International Journal of Business Management and Processes (IJBMP)
Vol 4. Issue No.2. November, 2018. PP 127-135. ISSN 2616-3209

INFLUENCE OF CREATIVE ACCOUNTING PRACTICES ON TAX EVASION AMONGST SMALL AND MEDIUM ENTERPRISES IN NAKURU, KENYA

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Abstract
Tax evasion has become a challenge to the Kenya Revenue Authority (KRA). In April of 2018 for instance, KRA charged a business person with a KSh. 7 billion tax evasion that was undertaken through use of fraudulent accounting practices. This study thus sought to examine the influence of creative accounting practices on tax evasion amongst small and medium enterprises (SMEs) in Nakuru in Kenya. It was guided by the deterrence theory and economics of crime theory and employed descriptive research design. The study specifically targeted the owners/managers of all the 20,355 SMEs operating within Nakuru County. Nassiuma (2000) formula was employed to arrive at a sample size of 100 SMEs'owners/managers. Proportional stratified random sampling technique was used to select the 100 owners/managers of SMEs from the target population. A structured questionnaire was used to gather primary data while secondary data was collected through document analysis. Content validity of questionnaires was based on responses given by five content experts. Cronbach Alpha coefficient of 0.71 was realized as a test for reliability of the instrument. Descriptive statistics that included frequencies and percentages as well as inferential statistics such as correlation and regression analysis were employed in data analysis. The study found that creative accounting practices positively influence tax evasion amongst SMEs in Nakuru. It recommended that the KRA should enforce the use of Electronic Tax Registers to eliminate loopholes that allow for manipulation of source documents, understatement of sales figures, and overstatement of purchase figures by SMEs.

Keywords: *Creative Accounting, Monitoring of Tax Payments, Small and Medium Enterprises, Tax, Tax Evasion*

I.INTRODUCTION

Tax is a mandatory financial charge or some other type of levy imposed upon a taxpayer (an individual or other legal entity) by a governmental organization in order to fund various public expenditures (Ogunsanwo,2013). The purpose of taxation is to enable the government to fund its programs and service delivery to the citizens. Diverse taxes can be levied by the government including income taxes, property taxes, value added taxes, and sales taxes amongst other types of taxes (Karanja, Ndirangu, & Kiema, 2004). The different types of taxes are applicable to diverse countries based on their needs, legal system in place and economic policies (Adem, 2015).In Kenya, tax is collected by the Kenya Revenue Authority (KRA) and the funds used for the purposes of funding government service delivery to citizens (Guandaru, Mutiso, & Ngui, 2012). The Kenya Revenue Authority (KRA) was established by an Act of Parliament, Chapter 469 of the laws of Kenya, which became effective on 1st July 1995. The Authority is charged with the responsibility of collecting revenue on behalf of the Government of Kenya.

Tax evasion is a major problem across the world. Tax evasion refers to failure of paying taxes and can be denoted from tax gap which is the difference between what the SMEs ought to pay against what is paid (Buchan, 2017). According to Viljoen (2016) tax evasion refers to the practice of the businesses and individuals illegally failing to pay taxes. On the other hand, Kiema (2016) notes that tax evasion as the deliberate failure to pay taxes. This could take diverse forms including misrepresentation of tax liability, and dishonest reporting such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions (Viljoen,2016). Other forms include withholding of information to tax authorities, submission of inaccurate tax information, document manipulation, non-disclosure of income, and claim of higher expenses to reduce taxable income (Chen & Wang, 2010).These activities are undertaken with a view of reducing the tax amount payable. The opposite of tax evasion is tax compliance aspects.

There are diverse aspects influencing the tax evasion by SMEs and creative accounting aspects counts in the list. Among the creative accounting practices include transactions not being backed by source documents, understatement of sales figures, overstatement of purchase figures, omissions of incomes, and overstatement of bad debts. Creative accounting acts have been found to reduce the tax revenues that are due for payments (Uge & Akpotohwo, 2011). Further, separation of ownership in public companies has been found to provide opportunities for the management to make a method selection or accounting policy for personal gain (Ayu & Putri, 2017). Nakiwala (2010) noted that time factor including wastage of time in meeting URA requirements, completion of tax returns taking time, completion of paper work taking time, and a lot of time required in maintaining records for tax compliance purposes were aspects that influence tax evasion.

II.RESEARCH OBJECTIVES

(i) The influence of creative accounting practices on tax evasion amongst small and medium enterprises in Nakuru, Kenya.

III.RESEARCH HYPOTHESES

(i) **H_0**: There is no statistically significant influence of creative accounting practices on tax evasion amongst small and medium enterprises in Nakuru, Kenya

IV. LITERATURE REVIEW

Theoretical Literature Review

This study was guided by the deterrence theory and economics of crime theory which are unpacked in this section:

Deterrence Theory

This theory is attributed to Gary Becker in 1968 given opportunities, the tax payers would utilize the economic motives such as profit maximizations and probability of detection to evade taxes (Malonza, 2016). In this context, the tax payers examine pathways that enable them to evade taxes, minimize probability of detections as well as the accruing sanctions from the cases. Therefore to counter the amoral utility maximization of the tax payers, the tax authorities must create measures for preventing this behaviour (Uge & Akpotohwo, 2011). This is with the understanding that the benefits and costs of evasions influence tax evasion aspects.

This theory is applicable in this study as it examines the diverse ways in which SMEs seek to have amoral utility maximization. In this context, the costs of complying with the tax laws could aid in tax evasions as the SMEs seek to maximize their profitability. The SMEs may seek to avoid costs associated with filling the taxes such as accounting costs, economic costs, and training costs. Others are costs of hiring in house tax advisor, and outsourcing tax advisory services (Musau, 2015). In respect to the capacity of monitoring tax payments by tax authorities, the SMEs seek to increase their amoral utility maximization and profit maximization through creative accounting. Amongst these creative accounting practices include transactions not being backed by source documents, understatement of sales figures, overstatement of purchase figures, omissions of incomes, and overstatement of bad debts

(Uge and Akpotohwo, 2011). The net effect of these aspects is to try to reduce tax liability that is due.

Economics of Crime Theory

This theory is attributed to Gary Becker who formulated it in 1968. The theory indicates that a rational individual examines the expected benefits of tax evasion against the potential benefits of tax evasion aspects. In this context, the tax compliance aspects is an act of balancing the consequences of tax evasion aspects and the benefits of tax evasion (Malonza, 2016). The tax audits and the enforcement capabilities become important in ensuring tax compliance aspects. The economics of crime theory indicates that the enforcement of tax compliance is critical in ensuring there are minimal tax evasion aspects. A purely economic analysis of the evasion gamble suggests that most rational individuals should either underreport income not subject to source withholding or over claim deductions not subject to independent verification because it is extremely unlikely that such cheating is caught and penalized (Uge & Akpotohwo, 2011). The levels of audit and verification and penalty rates may be high, but other factors such as corruption actually allow many taxpayers to take the gamble, as they are likely to get away with it.

Empirical Literature Review

This section reviews relevant literature as guided by the research objective of this study:

Creative Accounting Practices and Tax Evasion

According to Guandaru et al. (2012) creative accounting relates to the accounting activities that are technically legalbut are not conventionally accepted. The objectives of creative accounting is to make the financial position of the firm to appear stronger or weaker depending on the management’s aspirations (Guandaru et al., 2012). The creative accounting practices also known as earnings management have been used for tax evasion across the world.

Guandaru et al., (2012) undertook a study that sought to examine the role of creative accounting practices amongst Kenyan companies. The study utilized a descriptive survey research design and a sample size of 36 respondents made of accountants from diverse companies across the country. A four point likert scale (Strongly disagrees, disagree, agree and strongly agree) structured questionnaire was utilized for data collection purposes. In respect to the question as to whether the creative accounting influences tax evasion in Kenya, a mean of 3.0833 was achieved indicating a bias towards strongly agreeing. There was a high consensus level amongst the respondents as indicated through a small standard deviation of 0.122 which was below 0.5. This study utilized a descriptive survey research design and a sample size of 36 respondents made of accountants from diverse companies across the country. This study therefore poses a research gap since it utilized a very small sample size. The current study filled this gap by utilizing a sample size of 100 SMEs to get an in depth understanding of the concept

Kamau, Namusonge, and Okibo (2016) undertook a study that sought to examine the role of creative accounting on listed firms at the Nairobi Securities Exchange (NSE). The study utilized a cross sectional survey research design and a sample made of thirty seven companies that were purposively chosen from sixty four listed companies. Amongst these firms structured questionnaires and interviews were utilized to collect data from accountants, internal auditors and managers from the identified firms. Using a five point likert scale, Kamau et al., (2016) the study found that 41.03% of the respondents agreed that creative accounting were used to lower tax payables that were due. This was compared to 13.68% who strongly agreed, and 28.21% who were disagreed. This study presents a methodological gap that the current study seeks to fill since it utilized a cross sectional survey research design and employed purposively sampling to select 37 companies. The current study adopted a descriptive research design and utilized simple random sampling to select 100 SMEs to form the sample

In Nigeria, Uge and Akpotohwo (2011) sought to examine the role of creative accounting on the income tax compliance amongst firms in Delta state. The study adopted a survey design and a sample size of 60 respondents. These respondents were purposively derived from twenty business lecturers at federal college of education, twenty officers from Delta state revenue service and twenty business managers from the local regions. A five point Likert scale (1=Strongly Disagree to 5=Strongly Agree) structured questionnaires were utilized for data collection. Amongst the creative accounting practices that were undertaken include transactions not being backed by source documents (mean of 2.96), manipulation of source documents (mean of 2.50), understatement of sales figures (mean of 2.87), overstatement of purchase figures (mean of 2.67), omissions of incomes (mean of 2.73), and overstatement of bad debts (mean of 3.90). In respect to the effect of creative accounting on the tax revenues, Uge and Akpotohwo (2011) found that creative accounting acts to reduce the tax revenues that are due for payments as indicated by a mean of 4.80.

In Indonesia, Ayu and Putri (2017) undertook a study that sought to examine the role of creative accounting on tax evasion. The study used a population composed of all listed manufacturing firms assumed to do tax evasion from the year 2009 to 2012. The firms had been listed at the Indonesian Stock Exchange. The firms had purposively being selected. Ayu and Putri (2017) using regression analysis found that a unit increase in earnings management led to a 0.284 increase in tax avoidance due to a regression coefficient of 0.284. These results were found to be positive at 1% level of significance due to a p value of 0.000. The study concluded that separation of ownership in public companies provided opportunities for the management to make a method selection or accounting policy for personal gain. Studies by Uge and Akpotohwo (2011) and Ayu and Putri (2017)are contextually different from the current study since they were undertaken in Nigeria and Indonesia respectively, while the current one was carried out in Kenya.

V.RESEARCH METHODOLOGY

The study employed a descriptive research design and it specifically targeted the owners/managers of all the 20,355 SMEs operating within Nakuru County. Nassiuma (2009) formula was employed to arrive at a sample size of 100 SMEs'owners/managers and then proportional stratified random sampling technique used to select the 100 owners/managers of SMEs from the target population. A structured questionnaire was used to gather primary data while secondary data was collected through document analysis. Content validity of questionnaires was based on responses given by five content experts. Cronbach Alpha oefficient of 0.71 was realized as a test for reliability of the instrument. Cronbach Alpha test of internal consistency gives a coefficient in the range of 0 to 1 and when the coefficient is at least at 0.7, confirms the reliability of research instrument as recommended by (Mugenda, 2003) To analyse the data, descriptive statistics that included frequencies and percentages as well as inferential statistics such as correlation and regression analysis were employed.

VI.RESEARCH FINDINGS AND DISCUSSIONS

Creative Accounting Practices and Tax Evasion

The objective of this study was to examine the influence of creative accounting practices on tax evasion amongst Small and Medium Enterprises in Nakuru, Kenya. The participants were requested to indicate the extent of agreement to the statements on various creative accounting practices. The indicators for the creative accounting practices included manipulation of source documents, understatement of sales figures, and overstatement of purchase figures. The rating of the statements was done using a five point Likert scale as follows; 1=No Extent, 2=Small Extent, 3=Moderate Extent, 4=Large Extent, and 5= Very Large Extent and results presented in Table 1.

About half of the respondents (48.9%) indicated that to large extent transactions of the SMEs not being backed by source documents lowers tax payables that are due. The study also established that 29.5% of the respondents agreed to a moderate extent that tax payables that are due are lowered by transactions not being backed by source documents. Additionally, 10.2% and 8.0% of the respondents agreed to small and very great extents that tax payables that are due are lowered by transactions not being backed by source documents.

Table 1: Responses on Creative Accounting Practices

	NE	SE	ME	LE	VLE	Chi Square	
	%	%	%	%	%	Value	P
Transactions not being backed by source documents lowers tax payables that are due	3.4	10.2	29.5	48.9	8.0	29.491	0.000
Manipulation of source documents lowers tax payables that are due	2.3	9.1	27.3	58.0	3.4	18.881	0.004
Understatement of sales figures lowers tax payables that are due	1.1	14.8	31.8	43.2	9.1	18.342	0.006
Omissions of income reduces the tax revenues that are due for payments	0.0	10.2	40.9	42.0	6.8	20.466	0.001
Overstatement of purchase figures lowers tax payables	4.5	5.7	31.8	52.3	5.7	34.580	0.000

However, a negligible 3.4% of respondents completely disagreed and indicated there to no extent are tax payables that are due lowered by transactions not being backed by source documents. Kamau, Namusonge, and Okibo (2016) undertook a study that sought to examine the role of creative accounting on listed firms at the Nairobi Securities Exchange (NSE). Using a five point Likert scale, the study also found that 41.03% of the respondents agreed that creative accounting were used to lower tax payables that were due. However, Kamau *et al*., (2016) found a high number of respondents (28.21%) who were disagreed that creative accounting were used to lower tax payables that were due than those in the current study (3.4%).

The study conducted a Fisher's exact test to determine whether there is an association between source documents backing of transactions and tax evasion amongst SMEs in Nakuru, Kenya. Fisher's exact test is a special type of chi-square test that is used when the cells count is below five against the assumption of Pearson-Chi-square Test. Fisher's exact test measures the relationship between variables that are measured as categorical. The null hypothesis of Fisher's exact test is that the two categorical variables are independent of each other. The rule of the thumb is that p-values less than the set significance level for Fisher's exact test leads to rejection of the null hypothesis while p-values equal or greater than the set significance level leads to acceptance of the null hypothesis. This study used significance level of 0.05 which was the threshold for rejection or acceptance of the null hypothesis (statistical significance). The test gave a Fisher's value of 29.491 and a p-value less than 0.05 (0.000) which revealed that source documents backing of transactions and tax evasion amongst SMEs in Nakuru, Kenya are associated.

A bulk of the respondents (58.0%) constituted of those who agreed to a large extent that tax payables that are due are lowered by manipulation of source documents. There were other respondents who agreed that tax payables that are due are lowered by manipulation of source documents of SMEs on varying extents, including 9.1% (small extent), 27.3% (moderate extent), and 3.4% (very great extent). The respondents who disagreed were 2.3% who indicated that manipulation of source documents of SMEs does not lower tax payables that are due. The study found that there is a significant association between manipulation of source documents and tax evasion amongst SMEs in Nakuru, Kenya due to a Fisher's exact value of 18.881 and a p-value of 0.004 which was less than 0.05.

In the context of understatement of sales figures, most of the respondents agreed to a large extent (43.2%) that understatement of sales figures lowers tax payables that are due. Further, 31.8% agreed with the statement to a moderate extent, 14.8% to a small extent, and 9.1% to a very large extent. A negligible 1.1% of the respondents had differing sentiments as they disagreed and indicated that understatement of sales figures does not lower tax payables that are due from SMEs. From Table 4.1, the Fisher's exact test gave a value of 18.342 and a p-value of 0.006 ($p<0.05$) which showed that understatement of sales figures and tax evasion amongst SMEs in Nakuru, Kenya have an association that is significant.

All respondents in the study agreed, though differed in the extent of agreement, that omission of income reduces the tax revenues that are due for payment by the SMEs. This is because there was no respondents who answered using the "no extent" prompt (0.0%). Therefore, respondents agree to a large extent (42.0%), moderate extent (40.9%), small extent (10.2%) and very large extent (6.8%) that omission of income reduces the tax revenues that are due for payment by the SMEs. The study found that a significant association exists between omissions of income and tax evasion amongst SMEs in Nakuru, Kenya (Fisher's exact value of 20.466; p-value of 0.001).

The study sought to get respondents perceptions on whether overstatement of purchase figures lowers tax payables by SMEs. In this context, about half of the respondents agreed to a large extent (52.3%) that overstatement of purchase figures lowers tax payables by SMEs. Further, 31.8%, 5.7%, and 5.7% of the respondents agreed with the statement to a moderate extent, very large extent, and small extent. However, there were some respondent who disagreed with the statement and chose the "no extent" prompt. These respondents (4.5%) therefore were of the opinion that overstatement of purchase figures does not lower tax payables by SMEs. Results of the Fisher's exact test give evidence that there is an association between overstatement of purchase figures and tax evasion amongst SMEs in Nakuru, Kenya (Fisher's exact value of 34.580; p-value of 0.000).

Multiple linear regression was used to establish the relationship between creative accounting practices, cost of compliance to tax laws, capacity of monitoring of tax payments and time requirements for tax payment process. Table 2 shows the model summary.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.856[a]	0.733	0.721	0.19686

a. Predictors: (Constant), Time Requirements, Capacity of Monitoring, Creative Accounting, Compliance Cost

The model summary gives the R value, R Square value, Adjusted R Square and standard error of estimate. R Value shows the correlation coefficient between the observed and predicted values of Tax evasion. It indicates the goodness of fit of the regression model. The study obtained an R value of 0.856, which implies that there was a strong correlation between observed and predicted values of Tax evasion. It implies that the regression model fits well to the data. R square gives variability of the dependent variable as explained by the independent variables. An R Square Value of 0.733 implies that 73.3% of the variability in Tax evasion is explained by creative accounting practices, cost of compliance to tax laws, capacity of monitoring of tax payments and time requirements for tax payment process cumulatively.

Adjusted R Square shows the probability of an additional predictor variable to improve the model. Adjusted R Square value of 0.721 implies that any additional predictor variable improves the regression model less than expected. Standard error of estimate indicates the accuracy of the model whereby a small standard error of estimate (less than 1.0) indicates that the model is accurate in its prediction while high standard error of estimate (1.0 and above) indicates lack of accuracy of the regression model. Standard error of estimate of 0.19686 indicates that the regression model is accurate in its prediction. The study further sought to establish whether the regression model has predictive capacity as a whole using analysis of variance and F-test. This is shown in Table 3.

Table 3: ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	8.848	4	2.212	57.073	0.000[b]
Residual	3.217	83	0.039		
Total	12.064	87			

a. Dependent Variable: Tax Evasion
b. Predictors: (Constant), Time Requirements, Capacity of Monitoring, Creative Accounting, Compliance Cost

F-test is used to show whether a regression model provides a better prediction than a model than contains no predictors. The null hypothesis of F-test in a regression analysis states that the model dies not provide a better prediction than a model that contains zero predictors. A p-value less than 0.05 provide evidence to reject the null hypothesis while a p-value of 0.05 and above indicates evidence to support the null hypothesis. The results; $F(4,83)=57.073$, $P<0.05$ indicates that the regression model provides a better prediction than a model that contains no predictor variables and therefore creative accounting practices, cost of compliance to tax laws, capacity of monitoring of tax payments and time requirements for tax payment process were found to be significant predictors of tax evasion.

This study sought to test the research hypothesis of the study using beta coefficients in the multiple linear regression as shown in Table 4.

Table 4: Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.119	0.164		6.838	0.000
Creative Accounting	0.221	0.050	0.320	4.406	0.000
Compliance Cost	0.303	0.048	0.466	6.320	0.000
Capacity of Monitoring	-0.162	0.050	0.093	3.076	0.004
Time Requirements	0.102	0.048	0.162	2.099	0.039

a. Dependent Variable: Tax Evasion

The following unstandardized beta coefficients were obtained; 0.221 for creative accounting practices, 0.303 for compliance cost to tax laws, -0.162 for capacity of monitoring of tax payments, and 0.102 for the time requirement for tax payment process. Unstandardized beta coefficients show the contribution of each of the predictor variable in the variability of the predicted variable. This implies the compliance cost to tax laws contributed largely to tax evasion, followed by creative accounting practices, then Capacity of Monitoring and lastly by time requirement for tax payment process.

The study hypothesis stated that there is no statistically significant influence of creative accounting practices on tax evasion amongst small and medium enterprises in Nakuru, Kenya. This hypothesis was rejected due to a p-value less than 0.05 and t-statistic of 4.406 which is greater than the critical value of 1.990. It was therefore established that one unit increase in creative accounting practices increases tax evasion by 0.221 units. In Indonesia, Ayu and Putri (2017) undertook a study that sought to examine the role of creative accounting on tax evasion. Using regression analysis the study also found that a unit increase in earnings management led to a 0.284 increase in tax avoidance due to a regression coefficient of 0.284. However the results were found to be positive at 1% level of significance while the current study’s level of significance was 5%. Ayu and Putri (2017) concluded that separation of ownership in public companies provided opportunities for the management to make a method selection or accounting policy for personal gain.

VII.CONCLUSION OF THE STUDY

The study established that creative accounting practices, cost of compliance to tax laws, capacity of monitoring of tax payments and time requirements for tax payment process cumulatively account for 73.3% of the variability in tax evasion amongst SMEs in Nakuru, Kenya. Also, the regression analysis showed that one unit increase in creative accounting practices increases tax evasion by 0.221 units. The study thus concluded that creative accounting practices were among the aspects that positively influence tax evasion amongst SMEs in Nakuru, Kenya.

VIII.RECOMMENDATION OF THE STUDY

The study recommends that KRA should enforce the use of Electronic Tax Registers to eliminate loopholes that allow for manipulation of source documents, understatement of sales figures, and overstatement of purchase figures by SMEs.

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How to Cite This Paper:

John, H. R., Kamu, J. G., & Nzioki, P. M. (2018). Influence of Creative Accounting Practices on Tax Evasion amongst Small and Medium Enterprises in Nakuru, Kenya. *International Journal of Business Management and Processes (IJBMP)*, *4*(2), 127–135.