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# EFFECTIVE TAX ADMINISTRATION AND INSTITUTIONALIZATION OF ACCOUNTING SYSTEMS IN SMALL AND MEDIUM SCALE ENTERPRISES: EVIDENCE FROM NIGERIA

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## ABSTRACT

*The study investigated the role of effective tax administration in institutionalizing accounting systems in Small and Medium Scale Enterprises (SMEs) in Nigeria against the backdrop of the prevalence of poor accounting systems in this sector. Data was obtained from SME operators and staff of the internal revenue agencies like the Federal Inland Revenue Service (FIRS) and State Boards of Internal Revenue (SBIRs) as applicable in Nigeria. The econometric e-view was used to analyze the data so obtained, and it was observed that the lack of an effective tax administrative system which undermines the collection of profit tax from the operators of this sector accounts to a large extent for the non institutionalization of accounting systems SMEs in Nigeria. The study also identified several variables that militate against the establishment of an effective tax administrative system in the country. Accordingly the study advocated the need to build strong institutions, enact appropriate laws and implement stiffer penalties for defaulters. This should be predicated on the basis of an enhanced citizens' confidence in the government and its institutions, which can be attained through the enthronement of fiscal transparency and accountability framework and good governance that has the capacity for building trust thereby enhancing voluntary compliance with tax laws.*

**Keywords:** Tax administration, Institutionalization, Accounting system, Decision useful accounting information, Effective, Smes, National economies.

## Contribution/ Originality

The study contributes to the existing literature accounting systems of SMEs. This study used new estimation methodology via econometric e-view analyses and SPSS. This study is one of very few studies which have examined the hypothesized relationship and primarily contributes to addressing challenges of financial management by SMEs in developing countries.

## 1. INTRODUCTION

The preponderance of small and medium scale enterprises (SMEs) in economies of nations and in the global arena is well documented in literature. Also it is an empirical fact that there are more small and medium scale enterprises (SMEs) than large scale firms in all national economies. The statistical significance of their number is a clear indicator, not only of their prevalence rate but also, of their importance to national economies. Their importance to both national economies and the global economy is anchored on the critical and essential roles they play in the economic arena. Various studies had enumerated the critical roles played by this class of businesses. An aggregation of their roles in the socio-economic development of nations and the global economy would be mind boggling. This is because this aggregation would show beyond national economic statistics the extent of reliance of the global economy on the essential and critical services provided by the SME sector (Beck *et al*., 2005; Pontus, 2009; International Federation of Accountants (IFAC), 2010). Imagine a national or global economy without a vibrant SME sector? The recognition of this importance no doubt accounts for the various policy initiatives at both the national and international levels aimed at ensuring a vibrant and viable SME sector.

A key determinant of SME survival and growth is effective and efficient management. (Penrose, 1959; Teece *et al*., 1997) as cited in International Federation of Accountants (IFAC) (2010) submitted that SMEs need to develop and have competencies to survive in an ever changing and dynamic environment. Effective and efficient management of any enterprise largely depends on optimal and informed decision making. To a large extent, optimal decision making depends on the availability of relevant and reliable information that is timely. Sub-optimal decisions and their attendant implications mar the SME arena as evidenced by their high mortality rate. This makes imperative the availability of decision-useful information for the proper management of SMEs.

The nature of decision-useful information required for the optimal management of SMEs cuts across production or service through marketing to accounting information systems. Of particular interest to the current study is the place of decision useful accounting information. One segment of decision useful accounting information is the financial accounting segment. The place of decision useful financial accounting information in the effective and efficient management of SMEs is clearly captured in the submissions of (Holmes and Nicholls, 1989; Stice *et al*., 1999; Deakins *et al*., 2001; Haldma and Laats, 2002). Furthermore, the literature has also clearly documented the existence of multiple of users and uses of accounting information. Government through its tax agency represents one typology of user. Tax agencies require statement of financial performance for the purpose of tax assessment and collection. Proper evaluation and assessment of tax, both at the individual and corporate levels, is inevitable as an integral part of effective tax administration.

As evidenced in the literature, the SME sector is often described as the informal sector, which presupposes the preponderance of the rule of the thumb approach to decision useful information generation and dissemination. As depositioned by (Dodge and Robbins, 1992; Sarapaivanich, 2003) most SMEs lack proper accounting information systems, thus creating serious challenges

for their survival and growth; by extension the prevalence of lack of the preparation of annual financial performance reports as the case with large and public firms. The capacity of an SME to generate decision useful accounting information through the institutionalization of a proper accounting information system is a critical success factor. The implications arising from this scenario are numerous, but of prime concern to this current research effort is the resultant challenge associated with determining the income tax liability of SMEs. The difficulty associated with SME tax evaluation and assessment impacts negatively on the aggregate tax yield from this sector of the economy.

Several reasons had be advanced as to why most SMEs are unable to prepare annual financial performance reports. But this research effort investigated effective tax administration as tool for enshrining financial accounting information system in SMEs. This is premised on its mandatory compliance requirement by law and the attendant legal implications arising from non compliance. In developed economies, criminal proceedings have been instituted severally against tax defaulters but the situation in Nigeria is somewhat different. There is a high prevalence rate of tax default by both individuals and corporate bodies hence the justification for this current research effort.

## 2. WHAT IS KNOWN IN THE LITERATURE

### 2.1. The SME Acronym

The literature is agog with definitional dialectics of the acronym SME. The controversy generated by the initial definitional attempts had been largely resolved. It is now universally accepted that any definition of SME must be premised on certain national, and or, international benchmarks contingent upon the perspective and purpose of the definition. Although for purposes of policy formulation and implementation, the scaling of the criteria does vary among nations. These variations account for the lack of a universally accepted definition of SME. For instance, not even the definition provided by the International Accounting Standards Committee Foundation in 2007, which described an SME as "an entity that does not have public accountability and thus publishes general purpose financial statements for external users" is generally applicable in policy formulation and implementation across nations. But one commonality that characterizes the definitional dialectics of SMEs is the fact that the benchmarking is based on each country's level of socio–economic development.

While the current study is not focused on the definitional dialectics of SMEs, it must be noted that the acronym SME evokes a picture of small in all minds. Furthermore, based on the variations in the benchmarking of SMEs across nations, there is the need for an operational definition of SME in this paper within the context of Nigeria. This is because the study is based on the Nigerian economic setting. Therefore for the purpose of this paper, the Central Bank of Nigeria's policy definition of SME was adopted which described an SME as "one that has an annual turnover below ₦500 million and has a staff strength not exceeding 300 employees".

Despite the variations in the indices used for benchmarking of SMEs, there is a global consensus amongst scholars and policy makers that SMEs play a critical role in both national

economies and the global economy. The fact that SMEs play very important part, not only in the economic growth of nations but, in the sustainable development of nations is well documented in literaure. Various studies by (Holmes and Nicholls, 1988; Wynarczyk *et al*., 1993; Mitchell *et al*., 1998; Norwell, 1998; Hallberg, 2001) amongst others have provided empirical evidence to support the role played by SMEs in national economies. SMEs play a crucial role in developed and developing nations (International Federation of Accountants (IFAC), 2010). This assertion by IFAC was substantiated on the basis of the statistics obtained from the European Union which reported that SMEs contribute to over 99% of all enterprises and 100 million jobs, representing 67.1% of private sector employment. The submission of Nelson and Onias (2011) citing the empirical work of Zindiye *et al*. (2008) in the Zimbabwean economy also lends credence to the critical role played by SMEs. In Nigeria the empirical account as reported by the Federal Office of Statistics is indicative of the fact that SMEs make up over 97% of businesses in Nigeria, thus carrying along the benefits derivable there from. For a more detailed account of the role of SMEs in the economies of nations, see the work of Ludovica and Nicoleta (2011).

From the foregoing it is commonly and widely accepted that SMEs contribute more to economic development on the aggregate level than large scale firms. Incidentally, there are more SMEs in developed countries than in developing countries. SMEs bridge the gap created by the challenges of rationalization which has resulted in the creation of lean organizations, and outsourcing of non critical functions to gain competitive cost advantage by large scale firms in the market place.

### 2.2. Imperative of Accounting Information System (AIS) in SME Operations

Drawing from the submission of Penrose (1959), Teece *et al*. (1997) as cited in International Federation of Accountants (IFAC) (2010), which depositioned that SMEs need to develop and have competencies in order to survive in a changing environment, the place of decision useful accounting information clearly comes to the fore. Efficient management of an enterprise would be a wild goose chase if decision useful financial information is not available for optimal decision making. The European Commission in 2008 recognized the fact that appropriate accounting information is vital to the successful management of any business entity, whether large of small. The place of decision useful accounting information in the proper management of SMEs was clearly emphasized in the submissions of (Holmes and Nicholls, 1989; Nayak and Greenfield, 1994; McMahon, 1999; Deakins *et al*., 2001; Berry *et al*., 2002; Haldma and Laats, 2002). In view of their size, according to (Padachi, 2012) SMEs need continues support in their functional areas. The often neglected area is the accounting and finance function and yet this has not attracted much interest from SME support agencies with severe implications for their growth and sustainability. Their high mortality rate is predicated on poor financial management. Dodge and Robbins (1992) emphasized the implications of the absence of accounting information systems to provide owner managers with decision useful information. In lending further credence to the place of accounting information system, (Berry *et al*., 2002; Padachi, 2012) reported in their studies that as an SME moves along the different stages of its business life cycle, accounting–

related problems becomes more important for its promoter/manager to consider seriously. The absence of serious consideration mars control and presents working capital funding challenges (Dodge and Robbins, 1992; Sarapaivanich, 2003).

The literature had catalogued the existence of several problems associated with the SME sector. As a result, it is not surprising that an earlier empirical study by Wichmann (1983) noted accounting as the most frequent problem of SMEs. Therefore to survive and grow their enterprises, SME promoters must of necessity develop and institute proper accounting systems (Mitchell *et al*., 1998; Amidu and Abor, 2005; Stefanou, 2006). Various variables had also been identified in the literature as the drivers of the low level of accounting practice in SMEs. These range from the level of education of the promoter to resource gap amongst others (Holmes and Nicholls, 1989; Lybaert, 1998; Marriott and Marriott, 1999; Collis and Jarvis, 2002).

### 2.3. Tax Administration in Nigeria

Tax which hitherto serves as the prime source of revenue for financing government activities suffered a major setback in most developing countries as a result of others sources of government revenue. In Nigeria the boom resulting from natural resources like crude oil accounted for this development. Prior to the era of the oil boom in the early seventies (Ariyo, 1997), the Nigerian nation depended upon taxation. Her colonial master instituted a tax system early in the administration of the country which was inherited by the country upon independence in 1960. But the discovery of crude oil in commercial quantity in 1957 and the resultant oil boom in the early seventies methodically confined tax, which was the primary instrument for public revenue generation, to the background. This resulted in the demise of tax institutions and massive corruption in customs tax administration. However, the resultant fluctuations in the international oil market, coupled with the lack of safety nets provided for the economy during the period of the oil boom, led to massive deficit budgeting, excessive borrowing and a near total collapse of the nation's economy in the early 80s.

The stochastic nature of the international oil market and the resultant devastating effects on the national economy became the impetus required to rejuvenate the country's tax administrative system and therefore the tax reform policies initiatives implemented thus far. The foregoing scenario meant that the noble objectives of taxation as elucidated by (Lymer and Oats, 2010) as cited in James and Moses (2012) did not form the initial policy trust of the Nigerian tax system after independence.

Drawing from the deposition of Bird and Milka (1992), which concluded on the need to improve tax administration in developing countries, the several years of neglect of the sector via total reliance on oil revenue meant that there was no clear tax policy trust in Nigeria. Tax administration was in comatose. The long years of neglect created enormous challenges for reforming the system. See Aberbach and Tom (2007) for challenges of modernizing tax systems in developing countries. Thus, the Nigerian tax system (Ariyo, 1997; Ayodele, 2006; Popoola, 2009) was enmeshed with challenges which range from antiquate laws, corruption, poor funding of tax agencies, multiple taxation, a dominant informal sector, to citizens' apathy etc. The

dominance of the informal sector (Ayodele, 2006)meant that majority of the eligible tax payers were outside the tax net. Tax yield was therefore very low. Its component of the national annual revenue projection (budget) was very insignificant since oil revenue accounted for nearly 100% of the budget for a long while. Of particular importance was the issue of multiple taxation (Ahunwan, 2009), which became prevalent amongst the few complying organizations. This resulted from the lack of a unified tax administrative system and tax laws amongst the three tiers of government, since the governance structure of the country is calibrated along Local, State and Federal Government lines. These characteristics as enumerated above are akin to the ones listed by Lewis (2005) and Richard and Eric (2008). The conclusion from the literature is that effective tax administration is the impetus required for achieving the goals of taxation (Bird *et al*., 2008; Jaime and Bird, 2011).

Nigeria has a system of tax administration that is characterized by several agencies at the Federal level, led by the Federal Inland Revenue Service (FIRS), Boards of Internal Revenue (BIR) at the State levels and Revenue Departments at the Local government levels etc. Recent reforms which led to the establishment of the Joint Tax Board (JTB) are yet to completely harmonize the tax administrative structure of the nation.

### 2.4. Hypothesis Development

Studies by (Javis *et al*., 1996; Kirby and King, 1997) amongst others did advance various reasons for the introduction of accounting systems in SMEs, but of particular interest to the current study is the deposition that a major driving force underpinning the institution of proper accounting system in most SMEs is preparing the necessary financial documentation for tax purposes (Stefanou, 2006; European Commission (Enterprise and Industry Directorate-General), 2008). Akin to this is the need to fulfill statutory requirements (regulation) for the preparation of financial performance reporting by SMEs (Tanwongsval and Pinvanichkul, 2008; Lalin and Sabir, 2010). This deposition predicated against the backdrop of the character of the tax administrative system in Nigeria constitutes the necessary background for this study. This is the basis for the hypothesized relationship as indicated below:

**Ho1**: There is no significant relationship between effective tax administration and institutionalization of accounting system in SMEs in Nigeria.

## 3. MATERIALS AND METHODS

The data for this current study was obtained using a structured questionnaire administered to tax agencies of the government and SME operators. They included the Federal Inland Revenue Service (FIRS), State Boards of Internal Revenue from the six states that make up South–South region of Nigeria, Local Government Revenue Departments (comprising a total 70 respondents) and 200 SME operators within the same South–South region of the country. The data was obtained between July 2013 and February 2014. Both descriptive and inferential statistics was used to analyse the data using e-view and the SPSS platform for the descriptive statistics. Accordingly, Excel was used to transform the data into analyzable format, after which

the least square regression was used on the E-View software platform as espoused by Gujarati and Porter (2009), that the ordinary least square regression analysis shows the direction of cause and effect between the regressand and the regressor variables.

The ordinary least square was guided by the following models.

$Y = f(x)$---------- (1)

Where x means the tax administration in Nigeria.(Tax) and the factors that affect tax administration in Nigeria, and Y , being institutionalization of accounting systems in SMEs(a1SMEs)

$a1SMEs = a0 + Tax + E$ ------- (2)

A priori expectation of the linear function is as below

$SMEs / Tax > 0$;

a1, is the co-efficient of the regression and a is the intercept of the regression and E is the error term, capturing other explanatory variables not included in the model.

## 4. RESULTS, IMPLICATIONS AND CONCLUSION

### 4.1. Descriptive Statistics

**Table-4.1.1.** Descriptive Statistics of variables characterizing Nigeria tax system

| | N | Minimum | Maximum | Mean | | Std. Deviation | Skewness | | Kurtosis | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Statistic | Statistic | Statistic | Statistic | Std. Error | Statistic | Statistic | Std. Error | Statistic | Std. Error |
| Improperlaws | 5 | .00 | 108.00 | 54.0000 | 22.62521 | 50.59150 | .372 | .913 | -2.903 | 2.000 |
| Poorassessmentandevaluation | 5 | .00 | 130.00 | 54.0000 | 24.74672 | 55.33534 | .340 | .913 | -1.240 | 2.000 |
| Lackoflogisticsupportandoperationfacilities | 5 | .00 | 216.00 | 54.0000 | 41.15337 | 92.02174 | 2.069 | .913 | 4.348 | 2.000 |
| weaksanctionsfordefaulters | 5 | .00 | 249.00 | 54.0000 | 48.91932 | 109.38693 | 2.199 | .913 | 4.857 | 2.000 |
| Taxevationandavoidance | 5 | .00 | 179.00 | 54.0000 | 35.87618 | 80.22157 | 1.236 | .913 | .195 | 2.000 |
| Lackoftrust | 5 | .00 | 101.00 | 54.0000 | 22.27779 | 49.81466 | -.513 | .913 | -3.178 | 2.000 |
| Lowcompliancerate | 5 | .00 | 117.00 | 54.0000 | 20.34699 | 45.49725 | .269 | .913 | -.561 | 2.000 |
| Multipletaxation | 5 | .00 | 119.00 | 54.0000 | 24.58251 | 54.96817 | .127 | .913 | -2.666 | 2.000 |
| Valid N (listwise) | 5 | | | | | | | | | |

**Source:** SPSS print out (2014)

Table 4.1.1 above clearly encapsulates the descriptive statistics of the variables that characterize the Nigeria tax system. Using the descriptive statistics as evidenced in table 4.1.1, the result shows that weak sanctions for defaulters is one of the major factors that characterizes the Nigeria tax system. This is evidenced by the mean standard error of 48.91932 which is the highest. This is followed by lack of logistic support and operational facilities with a mean standard error of 41.15337. The result also shows a 4.857 to -3.178, which meant that the variables were not normally distributed with a skewness of 2.199 to -.513.

**Table-4.1.2.** Descriptive Statistics on variables that undermine Nigeria tax administrative system

| | N | Minimum | Maximum | Mean | | Std. Deviation | Skewness | | Kurtosis | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Statistic | Statistic | Statistic | Statistic | Std. Error | Statistic | Statistic | Std. Error | Statistic | Std. Error |
| Highlevelofcorruption | 5 | .00 | 108.00 | 54.0000 | 23.45847 | 52.45474 | .154 | .913 | -2.982 | 2.000 |
| Lackofdata | 5 | .00 | 162.00 | 54.0000 | 29.57702 | 66.13622 | 1.361 | .913 | 2.000 | 2.000 |
| Absenceofenforcment | 5 | .00 | 162.00 | 54.0000 | 34.15260 | 76.36753 | .884 | .913 | -1.750 | 2.000 |
| Highlevelofpoverty | 5 | .00 | 116.00 | 54.0000 | 23.24435 | 51.97596 | -.140 | .913 | -2.421 | 2.000 |
| Highlevelofilliteracy | 5 | .00 | 127.00 | 54.0000 | 21.86321 | 48.88763 | .710 | .913 | .346 | 2.000 |
| Lackofexperience | 5 | .00 | 136.00 | 54.0000 | 26.17441 | 58.52777 | .791 | .913 | -1.675 | 2.000 |
| Lackofpropercordination | 5 | .00 | 119.00 | 54.0000 | 22.60973 | 50.55690 | .260 | .913 | -2.016 | 2.000 |
| Loopholes | 5 | .00 | 213.00 | 54.0000 | 40.99634 | 91.67061 | 1.936 | .913 | 3.725 | 2.000 |
| Overriding | 5 | .00 | 123.00 | 54.0000 | 24.95596 | 55.80323 | .372 | .913 | -2.606 | 2.000 |
| Valid N (listwise) | 5 | | | | | | | | | |

**Source:** SPSS print out (2014)

Table 4.1.2 above discloses the descriptive statistics on variables that undermine the Nigerian tax administrative system. From table 4.1.2 above, the result highlights loopholes in the tax laws as the major factor that undermines Nigeria's tax administrative system. This is shown in the table by the mean standard error of 40.99634 which is the highest value. This is followed by absence of enforcement with a mean standard error of 34.15260. The result also shows a 3.725 to -2.982 distribution spread, which means that the variables are not normally distributed with a skewness of 1.936 to .154.

**Table-4.1.3.** Descriptive Statistics on the extent to which effective tax system impacts on SME operations

| | N | Minimum | Maximum | Mean | | Std. Deviation | Skewness | | Kurtosis | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Statistic | Statistic | Statistic | Statistic | Std. Error | Statistic | Statistic | Std. Error | Statistic | Std. Error |
| adequateandproper | 5 | .00 | 114.00 | 54.0000 | 24.22396 | 54.16641 | .031 | .913 | -2.878 | 2.000 |
| properapplication | 5 | .00 | 162.00 | 54.0000 | 34.15260 | 76.36753 | .884 | .913 | -1.750 | 2.000 |
| Welldeveloped | 5 | .00 | 170.00 | 54.0000 | 32.40525 | 72.46033 | 1.342 | .913 | 1.053 | 2.000 |
| relianceonaccounting | 5 | .00 | 162.00 | 54.0000 | 34.15260 | 76.36753 | .884 | .913 | -1.750 | 2.000 |
| effectivemeasurement | 5 | .00 | 162.00 | 54.0000 | 34.15260 | 76.36753 | .884 | .913 | -1.750 | 2.000 |
| preparationofannual | 5 | .00 | 143.00 | 54.0000 | 30.52704 | 68.26053 | .689 | .913 | -2.624 | 2.000 |
| Astronginternal | 5 | .00 | 149.00 | 54.0000 | 29.79429 | 66.62207 | .842 | .913 | -1.456 | 2.000 |
| Easewithwhich | 5 | .00 | 192.00 | 54.0000 | 35.89986 | 80.27453 | 1.841 | .913 | 3.454 | 2.000 |
| Valid N (listwise) | 5 | | | | | | | | | |

As indicated in table 4.1.3 above, an effective tax administrative system compels the institution of accounting systems for regulatory audit for the purpose of tax assessment and filing of tax returns. The result shows the resultant ease with which third party audit is carried out in compliance to tax requirements. This is evidenced by the mean standard error of 35.89986 which has the highest value. This is followed by proper application of accounting principles with a mean standard error of 34.15260. from the table it is also informative to note that the variables are not normally distributed with a skewness of 1.841 to .031.

**Table-4.1.4.** Descriptive statistics

| **Mean** | ***3.381000*** | ***3.857000*** |
|---|---|---|
| Median | 3.000000 | 4.000000 |
| Maximum | 5.000000 | 5.000000 |
| Minimum | 2.000000 | 2.000000 |
| Std. Dev. | 0.827757 | 0.831202 |
| Skewness | 0.236304 | -0.015386 |
| Kurtosis | 2.538054 | 1.993884 |
| Jarque-Bera | 36.39607 | 84.43468 |
| Probability | 0.000000 | 0.000000 |
| Observations | 2000 | 2000 |

Table 4.1.4 shows a JarqueBera test of normality as follows; Skewness 0.236304, -0.015386 and Kurtosis as 2.538054, 1.993884. With a skewness of less than 0, and kurtosis of less than 3, and a probability of 0.0000, the null hypothesis is rejected and the alternative is accepted since the observed variables residuals are not perfectly normally distributed as in the table.

### 4.2. Inferential Statistics

**Table-4.2.1.**Dependent Variable: AS Method: Least Squares Date: 04/12/14 Time: 08:42 Sample: 1 2000 Included observations: 2000

| **Variable** | **Coefficient** | **Std. Error** | **t-Statistic** | **Prob.** |
|---|---|---|---|---|
| C | 1.077594 | 0.044906 | 23.99641 | 0.0000 |
| SMES | 0.822066 | 0.012901 | 63.72025 | 0.0000 |
| R-squared | 0.670203 | Mean dependent var | | 3.857000 |
| Adjusted R-squared | 0.670038 | S.D. dependent var | | 0.831202 |
| S.E. of regression | 0.477462 | Akaike info criterion | | 1.360334 |
| Sum squared resid | 455.4834 | Schwarz criterion | | 1.365935 |
| Log likelihood | -1358.334 | F-statistic | | 4060.271 |
| Durbin-Watson stat | 0.011037 | Prob(F-statistic) | | 0.000000 |

Table 4.2.1 presents the multiple regression result on the relationship between effective tax administration and institutionalization accounting system in small scale enterprises. The result shows that a 0.822 percent improvement in improvement in tax administration in Nigeria will lead to a 1 percent improvement in the accounting system of small scale enterprises. The adjusted R-squared indicated that tax administration system interprets 67% of the behaviour of accounting system in SMEs.

### 4.3. Durbin-Waston Statistical Test

From table, the Durbin-Waston stat test of auto-correlation is 0.011037, which shows that the data is stable, and that the result is not capable to forecast a long-run relationship between the dependent and the independent variables of the model. Again the Durbin-waston statatis test tabulated is 0.792 to 1.991 which is greater than 0.011037, indicating that there is the presence of positive first order serial correlation in the model.

**Table-4.2.2.** White Heteroskedasticity Test

| | | | |
|---|---|---|---|
| F-statistic | 389.6859 | Probability | 0.000000 |
| Obs*R-squared | 561.4319 | Probability | 0.000000 |

From table 4.2.2, the result indicated a probability of 0.000 which is less than the critical value of 0.05. showing that there is no heteroskedasticity in the model.

**Table-4.2.3.** Ramsey RESET Test

| | | | |
|---|---|---|---|
| F-statistic | 59.30829 | Probability | 0.000000 |
| Log likelihood ratio | 115.4567 | Probability | 0.000000 |

The result from table 4.2.3 indicated a probability of 0.0000 which is less than the critical value of 0.05. Showing that the model for the study is well specified.

**4.4.** Corrolation Coefficient (SPSS)

| | **TAX** | **SMES** |
|---|---|---|
| TAX | 1.000000 | 0.818659 |
| SMES | 0.818659 | 1.000000 |

**Table-4.2.4.**

**Correlations**

| | | Taxadministrative system | Account and sme |
|---|---|---|---|
| Taxadministrativesystem | Pearson Correlation | 1 | .850 |
| | Sig. (2-tailed) | | .068 |
| | N | 5 | 5 |
| Accountandsme | Pearson Correlation | .850 | 1 |
| | Sig. (2-tailed) | .068 | |
| | N | 5 | 5 |

**Source:** SPSS print out (2014) *Correlation is significant at the 0.01 level (2tailed) Researchers' field work 2014.

The Pearson rank order correlation coefficient on the effect of tax administration system on accounting systems of SMEs is 0.850 with p=0.068, implying a statistically significant correlation. This result shows that the accounting system of SMEs has a significant positive relationship with tax administrative system. Therefore, an effective tax administrative system will impact positively on the financial management capacity of SMEs through the institutionalization of a proper accounting system even if outsourcing is relied upon as a result of resource gap. This conclusion is supported with empirical evidence in the literature for developed countries that rely on taxation as the primary source of government revenue, where non compliance with tax laws is severely sanctioned. The lack of an effective tax administrative system does undermine the institution of proper accounting systems in SMEs and by implication limiting income tax yield from this sector.

Accordingly the study advocates the need to build strong institutions, enact appropriate laws and implement stiffer penalties for defaulters. This should be predicated on the basis of an enhanced citizens' confidence in the government and its institutions, which can be attained

through the enthronement of fiscal transparency and accountability framework and good governance that has the capacity for building trust. This will enhance voluntary compliance with tax laws.

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