EFFECTIVE TAX ADMINISTRATION AND INSTITUTIONALIZATION OF ACCOUNTING SYSTEMS IN SMALL AND MEDIUM SCALE ENTERPRISES

Stanley OGOUN
Department of Finance and Accountancy,
Niger Delta University,Wilberforce Island,
PMB 071, Yenagoa, Bayelsa State, Nigeria.
Email: sko1200@yahoo.com

Abstract
This 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 were obtained from SMEs operators and staff of Federal Inland Revenue Services (FIRSs) and State Boards of Internal Revenues (SBIRs) as applicable in Nigeria. The econometric view (e-view) was used to analyze the data so obtained, and it was observed that 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 factors 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 tax 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, accountability framework and good governance that has the capacity for building trust thereby enhancing voluntary compliance with tax laws.

Keywords: Tax administration, Institutionalization, Decision Useful accounting information, Small and Medium Scale Enterprises, Federal Inland Revenue Services

1 Introduction

The preponderance of Small and Medium Scale Enterprises (SMEs) in economies of nations and in the global arena is well documented in the literature. Also it is an empirical fact that there are more SMEs than large scale firms in all national economies. The 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 and global economies is anchored on the critical and essential role they play in the economy. Various studies have enumerated the critical role played by this class of businesses. An aggregation of their role 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 SMEs(see Beck, Asli, & Ross, 2005; Pontus, 2009; IFAC, 2010;Edinburgh Group, 2013).

Imagine a national or global economy without a vibrant SME sector? One critical sector dominated by SMEs is the knowledge industry. 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 SMEs sector.

A key determinant of SMEs survival and growth is effective and efficient management. Teece et al., (1997) as cited in 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 or informed decision making. To a large extent, optimal decision making depends on the availability of relevant and reliable informational that is timely. Sub-optimal decisions and their attendant implications marred SMEs 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. 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 & Nichoils, 1989; Turner, 1997; Stice, et al., 1999; Deakins et al. 2001; Biggs, 2002; Haldma &Laats, 2002). Government through its tax agency represents one typology of users. Tax agencies require statement of financial performance for the purpose 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, SMEs 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 observed byDodge & 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 SMEs to generate decision useful accounting information through the institutionalization of a proper accounting information system is a critical success factor. The implication 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 with tax evaluation and assessment impacts negatively on the aggregate tax yield from this sector of the economy. Several reasons have been advanced as to the inability of most SMEs to prepare annual financial performance reports and how SMEs can be encouraged to do so. But this paper investigated effective tax administration as tool for

Enshrining financial accounting information system in SMEs. This is premised on the mandatory compliance and the attendant legal implications a rising 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 both by individuals and corporate bodies hence, the justification for this current study. Thus, the objective of this study is geared towards investigating the role of effective tax administration and institutionalization of accounting systems in SMEs in Nigeria. The remaining part of the paper is divided into literature review, materials and methods, discussion of results conclusion and recommendations

2. a. The SMEs Concept

The literature is agog with definitional dialectics of the acronym SMEs. The controversy generated by the initial definitional attempts has been largely resolved. It is now universally accepted that any definition of SMEs 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 varies among nations. These variations account for the lack of a universally acceptable definition of SMEs. For instance, not even the definition provided by the International Accounting Standards Committee Foundation in 2007 which described SMEs 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 by socio-economic development while the current study is not focused on the definitional dialectics of SMEs, it must be noted that the acronym SMEs evoke a picture of small in all minds. Furthermore, recognition of the minor variations in the benchmarking of SMEs across nations necessitates the need for an operational definition of an SME within the Nigerian context. This is because the study is based on the Nigerian economic setting. Therefore for the purpose ofthis paper, the Central Bank of Nigeria's operational definition was adopted which described an SME as an enterprise that has an annual turnover below N500 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. Moore et al. (2008) noted that SMEs play very important part not only in the economic growth of nations but in the sustainable development of nations. Various studies by Holmes &Nichollas, (1988); Wynarzyk et al. (1993); Norwell, (1998); Mitchell, Reid &Smith, (1998); Hallberg, (2001); Biggs, (2002); Ayyagari et al.(2007) amongst others have provided empirical evidence to support the role played by

SMEs in national economies. SMEs play a crucial role in most developed and developing nations (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 & Onias (2011) citing Zindiye et al (2008) in the Zimbabwean economy also lends credence to the critical role played by SMEs. In Nigeria, the empirical evidence 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 therefrom. 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 developing countries. These 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.

b. Accounting Information Systems (AISs) and SMEs Operation

Drawing from the submission of Penrose (1959), Teece et al. (1997) as cited in IFAC (2010), which opined 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 or small. The place of decision useful accounting information in the proper management of SMEs was clearly emphasized in the submissions of (Holmes &Nichoils, 1989; Nayak &Greenfield, 1994; Turner, 1997; McMahon, 1999; Deakins et al. 2001; Berry et al. 2002; Haldma & Laats, 2002). In view of their size, Padachi, (2012) noted that SMEs need to continuously provide support in their functional areas. The often neglected area is the accounting and finance function and yet this has not attracted much interest from SMEs support agencies (Padachi, 2012) with severe implications for their growth and sustainability. Their high mortality is predicated on poor financial management. Dodge &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 moe important for its promoter/manager to consider seriously. The absence of which mars control and presents working capital funding challenges (Dodge &Robbins, 1992; Sarapaivanich, 2003).

Various sectors have been identified as drivers of the low level of accounting practice in SMEs. These range from the level of education of the promoter to resource gap (see Holmes & Nicholis, 1989 ; Lybaert, 1998 ; Marriot& Marriot, 1999; Collis & Jarvis, 2002). As a result, it is not surprising that an earlier empirical study by Wichmann (1983) provide evidence that accounting is the most frequent problem of SMEs. Therefore to survive and grow their enterprises, SME promoters must of necessity develop and institute a proper accounting system (see Michell et al. 1998; Amidu &Abor, 2005; Stefanou, 2006).

c. 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 the boom resulting from natural resources like crude oil. Prior to the era of the oil boom in the early 70s (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. But 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 volatile 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 implies that the noble objectives of taxation as elucidated by (Nightingale, 2002; Lymer & Oats, 2010) as cited in James &Moses (2012) did not form the initial policy trust of the Nigerian tax system after independence.

Drawing from the deposition of Bird & Milka (1992), which concluded on the need to improve tax administration in developing countries, the aggregated years of neglect 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 (Aberbach & Tom, 2007). This however impinged the modernization of tax systems in developing countries. Thus, the Nigerian tax system as noted by Ariyo,(1997); Ayodele, (2006); Popoola,(2009), 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 meant that majority of eligible tax payers were outside the tax net (Ayodele, 2006) and tax yield was 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, which became prevalent amongst the few complying organizations (Ahunwan, 2009). 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 enumerated above are akin to the once listed by Lewis (2005); Richard &Eric (2008).

The conclusion from the literature is that effective tax administration is the impetus required for achieving the goals of taxation (see Bird, Jorge, &Benno, 2008; Jaime, &Bird, 2011).Nigeria has a system of tax administration 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. 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.

Hypothesis

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 study were 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 (SBIR) from the six (6) states that make up South-South region of Nigeria, Local Government Revenue Departments (comprising a total of 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 with econometric view (E-View) software. As explained by Gujarati &Porter (2009), the ordinary least square regression analysis shows the direction of implicit causality 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. Y being institutionalization of accounting systems in SMEs (SMEs)

$SMEs = a_0 + \beta_1 TAX + U_t$ ------- (2)

A priori expectation of the linear function is as below

$SMEs = TAX > 0$;

a_0, is the co-efficient of the regression and a, is the intercept of the regression and U_t is the error term, capturing other explanatory variables not included in the model.

4. Discussion of Results

The results of the descriptive statistics as regards factors characterizing tax system, undermining tax administration system and the extent to which effective tax system accounts on SMEs operations in Nigeria were reported in appendices I-III. First, the descriptive statistics (see appendix I), shows that weak sanctions for defaulters is one of the major factors that characterizes the Nigerian tax system. This was clearly reflected in the mean standard error of 48.91932 which has the highest figure, followed by lack of logistic support and operational facilities with a mean standard error of 41.15337.

Second, the result shows that loopholes in the tax laws is the major factor that undermining Nigeria's tax administrative system (see appendix II). This was evidences in the mean standard error of 40.99634 which has the highest figure, followed by absence of enforcement with a mean standard error of 34.15260. Third, we found that an effective tax administrative system compels institution accounting systems for regulatory audit for the purpose of tax assessment and filling of tax returns (see appendix III). The result shows the resultant ease with which third party audit is carried out in compliance with tax requirements. This was evidenced in the mean standard error of 35.89986 which has the highest figure, followed by proper application of accounting principles with a mean standard error of 34.15260.

Table 1: Normality Statistics

Skewness	0.236304	-0.015386
Kurtosis	2.538054	1.993884
Jarque-Bera	36.39607	84.43468
Probability	0.000000	0.000000
Observations	2000	2000

Source: E-view, 2014

Table 1 shows the Jarque-Bera tests of normality as follows: Skewness is 0.236304, -0.015386 and Kurtosis 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.

Table 2: Ordinary Least Square Results

Dependent Variable: TAX

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	

Source: E-view, 2014

Table 2 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 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 of SMEs.From table, the Durbin-Watson statistics of 0.011037 used in testing auto correlation, 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-Watson statistics test tabulated is between 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 3: White Heteroskedasticity Test

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

Source: E-view

From table 3, 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: Ramsey RESET Test

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

Source: E-view

The result from table 4 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.

Table 5 Pairwise Granger Causality Tests

Date: 04/12/14 Time: 08:51

Sample: 1 2000

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Probability
SMES does not Granger Cause TAX	1998	1.65123	0.19208
TAX does not Granger Cause SMES		0.88747	0.41186

Source: E-view

Table 5 above reports the pairwise granger causality test. From the table, the variables do not granger cause each other.

Table 6: Correlation Coefficient

		Taxadministrativesystem	Accountandsme
Taxadministrativesystem	Pearson Correlation	1	.850
	Sig. (2-tailed)		.068
	N	5	5
Accountandsme	Pearson Correlation	.850	1
	Sig. (2-tailed)	.068	
	N	5	5

*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 (p=0.068), implying a statistically significant correlation. This led to the rejection of the null hypothesis and acceptance of the alternative hypothesis which states that there is significant relationship between effective tax administration and institutionalization of accounting system in SMEs in Nigeria. However, we found 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.

5. Conclusion and Recommendations

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 of 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 undermines the collection of profit tax from the operators of this significant sector in the Nigerian economy. 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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APPENDICES

Appendix I: Descriptive Statistics of variables characterizing Nigeria tax system

	N	Minimum	Maximum	Mean		Std. Dev.	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
	5	.00	249.00	54.0000	48.91932	109.38693	2.199	.913	4.857	2.000
Weaksanctionsfordefaulters	5	.00	179.00	54.0000	35.87618	80.22157	1.236	.913	.195	2.000
Taxevationandavoidance	5	.00	101.00	54.0000	22.27779		-.513	.913	-3.178	2.000
	5	.00	117.00	54.0000		49.81466 45.49725	.269	.913	-.561	2.000
Lackoftrust	5	.00	119.00	54.0000	20.34699 24.58251	54.96817	.127	.913	-2.666	2.000
	5									

Source: SPSS print out (2014)

Appendix II: Descriptive Statistics on variables that undermine Nigeria tax administrative system

	N	Minimum	Maximum	Mean		Std. Dev.	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
Absenceofenforcement	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)

Appendix III: Descriptive Statistics on the extent to which effective tax system account on SME operations

	N	Minimum	Maximum	Mean		Std. Dev.	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Std. Error	Statistic	Std. Error