reasons:

1. To address non-filing of tax returns
2. To check the returns turned in by taxpayers
3. To ensure the right assessment is raised and the correct amount of tax is collected.

Hence, in the context of tax assessment, an **Audit** can be defined as the examination of an entity's (Person or organization) tax returns and sometimes underlying financial and non-financial records by tax authorities to ensure that the entity's' income declaration and deductions claimed are accurate. However, **tax investigation** may be carried out where fraud and deliberate false declarations are suspected. An investigation is much more detailed than an audit. While some of the techniques adopted in audits and investigations may be the same, investigations are conducted with the intention to legally prosecute or sanction more severely the concerned entity.

Background to Tax Audit and Investigation

A tax audit entails the review of a taxpayer's records to ascertain compliance with the relevant provisions of Nigeria tax laws. This review is usually conducted within a six-year period from the date of submission of the relevant returns. However, where the tax authority suspects *fraud, neglect or willful default*, an investigation may be conducted in the first instance **within the six year window** but where suspicion arises about previous years, the audit/investigation can go back to as many years as is required or relevant to the case.

Following the introduction of the **self-assessment tax filing regime in 2012**, the State Internal Revenue Service (SIRS) is required to periodically review and verify the tax returns submitted by taxpayers by way of an audit and/or investigation. The exercise essentially is meant to enable the SIRS verify that the relevant returns submitted by the taxpayer agree with the underlying records and are sufficient for the purpose of determining the taxable profits of the taxpayer and consequently the tax payable. Where self-assessments are not returned and the tax authority issues a **Best of Judgment (BoJ) Assessment** but receives an objection from the taxpayer, the Service may also conduct a tax audit. The audit can be conducted before it re-issues the BoJA/or a revised version based on its findings during the tax audit. Legally Section 40 – 58 of PITA 2004 (as Amended 2015) gives the authority to conduct audits including the right of the tax authority to access information. Additional assessments where errors are found, can be made under Section 55 of PITA and Section 20 of the Tax Administration (Self-Assessment) Regulations 2011 while Best of Judgment assessments are specifically premised on the provisions in section 54 (3) PITA 2004 (as Amended 2015).

Tax Appeal Tribunal in the case of Polaris Bank plc v Abia State Board of Internal Revenue - Appeal No. TAT/SEZ/001/17 (21August 2019)

A recent decision by the Tax Appeal Tribunal in the case of Polaris Bank plc v Abia State Board of Internal Revenue ruled that while an audit or investigation can be conducted without a time limit, an SIRS must issue any assessment within a period of six years from the date of submission of the relevant returns. However, where the tax authority establishes fraud, neglect or willful default, an the audit/investigation can go back to as many previous years as are relevant (i.e. without any time limit) and consequential assessments raised for those additional years of assessment. The tribunal also set aside the demand notices issued by ASBIR as statutory steps were not followed in determining the alleged final and conclusive assessments. The SIRSs must follow the procedures relating to objections (S58 PITA) including specifically addressing the issues raised in the objection and if necessary issuing a notice of refusal to amend the assessment under appeal.

Rationale for Tax Audit

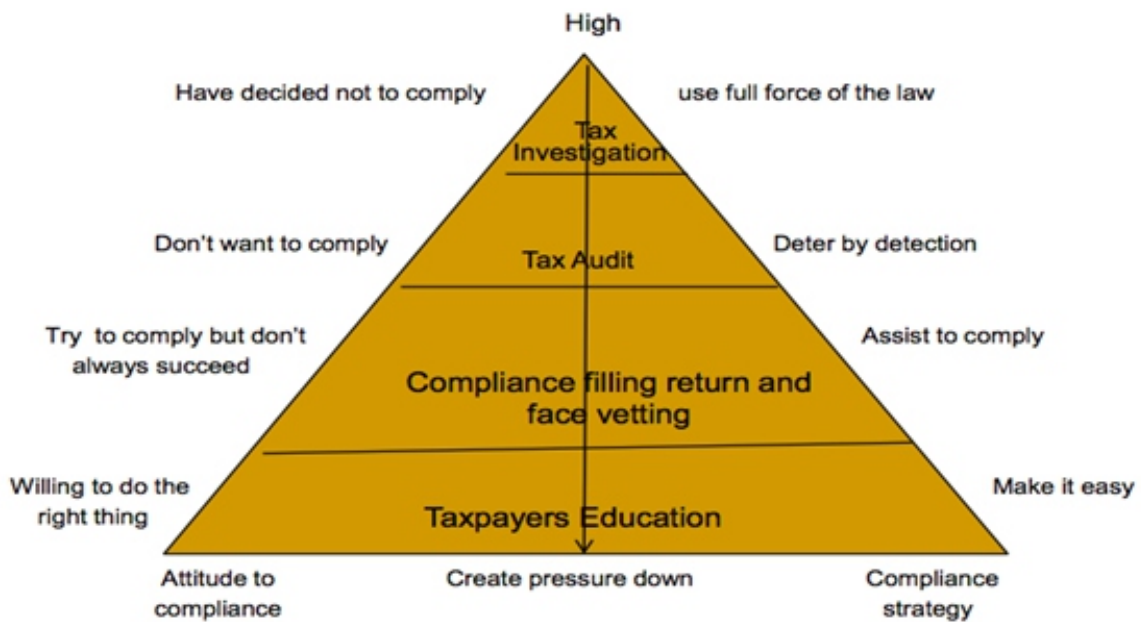


Figure 1: Pyramid of taxpayer behavior and possible SIRS approaches to address non-compliance

Evasion Activities

The following are evasion activities by taxpayers that are potentially criminal:

- Deliberately underreporting or omitting income
- Keeping two sets of books
- Making false entries in books and records
- Claiming false deductions
- Hiding or transferring assets or income

The Difference between Tax Audit and Tax Investigation

Tax Audit	Tax Investigation
<ol style="list-style-type: none"> 1. Examines the taxpayer's business records, accounts and financial affairs to ascertain the taxpayer's tax compliance. 2. Educates or clarifies contentious areas/ unclear issues relating to a taxpayer's return 3. Discrepancies established could lead to additional assessment being served on the taxpayer 	<ol style="list-style-type: none"> 1. Conducted where there is suspicion of tax avoidance and evasion 2. Investigates taxpayer's business records, accounts and financial affairs to gather admissible evidence to prosecute where possible 3. Established contraventions with the revenue laws could lead to criminal prosecution or distraints to recover tax undercharged

Tax audits are permitted by the law and are conducted by a certified/trained tax inspector or relevant officer who is a staff of the SIRS and possesses investigative skills acquired through specific training including the rules of evidence. It is often planned and requires formal communication about the audit (including their rights and obligations) be sent to the taxpayer. However, the SIRS do not need to divulge specific information on areas to be reviewed. Generally, tax audits start at the point the last audit ended, hence a tax audit cannot be carried out on previously SIRS audited financial statements unless new information is discovered, at which point, the SIRS should consider conducting a tax investigation. The findings of a tax audit may lead to additional assessments; or be extended to a full investigation, which will focus on areas of risk of non-compliance. Tax audits rely on evidence submitted by a taxpayer and what can be garnered by enquiry using good interview techniques.

A tax investigation on the other hand can override audit if appropriate. Good practice is that taxpayers are informed that an investigation is taking place and are given advance warning of their rights and responsibilities just like in the case of audit. Tax investigation may lead to prosecution or end with an audit being closed with no action. It is often initiated based on suspicion and evidence may arise from sources other than the taxpayer/entity- Information from informants or indictments from a money trail/account/computer forensic, third party etc.). The purpose of an investigation is to collect evidence, which may satisfy three conditions affirmed hereunder as:

- A criminal violation
- Loss to government revenue
- Intent to deny government revenue

Objectives of Tax Audit

Tax audits allow the SIRS authorities to:

- Determine if adequate accounting books and records exist for the purpose of determining the taxable profits or loss of the taxpayer and consequently the tax payable
- Determine if the tax computations submitted to the authority by the taxpayer agree with the underlying records
- Determine if all applicable tax legislations have been complied with
- Detect and correct accounting and/or arithmetic errors in tax returns
- Identify cases involving tax fraud and recommend them for investigation
- Forestall a taxable person's failure to render correct tax returns in the future
- Counter a taxable person rendering incomplete or inaccurate returns in support of the self-assessment scheme.

- Provide a reasonable source of information for a BoJA in cases where records are incomplete.
- Provide an avenue to educate taxpayers on the interpretation of the law and their obligations
- Discourage tax evasion by creating an understanding that returns will be checked
- Detect and correct accounting and arithmetical errors (negligence)
- Provide SIRS management feedback on the provision of the laws and recommendations to counter any lacuna or unintended impacts.
- Validate the assumptions behind a BoJA and/ provide evidence to uphold, amend or discharge the BoJA

Section Two:

Taxpayers Rights and Obligations

In conducting all tax activities, it is important to bear the taxpayer's rights and obligations in mind. This is more so during the conduct of audits where an SIRS charter of taxpayers rights and obligations make it clear to both staff and taxpayers what each party should do.

Taxpayers Rights	Taxpayers Obligations
<ul style="list-style-type: none">● Impartial treatment● Privacy and confidentiality● Presumption of honesty● To object to tax assessments● To benefit from tax reliefs and exemptions under the law● Non-suspension of business operations during audit● Information on consequences for non-compliance	<ul style="list-style-type: none">● Registration with tax authorities● Filing of returns on time● Accuracy of returns● Timely payment of taxes● Issuance and demand of fiscal receipts/tax invoices● Cooperation with SIRS<ul style="list-style-type: none">* Respond to queries* Provide access to relevant books, places, documents, records, etc.

Section Three:

The Audit Process

Desk audits are routinely carried out and the focus is to look for apparent errors or mistakes in computations or obvious inconsistencies with known facts. If material matters are found then a field audit may ensue. However, this is guided by the process detailed below;

Stage 1: Case Selection

An inspector reviews taxpayer returns and information and selects a case for potential audit; recommending next steps to his/her manager.

Stage 2: Pre-Audit Work

The manager reviews and if in agreement, asks for an audit plan, which often includes a review of the case and findings, areas of concern and ways to manage possible taxpayer resistance or risks identified with the case. The lead inspector while preparing the audit plan should identify also the number of staff needed to conduct the audit. The number of staff will depend on the size, complexity and related security issues. Everyone in the team must be aware of the background of the case for audit.

Stage 3: Notice Letter/Information Enquiry Letter

A letter is sent to the taxpayer putting he/she on notice for audit and informing the individual of his/her rights and responsibilities as well as asking initial questions and/ inviting the taxpayer for an interview/meeting.

Stage 4: Audit Interview/Meetings

Depending on preliminary assessment and taxpayer compliance with notice or information enquiry, a field audit can commence or the concerned taxpayer can be invited for interview at the revenue service. If an interview is to be conducted, the lead inspector is expected to develop interview questions that will aid clarity on the case and possibly make the case conclusive.

Stage 5: Interim Report

Interim reports for SIRS Management are provided at regular intervals (minimum 3-6

months); highlighting additions to tax assessments or reductions to existing assessments, to ensure the case is being actively worked.

It should:

- Highlight potential dispute areas and suggest resolution strategies
- Outline next steps for approval by management.

Stage 6: Reconciliation Meetings

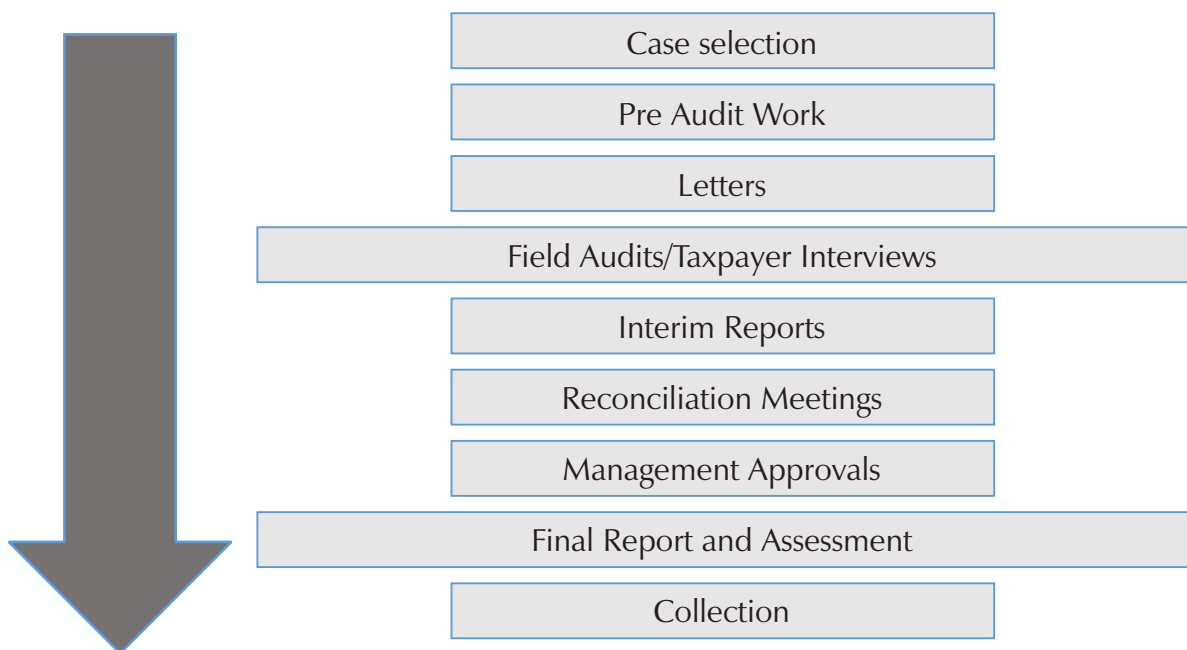
A reconciliation meeting is scheduled with the taxpayer being audited to clarify grey areas and go over his/her assessment. At this point the taxpayer can raise objections tendering counter facts to his/her favor where existent. The aim of the reconciliation meeting is to reach an agreement on the BoJA/a revised version.

Stage 7: Management Approval

The revised BoJA is presented to management for further review and approval.

Stage 8: Final Report and Assessment

Based on the management's review submission, a case report is developed and the approved BoJA is served on the taxpayer for payment.



The Polaris Bank plc v Abia State Internal Revenue Service reinforces the need to have and follow basic processes, as this ensures that any case proceeding to litigation is solid and without basic primary flaws that will undermine the SIRS's case.

Check List for Audit

Using an audit checklist is a simple way of making sure that all relevant information has been collected and gaps or information not considered at this point may adversely affect later audit activities.

- Taxpayer details:
 - Name/Taxpayer Identification Number (TIN)
 - Address
 - Business address
 - Registered Enterprise
 - Date of commencement and accounting year
 - Nature of trade(s)
 - Any advisers/accountants
 - Associated company directorships
 - Public information held
- Revenue information held
- Accounts held
- Returns held
- Information held
- Years under enquiry
- Previous audits and outcomes
- Records and books needed
- Business economics ratios for similar businesses if applicable.
- Assets owned/held
- Profitability tests
- Areas of likely risks:
 - Cash business
 - Out sourcing
 - Income suspected to have been omitted

Approaches to Selecting Cases for a Tax Audit

The SIRS may adopt any of the approaches below or a combination in conducting its reviews.

1. **Holistic Approach:** Under this option, taxpayers are selected for a review periodically. The review is to enable the SIRS confirm the appropriateness of self-assessed returns. The exercise is typically carried out annually or biennially etc., and it is solely at the discretion of the SIRS to determine the frequency. It is also called the RANDOM Approach

2. **Targeted Approach:** Under this option, the taxpayer's records may be reviewed based on leads from intelligence gathered internally or from external sources. The SIRS would typically focus on the 'suspicious' areas during this type of audit.
3. **Risk-based Approach:** Under this option, the SIRS assess the taxpayer's records against industry standards and operational peculiarities based on predetermined parameters. Thereafter, only selected records that fall within the predetermined parameters are identified for review.

These approaches are all in keeping with the case of *CIR v Attah (1970) NCLR 121*

The SIRS may adopt any of the criteria below or a combination in conducting its reviews for potential audits:

1. **Self-Assessment case:** Under this option, taxpayers are selected for a review if at least 2 years have passed since last audit
2. **Taxpayers with refund claims:** Generally to qualify for tax refunds an audit will be conducted
3. **Taxpayers with nil returns and/or permanent losses**
4. **Taxpayers with low adequacy ratio** (*The facts preliminary facts of their return) do not add up*)
5. **Third party information sources and reports**
6. **Secondary relationships with other taxpayers or businesses under review or audit.**
7. **Unusual businesses or requests.**

Section Four:

Conducting Interview Meetings

Interview meetings with the taxpayer are a vital part of more complex audit work. Correspondence or meetings with the taxpayer's accountant are not normally an adequate substitute. The best way to get the facts about a business and the proprietor or director's financial affairs is face to face.

Why Conduct Interview Meetings?

Interview meetings enable the inspector to:

- Obtain facts from the taxpayer about their business; how he/she runs it and the records that he/she keeps.
- Obtain the facts in non-business audits to provide context
- Explain the purpose of the audit. Taxpayers may not always be fully aware of the extent of the SIRS audit
- Establish whether the taxpayer wishes to disclose omissions
- Agree what action is required and by whom, to move the audit towards conclusion
- Ensure that, where omissions have been found, the taxpayer is aware what offence has been committed, the likelihood of penalties and the benefits of cooperating in bringing about an appropriate settlement as soon as possible. But, the inspector should make it clear that it is entirely up to the taxpayer to decide whether to cooperate and to what extent he/she will
- Quantify and agree on omissions/inaccuracies and establish the underlying behaviours that led to them
- To possibly bring the tax audit to a conclusive end

When conducting an audit the inspector needs to consider whether holding a meeting with the taxpayer and/ their accountant will be the most effective way of establishing all the relevant facts. The information needed for most audits will not just consist of records and documentation but also explanations from the taxpayer. It will often save time and cost less if these are obtained at a meeting rather than by correspondence.

A meeting with the taxpayer or their business's accountant, if they have one, may also be valuable in understanding how the records were built up and linked together and how the

accounts have been prepared. In some cases a meeting with the accountant may enable inspector to resolve issues without troubling the taxpayer. The number of meetings, the subject matter and who attends will depend on the emerging circumstances but the inspector should bear in mind that interview meetings can be expensive and inconvenient for taxpayers.

To this end inspectors should:

- Prepare thoroughly including mastering the appropriate laws and relevant facts of the case
- Prepare and issue an agenda
- Make it clear to the taxpayer and agent at the end of the meeting exactly what is required of them after the meeting.

Approach to Conducting a Good Interview Meeting

Below are key activities to conducting an interview meeting:

1. Prepare for the Interview Meetings

In the early stages of an audit, an inspector must view the opening meeting as an opportunity to establish facts and raise concerns with the taxpayer face to face.

The extent of preparation is unique to each case; however, an inspector should always do the following when preparing for a meeting.

- Consider the purpose of the meeting. What are the facts of the case and what remains unclear? What information is needed to address the risks identified and any concerns of note?
- Ensure efforts are made to explain the reason for the meeting
- Document the interview questions and ensure they are clear and not ambiguous.
- Review thoroughly all information relevant to the case. Well-ordered and documented reviews notes allow an inspector refer to matters quickly and easily during meetings.
- Ensure there is a consensus with management on applicable parameters within which you can reach an agreement of profit levels or the basis of settlement. In many cases, it will become clear during the course of the interview that omissions are sufficiently large and culpable for the audit to be extended into earlier years. The middle of a productive meeting is not the time to break off to check with managers, as this might cause a delay in settlement.

2. Secure a Safe and Comfortable Venue

Interview meetings can be held at the taxpayer's business premises or at the SIRS. It is usually beneficial to the inspector and more comfortable for the taxpayer if the meetings are held at the business premises of the taxpayer. This will allow the inspector get a hang of the day-to-

day operation of the business and easier access to business records on demand where necessary. Also, the accountant of the business can be co-opted in the meeting where substantial clarification is required. If the meeting must be held anywhere else such as the private residence of the taxpayer, safety is paramount and must be ascertained before proceeding. The inspector must uphold the highest levels of professionalism and perhaps go with a small team to limit the chances for misinterpretations or allegations.

3. Develop an Agenda and Inform the Taxpayer in Advance

An inspector must always develop and provide the taxpayer an agenda ahead of the meeting highlighting the main areas for discussion. This will enable the taxpayer and/his/her agent to carry out any necessary preparation or research in advance of the meeting therefore saving time. It should be case specific but not the detailed list of questions meant for the interview. It should also not be seen by either party to be exhaustive or restrictive. The whole point of the meeting is to obtain information and answers that can help clarify grey areas or uncertainty in the case. However, this could inevitably lead to further questions, which is why meetings can bring much faster progress than correspondence. An inspector can ask non-specific questions, as long as it helps to establish facts of the case, especially when something unexpected is revealed shortly before or during the course of the meeting. Although, it is good practice to stay within the agenda to keep meetings short and simple to avoid time cost to the SIRS and the taxpayer.

4. Invite Taxpayer's Agent/Accountant

If the taxpayer has an agent/accountant and wants he or she to be present for the meeting, the inspector should make do to extend an invitation alongside the agenda for the meeting. On this note the meeting should only proceed in the absence of the taxpayer's agent/accountant if he/she had declined the invitation to attend or the taxpayer is adamant and comfortable with proceeding without the agent/accountant.

In the case where an agent/accountant is present, such person may attempt to answer questions on behalf of the taxpayer, it is advised that the inspector does not allow this but ensure the taxpayer provide feedback himself/herself on questions or matters arising. The agent/accountant should be informed that he/she is there in the capacity of a counsel to the taxpayer and not as a respondent. Hence, the agent/accountant can be allowed interjectory recess to deliberate with the taxpayer, perhaps where he/she believes the taxpayer can provide better clarity to answers provided.

5. Take Meeting Notes

An interview note is a factual summary highlighting all the important points of a meeting or telephone conversation with the taxpayer. An inspector should always make notes in meetings and telephone conversations with the taxpayer. It is advisable not to make **audio**

or video recording of the meeting, as there are legal implications. Hence, the SIRS should have a strong policy regarding recordings to avoid avertable lawsuits. However, the inspector's notes should be an accurate interpretation of the discussion that happened during the meeting/conversation and not subjective or implied thoughts of the either parties.

At the end of the meeting or conversions, a copy of the notes should be made available to the taxpayer and his/her agent/accountant to agree as to the accuracy of the notes. Like many aspects of audit work, an inspector's conduct of interview meetings improves with practice and experience. However, this is premised on good and adequate preparation for meetings. An inspector must always have an objective for every meeting; establishing the scope of findings upon which questions will be asked, what is to be achieved and what information to obtain.

The guidance below explains what notes inspectors should make, how to make sure they produce good quality notes and how to use them appropriately.

- **Prepare a Brief**

An inspector is expected to prepare a brief prior to the meeting to act as a prompt as the interview progresses. A brief would usually include indicative questions that will provide clarity to the case if answered. This helps keep the interview focused and brief.

- **Take Correspondence Notes**

The inspector should ensure the taxpayer and his/her agent/accountant are informed that the meeting will be recorded and all information exchanged are evidence to the case be it in writing or by verbal submission. Also, the inspector should inform both parties that a copy of the notes would be made available to them. Upon agreement to proceed, the inspector should take note of all correspondence during the meeting, not necessarily word for word but ensure feedback to the indicative questions are clearly captured as provided by the taxpayer. Where the taxpayer makes critical/decisive submissions to indicative questions during the meeting, it is important the inspector repeats to the taxpayer exactly what their statements or evidence filing implies just so both parties understand and are in agreement of the interpretation. At this point it is common for taxpayers to put up an attitude; the inspector must remain professional disregarding in his notes any demeanour, appearance or attitude of those attending the meeting, unless their behaviour interrupts the progress of the meeting. Also, the inspector's perception of the taxpayer for any reason should not play an evidentiary role or be included in the notes. Correspondence notes are important hence should be kept even after a synthesis report has been developed after the meeting.

Correspondence notes may be useful if there is a dispute about what was said and may be required if the case goes to a tribunal hearing.

- **Communicate Immediate Next Steps at the End of the Meeting**

At the end of the meeting, it is vital that the taxpayer leaves knowing exactly where he or she stands. If there is likely to be additional liability, what does he or she need to do in terms of co-operation, payments on account, etc. If more information or documents are needed, the taxpayer should know what has to be provided and within what timeframe.

To avoid any miscommunication/misunderstanding the inspector should follow up with a letter as soon as possible after the meeting, setting out the details required and timetable for submission. The letter should state anything that was agreed as next steps including interest calculations where applicable. Final report of the meeting can follow separately where it has not been developed.

- **Prepare a Synthesis/Final Report**

Upon concluding the interview meeting, the inspector should prepare a synthesis/final report, often a concise version of the correspondence notes. It is advisable that this is done the same day because the longer the delay in preparing the report the more likely it is that there will be omissions and errors. Also, delays have legal implications for report accuracy. For example, if an inspector is called as a witness at a tribunal hearing, cross-examination would quickly establish the length of time since the interview, the number of meetings held and the lack of reliance which can be placed on delayed reporting of interview events or submission especially where discrepancies are identified between the correspondence notes and the final report. In case of the latter, the inspector's testimony loses credibility and waters down any supposed facts emerging from the report. Usually a final report will include the following:

- The date on which the meeting took place, the location and the names of all participants
- The starting and ending time of the meeting
- The titles of all present consistently. For example, participants' titles should be consistent across all notes and reports to ensure accurate interpretation
- A factual summary of what took place
- A list of information/documentation exchanged between the taxpayer and the inspector.
- The date the final report was concluded as the inspector might not conclude his/her report the same day as the interview meeting due to several reasons including expectation of additional information from the taxpayer agreed to at the meeting. Also, all required parties might not sign off on the report the same day

Similarly, a final report must not include the following.

- Just like in the correspondence notes, the final report should disregard any demeanour, appearance or attitude of those attending the meeting, unless their behaviour interrupted the progress of the meeting. It should only record the relevant facts and should not under any circumstances record any comments about the inspector's perception of the taxpayer/his/her agent/accountant.
- The report should not read any statement or event that did not happen as this will only misrepresent facts and discredit supposed facts that might actually emerge from the report.

- **Sign the Final Report**

Immediately after a series of thorough reviews to ensure compliance with the guidelines provided above, the inspector and any other SIRS officer present at the interview can sign (with date) once satisfied with the content.

- **Communicate Final Report to Taxpayer and Agent/Accountant**

The signed final report should be communicated to the taxpayer. However, it is possible that the inspector just after signing off uncovers additional information, which might warrant an amendment to the report. In this case a separate note has to be provided, indicating the reason for the amendment rather than making manuscript amendments to the first version of the final note. It follows that where an inspector has provided the first version of the final report to the taxpayer (and agent/accountant), they should be given the opportunity to consider any amendment that might arise afterwards.

- **Agree Final Report with Taxpayer and Agent/Accountant**

Where the inspector had informed the taxpayer (and agent/accountant) of the need to sign communicated final report, it is expected that they comply except for instances where either parties object to content and desire an amendment. In which case, amendments will be recorded in a separate document. Overall, it is important the taxpayer sees what the inspector recorded to avoid problems later in the audit or post-audit legal processes.

Even the best audit officers can make mistakes in writing up the notes/report hence the need for both parties to agree on the final report content.

These are reasons to share the final report:

- The taxpayer may disagree with the report due to an error in the presentation of facts, which might arise from misinterpretation of some statements by the taxpayer.
- The taxpayer may disagree with the report because he/she wishes to change testimony or provide additional information/evidence to back certain statements made at the

meeting. In this case, the taxpayer will have to agree initially to the first version of the final report as a true record of the meeting and then set out the revised information desired for inclusion in a separate document.

The value of a signed record is in preventing later disputes about what was said. If the taxpayer refuses to sign and does not provide a credible reason for the refusal, this may cast doubt on the accuracy of what was said. Occasionally, taxpayers who were dishonest with their testimony during interviews struggle to sign off on final reports. However, inspectors should not spend too much time in getting notes agreed upon. This can distract them from the main purpose of an audit – which is to check the accuracy and completeness of a return. It is up to an inspector to decide how important it is to obtain a signed final report in any individual case. If it is expected that there will be trouble getting a sign off, it is advisable that the inspector gets other officers to sit in the interview and take notes. This will avail the inspector multiple correspondence notes with which comparison can be made and a basis for them signing off on final report can be further established. If a dispute ever arises about what was said and the matter goes to appeal, the other officers will be able to confirm the accuracy of the final report and the accounts therein.

Testing Taxpayer Explanations

Non-Taxable Sources of Income

The taxpayer might admit to the existence of undeclared investment income or gains but claim that the underlying capital arose from a previously taxed or non-taxable source. There will be occasions when an inspector will be able to accept that the omission from the return is due to an oversight or misunderstanding, and the underlying savings originate from a taxed or non-taxable source which can be proved or which the inspector accepts having spoken to the taxpayer and weighed up all the facts and explanations. But many of such claims involve cash hoards, betting wins, gifts, legacies, sale of personal assets. It is important to deal with such stories firmly and try to obtain as much corroborative evidence there and then. If the explanation being offered is untrue, often times the taxpayer will be unable to sustain his or her story under close questioning. Where the taxpayer says the capital was saved from drawings or other declared income, an inspector will have to decide whether this is at all likely in the light of personal commitments, investments and income identified/linked to the taxpayer.

As an inspector, allegations about irregularities or omissions cannot be made except where admitted by the taxpayer or proven with evidence. Hence, inspectors should be cautious of what they say to avoid being labelled with misconduct or as vindictive.

Trader or Director

Where the taxpayer carries on a trade or profession either as a sole proprietor/partner/director of a company, an inspector must reconcile any savings revealed or further disclosures with the available income declared year by year in the accounts and returns, taking into account the taxpayer's personal and private expenditure (including any exceptional ones such as luxury purchases). To this end, the inspector must look through the bank statements of the taxpayer thoroughly establishing the purpose of every transaction of expenditure. Also, where the taxpayer does not have a business but is married to or living with someone who is a proprietor or director, the inspector should consider whether they could be transferring funds to their spouse or partner, money which neither of them declared. If the inspector is able to show that declared means do not match expenditure and cannot finance revealed savings or other disclosures and the taxpayer still cannot provide acceptable explanations of the discrepancies and mismatch, the inspector has strong grounds to allege that the taxpayer had omitted/understated profits/income. This would constitute a discovery, providing grounds for amending the current year's return or for making discovery assessments.

Use of Evidence

The problem of when best to use the evidence held is always a difficult one. Disclosing precise information/evidence too early may result in the taxpayer concealing unknown facts that might further implicate him/her. On the other hand, the taxpayer should not be allowed to commit himself or herself to anything the inspector knows is factually incorrect.

In dealing with other matters, some refinement of approach is needed. For example, when an inspector has some independent 'evidence' about the type and scale of a business which is known for a fact not to be in line with the taxpayer's profile/statements (for example, a newspaper article/advert/even personal observation) it may be better to ask further specific questions rather than confronting the taxpayer with circumstantial evidence that can be strengthened.

Where statements involve general claims about the effects of wastage, competition, defalcations etc. Such commercial hazards, which do undoubtedly arise, should not be dismissed out of hand. The inspectors approach should be towards precise quantification. The inspector can latch on common knowledge of what is normal in the trade and put direct questions in the form of requests for explanations for apparent abnormalities. It will often be found that, even when quite generous allowances are made for these effects, they do not account for the difference between expected and disclosed profits.

Other Things to Consider while Conducting an Interview Meeting

Inspectors are left with a difficult task of ascertaining whether taxpayers are telling the truth and be alert to follow up on leads that might surface during the interview and are key to concluding a case. However, the following factors can derail the outcome of an interview meeting.

- The taxpayer may be nervous. That need not be a sign that there is anything wrong with the return. For many people the world of enclosed offices, figures and forms is unfamiliar, and the prospect of meeting a tax official is quite daunting. An inspector should recognise that this may be the case and try to avoid any words or actions that might likely cause a taxpayer to give an exaggerated/untrue response. The inspector upon spotting a nervous taxpayer should put him/her at ease. This is sometimes achieved by just talking about the taxpayer business or industry generally, which is a subject he/she will be familiar with.
- Inspectors should be cautious of posing questions that might invade the personal space of a taxpayer such as their standard of living/private assets because there is likely to be push back. If the inspector must ask, he/she must be prepared to explain why it is necessary for the taxpayer to respond. For example, the inspector could explain that the questions are to validate figures shown by the returns or accounts. Under the Human Rights Act 1998 (Article 8) any interference with a person's rights of privacy must be in accordance with the law and proportionate to one's aim. However, inspectors should be firm and stay within the provisions of the law when dealing with the taxpayer and his or her agent/accountant. For example, an inspector has a statutory right to enquire into a return - SS 40 – 58 PITA 2004 (Amended 2015).
- As best practice it is good to give the taxpayer a chance to provide concluding remarks on their testimony at the end of the meeting. Perhaps, anything, which has not been covered but the taxpayer considers relevant to the points discussed.

Overcoming Objections to Attending Meetings

Inspectors can reduce or overcome resistance to a meeting by explaining that meetings can actually reduce the costs and length of an audit, because so much more can be covered at a meeting than in protracted correspondence requesting clarity on grey areas of the case. Inspectors should make it clear that they are entitled to enquire into a taxpayer's return and information required can only be given by the taxpayer in person. To co-opt the taxpayer and his/her agent/accountant into agreement, it might be worthwhile ensuring the taxpayer's agent/accountant is aware that he/she will be provided with a copy of the final report of the interview meeting. This way the agent/accountant is comfortable with the taxpayer-answering questions, even in his/her absence, since any area considered inaccurate in the taxpayer's testimony can be revised upon the provision of superior evidence even after the interview.

But if the taxpayer and agent/accountant decline the inspector's invite, a best of judgement assessment can be raised and issued on the taxpayer as seen appropriate. At this point the taxpayer can object to the amendment or assessment issued and ask for a review or notify the tax appeal tribunal. During the tax appeal tribunal hearing the taxpayer may need to give evidence to support the returns and accounts submitted and can then be questioned as part of the inspector's cross examination.

Case Study Exercise

Split into two groups. One group will be the taxpayer while the other group will be the inspector. Both groups will be given different information scripts for their respective interviews.

- As a group, review the information in the scripts provided in **Appendix One** for your role and develop a strategy on how to proceed.
- Elect one person to be the taxpayer and one to be the Inspector.

Hint:

Using the guidance provided in the last section, you might want to consider the following hints as you proceed in this exercise:

- Do a checklist of the information you have and seek
- Develop indicative questions that might help unravel related answers
- Develop an agenda to guide your meeting
- Invite the taxpayer and communicate the agenda and objective of the interview meeting – *you are not obliged however to disclose your evidence gathered at this stage*
- Start the interview meeting by acquainting yourself with the taxpayer to make them ease up and become comfortable. *Confirm background information without giving away that this is all the information that you hold – this is to provide scope for further disclosures*
- It is good to get the taxpayer to confirm certain facts you might have already ascertained just to have his/her admission on record. Hence, you can provide the taxpayer with an audit brief without being specific/giving your advantage out. You should also ask your indicative questions to gain clarity on grey areas - *Get additional and if possible unknown information.*
- Where the taxpayer provides contradictory testimonies to assessment, request they provide evidence – *It is always helpful to have the taxpayer's bank statements and business records in the financial statement of their businesses where applicable.*
- Agree with the taxpayer on next steps/action
- Remind the taxpayer that a copy of the final report for the interview meeting will be communicated to him/her and the agent to confirm the accuracy.

The objective of this exercise is to assess the audit skills of the individual groups and interviewing skills of the lead inspector who will be conducting the meeting.

Section Five:

Best of Judgment Assessments

Although the law allows taxpayers to be self-assessed (Tax Administration (Self-Assessment) Regulations 2011) and return their taxable income as well as compute their tax bills, this rarely happens in Nigeria. Hence, tax authorities have to estimate their assessable income and serve defaulters with a notice for payment (*7up Bottling Co. Plc. V LSIRB (2000) 3 NWLR (Pt. 650) 565 at 603*). This estimation exercise is referred to as a Best of Judgment Assessment (BoJA). Accordingly, Sections 54 (2) (b) and 54 (3) of PITA for individuals permits for Best-of-Judgment assessment in the following circumstances:

- (a) Where an individual or company has submitted audited returns and the SIRS has refused to accept the returns
- (b) Where an individual or company has not submitted returns within the prescribed time period
- (c) Where it appears practicable for the SIRS to issue best-of-judgment assessment

As is to be expected, SIRS are faced with a lot of objections by taxpayers, as BoJAs served are often unrealistic due to poor estimation and wrong assumptions amongst other reasons. If BoJAs are perceived to be vindictive they will not be upheld in court (*Ola v FBIR (1976) NCLR 85*). It is therefore important that good methods are adopted in the conduct of the audit to get adequate information to make a realistic BoJAs.

Approaches to making realistic best of judgment assessments include the following¹:

- Business economics exercise
- Capital statement
- Income reconstruction
- Expenditure Approach- Another Variation of a Capital Statement
- Net Worth Approach

Business Economics Exercise

This involves a basic study of the nature of the taxpayer's business and preferably the use of a business sector database to estimate the income/profit figures of a taxpayer/business. This can be done in one of two ways:

¹These are approaches are in line with case law, for example *FBIR v FM Solanke (2011) 4 TLRN 164 @180*.

1. Break down the business into its component sources of income (making assumptions where needed) and estimate the assessable income
2. Use an average income estimated for the business from records of similar businesses that have either made returns or have been audited Case Study

A similar approach is replicated under the 'presumptive tax approach'. In such a case, the SIRS will have a list of businesses that have accepted a certain level of tax demand and this can be averaged out for the sector. Consequently, all similar-sized businesses in the sector are then assessed at the same rate and objections considered for validity, correction or occasionally audit when circumstances warrant it.

Case Study

Entity:

A hotel business where the State has instituted an entertainment tax and consumption tax of 3% each.

Suppose the hotel has 20 rooms. (15 rooms @ ₦10, 000 per night and 5 rooms @ ₦15, 000 per night) and it is always busy and during peak times of holidays, full to capacity. Assuming an average occupancy rate of 70% over the 300 days in a year should provide an estimate base for assessment.

Hint:

Find the number of rooms, price of rooms and make assumptions based on local knowledge of its location, popularity as well as any activity that may affect customers and turnover.

@70% occupancy:

11 x ₦10, 000 = ₦110, 000/night

5 x ₦15, 000 = ₦75, 000/night

Total = ₦185, 000/night

So for 300 nights that is ₦185, 000 x 300 = ₦55, 500, 000/per annum

@ 3% entertainment tax = ₦1, 665, 000

Assuming on average guests eat 2 meals per day @ 1000/meal = 2 meals x 14 guests x 300 nights x ₦1000 = ₦8, 400, 000

Tax at 3% x ₦8, 400, 000 = ₦252, 000 in consumption tax.

You could assume a similar figure for drinks so a further ₦252, 000 tax on drinks. Since the entertainment tax is on the gross income and do not require expense accounting, a tax officer can safely issue a BoJA followed by a demand notice for at least ₦2, 169, 000. But it is unlikely you will have identified all the potential income so it is safe to revise upwards and round off at ₦2, 500, 000 for the first BOJA.

Capital Statement

SIRS to detect income of an individual taxpayer including directors of companies and self-employed individuals often use this investigative/audit method. This is an alternative approach to using the profit and loss account approach to arrive at the income statement and balance sheet of an individual taxpayer.

It is a series of balance sheets assessing assets and liabilities of an individual taxpayer on a cash basis. It compares their expenses and savings with their earned income, which is termed as available income. Available income simply refers to individual taxpayer's income, which has been disclosed in their tax returns and other private incomes. Some examples of available income are business income, salary, rental income, dividend and interest.

Furthermore, the capital statement can provide an overview of an individual's lifestyle and spending habits. Credit cards or debit cards are good indicators of an individual taxpayer's spending habits. Capital statement can even reveal the existence of capital, income or assets undisclosed previously.

Case Study

Hint:

If a taxpayer earns ₦6,000,000 per year, how can he/she afford to buy a house priced at ₦100,000,000 if he/she did not apply for a housing loan? The money for the transaction must come from somewhere, either from personal savings, inheritance income, capital income or other income. This is where the question of "Does the taxpayer assets match his/her declared income?" comes into question.

If an individual taxpayer does not have an additional source of income, how then can he/she buy the house of ₦100,000,000 with his/her annual earnings of ₦6,000,000? The money used to finance the purchase will be incorporated into the capital statement. Capital simply means money or anything that can be converted into cash for spending such as savings, loans, business capital and so on.

In summary, the idea is to link traceable assets to a combination of loans and income. However, one must exercise caution in using this approach to avoid displacement of facts by claims that loans, inheritances or gifts were used to finance traced assets. Although, where loans are genuinely used, one should be able to compare the activities with the 'Badges of Trade' - FN1- FIRS information circular published: August, 2010; what constitutes 'Trade' for tax purposes: Guidelines for the general public: www.firs.gov.ng/Resource-Centre/Pages/Tax-Circulars.aspx

	Estimated value	2014	2015	2016
Estate buildings Nil	–	–	–	–
Estate buildings 20 units	NGN 10m/unit	NGN 200m		
Estate buildings 40 units	NGN 10m/unit		NGN 400m	NGN 400m
Increase in assets		NGN 200m	NGN 200m	NGN 0m
Take increase in assets as income spent so annual assessable income		NGN 200m	NGN 200m	
BOJA Income* 18% marginal tax rate		NGN 36m	NGN 36m	Nil but look for other assets or rental streams

Assuming a taxpayer has been identified to own a large estate (built over two years), which has not been rented out, a tax authority could employ a capital statement approach to estimate the income per year over. From the assessment above, a tax authority could serve this identified taxpayer a BoJA of ₦200, 000, 000 assessable incomes per annum or tax of ₦36, 000, 000 per annum before expenses as a starting point.

Where such a taxpayer is not cooperative and intends to claim expenses, it will only reveal an opportunity to get further information. Also if this is a property developer that claims the assessed income is capital and subject to capital gains tax, the tax authority should compare the activities with the 'Badges of Trade'

Income Reconstruction

In some cases, the tax authority may have some expenditure and income information, which are incomplete for accurate assessment. In this circumstance, a combination of business economics approach and capital statements should be explored to estimate the missing figures on which to base a BoJA.

Case Study

Assuming, expenses over ₦3,000,000 (wages and cost of materials) is traced to a trader who has no comprehensive record of his income available besides from the declaration of buying materials at ₦100,000 a load and reselling same load at ₦150,000. Receipts available indicate the trader had bought materials worth NGN ₦3,000,000 in three months. Hence, the trader must have sold these materials for ₦4,500,000, even though, sales recorded were staggered across the year.

Based on this, the tax authority can estimate that the trader spends at least ₦3,000,000 a quarter and ₦12,000,000 a year on purchases, accruing to him an annual income of ₦18,000,000. Hence, the trader's gross profit will be ₦6,000,000. A similar analysis for his wages and rent expenses at ₦1,200,000 per annum will leave the tax authority with a gross assessable income of ₦18,000,000 less materials ₦12,000,000 and other expenses ₦1,200,000.

This gives a net assessable profit of ₦4,800,000 and a tax of ₦864,000 (assuming a marginal rate of 18%). So, the BoJA could safely be put at ₦5,000,000 the first time, with less probability of objection by the taxpayer

Expenditure Approach

The expenditure approach involves listing the applications of funds first and then subtracting the sources. If the taxpayer's known cash sources exceed his or her known cash receipts (including cash on hand at the beginning of the year), any difference is unreported income.

Net Worth Approach - Another Variation of a Capital Statement

The net worth method is a common indirect balance sheet approach to estimating income. To use the net worth technique, the SIRS must calculate the person's net worth (the known assets less known liabilities) at the beginning and ending of a period. The SIRS adds nondeductible living expenses to the increase in net worth. If there is a difference between the reported income and the increase in net worth during the year, the SIRS tries to account for the difference as (1) nontaxable income and (2) unidentified differences. Any unidentified difference may be an approximation of the amount of theft, unreported income, or embezzlement funds (e.g., an inference of unreported income)

Case Study

These are more complicated but can be developed based on an the analysis of the taxpayer's lifestyle, known assets and expenses such as number of motor vehicles, houses, donations in public and so on.

Taxpayer X is a single male in his mid-20s who is a self-employed designer that is popular and always seen in high profile events where his clothes are worn. He is a sole trader who returns his income to the SIRS to get a tax clearance certificate. On examination, his net profits after expenses are around ₦250, 000. This gives Mr. X about ₦20, 000 worth of available income per month based on his return. However, he owns a Porsche, lives in a part of town where the rent is ₦1, 500, 000 for a flat and the newspapers suggest he owns more than one basic flat. These expenses should raise a red flag for tax investigators as his lifestyle and income declaration do not tally.

If he refuses to cooperate when asked to supply more information, the tax authority could reasonably build a means profile (that is how much he needs to live his lifestyle) for a BoJA. Such a BoJA would ensure that Mr X comes to the SIRS to discuss his tax affairs more comprehensively. In most cases, the taxpayer may object, so the assessment must be largely factual to ensure the taxpayer complies and pays.

Common Experiences in Administering Best of Judgment Assessments (BoJA)

There have been instances when tax liability as per tax returns submitted are either higher or lower compared to the BoJA raised and also where audited returns are submitted immediately after BoJA has been served on the tax payer. The following steps should be adopted in resolving such reported instance.

- Where BoJA is higher than tax liability as per tax returns:

The tax officer should enforce payment of BoJA and where the taxpayer objects, such an objection should be subjected to a dispute resolution process after an initial reconciliation meeting has been held inconclusively.

- Where BoJA is lower than tax liability as per tax returns:

The tax officer should raise an additional assessment to cover the difference in assessment and consider what was missing and why.

- Where accounts are submitted immediately after BoJA has been raised, although still pending service of notice on taxpayer:

BoJA should be amended and assessment raised based on the audited returns. It should be noted however that penalty for late filling of returns should be imposed.

Always remember that taxpayers have a 30-day window to object to an assessment.

Case Study Exercise

Based on the approaches discussed above and the information provided in **Appendix Two** on Mr. Big and Better businesses, estimate and raise a BoJA you consider realistic.

1. Identify all Mr. Big's sources of income that Better land IRS can and should asses to tax or levy etc. under The Collection of Taxes & Levies Act 2004 as Amended 2015.
2. For each source where possible make a BoJA for 2017 (the year being audited).
 - a) Please state clearly any assumptions you have made in reaching the BoJA
 - b) List all questions that you still need answers to help you to improve the BoJA accuracy
 - c) If you have additions or no previous returns can you raise assessments for earlier years?
3. Summarize each source of income in BoJA and estimate the actual tax due
 - a) On Mr. Big (PIT)
 - b) On Better Hotel (Entertainment & Hotel Occupancy)
 - c) On the hotel what is the PAYE bill
4. How much do you think is Mr. Big's minimum capital asset position?
5. What other taxes and sources of income do you think could be enquired into and or assessed?
 - a) How much do you think is Mr. Big's minimum capital asset position?
 - b) What other taxes and sources of income do you think could be enquired into and or assessed?

Appendix One:

Interview Meeting Case Study Exercise

Interview scripts

(Both Inspector and taxpayer get this sheet)

Duration

Group Review: 15minutes

Interview Meeting: 10 Minutes

Objective

To improve inspectors' investigative and interview skills for conducting effective and successful tax audits

Background

The purpose of this exercise is to enable participants understand the basics of conducting an effective interview. Remember that your tone of voice and body language are also part of the interaction during the interview.

- You will have a basic set of information depending on the role assigned to your group, taxpayer or Inspector.
- You will need to read and understand the points in your script and any documents you have been given. If you are the interviewer (Inspector) you must from the information you have consider the gaps, if any, and the issues you want to explore. If you are the taxpayer you must understand the script you have been given and responses you MUST give if asked the right question.
- You are both encouraged to take poetic licence as long as the essence of your script is adhered to.
- If you are assigned the Inspector role you will have to review material and think of how to frame your questions to get further relevant information.
- If you are assigned the taxpayer role it gives you an opportunity to view materials from the taxpayer's point of view (a critical skill for good interviewers), anticipate questions you may be asked and possible ways to confuse the picture without being obstructive when answering.

Taxpayer's Script

(Only the taxpayer gets this sheet at the start of the exercise)

Taxpayer Name: Mr Adamu Olu Emeka

- Your name is *Adamu Olu Emeka* and you own a trading enterprise. Though you engage in several profitable businesses of buying and selling, your main business is buying and selling of electronics on both a wholesale and retail scale. You also have a company, which you sometimes use to make supplies to government departments.
- In the last year you recorded a turnover of ₦50, 000, 000 and your profit margin is about 15% net of all expenses. You mainly deal in fridges and air conditioners.
- You have also had two large supplies to government, which availed you a healthy profit, and you have drawn ₦5, 000, 000 as your share of the company's profit for private expenses.
- You have 5 sales assistants who you pay an allowance of ₦8, 000 per month and you give them a ₦20, 000 bonus at Christmas.
- You also run an Air condition and fridge servicing business which you operate using two engineers who you pay on a commission basis (per jobs they do). You are happy that you pocket at least ₦180, 000 every month from this side business after all expenses.
- The tax authority has sent you a BoJA for ₦5, 000, 000 and a tax bill of ₦884, 060.
- You objected and the tax authority has now invited you for an interview which is said is 'to understand your business and your objection'

Instructions

If the inspector asks you directly about your sources of income you are only obliged at first to mention the buying and selling enterprise. You can only tell him about other sources if he asks specially about contract work and or repairs.

You must answer truthfully any **DIRECT** questions the inspector asks, but you should not volunteer information, remember the more information he gets the higher your tax bill will be.

Inspector's Script

(Only the inspector gets this sheet at the start of the exercise)

Inspector's Script: Zebrudaya

- You are the audit inspector at the SIRS.
- Your supervisor has assigned you the case of a taxpayer who used to repair his air conditioner but is now a big man selling air conditioners in the market.
- When you reviewed the files you saw the notice of assessment, taxpayer return, WHT credit note and a letter from the taxpayer disputing his BoJA.

Instructions

The taxpayer may be evasive in his answers and so you have to prepare your questions to be both direct enough to get all information and open-ended. Remember, the more at ease you make the taxpayer feel the more likely he/she will open up and tell you what you inquire.

For the purpose of this exercise, the taxpayer has been instructed, *“to answer truthfully any DIRECT questions you ask but would not volunteer information”*. Remember the more information he gets the higher your tax bill will be¹.

Hence, use clues you have from the file to carefully develop indicative questions that will help you get the best out of the interview and make the case conclusive.

Best of Judgement Assessment (BoJA) Notice

(Both taxpayer and inspector to have this document at the start of exercise)

KKB State Internal Revenue Service Best of Judgement Assessment

Date: 5th April 2018

Name: Adamu Olu Emeka

Address: 127 Abaji, KKB State

TIN No: 2186452814AX

NOTICE OF ASSESSMENT

Assessed Income (After Allowances): ₦5,000,000

Source of Income: Trading (electronics)

Annual income (NGN)		Tax payable (NGN)
First 300,000	@7%	21,000
Next 300,000	@11%	33,000
Next 500,000	@15%	75,000
Next 500,000	@19%	95,000
Next 1,600,000	@21%	336,000
Over 3,200,000	@24%	432,000
Tax to pay for 2017		992,000

You have 30 days to object otherwise this will become final and the tax due.

You can pay using the details below.

Tax Return

(Both taxpayer and inspector to have this document at the start of exercise)


Form A

PERSONAL INCOME TAX RETURN FORM

RETURNS FOR INCOME TAX YEAR ENDED 31ST DECEMBER 20_____

Quote your IRS TIN here
2181445628199X

Please complete this form in CAPITAL letters

PART A: PERSONAL DETAILS

Surname: **EMEKA** First Name: **ADAMU** Middle Name: **OLU**

Title (Mr/Ms/Msrs/Obi): **MR** Marital Status (Married/Single/Other): **MARRIED** Date of Birth: **16/01/97**

Current Residential Address:

House/Plot No.: **ADAMU CRES LENT** Street/Avenue/Road or Others: _____

Town/District: **1127** Area Council/LGA: **ABIAJI** State/CT: **ANY STATE**

Nationality: _____ Occupation/Profession: **TRADER ELECTRONIC** Contact Telephone No(s): _____

Name and Address of Employer/Business:

Name of Employer: **42 MAIN ROAD ANY TONA** Any ID Card: _____

Office/Plot No.: _____ Street/Avenue/Road or Others: _____

Town/District: _____ LGA/Area Council: _____ State/CT: _____ Country: _____

For any changes in the above circumstances during or since the year ended 31st December 20_____
Particulars that changed and dates: _____ Any ID Card: _____

For Foreign Employer/Service in Abuja, FCT
Date of Arrival: _____ Date of Departure: _____

If Married, State Spouse's details:

Full name: **MRS ADAMU** Date of Birth: _____
Employer's/Business Name: _____ Occupation: **HOUSEWIFE**

Employer's/Business Address: _____

Full name of Children	Dates of Birth	Name & Address of Educational Institution Attended	Child's Income in Ns or Bir (per child (N))
1 ADAMU	/ / / / /		
2 OLU	/ / / / /		
3 EMEKA	/ / / / /		

First Name: _____ JTB TIN: _____ STATE IRS TIN: _____

PART B: STATEMENT OF INCOME FOR THE YEAR ENDED 31ST DECEMBER 20_____

(i) Trade, Business, Profession, Vocation etc N **2,000,000** (v) Dividends from Nigerian Companies _____ N
 Attach copies of Accounts for the Year Ended 31st December 20_____
 Dividends from outside the Country _____ N
 (Enter the gross amount before tax deduction)

(ii) Employment: Salary _____ N (vi) Interest _____ N
 Commissions, Bonuses etc _____ N (Attach a list giving details of each source and the
 Allowances _____ N gross income received therefrom)

Attach details of each allowances paid on your behalf) (vii) Rents _____ N
 (Attach a list showing for each property, the amount of gross and
 other expenses) Rent & or premium received therefrom with rates

(iii) Pension From _____ N (viii) Income in respect of other profits arising
 Annuity From _____ N from sources not included above _____ N
 Gratuities _____ N (Attach details of each source and the income therefrom)

(State name and address of the payer)

(iv) Income received in or brought into Nigeria from all sources outside Nigeria _____ N

Aggregate earned income (i-iv above) (X) _____ N Aggregate investment income (v-viii above) (Y) _____ N

Note: When any source of income have been acquired or have ceased during the year ended 31st December, 20_____. (Attach particulars and dates)

TOTAL INCOME (X + Y) _____ N

Notice of Objection to Best of Judgement (BoJA)

(Both taxpayer and inspector to have this document at the start of exercise)

127 Abaji, KKB State
15th April 2018

The KKB State Internal Revenue Service
KKB State
Mr Zebrudaya

Notice of objection to Best of Judgement Assessment

I hereby object to the assessment you sent to me saying I earn ₦5, 000, 000 and should pay over ₦900, 000 in tax. I have never made that kind of money.

I can agree to pay like ₦50, 000 if you agree.

Yours faithfully

Adamu Olu Emeka

Bank Alert on Mr. Adamu Olu Emeka Current Account.

(Only taxpayer to have this document at the start of exercise)

Account: 100****254

DT: 5/2/18: 7:38PM

NIP CR: Mrs Adamu BANK A

DR Amt: NGN 160,000

Bal: 1,876,889.55

REF: 361873478

With Holding Tax (WHT) Note

Only inspector to have this document at the start of exercise)



Date: 16 May 2016

Received from: State Ministry of Lands and Housing

Name of Taxpayer: Aircon supplies Limited

TIN: 2223783948494

Tax type: WHT

The sum of

In words.....Ten Million Naira Only.....

Being Withholding Tax on Contract amount:₦100,000,000

Period covered from.....Jan 2016.....**To**Jan 2017.....

Tax Office: KKB SIR oo2X

Payment Date 25 May 2016

Issuing Officer: Adamu

Supervising Officer. Onyeka

Email Petition

(Only inspector to have this document at the start of exercise)

January 2018

To: KKB SIRS

Cc: EFCC, Code of Conduct, Human Rights Commission, Police.

Petition Against my Oga Mr Adamu Olu Emeka

Mr Emeka owes me ₦196, 000, which is my commission for air conditioner repairs I did for him. He normally pays me 10% of the profit made from repairs but in this instance he has refused to pay me for my money, which covers repairs spanning three months even after I have pleaded with him.

Please use your office to force him to pay me my money, my family is suffering and he is just buying land everywhere. He even plans to start a hotel business for his wife who is selling at a very popular mama-put near police barracks kado road.

I take God beg una.

Disgruntled engineer

Linus

Suggested Answer and Minimum Points to Make in the Interview Meeting Case Study Exercise

You issued a BoJA on an assessable income of ₦5, 000, 000 and the taxpayer objects, denying earning the income of ₦5, 000, 000 and rejecting the tax bill of ₦884, 060.

Reviewing the evidence and facts of the case one after the other, the following apply:

1. His self-return reflects a declaration of ₦2, 000, 000 which if assessed will be:

Calculation

Self returned assessable income: ₦2, 000, 000

Less allowance:

₦200, 000 plus 20% of ₦2, 000, 000 (₦400, 000) = 600,0000

Net assessable income: ₦1, 400, 000

Annual income (NGN)	Tax payable (NGN)
First 300,000 @7%	21, 000
Next 300,000 @11%	33, 000
Next 500,000 @15%	75, 000
Next 500,000 @19%	57, 000
Tax to pay 2017	186, 000

2. You should be able to establish by correct review of records available to you as an inspector and through correct questioning during the interview the following:

- That he has a good turnover on sales of air-conditioner and fridge {taxpayer script puts this turnover at ₦50, 000, 000 per annum and at 15% Net profit – a potentially taxable sum of ₦7, 500, 000
- PAYE from the salary of his 5 sales assistants
PAYE per assistant [(₦8,000 X 12) + ₦20,000] x 1% tax rate = ₦1, 160
Therefore, PAYE for all 5 assistants is ₦1, 160 x 5 = ₦5, 800
- Share of profits from company supplies to Government ₦5, 000, 000
- The WHT receipt of ₦10, 000, 000 indicate the company must have made a turnover of at least ₦100, 000, 000 from the supplies made to government.
- Profit from air-conditioner repairs services monthly (net of costs) - ₦180, 000 X 12 = ₦2, 160, 000. But if he owes ₦190, 000 as petitioned by one of his engineers, this represents 10% of a turnover of ₦1, 960, 000 in just three months and there are two engineers. So definitely the ₦2, 160, 000 is an under declaration.
- He has ₦1, 800, 000 in cash in his bank account so should be able to comfortably pay the tax.

Appendix Two:

Audit Case Study Exercise

Background

Background information on the taxpayer and his business operations are outlined below.

1. Mr Ali Tunde Okwu (Mr. Big) is a successful businessman in Nigeria. He regularly appears in the news alongside leaders of the community. He is known to be generous to projects dear to his heart. He is resident in the fictional State of “*Better land*”.
2. Stamp duty records in the Stamp Duty Commissioner's office show that he has two properties, which he bought in 2014 and 2016 respectively. The stamp duty was ₦1,500,000 and ₦2,000,000 in each of the years. The 2014 property is located in “*Better town*” - a known agricultural trading hub and commercial city while the 2016 property is located in a bustling city where a lot of manufacturing businesses are located.
3. Mr Big runs a hotel in “*Better city*” called *Better hotel* through a limited company. The hotel is 3-star with a popular garden and drinks club located on his property.
On previous visits, the *Better land* IRS have found out that vendors in his garden and club pay rent to sell their produce (fish, suya, etc.) There are four stands in the garden and they bitterly complain about the ₦30,000 per month that they pay to sell their fish and suya. But they continue, as the location is very lucrative. These rents are paid to Mr. Big directly and not to the *Better hotel* management.
4. In *Better town*, Mr Big has converted his property to a 30-store plaza, which he also rents out each store at ₦200,000 per annum. Mr Big apparently uses two of the shops from which he wholesales rice packaged under the “*Mr Big Brand*”.
5. Mr Big is a large-scale farmer with 50 hectares of rice under cultivation. He is known as one of the more successful farmers getting high yields of up to 4 tonnes per hectare. He shares his experiences with farmers nearby and buys their entire rice paddy at harvest at fair open market rates (Arm's length transactions). One agricultural extension worker estimates that he buys over 4,000 tonnes (40,000 100kg bags) from the farmers who all love him.
6. Mr. Big uses his connections with government to get his rice milled at ₦15,000 per tonne. The normal charge is ₦20,000 per tonne but because of the volume he passes through the discount is actually considered a fair business price and there have been no allegations of collusion with government officials.

Notes on Exchange of Information with Local FIRS Office

- Mr. Big's hotel "Better Hotel" is VAT delinquent and is assessed at an estimated ₦240,000 per VAT month. The FIRS believes that even this is a sub-standard assessment but wants to proceed to distraint action on the figure.
- FIRS did a CAC search and records show Mr Big is a director of two companies:
 - Better Hotel Ltd in Better city, and
 - Better Contracting Ltd.
- Accounts for two companies show
 - Better Hotel Ltd a positive Director's loan account of ₦150,000,000
 - Better Contractors Ltd.- A WHT note from Better State government for building contracts. The WHT note is for ₦50,000,000.

Stamp Duty Rate (*Better land*)

See JT/B 1/7/2002 where the rate of stamp duty ad valorem for property is 2%

- Thus a stamp duty Ad Valorem of ₦2,000,000 means that the property exchanged hands for ₦100,000,000 (one hundred million Naira only)

N.B- *Ad Valorem* is the rate used in Land Contracts and refers to the value of the land transaction

Description of Locality and Economy

Wikipedia and Google Maps extracts

Better Town: A trading hub for agricultural and other products since the 15th century, it is a highly populated town (2 million residents) and is situated on meeting point of the trade routes of Nigeria. Most grains in Nigeria including rice and millet are bought and sold wholesale after basic processing in the city and are then transported for further sale around the country.

Better City: is the industrial and manufacturing hub of Nigeria. Industries include shoes, bags, belts and basic plastics (utensils, furniture, and packaging) and aluminium products. The nightlife is very vibrant and it is known for its 'work hard, play hard' culture. Hotel businesses thrive in the city and occupancy of its ten 3 star hotels is close to 70% all year round with peaks at the annual trade fair.

Newspaper Article

Hotel owners complain about the 3% Entertainment Tax and 5% Hotel Room Occupancy rate charged by the *Better land* State Government

The Hotel Owners Association has written to the Executive Governor of *Better land* State complaining that the 3% Entertainment tax and 5% Hotel room occupancy rate introduced by the government in 2015 is cutting deeply into their profits.

However, an investigation by this paper's reporters found that while these 'taxes' are imposed on the hotel owners they do not appear to actually pay over the money charged to the BIRS and so are actually profiteering (as they pass on the charge to occupants) at the expense of the tax payers. Many people interviewed in the garden of Better Hotel, one of the leading hotels, were of the view that since they were charged by the hotel the money should be paid over. The Better Hotel is very popular especially at weekends and at times there is no space for customers while the fish and suya sellers "rake in a fortune" according to the patrons.

Mr Big, Chairman of *Better city* Hoteliers complains that though he already pays too much tax including PAYE on his 20 staff who all earn at least ₦15, 000 per month (and 5 of which are managers earning at least ₦60, 000 per month, he has to pay for his Infrastructure needs such as water and power

Local Newspaper Article



Local Business Man Donates Six-Classroom Block

Mr Big a local man who has done well built and donated a building block of six classrooms at an estimated cost of ₦20, 000, 000 to his Alma Matter. The Principal of the school at the handover ceremony commended the 'old boy' of the school for his magnanimous donation in keeping with similar donations he has made to the needy in the past.

Magazine Article

Rice is the New Gold

Rice production in *Better land* State is at an all-time high our reporters have found. The CBN Anchor Borrower Scheme and the intervention by some large, independent farmers and rice paddy traders is making all in the rice business smile to the bank. Our investigations into the economics of rice production have revealed that if you grow rice and process it (or buy and process) you can make up to ₦200, 000 from four tonnes of raw paddy. Cost of planting a hectare of rice to harvest is ₦300, 000 and yields are from 3-5 tonnes with the average of 4 tonnes for the rice cultivars distributed by the Ministry of Agriculture. Processing costs per tonnes; ₦10, 000 for parboiling and ₦20,000 for milling which includes destoning and bagging in 25/50 kg bags. Sale of 25kg bags of milled and distilled rice goes at wholesale price of ₦6000. So a farmer can make over ₦200, 000 gross per hectare for milled rice, or ₦100, 000 if sold as paddy to a processor/wholesaler. Many small-scale farmers prefer to sell as paddy to avoid the additional cost of storage and transport and their need for ready cash. One large-scale farmer confirmed that he makes over ₦200, 000 per hectare after all costs. It is also reported that the yield of milled and destoned rice to paddy processed is 65% and miscellaneous costs (transport and labour etc.) amount to ₦10, 000 per tonne.

Better city Hotel Rate Card

Welcome to Better city Hotel

Rate Card

You will enjoy your stay in one of our 25 rooms at rates that are competitive. Our staff is friendly and well trained and ready to pamper you.

Rooms

Standard- ₦15, 000/night (10 Rooms)

Deluxe- ₦18, 500/night (10 Rooms)

Suites- ₦23, 000/night (5 Suites)

Halls for Rent

Wakanda Hall- ₦50,000/day

Meeting Room- ₦20, 000/day

Grand Reception Hall- ₦250, 000/day

Rates include:

VAT 5%

Hotel Occupancy 5%

Food/Drinks attract 3% Entertainment tax

Discounts of 10% available for bookings of three days or more or group bookings.

Gym: Free to residents, ₦2, 000 daily for visitors or ₦20, 000 per month for gym membership and use anytime it is open 7 am to 10pm

Suggested answer to BoJA Case Study Exercise

(To be completed and not in same pack as questions)

1. Mr. Big's sources of income are:

a) Profits from Rice growing:

Sale: So, 50 Hectares x 4 tonnes (yield per hectare) x ₦100, 000 (per tonnes price of raw paddy) = ₦20,000,000

Recall 4 tonnes is 4000 Kg, hence 4, 000 kg is 40 100kg bags

So, sale of raw paddy of 40 100kg bags = ₦20,000,000

Less:

Costs: 50 hectares x ₦300, 000 (cost of cultivation per hectare) = ₦15, 000, 000

Potentially assessable profit: = ₦20, 000, 000 - ₦15, 000, 000 = ₦5, 000, 000.

b) Profits from Rice Processing

Sale: He buys over 4, 000 tonnes (40, 000 100kg/160, 000 25kg bag) from the farmers as seen in the background note. Yield of milled and destoned rice to paddy processed is 65% hence, 65% of 40, 000 100 kg/160, 000 25kg bags is 26, 000 100kg bags/104, 000 25kg bags.

At wholesale price of ₦6, 000 per 25kg bag total sales will be 104, 000 25kg bags x ₦6, 000 = ₦624, 000, 000.

Less:

Estimated cost of paddy available to him: 4000 tonnes x ₦100, 000 (per tonnes price of raw paddy) = ₦400, 000, 000

Recall, 4, 000 tonnes = 4, 000, 000 Kg = 160, 000 25kg bags

160, 000 25kg bags = ₦400, 000, 000

Other costs:

a. Processing cost - ₦10, 000 (parboiling) + ₦15, 000 (discounted milling with government) per tonne = 4000 tonnes x ₦25, 000 = ₦100, 000, 000

b. Misc. costs per tonne ₦10, 000 = 4000 tonnes x ₦10, 000 = ₦40, 000, 000

Total Costs: ₦400, 000, 000 + ₦100, 000, 000 + ₦40, 000, 000

= ₦540, 000, 000. Hence, processing 160, 000 25kg bags will cost ₦540, 000, 000

Potentially assessable profit: ₦624, 000, 000. - ₦540, 000, 000

= ₦84, 000, 000

c. Profits from rent

Plaza 30 x 200,000 = ₦6, 000, 000

Hotel vendors in garden 4 x 30,000 x 12 = ₦1,440,000

Potentially Assessable profit from Rent (unearned income) = ₦7, 440, 000

²Mr Big mills at ₦15, 000 per tonne not ₦20, 000

d. Other sources of income one can explore

- Director's fees/dividends - Ask as not known and look at director's loan account to see movements and any interest received without WHT.
- PAYE income from Hotel and Construction Company – Ask as not known

2. Best of Judgement Assessment

Mr Big	Better city Hotel	Better land contractors?
Rice ₦120, 000, 000 + ₦5, 000, 000 = ₦125, 000, 000	Hotel Occupancy ₦5, 700, 000	Not known so ask for more info as there may be WHT
Rent ₦7, 500, 000	Entertainment Tax ₦800, 000	
Directors income e ₦5, 000, 000 ³	PAYE: ₦199, 000	
	WHT - ? 5% of ₦10, 000, 000?	
Total ₦137.5m	₦7m	

3. Tax computation

3a. Mr Big

We have not bothered with the actual calculation as we can be sure he will object so we have assumed marginal tax⁴ rate of 18% of ₦137, 500, 000 Tax due ₦24, 750, 000.

3b. Better Hotel Ltd.

The sources of income that can be assessed by Better land IRS are:

- Hotel Occupancy tax
- Entertainment tax
- WHT on contracts
- PAYE

³This could be any figure you choose, ₦5, 000, 000 was chosen at random and ask questions when he objects.

Hotel Occupancy tax:

Rooms $10 \times \text{N}15,000 = \text{N}150,000$

$10 \times \text{N}18,500 = \text{N}185,000$

$5 \times \text{N}23,000 = \text{N}115,000$

$\text{N}450,000$ at 100% occupancy

But assume 70% occupancy for 360 days (Allow 5 days off?)

$= \text{N}315,000$ per night

$\times 360$ nights

$\text{N}113,400,000$

At 5% Hotel occupancy

$= \text{N}5,670,000$

Entertainment Tax

Assume vendors charge their patrons directly so no charge so no bill for *Better Hotel* but how will you assess the vendors to collect the tax they have charged and collected?

Better Hotel itself – Estimate Food and drink by patrons of hotel at $\text{N}5000$ per day at 70% of 25 rooms. $\text{N}5000 \times 25 \times 70\% = \text{N}87,500$

And $\text{N}87,500 \times 300$ days (allow 5 days?) $= \text{N}26,250,000$

$\text{N}26,250,000 \times 3\% = \text{N}787,500$

WHT on contracts

Better Hotel is required to withhold tax on any individuals that supply it regularly. These could be food, drinks, fuel etc. We need to ask questions but given the turnover of the hotel an estimate at 5% of $\text{N}10,000,000$ would be as good a start as any.

3c. *Better Hotel Ltd.* PAYE

Facts Known from paper:

20 staff of which 15 at $\text{N}15,000$ each monthly and 5 are paid at $\text{N}60,000$ each monthly

a. PAYE of the 15 at $\text{N}15,000$ per month

A staff at $\text{N}15,000$ equals an annual pay of $\text{N}180,000$. This is below the tax free allowance of $\text{N}200,000$ per person per year so the only tax due is 1% which is $\text{N}1,800$ per annum or $\text{N}150$ per month. For 15 staff that is $\text{N}27,000$ annually or $\text{N}2,250$ per month.

b. PAYE of the 5 at $\text{N}60,000$ per month

A staff at $\text{N}60,000$ is $\text{N}720,000$ per annum. The calculation of tax dues is as follows:

Gross income: $\text{N}720,000$

⁴The marginal rate of 18% assumes the effect of giving the, $\text{N}200,000$ plus 20% of gross income, allowance.

Less:

Tax free allowance: ₦200,000 plus 20% of ₦720,000 = ₦344,000

Less:

8% pension = ₦57,600

Net assessable to tax = ₦318,400

₦300,000 @7% = ₦21,000

₦18,400 @11% = ₦2,024

Total Tax = ₦23,024 per annum or ₦1,918.67 per month

For 5 staff that is ₦115,120 annually or ₦9,593.35 per month

c. Mr Big's suspected Capital position:

Farm Lands (50 Ha)? ₦50,000,000 at ₦1,000,000 per ha?

Hotel – Land ₦200,000,000 – Buildings etc.? e ₦500,000,000?

Plaza – Land ₦150,000,000 – Building etc.? e ₦200,000,000?

Home?

Motor Vehicles?

Director's loan account ₦150,000,000

d. What other sources and questions.

There are many questions arising and there is no right set of questions arising but the following are some obvious ones:

- Q. Where did you get the money to buy properties in 2014 - ₦200,000,000 and 2016- ₦150,000,000? If no credible answer then add to income for each year and tax at the appropriate rate
- Q. Vendors charge their patrons directly so no entertainment tax charge and no bill for *Better Hotel* but how will you assess the vendors to collect the entertainment tax they have charged and collected?
- Q. What other sources of income does Mr Big's have?
- Q. What is the source of the ₦150,000,000 introduced into Better hotel and held in the balance sheet as a director's loan to the company of ₦150,000,000? *Is there any interest paid on the loan and what has happened to the WHT in the interest?*
- Q. What are the details of the vendors who pay him rent as these can be followed up to assess them. If the pay rent at ₦360,000 per year then their income must be considerably higher.
- Q. How much exactly is paid to staff earning more than ₦60,000 as there may be significantly more PAYE to collect. Is Mr Big's paid a salary?
- Q. What was the source of funds for the ₦20,000,000 classroom donation? What other such donations have been made?
- Q. What exactly does Better Contractors do? What is Mr Big's role and how much does he make from the company?
- Q. Where is his residence and how much did it cost?

Appendix Three:

Accessing Support from the HelpDesk

Step One

Visit the HelpDesk Portal via www.ngf.org.ng/helpdesk



Step Two

Complete the Request for Support/Further Support form (Attach a cover letter signed by a high-level State official) and submit online



Step Three

A preliminary assessment is conducted on the request for support/further support form submitted to ascertain what kind of intervention is best fit. Where necessary a diagnostic study visit to the State is conducted



Step Four

- Based on preliminary assessment/diagnostic study report:
- Knowledge guides/tools are deployed where available and applicable
 - Direct technical assistance is provided-Advisory/capacity building support



Step Five

An evaluation exercise is carried out to track the impact of the support

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