EFFECTS OF ELECTRONIC TAXATION ON FINANCIAL PERFORMANCE OF AUDIT FIRMS IN KENYA

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DECLARATION

I declare that this research project is my original work and has not been presented in any other institution

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This research project has been submitted with my approval as the university supervisor

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DEDICATION

I dedicate this project to my parents and siblings for the great love and inspiration on my life, no words can express my deepest appreciation for your support

ACKNOWLEDEGEMENT

First and foremost, I would wish to thank the almighty God for the free gift of life and for guiding me; giving me strength, wisdom and the ability to successfully complete this study.

To my loving parents, for the wonderful support you have provided both materially and morally, you are highly appreciated

I wish to acknowledge the contribution and constructive critique of my supervisor PROF Aduda who tirelessly guided me through the development of this project

To all of you, I say God bless you.

ABSTRACT

Kenya introduced the Tax Modernisation Programme in 1986 with the hope that this would, among other things, enhance revenue collection, improve tax administration and reduce compliance and collection costs. Despite the tax modernization, there are concerns that the challenges that confront the Ministry of Finance and Kenya Revenue Authority today are not much different from the challenges that faced these revenue authorities before the reforms. There are also concerns that tax competitiveness in Kenya is low and the country remains among the most tax unfriendly countries in the world. This study reviews tax revenue performance as well as tax design and administration changes during the period 1996 - 2005 in order to identify priorities for further tax reform. Even though the tax system has continuously changed, in pursuit of the objectives of the Tax Modernization Programme that came into force in 1986, the challenges that confront the tax authorities today are not much different from the pre-reform challenges. With Kenyan firms reporting that about 68.2% of profit is taken away in taxes, tax competitiveness is low and the country remains among the most tax unfriendly countries in the world. Tax evasion remains high, with a tax gap of about 35% and 33.1% in 2000/1 and 2001/2 respectively. The tax code is still complex and cumbersome, characterized by uneven and unfair taxes, a narrow tax base with very high tax rates and rates dispersions with respect to trade, and low compliance. Additional challenges include tax systems with rates and structures that are difficult to administer and comply with; are unresponsive to growth and discretionary policy hence low productivity; raise little revenue but introduce serious economic distortions; treat labour and capital in similar circumstances differently; and are selective and skewed in favour of those with the ability to defeat the tax administration and enforcement system. Beginning in the mid-1980's, tax reforms became part of the larger Structural Adjustment Programmes that were incorporated in the economic restructuring agreement between the Government of Kenya and the International Financial Institutions. Unfortunately, such reforms focused on the Central Government tax system but left out local government tax reforms. Substantial tax reforms followed fiscal crises that were being experienced at the time and the resulting pressures for reform from the IMF and World Bank. The pressure to liberalize happened simultaneously with the realization within the Government that the economic situation was untenable. Thus, Kenya's tax reform was adopted voluntarily to gain favour with powerful international donors.

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LIST OF ABBREVIATIONS

ECR	-	Electric Cash Register
ETR	-	Electronic Tax Registers
ESD	-	Electronic Signature Devise
I-tax	-	Integrated Tax Management System
ICPAK	-	Institute of Certified Public Accountants Of Kenya
SAP	-	Structural Adjustment Programmes
KRA	-	Kenya Revenue Authority
VAT	-	Value Addition Tax

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Tax (from the Latin taxo "rate") is a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by the functional equivalent of a state such that failure to pay, or evasion of or resistance to collection, is punishable by law, (Sah, 1991). In Kenya, taxation is the single largest source of government budgetary resources. Between 1995 and 2004, tax revenue constituted 80.4% of total government revenue .Relatively, the importance of non-tax revenue is also significant in sustaining the public budget,although its importance is much less than the role of taxation given that it's share over the sameperiod was 15.1%. Foreign grants play a minimal role as they have averaged only 4.5%. Given it's central role, taxation has been applied to meet two objectives. First, taxation is used to raise sufficient revenue to fund public spending without recourse to excessive public sector borrowing.Second, it is used to mobilize revenue in ways that are equitable and that minimize its disincentive effects on economic activities. Moyi and Ronge (2006)

Over time, Kenya has moved from being a low tax burden country to a high tax burden country yet the country faces the obvious need for more tax revenues to maintain public services. Given the high tax burden, prospects to raise additional revenue seem bleak. In addition, Kenyans are yet to accept a tax paying "culture". On one hand, those with political power and economic ability are few and do not want to pay tax. On the other hand, those without political power are many, have almost nothing to tax, and do also resist paying taxes. Since no one enjoys paying taxes, there is mistrust between those collecting taxes and taxpayers. This mistrust generates a game theoretic coexistence between tax agents and tax payers, with agents perceiving taxpayers as criminals unwilling to pay their taxes, and tax payers wary of government agencies' high-handedness in collection of taxes . This creates the need for the tax agents to improve their image by building trust and public confidence.

Moyi and Ronge (2006)

An analysis of Kenya's fiscal structure reveals a number of important aspects. First,compared with a sample of low-income sub-Saharan countries, Kenya's tax/GDPratio is higher than the sample average. Second, the imbalance between government revenue and expenditure results in large and chronic fiscal deficits. In theory, the financing of a deficit especially through foreign borrowing or additional foreign financing mayhave considerable effects on interest rates, the balance of payments and the external value of the currency, in this case the shilling. Third, Kenya initiated reforms in the tax structure with diverse objectives. Unfortunately, the reform process began at a time when the macroeconomic environment was unstable. When there is a rapid and significant change in macroeconomic policies, it is much more difficult for tax reforms to have important and identifiable revenue effects .Tanzi(1988).

1.1.1 I-Tax

Beginning in the mid-1980's, tax reforms became part of the larger Structural Adjustment Programmes that were incorporated in the economic restructuring agreement between the Government of Kenya and the International Financial Institutions (Fjeldstad and Rakner, 2003). Unfortunately, such reforms focused on the Central Government tax system but left out local government tax reforms. Substantial tax reforms followed fiscal crises that were beingexperienced at the time and the resulting pressures for reform from the IMF and World Bank.The pressure to liberalize happened simultaneously with the realization within the Government that the economic situation was untenable,Thus Kenya's tax reform was adopted voluntarily to gain favor with powerful international donors. Moyi and Ronge (2006)

Even though the tax system has continuously changed, in pursuit of the objectives of the Tax Modernization Programme that came into force in 1986, the challenges that confront the tax authorities today are not much different from the pre-reform challenges. With Kenyan firms reporting that about 68.2% of profit is taken away in taxes, tax competitiveness is low and the country remains among the most tax unfriendly countries in the world3. Tax evasion remains high, with a tax gap4 of about 35% and 33.1% in 2000/1 and 2001/2 respectively (KIPPRA,2004). The tax code is still complex and cumbersome, characterized by uneven and unfair taxes, a narrow tax base with very high tax rates and rates dispersions with respect to trade, and low compliance .Additional challenges include tax systems with rates and structures that , are difficult to administer and comply with; are unresponsive to growth and discretionary policy hence low productivity; raise little revenue but introduce serious economic distortions; treat labor and capital in similar circumstances differently; and are selective and skewed in favor of those with the ability to defeat the tax administration and enforcement system. Lumumba et al, (2010)

The KRA introduced Electronic Tax Registers (ETRs) in 2005 to ensure full remittance of VAT by retailers. This was resisted openly through strikes and street demonstrations in majortowns in the country. Currently, ETRs are the subject of court battles between KRA and Traders (under the United Business Association). The introduction of Simba 2005 system, anonline value declaration customs system, has been strongly resisted, especially after it becameevident that some imported vehicles had escaped the net following collusion between importersand customs officials.Moyi and Ronge (2006)

In understanding the tax reform experience in Kenya, one of the questions that must be answered is what is the role of the tax system In practice, there are three common objectives of a tax system: (i) to raise revenue to fund government operations; (ii) to assist in the redistribution of wealth or income; and (iii) to encourage or discourage certain activities through the use of tax provisions. While all tax systems share these objectives, what differs is the weight placed in a given country to each of these objectives. The capacities of different countries' tax systems to achieve these objectives also differ. In Kenya, raising revenue can be said to have been the overriding concern. Moreover, with a limited degree of success, the tax system is also used to address issues of inequality as can be deduced from the nominal progressivity of the income tax structure. Karingi and Wanjala (2005)

Kenya has witnessed significant changes in many aspects of its economy over the last four decades. One of the striking characteristics of Kenya is that unlike many other Sub-Saharan countries today, it is a high tax-yield country with a tax-to-GDP ratio of over 20 per cent. Kenya is able to finance a large share of its budget, while external donor finances are used to cover a much smaller share than in other countries of the region. This striking feature, however, does not mean that the country is not without its problems with the tax system. Like most developing countries, it has had to contend and still contends with the common problems that plague tax systems of developing countries. These problems are the existence of tax systems , with rates and structures that are difficult to administer and comply with; that are unresponsiveness both to growth and discretionary tax measures hence offering low tax productivity; that raise little revenue but introduce serious economic distortions.

Karingi and Wanjala (2005)

The sign of the relationship between efficiency and the method of processing tax returns and the system of tax collection used by taxpayers is one of the questions that still are not resolved nowadays.Allingham and Sandmo (1972) introduced the portfolio approach to solve the individual tax cost problem and showed that, under weak tax processing systems, a number of costs are incurred. However, Yitzhaki (1994) found out that a rise in the tax rate increases the amount of tax processing costs.

A number of issues can therefore be regarded as possible problems that are faced by taxpayers in processing of their VAT returns using Electronic Tax Registers. Such issues include: Time taken in processing VAT returns; Tax preparation costs; Staff costs required to process returns and improve revenue capture through more accurate data entry; Costs of stationery in form of receipt books, writing materials, files and filing of tax returns systems; Costs that are incurred in processing tax refunds; Costs of auditing sales records; Insurance costs for the ETRs; Space for keeping past data records; and Prosecution and refund follow up time and costs. Despite dramatic improvements in recent years in information technology, including automated data capture, the administrative and taxpayer compliance burden associated with large-scale invoice matching continues to be significant. Recent diagnostic reviews by FAD of invoice cross-checking systems have shown that these systems continue to generate considerable unproductive work .Lumumba (2010)

An IMF study, 2005 on VAT refunds found out that a pre-condition for successful reform is a strong commitment on the part of government and key stakeholders. The premises and equipment necessary for automation may include new or rehabilitated offices, hardware, software, internal communication systems and connections to external networks, and they may also require the set-up of wireless networks and links.

Furthermore, the introduction of ICTs needs to be accompanied by extensive capacity building.Benefits of automation include a reduction of fraud, remote access to information, improved collection of statistics, and uniform application of tax legislation. The introduction of tax automation minimizes directcontacts between tax collection officers and traders or their agents, and hence leads to a reduction of corruption. Further benefits achieved through customs automation include improved reporting, control of file transfers, automatic reconciliation of tax returns declarations, and compliance testing of bank files. Paperless declarations and customs automation save time and make it easier to focus on inspecting high-risk consignments. The possibility of submitting tax returns declarations on-line has in some cases made it possible to reduce the associated fees; in other cases it has helped eliminate the obligatory contracting of Customs agents, (Robert, 1997).

ICTs can significantly reduce the number and the potential negative impact of physical inspections. ICTs allow, inter alia, for pre-arrival clearance, risk analysis by tax authorities, and separation of release from clearance. With the help of ICTs, it is further possible to better plan the timing and location of physical inspections, thus significantly reducing the waiting times for trucks and containers. Finally, ICT solutions allow for better measurement of the length and number of physical inspections. Such measurement needs to cover the complete trade and transport operation and not be limited to tax clearance times only. Lumumba (2010)

1.1.2 Financial Performance Of Audit Firms

The rise in audit fees is expected to lift the earnings of the accounting firms, notably the Big Four who control nearly 85 per cent of the market, as the players emerge from a business environment that had kept fees nearly stagnant in the three years to 2010. Auditing fees account for between 50 and 70 per cent of the auditors' earnings with the remaining share being taken by consulting, tax and financial advisory. The flat fees had been attributed to a bitter pricing war among the top firms as they race to snap up top corporate clients until the ballooning wage bill forced the firms to change tact. The rise could have been higher was it not for the competition, especially for blue chip listed firms," said Mr Kassam. The competition, however, has not changed the market structure with the four top firms maintaining a stranglehold of the auditing contracts and their market shares based on fees from NSE listed firms--which is a proxy measure of industry trends-has also remained the same in recent years. Nikhil (2011)

Fat accountants' salaries and the cost of complying with new work standards have forced firms looking at the books of publicly-traded companies to raise their fees by an average of 13.2 per cent. Executives from the "Big Four" accounting firms said salaries in the profession have more than doubled over the past five years as increased poaching of top talent pushed financial advisory companies to raise their wages to retain key staff. As a result, Price Waterhouse Coopers (PwC), Deloitte, Ernst & Young and KPMG are increasing fees to cover the rising cost of doing business that has been worsened by the complexity of auditing due to a change in rules. The expansion of Kenyan companies to the region has also added a new layer of workload to the auditors watering the market for the advisory firms to grow their earnings. Nikhil (2011)

Data from the annual reports of 42 companies listed in the main investments market at the Nairobi Securities Exchange (NSE) indicate that firms spent Sh342.5 million on auditing up from Sh302.5 million in 2010.This represented a growth of 13.2 per cent increase and the auditors say the increments among the listed companies which act as a bellwether of auditing trends across the economy--will also reflect this year. The increase in fees is a reflection of the rise in wages in the auditing field in recent years due to the scramble for top talent and expect it to maintain the same gradient this year, said Sammy Onyango, the managing partner at Deloitte. “The effects of the revision of accounting rules and expansion of companies have also increased workload” he said. Similar comments were echoed by Ashif Kassam, the managing partner at RSM Ashvir—a regional audit firm. Salaries for auditors have been increasing by between 15 and 20 per cent annually over the past three years. This is having an impact on fees we charge,” said Mr Kassam. The pay of a senior auditor has risen to an average of Sh240, 000 from about Sh150, 000 in a period of three years. Last year, audit fees rose 10.7 per cent. Nikhil (2011)

1.1.3 I -Tax And Financial Performance Of Audit Firms

Beginning in the mid-1980’s, tax reforms became part of the larger Structural Adjustment Programmes that were incorporated in the economic restructuring agreement between the Government of Kenya and the International Financial Institutions (Fjeldstad and Rakner, 2003). Unfortunately, such reforms focused on the Central Government tax system but left out local government tax reforms. Substantial tax reforms followed fiscal crises that were beingexperienced at the time and the resulting pressures for reform from the IMF and World Bank.The pressure to liberalize happened simultaneously with the realization within the Government that the economic situation was untenable. Thus, Kenya's tax reform was adopted voluntarily to gain favor with powerful international donors. Eliud Moyi & Eric Ronge (2006)

The auditing industry in Kenya particularly accumulates certain characteristics that make it very interesting from a strategic management point of view. The industry is extremely wide, diverse, dynamic and very competitive. Since the late 1990s the number of firms has grown extensively, there were 583 audit firms registered with ICPAK of which 320 were located in Nairobi. According to ICPAK (2012) within the past five years the number of audit firms registered with ICPAK has increased to 713 with 515 firms located in Nairobi and 198 in other locations. .Nyakang'o (2007)

1.1.4 Audit Firms In Kenya

In a bid to remain competitive and compete in the local and international arena, various audit firms in Kenya have adopted various competitive and positioning strategies. Nyakang'o (2007) noted that there are three categories of audit firms in Kenya; the multinational firms with a foreign background and doing business in many countries, locally owned firms with all partners resident in Kenya and original local firms with foreign entity strategic alliances.

According to ICPAK (2012), there are sixteen large audit firms in Kenya ,among these, Deloitte &Touche, Klynveld Peat Marwick Goerdeler (KPMG), PricewaterCoopers (PWC) and Ernst and Young, are the four exceptionally large firms within the group commonly known as "The Big Four''. According to Wikipedia, these are the four largest international professional services networks in accountancy and professional services, which handle the vast majority of audits for publicly traded companies as well as many private companies, creating an oligopoly in auditing large companies. This group was once known as the "Big Eight", and was reduced to the "Big Five" by a series of mergers and alliances formed between British and US accountancy firms in the 19th or early 20th centuries. One of the largest of these mergers was in 1987, when Peat Marwick merged with the Klynveld Main Goerdeler (KMG) group to become KPMG Peat Marwick, later known simply as KPMG. In July 1998 when Price Waterhouse merged with Coopers & Lybrand to form PricewaterhouseCoopers.

According to Deloitte (2012) audit firms have an important role in every economy. An independent audit of financial statements is one of the foundations for the effective operation of the capital markets. The financial statements are also essential for tax revenue collection by the Kenya Revenue Authority (KRA) and other statutory compliance practices. The audit firms generate revenues through provision of the three core services namely Assurance, Tax, Transactions and Advisory. Audit quality is vital for maintaining trust in the financial reporting process and the integrity of financial information. The influx of many audit firms coupled with advances in the industry has heightened the competition of the audit firms. For this reason, strategic practices in audit firms have been studied and researched upon by various authors and scholars.

1.2 Statement of the Problem

The aim of this study is to explore the impact of Integrated Tax Management system on audit firms. Central to the intention of the beginning of I- tax system is a boost in the effectiveness of tax collection for the Kenya tax authority; however, of more fundamental importance is the need to facilitate this without having an unacceptable unfavorable effect on the other key characteristics of a well-designed tax system.

The introduction of Simba 2005 system, an online value declaration customs system, has been strongly resisted, especially after it became evident that some imported vehicles had escaped the net following collusion between importers and customs officials. Developing systems that can enhance access to third-party sources of information. KRA still lacks adequate and frequently updated information systems on registered taxpayers. Computerization of taxpayer records is still incomplete. There is need to develop systems that can access third party sources of information, such as withholdings, bank transactions, foreign exchange transactions, transactions in securities and large transactions (involving real estate, cars, tax-deductible transactions, customs payments.Moyi and Ronge (2006)

While the new online filling system that KRA has adopted may go a long way to elevate matters it has been estimated that in development countries non compliance in tax rules and regulation can be as high as 60%,introduction of I-tax e.g ETR has reduced the degree of non compliance Lumumba et al (2010), this is in contrast as the introduction of the 2005 system, an online value declaration customs system, has been strongly resisted, especially after it became evident that some imported vehicles had escaped the net following collusion between importers and customs officials. Moyi and Ronge (2006)

The introduction of I-tax in Kenya was introduced with the main aim of combating vices that were mainly associated with the collection of taxes like; Tax evasion, filing of wrong tax returns and claiming of undeserved tax refunds. As much as it was initially looked from such a perspective, a clear analysis has to be made to establish if it also benefits the traders as well. Indications are that it assists traders in such ways as; Saves time initially wasted in perusing of records. Reduction in tax preparation costs for example those paid to tax agencies. Reduction in labour costs e.g. overtime cost. Good record keeping increases profits, Increases efficiency in businesses, reduces costs of tax refund claims. For example the adoption of Electronic Tax Registers by traders as a means of processing VAT returns has been a court battle for a long time. Traders claim that there were punitive operating expenses that the KRA is unwilling to bear besides the actual cost of the machine. On the contrary KRA is of the view that the ETR machines will help increase efficiencies in operations as well as in VAT processing. It is therefore important to assess the effectiveness of ETRs by taxpayers in processing of VAT returns and if their use has also assisted the Kenya Revenue Authority to collect as much VAT as possible. ETRs are expected to help taxpayers process their VAT returns efficiently without major problems that were associated with the earlier paperwork system. The costs of installing and operating the machines will be expected to be correlated with the benefits accruing to their use and comparatively lower than those incurred in the earlier system. Lumumba et al, (2010)

Business in Kenya find themselves having to make in excess of 50 payment a year to meet their tax obligation .clearly this bureaucratic system act as a hindrance when it comes to compliance and no doubt deter direct foreign investments .a key to encourages investment has to be a clear and concise .while the new online filling system that KRA has adopted may go a long way to elevate matters it has been estimated that in development countries non compliance in VAT rules and regulation can be as high as 60%,introduction of ETR has reduced the degree of non compliance . the use of IT systems and process that are manageable cannot be understated, as technology becomes more preference, tax payer is looking for is an easy to use online system that does not take too much time of their time because just like KRA the tax payer has scarcity of resources, if the system is not easy to use, wild horses will not make tax payer use it. Nikhil (2011)

This study sought to investigate whether I-tax can be used to solve cases of tax evasion,compliace and whether its better than the manual system Globally, tax agencies are leveraging on the electronic tax filing (e-filing) system to achieve greater tax administrative and compliance efficiency. However, taxpayers' resistance and under-utilization of e-filing technology remain the greatest concern and still plagued the various tax agencies that had embraced e-filing system

1.3 Objectives of the Study

The objective of the study was to establish the effects of electronic taxation on financial performance of audit firms in Kenya

1.4 Value Of The Study

This study contributes to existing literature on Integrated Tax Management System implementation. The study will further add to the debate on information system success evaluation literature, focusing on the development of an integrative framework in the context of I-Tax that could be beneficial to practitioners wishing to assess the success of such systems. For the body of knowledge on Integrated Tax Management Systems to grow, researchers must not shy away from investigating other aspects of the system.

Revenue Authorities such as KRA will gain a better understanding of the issues or factors to watch out for both at the internal and the external level vis-à-vis the assessment of the success of their I-tax. In some respect, the procedures used in this study and the insight it offer may help the management of Kenya Revenue Authority, overcome the purported lack of knowledge with regard to assessing its success or effectiveness of their acquired systems and related technologies. Given the pervasiveness of I-tax implementation worldwide, it is hoped that a study that aims to investigate the success of such systems in adopting firms would be of benefit to practitioners using such systems or with interest in the technology. Management of firms that have adopted, or those with the intention of adopting the system will gain insights from such an effort highlighting relevant factors and relationships in the context of I-tax success assessment.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter seeks to find the various theories of why individuals and corporate evade or are non tax compliance and the gains of I-tax through the years

2.2 Review of Theory

2.2.1 The Allingham And Sandmo "Portfolio" Theory

The basic theoretical model used in nearly all research on tax compliance begins with the economics-of-crime model.Here a rational individual is viewed as maximizing the expected utility of the tax evasion gamble, weighing the benefits of successful cheating against the risky prospect of detection and punishment, and the individual pays taxes because he or she is afraid of getting caught and penalized if he or she does not report all income. This "portfolio" approach gives the plausible and productive result that compliance depends upon audit rates and fine rates. Indeed, the central point of this approach is that an individual pays taxes because of this fear of detection and punishment. Allingham and Sandmo (1972).

However, this approach also concludes that an individual pays taxes only because of the economic consequences of detection and punishment. The many extensions of this portfolio approach considerably complicate the theoretical analyses, and generally render clear-cut analytical results impossible. Nevertheless, these extensions retain the basic approach and the basic result: individuals focus exclusively on the financial incentives of the evasion gamble, and individuals pay taxes only because they fear detection and punishment. (Allingham and Sandmo 1972).

However, it is clear to many observers that compliance cannot be explained entirely by such purely financial considerations, especially those generated by the level of enforcement. The percentage of individual income tax returns that are subject to a thorough tax audit is generally quite small in most countries, almost always well less than 1 percent of all returns. Similarly, the penalty on even fraudulent evasion seldom exceeds more than the amount of unpaid taxes, and these penalties are infrequently imposed; civil penalties on non-fraudulent evasion are even smaller. A purely economic analysis of the evasion gamble suggests that most rational individuals should either underreport income not subject to source withholding or overclaim deductions not subject to independent verification because it is extremely unlikely that such cheating will be caught and penalized.

However, even in the least compliant countries evasion seldom rises to levels predicted by a purely economic analysis, and in fact there are often substantial numbers of individuals who apparently pay all (or most) of their taxes all (or most) of the time, regardless of the financial incentives they face from the enforcement regime. he portfolio model of individual compliance behavior therefore implies that rational individuals (especially those whose incomes are not subject to third-party sources of information) should report virtually no income. Although compliance varies significantly across countries (and across taxes) and is often quite low, compliance seldom falls to a level predicted by the standard economic theory of compliance. It seems implausible that government enforcement activities alone can account for these levels of compliance; the basic model iscertainly unable to explain this behavior. Indeed, the puzzle of tax compliance behavior may. (Allingham and Sandmo 1972).

2.2.2 Economic Deterrence Theory

The economic deterrence theory states that taxpayer's behavior is influenced by factors such as the tax rate determining the benefits of evasion, and the probability of detection and penalties for fraud which determine the costs . This implies that if detection is likely and penalties are severe, few people will evade taxes. In contrast, under low audit probabilities and low penalties, the expected return to evasion is high. The model then predicts substantial noncompliance. For example, the fear of getting caught, or the probability of detection, has been found in some contexts to be an effective strategy to induce truthful behavior. The theoretical principles of economic deterrence have also been widely adopted by tax administrations when developing enforcement strategies that rely principally on penalties and the fear of getting caught. (Sandmo 2005)

2.2.3 Fiscal Exchange Theory

The fiscal exchange theory suggests that the presence of government expenditures may motivate compliance and that governments can increase compliance by providing goods that citizens prefer in a more efficient and accessible manner note that compliance increases with the availability of public goods and services. Accordingly, the main concern of taxpayers is what they get directly in return for their tax payments in the form of public services . In this perspective, taxation and the provision of public goods and services are interpreted as a contractual relationship between taxpayers and the government . Individuals may pay taxes because they value the goods provided by the government, recognizing that their payments are necessary both to help finance the goods and services and to get others to contribute (Fjeldstad and Semboja 2001).

The existence of positive benefits may increase the probability that taxpayers will comply voluntarily, without direct coercion. Although most taxpayers cannot assess the exact value of what they receive from the government in return for taxes paid, it can be argued that they have general impressions and attitudes concerning their own and others' terms of trade with the government It is then reasonable to assume that a taxpayer's behavior is affected by his/her satisfaction or lack of satisfaction with his/her terms of trade with the government. Thus, if the system of taxes is perceived to be unjust, tax evasion may, at least partly, be considered as an attempt by the taxpayer to adjust histerms of trade with the government. The fiscal exchange theory has received much attention and is well established theoretically. Empirical evidence to support the theory is, however, ambiguous (Moore 2004)

2.2.4 Social Influences Theory

In the social influence model, compliance behavior and attitudes towards the tax system is thought to be affected by the behavior and social norms of an individual's reference group It is reasonable to assume that human behavior in the area of taxation is influenced by social interactions much in the same way as other forms of behavior .Compliance behavior and attitudes towards the tax system may therefore be affected by the behavior of an individual's reference group such as relatives, neighbors and friends. Therefore, if a taxpayer knows many people in groups important to him who evade taxes, his/her commitment to comply will be weaker. On the other hand, social relationships may also help deter individuals from engaging in evasion in fear of the social sanctions imposed once discovered and revealed publicly. (Snavely 1990).

Theoretical research on herd behavior in economic situations also indicates that social influences may affect compliance, in particular by affecting the perceived probability of detection. One of the most consistent findings about taxpayer attitudes and behavior in Western countries is that those who report compliance believe that their peers and friends (and taxpayers in general) comply, whereas those who report cheating believe that others cheat . Evidence suggests that perceptions about the honesty of others may affect compliance behavior. (Banerjee 1992)

2.2.5 Comparative Treatment Theory

The comparative treatment model is based on equity theory and posits that addressing inequities in the exchange relationship between government and taxpayers would result in improved compliance. Citizens may not consider their relationship with the state in a vacuum where both parties are the only actors. Likewise, they may not think about their fellow citizens without considering their own relationship with the state. They may also consider how the state treats them relative to their fellow citizens. This judgment is likely to affect not only their judgment of the state, but also how they view their fellow citizens . If the state treats certain groups preferentially, this may color the citizen's relationship with the state and the group receiving favors. A crucial variable is then not just what a person gets from the state, but what the person gets from the state relative to those who are in the person's wider national community. This social psychology model highlights the importance of equity theory in the study of compliance and taxpayer behavior. (McKerchar and Evans 2009).

2.2.6 Political Legitimacy Theory

According to the political legitimacy theory, tax compliance is influenced by the extent that citizens trust their government . Legitimacy could be described as belief or trust in the authorities, institutions, and social arrangements to be appropriate, proper, just and work for the common good. Political scientists have addressed how political legitimacy and civic identification are fostered. argues that African countries that upon independence emphasized building national over ethnic identity have been more successful than those who allowed ethnicity to become the main animus of politics. In the following empirical analysis we will examine the extent to which the different theories of taxpayer compliance contribute to explaining people's attitude towards taxation in the selected African countries. (Persson 2008)

2.3 Review of Empirical Studies

In Malaysia, in 2006, in the first year of implementation of e-filing system for individuals, in spite of the extension of the tax filing deadline by one month and a promise to get faster tax refund for those who opted e-filing over manual filing just more than 120,000 out of 4 million individual taxpayers had used e-filing .This represented only 3% of the total individual taxpayers. Discomfort about e-filing technology and perceived insecurity of e-filing as well as lack of Internet familiarity and skills are potential threats to the adoption of e-filing in Malaysia Lai Ming Ling (2008)

Malaysian taxpayers in embracing e-filing ,as it is important to evaluate the response from the vantage point of those who use e-filing, hence, this papers aims to examine factors that motivated the use of e-filing and the impediments. Out of the 682 survey respondents, just 231 (33.7%) had attempted e-filing since it was launched in 2006.Of these, about 79% are successful in submitting their tax returns electronically About 21% (48 out of 231) claimed that they failed to e-file successfully To further probe the issue, we asked e-filers where they did e-filing. Figure 1 shows that 45.9% of e-filers did it from home, 40.4% from their office and 13.1% from the IRBM's office. Just 0.5% of the respondents did e-filing from cyber café. In respect of the time taken to e-file successfully, 36.1% of the e-filers indicated that they took less than 30 minutes, 47.5% took between 30 minutes to 1 hour, 9.3% took between 1 to 2 hours and 7.1% took more than 2 hours

The findings indicate that the duration to complete e-filing was rather long. When asked about their overall experience of e-filing, shows that 55.7% of e-filers found e-filing was convenient and easy to use. About 8.2% found e-filing was good and pleasant. However, 31.7% of e-filers indicated that e-filing was not as good as they had expected; and 4.4% found e-filing was unpleasant and tedious. Lai Ming Ling(2008)

With regards to reason for opting to use e-filing, the survey found 59.0% of the e-filers indicated that they chose e-filing over manual filing for the sake of convenience .About 18.0% used e-filing for the speed of filing, whilst 17.5% e-filers were hoping to get faster tax refund. Notably, 4.4% opted to use e-filing in 2006, because extension of filing deadline was given in year 2006 for those who used e-filing. Merely 1.1% tried e-filing to gain experience. Overall, the reasons for using e-filing are somewhat consistent with study of Fatimah (2007) when she surveyed the e-filing experience among members of Malaysian Institute of Taxation. Fatimah (2007) also found convenience, speed of tax filing and faster tax refund appeared to be the three most important considerations for Malaysian tax professionals to use e-filing. Lai Ming Ling(2008)

In the Asia-Pacific region, Malaysia and Japan were the 2 countries with lowest number of users making transactions using government online with just 12% and 13% respectively. Singapore leads the region with 53% although Australia has seen the most significant increase in online government service usage from 31% to 46%.Starting in 2006, Malaysian citizens are able to choose from two methods tax filing manual and internet based or e-filing. This is the first year the Inland Revenue Board (IRB) Malaysia introduced the use of online tax return filing. Lai Ming Ling(2008). Over recent years, government use of the internet as a platform to provide services to citizens has grown significantly. One of the major priorities already identified by many officials in charge of introducing electronic government is tax. Governments around the world have quickly realized that electronic filing of tax, if properly used, provide a way to greatly simplify the revenue collection process. Considerable savings can be derived from propagating internet tax filing system or e-filing as it is known in Malaysia. Forrester (2001)

In 2011 it was has identified that savings fall in the following three categories. Automated data entry yields great savings. Government clerks need not re-enter tax information once entered by taxpayer and sent electronically to the relevant government database. As a result, the productivity of data entry and checking doubles to tax files a day-reducing labour expenses for data handling personnel by 80 percent., Fewer errors lighten verification and correction burden. Intelligent data entry and the elimination of data re-entry, combine to bring the error rate to 5 percent in countries like Ireland, Electronic data exchange reduces printing and mailing costs. Tax departments may spend considerable amount of money to subcontract printing and mailing of tax forms, (Forrester, 2001).

Based on Forrester (2001) research, proper use of electronic tax systems could lead revenue authorities saving up to 70 percent of current cost in collecting taxes. Internet tax-filing software development; has been adopted by many EU countries in the last 5 years. Belgium: In February 2002 Inter VAT service was introduced to allow companies to declare VAT online. France since July 15, 2001, business in France with annual turnover of Euros 15 million have been mandated by law to file their corporate tax electronically Ireland: Ireland mandated the e-filing of VAT and contributions since second quarter 2001. Spain: Over 420,000 individuals now file online in the country and the process is mandatory for all companies with an annual turnover of more than Euro 6 million, (Yılmaz and Coolidge, 2013)

E-filing in Ukraine, Nepal and South Africa, the study first examined e-filing availability and policy implementation details in several developing countries. The team analyzed the determinants of firms' e-filing decisions and then focused on how e-filing may affect tax compliance costs, holding other variables (such as firm size, location, and sector) constant. Tax compliance cost surveys from South Africa, Ukraine, and Nepal were used in the analysis The results show that policy implementation plays a major role in the potential effectiveness of e-filing in reducing tax compliance costs. Among the three countries considered in the analysis, only South Africa managed the policy effectively, and only this country's results provide evidence that e-filing may be associated with a statistically significant decrease in compliance costs. In contrast, e-filers in Ukraine and Nepal experienced an increase in total costs, due largely to requirements for double reporting (paper filing and e-filing) or complicated filing processes. Reduction in total tax compliance costs may not be realized in the short-run. The empirical evidence suggests there is a clear “learning by doing” process; the more firms have had a chance to experience the system, the greater the reduction in costs they enjoy. In addition, the upfront investment (in capital, learning, and educating tax staff on the system) is sunk in the medium- to long-run and is thus irrelevant for e-filing decisions after it has been incurred. Yılmaz and Coolidge.(2013)

Success in policy implementation is certainly critical. In countries where e-filing fully replaces paper filing (such as South Africa), firms may enjoy a reduction in compliance costs, while this effect is reversed in countries (such as Ukraine and Nepal) where e-filing is implemented in addition to a continued requirement for paper submissions (hard copies of the tax returns or required supporting documentation). These results are statistically significant and economically important: On average, e-filing usage in South Africa is associated with a 22.4-percent reduction in tax compliance costs. E-filers in South Africa also spend about 21.8 percent fewer hours in VAT compliance than non-e-filers, when all other factors are held constant. In contrast, Nepalese firms face a 33-percent increase in tax compliance costs associated with e-filing usage in terms of time and money, and Ukrainian firms face about a 20- to 25-percent increase in compliance costs, probably due to the poor design or implementation of the countries’ e-filing procedures. Yılmaz and Coolidge.(2013)

The Kenya Government allows businesses to offset the cost of the ETR installation against the input VAT as well as training of traders on the use and benefits of those devices. The respondents were asked to indicate percentage of the business' total monthly VAT returns that was equivalent to the cost of the ETR machine, and out of those who were sampled, 35% indicated that they have less than 10%, and between 10% – 30 % (percentage) of the business' total monthly VAT returns equivalent to the cost of the ETR machine respectively. 22% indicated between 30%and 50 %, as 7% indicated above 50%. In addition, 39% of the respondents indicated that they have between 3% and 5% percentage of the Business' Total Monthly VAT Returns Equivalent to the Cost of the ETR Machine, as 35% indicated less than 1%, 16% indicated more than 5%, as 9% indicated between 1% – 3 %. This is an indication that most businesses in kisii town have between 3% and 5% percentage of the Business' Total Monthly VAT Returns Equivalent to the Cost of the ETR Machine. Lumumba et al, (2010)

The preparation of VAT returns at the end of the month may take different time ranges. The respondents were asked to indicate the time they take to prepare their VAT returns at the end of the month, and42% of the businesses take less than 2 days to prepare their VAT returns at the end of the month,33% indicated more than three days, as 23% indicated less than three days. This is an indication that the businesses prepare and file their VAT returns in good time to beat the KRA deadlines. Businesses sometime seek the involvement of tax agents' services in filling tax returns and with a proportion of the proportion of the monthly VAT returns paid to the agents. The respondents were asked to indicate whether they involve the tax agents' services in filling tax returns and with a proportion of the proportion of the monthly VAT returns paid to the agents, and 65% of the respondents indicated that they don't involve the tax agents' services in filling tax returns. Of the 35% who involve the tax agents' services in filling tax returns, 21% of them pay more than 30%, between 20% and 30%, and less than 10% of their monthly

VAT returns respectively to the tax agents' services in filling tax returns. This is an indication that most businesses can file their returns on their own, and even those who use agents are not exploited as they all pay a normal fee. Lumumba et al, (2010)

The use of ETR machines can lead to improved sales audit for the business, since everything that is vatable is captured to record. At the same time, it is expected that the sales audit frequency should be low. The respondents were asked to indicate whether they have enjoyed any benefits in the faculty of sales audit through the adoption of ETR machine, how frequent they do their sales audit post adoption of the ETR machine, and 73% of the respondents indicated that the use of ETR machines has led to improved sales audit for their business, as 27% indicated it has not improved. This is an indication that indeed the use of ETRs can improve sales audit on top of timely filling of monthly VAT returns. Also from the results, out of the 73% who enjoy the benefits of ETRs in sales audit, 62% of the businesses are able to conduct their sales audit daily. A clear indication that ETRs can reduce the frequency of audits giving prompted sales patterns and feedbacks. Lumumba et al, (2010)

2.4 Summary

Tax compliace can be categorized into Fiscal psychology models blend together aspects of economic deterrence models and social psychology models. The essential thrust of this approach is that individuals are not simply independent utility maximisers rather individuals are recognised to contain an array of attitudes and beliefs which interact and respond to social norms. Social psychology models inductively examine the attitudes and beliefs of taxpayers in order to understand and predict human behaviour.

An example of I-tax being ETR is one of the factors, most businesses have timely filling of VAT returns and is attributed to the adoption of the ETR machine. The use of ETR machines has also led to improved sales audit for the business, since everything that is VAT-able is captured to record. This is an indication that indeed the use of ETRs has improved sales audit on top of timely filling of monthly VAT returns. The frequency of sales auditing has reduced to daily giving prompted sales patterns and feedbacks. ETRs has improved stock taking in addition to timely sales audit.

For example the effectiveness of Electronic Tax Registers in processing of Value Added Tax returns; Electronic tax Registers reduce the tax-reporting burden on businesses while improving the efficiency and effectiveness of government operations, provides timely and accurate tax information to businesses, increases the availability of electronic tax filing, and models simplified state tax employment laws. It was

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter details the methodology that am going to adopt in carrying out the study. It outlines the research design, population, sampling procedures to be used, the methodology of data collection and instruments, how data is to be analyzed and the expected output of the study, and data validity and reliability

3.2 Research Design

The major purpose of this study is to examine the impact of I-tax on the financial performance of audit firms The study used descriptive design method with the intention of employing data to justify the current situation in practices to make more intellectual strategies to improve them.

3.3 Population of the Study

The according to ICPAK the number of registered audit firms in Kenya are 713 as at 2012 This population is aimed to give detailed information that was relevant to the analysis and interpretation of the data.

3.4 Sampling Techniques

Stratified random sampling procedures used with 25 audit firms chosen randomly, the target population was divided according to counties as strata

3.5 Data Collection Instruments

The data was obtained through questionnaire. The questionnaire conducted contained a list of pre-formulated questions to be asked to the respondents. Any doubts that the response has was clarified on the spot to avoid ambiguity. This enhanced reliability and validity of the data obtained.

3.6 Data Analysis

Data collected in this study was analyzed using the statistical package SPPS Version 20 from the answers obtained from the questionnaire Representation of data was inform of tables, pie- charts and graphs. The analysis was carried out using the statistical package for social sciences to ensure accurate presentation and interpretation.The interpretation of the results were presented both qualitatively and quantitavely.

3.6.1 Analytical Model

The following regression analysis was used to determine the effects of I-tax on financial performance of audit firms in Kenya. The relationship equation was as shown below-

$Y = \beta 0 + \beta 1 X1 + \beta 2 X2 + \beta 3 X3 + \beta 4 X4 + \pi$

Where:

Y =financial performance measured as return on assets (ROA) : profit before interest and tax /Total assets

β0- β4=regression coefficient of independent variable

X1= is the tax compliance; Tax compliance which was measured using various aspect of tax compliance captured by the questionnaire. Respondent observations measured through a five-point Likert-Type scale of 1- Strongly Agree, 2-Agree, 3-Moderate, 4-Disagree, 5-Strongly Disagree.

X2= is the tax evasion, it was used to measure the amount of tax evaded; it was measured using various aspect of tax evasion captured by the questionnaire. Respondent observations measured through a five-point Likert-Type scale of 1- Strongly Agree, 2-Agree, 3-Moderate, 4-Disagree, 5-Strongly Disagree.

X3=is the Tax refunds claims, it was used to measure the effects of tax refund claims which was measured using various aspect of tax refund claims captured by the questionnaire. Respondent observations measured through a five-point Likert-Type scale of 1- Strongly Agree, 2-Agree, 3-Moderate, 4-Disagree, 5-Strongly Disagree.

X4=is the firm size was measured by the number of value of the total assets

π= Error term, it accounts for the possible factors that could influence the dependent variable that were not captured in the model

3.6.2 Test of Significance

Analysis of Variance (ANOVA) was used to test the significance of the model, The significance of the regression model was determined at 95% confidence interval and 5% level of significance. Adjusted R squared was used to determine the variation in the dependent variable due to changes in the independent variables

3.7 Data Validity and Reliably

The research ensured that the data collected was valid and reliable through assign responds to certain categories (manager, supervisor, seniors, semi-seniors, audit assistant),this eliminated biases since the groups are mutually exclusive and collectively exhaustive groups

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents the findings to establish the effects of electronic taxation on financial performance of audit firms in Kenya. From the study population target of 25 respondents from 23 from audit firms were selected and presented with a questionnaire, out of 25 respondents, 23 respondents filled and returned their questionnaires, constituting 92 % response rate. Data analysis was done through Statistical Package for Social Scientists (SPSS). Frequencies and percentages were used to display the results which were presented in tables, charts and graphs.

4.2 Analysis and Interpretation

4.2.1 Compliance

Table 4.1: Reduction of penalties and fine due to I-Tax inception

Opinion	**Frequency**	**Percent**
Yes	14	60.9
No	9	39.1
Total	**23**	**100**

From the finding on the respondent opinion on whether there has been a reduction on penalties and fines since I-Tax inception, the study found that majority of the respondents as shown by 60.9% indicated that there has been reduction whereas 39.1% of the respondent indicated that there has been no reduction in penalties and fines since the inception of I-Tax, this is an indication that since the inception of I-Tax there has been reduction in penalties and fines.

Table 4.2: **Increase in tax refund due to I-Tax inception**

Opinion	**Frequency**	**Percent**
Yes	17	73.9
No	6	26.1
Total	**23**	**100**

On whether there has been increase in tax refunds since inception of I-tax, the study found majority of the respondent as shown by 73.9% indicated that there has been increase in tax refunds reduced since inception, wheraes 26.1% of the respondent indicated that there has been no reduction in tax refund since the inception of i-tax, this cleary show that compliance with I-tax has lead to increase in tax refunds.

Table 4.3: **Increase in tax base due to I-Tax inception**

Opinion	**Frequency**	**Percent**
Yes	19	82.6
No	4	17.4
Total	**23**	**100**

The study sought to determine whether the respondent think there would be an increase in tax base after the introduction of I-tax, from the finding the study found that majority of the respondent as shown by 82.6% indicated yes whereas 17.4% of the respondent indicated no, this is an indication that there would be an increase in increase in tax after the introduction of I-tax.

4.2.2 Tax Evasion

Table 4.4: Are taxpayers accounting records accurate, up-todate and reliable since I-tax inception

Opinion	Frequency	Percent
Yes	13	56.5
No	10	43.5
Total	**23**	**100**

From the finding on whether the taxpayers accounting records accurate, up-todate and reliable since I-tax inception, the study reveved that most of the respondent as shown 56.5% indicated yes wheraes 43.5% of the respondent indicated no, this is an indication that taxpayers accounting records accurate, up-todate and reliable since I-tax inception

Table 4.5: Reduction in case of fraud since inception of I-tax

Opinion	Frequency	Percent
Yes	16	69.6
No	7	30.4
Total	**23**	**100**

On weather the respondent think that there has been a reduction in cases of fraud due to I-tax, the study found that majority of the respondent as shown by 69.6% indicated yes wheraes 30.4% of the respondent indicated no , this cleary show that there ahs been reduction in case of fraud to inception of I-Tax.

Table 4.6: Timely filing of returns since inception of I-tax

Opinion	Frequency	Percent
Yes	11	47.8
No	12	52.2
Total	**23**	**100**

On the respondent opinion on whether there has been timely filing of return since the inception of I-tax, the study found that most of the respondent as shown by 52.2% indicated no wheraes 47.8% of the respondent indicated yes, this is an indication that there as been no timely filing of returns since inception of I-tax.

Table 4.7: Shorter Audit period since inception of I-tax

Opinion	Frequency	Percent
Yes	16	69.6
No	7	30.4
Total	**23**	**100**

On whether there has been decrease in the audit period after the introduction of I-tax, the study revealed that majority of the respondent as shown by 69.6% indicated that there has been reduction in the audit period due to introduction of I-tax, whereas 30.4% of the respondent indicated no, this is an indication that there has been a reduction in audit period due to introduction of I-Tax.

Table 4.8: Knowledge known about I-tax

Opinion	Frequency	Percent
Sufficiently knowledgeable	8	34.8
Quite knowledgeable	11	47.8
Knowledgeable	**4**	17.4
Total	**23**	**100**

From the finding on the respondent level of knowledge on I-tax, the study found that most of the respondent as shown by 47.8% indicated they were quite knowledgeable, 34.8% of the respondents indicated sufficiently knowledgeable, whereas 17.4% of the respondent indicated they were knowledgeable.

Table 4.9: Frequency of system failure when login in the online system

Frequency	**Frequency**	**Percent**
Very Frequently	5	21.7
Frequently	6	26.1
Less Frequently	12	52.2
Total	**23**	**100**

From the finding on the frequency of system failure when login in the online system, the study revealed that majority of the respondent as shown by 52.2% indicated less frequently , 26.1% of the respondent indicated frequently whereas 21.7% indicated very frequently , this is an indication that there less frequent system failure .

Table 4.10: I-Tax user manual friendly

Opinion	Frequency	Percent
Yes	7	30.4
No	16	69.6
Total	23	100

From the finding on whether the I-Tax was user manual friendly, the study found that 69.6% of the respondent indicated that I-Tax was not user manual friendly, whereas 30.4% of the respondent indicated that I-Tax was user manual friendly.

4.2.3 I-Tax Verse Vie Manual System

Table 4.11: Period taken to use I-Tax since inception

Period	Frequency	Percent
2-5 months	2	8.7
6-12 months	17	73.9
1-3 years	4	17.4
Total	**23**	**100**

From the finding on the period it took to start using the I-tax since inception, the study revealed that majority of the respondent started using it for 6 to 12 months since inception, 17.4% started suing it between 1 to 3 years, whereas 8.7% of the respondent started using it between 2 to 5 months since inception. The stduy further revealed that majority of the respondent indicated that the I-tax system was reliable and that I-tax was not user friendly. From the finding on whether the I-tax system cost effective, the study found that al respondent inducted that I-tax system was cost effective. The study further electronic cash register and electronic signature device.

From the finding on whether the government had done enough to educate the public on the I-tax, the study revealed that the government had not done enough to educate the public on the I-tax. On whether there were any tax incentives to move from manual to I-tax, the stduy revealed that there were no tax incentives to move from manual to I-tax. The study further revealed that KRA should have conducted adequate training to all Kenyans before introducing I-tax. The study also found that there has been a high degree of being detected for non payment of tax after introduction of I-tax. The stduy revaeeld taht there has been no incarese in audit fees after the introduction of I-tax . the study also found that the respondent heard about I-tax through, KRA Seminar , television, radio, through work colleagues, KRA website, billboards and through a friend.

4.2.4 Effects of I-Tax on Audit Firms

Table 4.12: Assess How I-Tax Has Affected Various Factors

Impact	Mean	Std deviation
Job loss e.g. messengers	1.143	0.813
Cost of purchasing a computer	1.167	0.671
Reduce paper work	2.627	0.651
Falsification of documents	2.813	0.790

From the finding on the various factors affected the study found that majority of the respondent indicated that the following factor were extremely affected Falsification of documents as shown by mean of 2.813 and Reduce paper work as shown by mean of 2.627, respondent that the following factor were   not affected Job loss e.g. messengers as shown by mean of 1.143 and cost of purchasing a computer as shown by mean of 1.167. The study revealed that there was need for enhancing system acceptability by ensuring it is user friendly, there was to increase awareness and also train people on how to use I-Tax System.

4.2.5 Regression Analysis

Table 4.13: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.859[a]	.738	.726	.07833

From the findings in the above table the value of adjusted R squared (co-efficent of determination) was 0.726 an indication that there was variation of 72.6% on financial performance due to changes in tax compliance, tax evasion, tax refunds claims and firm size at 95% confidence interval . This shows that 72.6% changes in financial performance could be accounted for by changes in tax compliance, tax evasion, tax refunds claims and firm size. The stduy also establshed that there is strong postive relationshoip between financial performance and x compliance, tax evasion, tax refunds claims and firm size as shown by correlation coefficent of 0.859.

Table 4.14: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.454	.155		2.939	.010
	Tax Compliance	.560	.148	.554	3.794	.001
	Tax Evasion	.295	.140	.308	2.109	.042
	Tax Refunds Claims	-.011	.133	.013	.085	.933
	Firm Size	.091	.150	.091	.605	.549

The established regression equation was

$Y = 0.454 + 0.560 X_1 + 0.295 X_2 - 0.011 X_3 + 0.091X_4$

From the above regression equation it was revealed that holding tax compliance, tax evasion, tax refunds claims and firm size to a constant zero, financial performance would be at 0.454, a unit increase in tax compliance would lead to increase in financial performance by factors of 0.560, unit increase in tax evasion would lead to increase in financial performance by factors of 0.295 , a unit increase in tax refunds claims lead to decrease in financial performance by a factor of 0.011, and further unit increase firm size lead to decrease in financial performance by a factor of 0.091.

4.3 Summary and Interpretation of Findings

On compliance the study revealed that since the inception of I-Tax there has been reduction in penalties and fines. On whether there has been reduction in tax refunds reduced since inception of I-tax, the study found that compliance with I-tax has lead to decraese in tax refunds.On whether the respondent think there would be an increase in tax after the introduction of I-tax, from the finding the study found that that there would be an increase in increase in tax after the introduction of I-tax. From the finding on whether the taxpayers accounting records accurate, up-todate and reliable since I-tax inception, the stduy revaeled that taxpayers accounting records accurate, up-todate and reliable since I-tax inception. On whehther that there ahs been reduction in case of fraud to inception of I-Tax. The study found that there as been no timely filing of returns since inception of I-tax. On whether there has been decrease in the audit period after the introduction of I-tax, the study revealed that there has been a reduction in audit period due to introduction of I-Tax. From the finding on the level of knowledge on I-tax, the study found that most of the respondents were quite knowledgeable. On the frequency of system failure when login in the online system, the study revealed that they were less. On whether the I-Tax was user manual friendly, the study found that I-Tax was user manual friendly.

On comparing the I-Tax Verse Vie Manual System, the study found that majority of the respondent started using it for 6 to 12 months since inception. The stduy further revealed that majority of the respondent indicated that the I-tax system was reliable and that I-tax was not user friendly. From the finding on whether the I-tax system cost effective, the study found that al respondent inducted that I-tax system was cost effective. The study further electronic cash register and electronic signature device.

From the finding on whether the government had done enough to educate the public on the I-tax, the study revealed that the government had not done enough to educate the public on the I-tax. On whether there were any tax incentives to move from manual to I-tax, the study revealed that there were no tax incentives to move from manual to I-tax.

The study further revealed that KRA should have conducted adequate training to all Kenyans before introducing I-tax. The study also found that there has been a high degree of being detected for non payment of tax after introduction of I-tax. The stduy revaeeld taht there has been no incarese in audit fees after the introduction of I-tax . the study also found that the respondent heard about I-tax through, KRA Seminar , television, radio, through work colleagues, KRA website, billboards and through a friend. On the effects of I-tax on audit firms, the study revealed that various factors affected extremely were Falsification of documents and Reduce paper work. Those that were not affected Job loss e.g. messengers and cost of purchasing a computer. The study revealed that there was need for enhancing system acceptability by ensuring it is user friendly, there was to increase awareness and also train people on how to use I-Tax System.

From the findings on the adjusted R squared the stduy found that there was variation of 72.6% on financial performance due to changes in tax compliance, tax evasion, tax refunds claims and firm size , This shows that 72.6% changes in financial performance could be accounted for by changes in tax compliance, tax evasion, tax refunds claims and firm size. The established regression equation was $Y = 0.454 + 0.560 X_1 - 0.295 X_2 - 0.011 X_3 + 0.091X_4$. From the regression equation it was revealed that a unit increase in tax compliance would lead to increase in financial performance, unit increase in tax evasion would lead to decrease in financial performance, a unit increase in tax refunds claims lead to decrease in financial performance and further unit increase firm size lead to decrease in financial performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The objective of the study was to establish the effects of electronic taxation on financial performance of audit firms in Kenya. From the study population target of 25 respondents from 23 from audit firms were selected and presented with a questionnaire, out of 25 respondents, 23 respondents filled and returned their questionnaires, constituting 92 % response rate. Data analysis was done through Statistical Package for Social Scientists (SPSS). Frequencies and percentages were used to display the results which were presented in tables, charts and graphs.

The study revealed that since the inception of I-Tax there has been reduction in penalties and fines. The study found that compliance with I-tax has lead to increase in tax refunds. The study found that that there would be an increase in increase in tax base after the introduction of I-tax. The study revaeled that taxpayers accounting records accurate, up-todate and reliable since I-tax inception. The study found that there as been timely filing of returns since inception of I-tax. The study revealed that there has been a reduction in audit period due to introduction of I-Tax. The study found that most of the respondents were quite knowledgeable. The study found that system failure when login were less. The study found that I-Tax was user manual friendly. The study found that majority of the respondent started using it for 6 to 12 months since inception. The study further revealed that the I-tax system was reliable and that I-tax was not user friendly. From the finding on whether the I-tax system cost effective, the study found that respondent inducted that I-tax system was cost effective. The study revealed that the government had not done enough to educate the public on the I-tax.

The study found that a unit increase in tax compliance would lead to increase in financial performance; unit increase in tax evasion would lead to decrease in financial performance, a unit increase in tax refunds claims lead to decrease in financial performance and further unit increase firm size lead to decrease in financial performance.

5.2 Conclusion

From the finding the study revealed that the study revealed that since the inception of I-Tax there has been reduction in penalties and fines, compliance with I-tax has lead to increase in tax refunds, there will be an increase in increase in tax base after the introduction of I-tax. The study aslo revaeled that taxpayers accounting records accurate, up-todate and reliable since I-tax inception.

From the finding the study found that there as been timely filing of returns since inception of I-tax, there has been a reduction in audit period due to introduction of I-Tax, respondents were quite knowledgeable. ,system failure when login were less, I-Tax was user manual friendly , I-tax system was reliable and that I-tax was not user friendly, I-tax system cost effective, I-tax system was cost effective and respondent were aware of that I-Tax system was electronic cash register and electronic signature device.

The study revealed that the government had not done enough to educate the public on the I-tax. The study found that financial performance could be accounted for by changes in tax compliance, tax evasion, tax refunds claims and firm size. The study found that a unit increase in tax compliance would lead to increase in financial performance; unit increase in tax evasion would lead to decrease in financial performance, a unit increase in tax refunds claims lead to decrease in financial performance and further unit increase firm size lead to decrease in financial performance.

5.3 Policy Recommendation

From the finding the study recommends that there is need for the government to create awareness on I-tax system as the study revealed that the government had not done enough to educate the public on the I-tax.

There is need for the Kenya Revenue Authority to invest on technology in order to reduce the system failure as the study revealed that system failure affects system logins. System failure discourages use of technology.

There is need for Kenya Revenue Authority to encourage compliance and also to ensure that I-tax System is user friendly as the study revealed that use friendly systems encourage compliance and compliance positively affects financial performance of audit firms.

5.4 Limitations of the Study

The method used is descriptive research design whereby the variables cannot be controlled by the researcher. The study intended to use questionnaire as the instrument for collecting data. This is because time for the data collection will be limited to two weeks. The study was carried out in only one sector due to financial constraints of the researcher.

In attaining its objective the study was limited to 25 audit firms in Kenya from which only one respondent was picked from each.

The study was also limited to the degree of precision of the data obtained from the respective respondents.

The study was also limited to establish the effects of electronic taxation on financial performance of audit firms in Kenya.

5.5 Areas for Further Research

The study recommends an in-depth study should be done to challenge facing the adoption of I-tax system in Kenya

The study recommends that an in-depth study should be done to factors influencing the implementation of I-tax system in Kenya.

The study also recommends a study to be carried out on effects of I-Tax system implemenation on tax base in Kenya .

The study furthers that an in-depth study should be conducted on the importance of of I-tax system to tax compalince.

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APPENDICES

Appendix I: Questionnaire

Please answer the questions in the spaces provided. All the information given will be treated in strict confidence.

SECTION A : COMPLIANCE

1) Has penalties and fines reduced since I-Tax inception?

   Yes ( )

   No ( )

2) Has tax refunds reduced since inception of I-tax ?

   Yes ( )

   No ( )

3) Do you think he tax base will increase after the introduction of I-tax?

   Yes ( )

   No ( )

SECTION B: TAX EVASION

1) Are taxpayers accounting records accurate, up-todate and reliable since I-tax inception?

   Yes ( )

   No ( )

2) Do you think that I-tax has reduced cases of fraud?

   Yes ( )

   No ( )

3) Have returns be filled timely since inception of I-tax?

   Yes ( )

   No ( )

4) Is there a shorter audit period after the introduction of I-tax

   Yes ( )

   No ( )

5) What knowledge do you have about the I-tax?

Sufficiently knowledgeable ( )

Quite knowledgeable ( )

Knowledgeable ( )

Not Knowledgeable ( )

6) How often is there a system failure when login in the online system?

Very Frequently ( )

Frequently ( )

Less Frequently ( )

7) Is the I-Tax user manual friendly?

Yes ( )

No ( )

I-TAX VERSE VIE MANUAL SYSTEM

SECTION C

1) How long did take to start using I-tax after its inception

Tick where appropriate (×)

0-4 Weeks	2-5 months	6-12 months	1-3 years	After 3years

2) Do you consider the I-tax system reliable?

Yes ( )

No ( )

1) Is the I-tax a user friendly system?

Yes ( )

No ( )

1) Is I-tax system cost effective

Yes ( )

No ( )

1) Do you know the I-tax system listed below

a) ERT (electronic tax register)

Yes ( )

No ( )

b) ECR (electronic cash register)

Yes ( )

No ( )

c) ESD (electronic signature device)

Yes ( )

No ( )

2) Do you think the government has done enough to educate the public on the I-tax

Yes ( )

No ( )

3) Was there any tax incentive to move from manual to I-tax

Yes ( )

No ( )

4) KRA should have conducted adequate training to all Kenyans before introducing I-tax

Yes ( )

No ( )

5) Has there been a high degree of being detected for non payment of tax after introduction of I-tax ?

Very High Degree ( )

High Degree ( )

Low Degree ( )

6) Has there been and increase in the audit fees after the introduction of I-tax ?

Yes ( )

No ( )

7) How did you hear about the I-tax system?

KRA Seminar ( )

Television, Radio ( )

Through work colleagues ( )

KRA website ( )

Billboards ( )

Through a friend ( )

Other, specify…………………………………………………………

Effects of I-Tax on Audit Firms

Assess how I-tax has affected the following variables 1-slightly affected, 2- not affected 3- extremely affected .Please tick in the table.

Impact	**1**	**2**	**3**
Job loss e.g. messengers			
Cost of purchasing a computer			
Reduce paper work			
Falsification of documents			

What improvement needs to be made to improve the I-Tax System?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

…………………………………………………………………………………………………

THANK YOU