

**CREATIVE ACCOUNTING PRACTICES, AND TAX COMPLIANCE AMONG  
SMALL AND MEDIUM ENTREPRISES IN NAIROBI CITY COUNTY, KENYA**

**BY**

**ANTHONY KIOKO MAINGA**

**MASTER OF SCIENCE IN COMMERCE**

**(FINANCE AND ACCOUNTING)**

**KCA UNIVERSITY**

**2025**

**CREATIVE ACCOUNTING PRACTICES, AND TAX COMPLIANCE AMONG  
SMALL AND MEDIUM ENTREPRISES IN NAIROBI CITY COUNTY, KENYA**

**BY**

**ANTHONY KIOKO MAINGA**

**22/00353**

**A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE  
REQUIREMENTS FOR THE AWARD OF MASTER OF SCIENCE IN COMMERCE  
(FINANCE AND ACCOUNTING) IN THE SCHOOL OF BUSINESS AT KCA  
UNIVERSITY**

**OCTOBER 2025**

**DECLARATION**

I declare that this project is my original work that has never been previously published or submitted elsewhere for award of a degree. I also declare that this proposal contains no material written or published by other people except where due reference is made and author duly acknowledged.

Signature..........Date..... 13/10/2025.....

**Anthony Kioko Mainga**

**Ref. No:22/00353**

I do hereby confirm that I have examined the master's project of

**Anthony Mainga**

And have certified that all revisions that the dissertation panel and examiners recommended have been adequately addressed.

Signature..........Date..........

**Dr. Michael Njogo**

**(Dissertation supervisor)**

## ABSTRACT

Many economies around the world continue to experience low tax compliance levels among Small and Medium Enterprises (SMEs), resulting in revenue authorities failing to meet their annual collection targets. This challenge significantly affects government operations, limiting its ability to provide essential services and implement development projects. Clearly, there is a need for governments and tax authorities to reassess their strategies in promoting compliance among taxpayers, especially SMEs, which form the backbone of many economies. The current study sought to establish the effect of creative accounting practices on tax compliance among SMEs in Nairobi City County, Kenya. The variables of interest were: income smoothing, accelerated depreciation, and off-balance sheet financing as the independent variables, while tax compliance was the dependent variable. The study was anchored on Agency Theory, Positive Accounting Theory, and the Theory of Planned Behavior. The study adopted a descriptive research design and the target population was 1,364 registered SMEs operating within Nairobi City County, from which a sample of 309 firms was selected using stratified sampling technique. Primary data was collected using a structured questionnaire. Data collected were coded and then analyzed using descriptive statistics, Pearson correlation analysis and multiple regression analysis. The results revealed that income smoothing had a positive and significant beta coefficient ( $\beta_1 = 0.319$ ,  $p = 0.000 < 0.05$ ). Similarly, accelerated depreciation had a positive and significant beta coefficient ( $\beta_2 = 0.426$ ,  $p = 0.000 < 0.05$ ). However, off-balance sheet financing had a negative but statistically insignificant beta coefficient ( $\beta_3 = -0.031$ ,  $p = 0.579 > 0.05$ ). Based on these findings, the study concluded that income smoothing and accelerated depreciation significantly enhance tax compliance among SMEs. Conversely, off-balance sheet financing does not significantly affect compliance. Among the three practices studied, accelerated depreciation had the greatest positive effect on tax compliance. The study recommends that the Kenya Revenue Authority (KRA) strengthen its engagement with SMEs by offering clearer guidelines and training on acceptable accounting practices—especially on income recognition and depreciation methods—to enhance voluntary compliance and boost tax revenue collection.

## **ACKNOWLEDGEMENT**

I want to express my gratitude to all who will be crucial in my project. Initially, I would want to express my gratitude to the KCA management for granting me permission to carry out this research. Moreover, I am deeply appreciative of my supervisor for his unwavering dedication, patience, support, and expert mentorship in my academic endeavors. Furthermore, I extend my gratitude to the Nairobi Small and Medium Enterprises (SMEs) who actively engage in completing the questionnaires. First and foremost, I wish to express my deepest gratitude to the Almighty for granting me good health, wisdom, and divine guidance throughout the course of my academic journey.

## TABLE OF CONTENTS

<b>DECLARATION</b> .....	<b>ii</b>
<b>ABSTRACT</b> .....	<b>iii</b>
<b>ACKNOWLEDGEMENT</b> .....	<b>iv</b>
<b>TABLE OF CONTENTS</b> .....	<b>v</b>
<b>DEDICATION</b> .....	<b>x</b>
<b>LIST OF TABLES</b> .....	<b>xi</b>
<b>LIST OF FIGURES</b> .....	<b>xii</b>
<b>ACRONYMS AND ABBREVIATION</b> .....	<b>xiii</b>
<b>DEFINITION OF TERMS</b> .....	<b>xiv</b>
<b>CHAPTER ONE</b> .....	<b>1</b>
<b>INTRODUCTION</b> .....	<b>1</b>
1.1 Background of the Study.....	1
1.1.1 Tax Compliance .....	5
1.1.2 Creative Accounting.....	8
1.1.3 Small and Medium Enterprises in Nairobi County, Kenya .....	9
1.2 Statement of Problem.....	12
1.3 Objectives of the study.....	14
1.3.1 General objective.....	14
1.3.2 Specific objectives.....	14
1.4 Research Hypotheses .....	14
1.5 Significance of the Study .....	14
1.5.1 The Kenya Revenue Authority .....	15
1.5.2 The Taxpayers.....	15
1.5.3 The Government.....	15
1.5.4 Academia .....	15
1.6 Scope of the Study .....	16

<b>CHAPTER TWO .....</b>	<b>17</b>
<b>LITERATURE REVIEW.....</b>	<b>17</b>
2.1 Introduction .....	17
2.2 Theoretical Review .....	17
2.2.1 Agency Theory.....	17
2.2.2 Legitimacy Theory .....	19
2.2.3 Theory of Planned Behavior .....	21
2.2.4 Deterrence Theory.....	24
2.3 Empirical Review .....	25
2.3.1 Income Smoothing and Tax Compliance .....	25
2.3.2 Accelerated Depreciation and Tax Compliance.....	28
2.3.3 Off Balance Sheet Financing and Tax Compliance .....	30
2.4 Summary of Literature and Research Gaps .....	32
2.5 Conceptual Framework.....	33
2.6 Operationalization and Measurements of Study Variables .....	34
<b>CHAPTER THREE .....</b>	<b>36</b>
<b>RESEARCH METHODOLOGY.....</b>	<b>36</b>
3.1 Introduction .....	36
3.2 Research Design .....	36
3.3 Target Population .....	36
3.4 Sampling Frame.....	37
3.4.1 Sample Size.....	38
3.4.2 Sampling Technique.....	38
3.5 Data Collection Instruments.....	39
3.6 Pilot Study.....	40
3.7 Reliability of Data Collection Instrument.....	40
3.8 Validity of Data Collection Instrument.....	41

3.9 Data Collection Procedure .....	41
3.10 Data Analysis and Presentation .....	42
3.11 Diagnostic Tests .....	42
3.11.1 Normality Test .....	43
3.11.2 Multi-collinearity Test .....	43
3.11.3 Linearity Test .....	43
3.11.4 Homoscedasticity Test .....	44
3.12 Ethical Considerations .....	44
<b>CHAPTER FOUR.....</b>	<b>46</b>
<b>DATA ANALYSIS, PRESENTATION AND DISCUSSION.....</b>	<b>46</b>
4.1 Introduction .....	46
4.2 Pilot Test Result.....	46
4.3 Response Rate .....	46
4.4 Demographic information .....	47
4.4.1 Respondent’s Gender.....	47
4.4.2 Length of Service in the SME.....	48
4.4.3 Position Held in the SME .....	48
4.5 Descriptive Statistics.....	49
4.5.1 Income Smoothing.....	49
4.5.2 Accelerated Depreciation.....	52
4.5.3 Off-Balance Sheet Financing.....	53
4.5.4 Tax Compliance .....	55
4.6 Diagnostic Tests .....	57
4.6.1 Normality Test .....	57
4.6.2 Multicollinearity Test .....	58
4.7 Correlation Matrix Table .....	58
4.8 The Model Summary .....	60

4.9 Analysis of Variance .....	62
4.10 Regression Coefficients .....	63
4.11 Discussion of Findings.....	65
4.11.1 Income Smoothing and Tax Compliance .....	65
4.11.2 Accelerated Depreciation and Tax Compliance.....	65
4.11.3 Off-Balance Sheet Financing and Tax Compliance .....	66
<b>CHAPTER FIVE.....</b>	<b>67</b>
<b>SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS .....</b>	<b>67</b>
5.1 Introduction .....	67
5.2 Summary of Findings.....	67
5.2.1 Income Smoothing and Tax Compliance .....	68
5.2.2 Accelerated Depreciation and Tax Compliance.....	69
5.2.3 Off-Balance Sheet Financing and Tax Compliance .....	69
5.3 Conclusions .....	69
5.3.1 Income Smoothing and Tax Compliance .....	70
5.3.2 Accelerated Depreciation and Tax Compliance.....	70
5.3.3 Off-Balance Sheet Financing and Tax Compliance .....	70
5.4 Recommendations.....	71
5.4.1 Income Smoothing and Tax Compliance .....	71
5.4.2 Accelerated Depreciation and Tax Compliance.....	71
5.4.3 Off-Balance Sheet Financing and Tax Compliance .....	71
5.5 Suggestions for Further Studies.....	71
5.6 Limitations of the Study.....	72
<b>REFERENCES.....</b>	<b>74</b>
<b>APPENDICES .....</b>	<b>80</b>
Appendix I: Introductory Letter .....	80
Appendix II: Questionnaire.....	81

Appendix III: Ethics Clearance Certificate..... 85  
Appendix IV: NACOSTI Form..... 86

## **DEDICATION**

I dedicate this work to my family and all those who played part in making me to achieve this milestone in academic journey.

## LIST OF TABLES

TABLE 1:Operationalization and measurements of variables .....	35
TABLE 2: Target Population .....	37
TABLE 3: Sample size.....	39
TABLE 4:Reliability Test results .....	46
TABLE 5:Length of Service in the SME .....	48
TABLE 6:Position Held in the SME.....	49
TABLE 7:Income Smoothing.....	50
TABLE 8:Table 4. 5 accelerated depreciation .....	52
TABLE 9: off-balance sheet financing .....	54
TABLE 10:Excise Duty Tax Compliance.....	56
TABLE 11:Normality Tests .....	57
TABLE 12:Multicollinearity Test.....	58
TABLE 13:Correlation Matrix Table.....	59
TABLE 14:Model Summary .....	61
TABLE 15:Analysis of Variance.....	62
TABLE 16:Regression Coefficients .....	63

## LIST OF FIGURES

FIGURE 1:Conceptual Framework .....	34
FIGURE 2:Response Rate.....	47
FIGURE 3: Respondent's Gender .....	47

## **ACRONYMS AND ABBREVIATION**

<b>ANOVA</b>	Analysis of Variance
<b>EU</b>	European Union
<b>GAAP</b>	Generally Accepted Accounting Principles
<b>KRA</b>	Kenya Revenue Authority
<b>NTA</b>	National Tax Administration
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>SMEs</b>	Small and Medium-Sized Enterprises
<b>URA</b>	Uganda Revenue Authority

## **DEFINITION OF TERMS**

### **Accelerated Depreciation**

It is a method that allows for higher depreciation expenses early in an asset's life, reflecting its actual usage pattern.

### **Creative Accounting**

It is a set of skills that allow people to produce an artistic, scientific or other creative activity that creates new, unusual and acceptable ideas, which are transformed into financial statements, which then form a positive view of the company's economic activities (Blazek, 2021).

### **Income Smoothing**

It is a practice involving modifying accounting figures to meet the desires and expectations of organizational directors and managers through manipulation of earnings, use of loan provisioning, no concealment of liabilities and the understatement of incomes (Bhasin, 2016).

### **Off-Balance Sheet Financing**

It is an accounting practice that allows companies to raise funds without showing specific assets or liabilities on their balance sheet

### **Tax compliance**

According to Orgler (2017), tax compliance refers to the willingness and ability of taxpayers to comply with tax laws through accurate declaration of income and payment of the resulting taxes on time.

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background of the Study**

Taxation is a critical mechanism for governments to generate revenue, fund public services, and stimulate economic development (Kinyondo, 2019). It is a legal obligation for all entities, including small and medium-sized enterprises (SMEs), to comply with tax regulations (Musyoka & Mwangi, 2021). Tax compliance requires businesses to file accurate returns, make timely payments, and adhere to relevant tax laws (Mutua & Wambua, 2022). For SMEs, compliance can be challenging due to limited financial resources, inadequate knowledge of tax laws, and complex reporting requirements (Kinyondo, 2019). Moreover, SMEs often lack sophisticated accounting systems, making accurate record-keeping and reporting difficult (Musyoka & Mwangi, 2021). Studies indicate that inadequate financial literacy and insufficient support from tax authorities are among the primary factors contributing to non-compliance among SMEs (Gitonga et al., 2023). These challenges highlight the need for effective policies and interventions aimed at enhancing SME tax compliance (Mutua & Wambua, 2022).

Tax compliance, in general, reflects the extent to which taxpayers meet their statutory obligations, encompassing both voluntary and enforced adherence to tax laws (Kinyondo, 2019). Non-compliance, whether intentional or unintentional, may result in financial penalties, legal action, or business disruptions (Musyoka & Mwangi, 2021). Research has demonstrated that firms with well-established accounting systems, digital reporting tools, and high levels of financial literacy are more likely to comply with tax regulations (Mutua & Wambua, 2022). Compliance is further influenced by factors such as perceived fairness of the tax system, trust in government institutions, and the availability of guidance or training for taxpayers (Gitonga et al., 2023). Hence, promoting compliance among SMEs requires both systemic reforms to simplify tax administration and educational initiatives to enhance taxpayers' knowledge and skills (Kinyondo, 2019).

In Canada, SMEs experience a relatively structured and supportive tax environment, where the Canada Revenue Agency (CRA) actively encourages compliance through digital solutions and targeted outreach programs (Canada Revenue Agency, 2025). The CRA has implemented risk-based auditing and provides online platforms for filing returns, paying taxes, and accessing guidance (Mutua & Wambua, 2022). These initiatives aim to reduce the administrative burden on SMEs and improve voluntary compliance (KPMG Canada, 2023). Research indicates that the combination of technological facilitation and taxpayer education in Canada has led to higher compliance rates among small businesses, demonstrating the effectiveness of proactive government support (Canada Revenue Agency, 2025). By reducing complexity and providing timely information, Canadian tax authorities help SMEs fulfill their obligations efficiently, promoting both transparency and trust in the system (Gitonga et al., 2023).

In China, tax compliance among SMEs has been improved through reforms that streamline reporting processes and encourage electronic filing (PwC China, 2025). Simplified tax registration procedures and the introduction of digital platforms have made it easier for SMEs to meet their obligations (Li & Zhang, 2022). Studies suggest that SMEs with greater trust in government institutions and better knowledge of tax regulations are more likely to comply with tax laws (KPMG China, 2023). The Chinese government's approach emphasizes transparency and predictability, aiming to reduce the perceived risks and costs associated with non-compliance (PwC China, 2025). Consequently, SMEs in China are more likely to engage in voluntary compliance when the tax system is accessible, user-friendly, and supported by clear guidelines (Li & Zhang, 2022).

In India, SMEs face compliance challenges due to complex tax frameworks and historically high administrative burdens (Finsmart Accounting, 2023). The implementation of the Goods and Services Tax (GST) and digital reporting mechanisms has simplified tax filing

processes (Mutua & Wambua, 2022). Yet many SMEs continue to struggle due to low financial literacy and limited access to accounting support (Gitonga et al., 2023). Studies reveal that a significant proportion of Indian SMEs fail to comply fully with tax obligations, often due to difficulties in understanding regulations or the perceived cost of compliance (Finsmart Accounting, 2023). These findings suggest that while technology and process simplification are beneficial, educational programs and continuous support are crucial for ensuring compliance among Indian SMEs (Kinyondo, 2019).

In Indonesia, SMEs often encounter compliance difficulties caused by inadequate accounting systems, low financial literacy, and perceptions of unfair tax enforcement (Wibowo et al., 2025). Research indicates that trust in government, coupled with perceived fairness and administrative efficiency, strongly influences compliance behavior (Mutua & Wambua, 2022). Simplified registration procedures and taxpayer education programs have been shown to improve voluntary compliance among SMEs in Indonesia (Gitonga et al., 2023). This demonstrates that both structural reforms and capacity-building measures are necessary to enhance adherence to tax obligations (Wibowo et al., 2025). Thus, fostering a supportive environment that combines education, transparency, and ease of compliance can significantly influence SMEs' tax behavior (Kinyondo, 2019).

In Nigeria, reforms aimed at increasing SME compliance have focused on streamlining tax processes and reducing administrative burdens (PwC Nigeria, 2025). Recent legislation, including the Nigeria Tax Reform Act of 2025, introduced simplified registration, filing, and payment procedures to encourage voluntary compliance (Mutua & Wambua, 2022). Research shows that SMEs are more likely to comply when policies are clear, consistent, and perceived as fair (Gitonga et al., 2023). These reforms highlight the importance of both regulatory clarity and supportive administration in enhancing SME compliance, particularly in countries where informal business practices are common (PwC Nigeria, 2025).

In Egypt, SMEs are encouraged to comply through regulatory reforms that simplify reporting and reduce penalties (KPMG Egypt, 2025). For instance, Law No. 5 of 2025 allows businesses to regularize their tax status without facing punitive measures (Mutua & Wambua, 2022). The law also introduces simplified procedures for registration and reporting (Gitonga et al., 2023). Such measures aim to reduce administrative complexity and incentivize voluntary compliance among SMEs (KPMG Egypt, 2025). Studies indicate that these reforms increase the willingness of SMEs to comply by promoting a perception of fairness and reducing the costs associated with tax obligations (Mutua & Wambua, 2022).

In South Africa, SME compliance is influenced by both regulatory complexity and perceptions of government effectiveness (Myburg, 2025). Research shows that trust in government institutions, clarity of regulations, and transparency in enforcement significantly affect SMEs' willingness to comply with tax obligations (Gitonga et al., 2023). South African SMEs often perceive compliance as burdensome, but reforms that simplify tax procedures and enhance trust in administration can promote adherence (Mutua & Wambua, 2022). This highlights the interplay between institutional support and voluntary compliance (Myburg, 2025).

In Ghana, SME compliance is closely tied to financial literacy, knowledge of regulations, and perceptions of fairness (Sajems, 2023). Informal businesses often evade taxes due to the high costs and complexities of compliance (Mutua & Wambua, 2022). Registered SMEs, however, exhibit higher compliance levels (Gitonga et al., 2023). Targeted educational programs, simplified tax procedures, and enforcement measures have been shown to improve voluntary compliance among SMEs in Ghana (Sajems, 2023). This indicates that compliance is influenced not only by formal regulations but also by SMEs' understanding and engagement with the tax system (Mutua & Wambua, 2022).

In Tanzania, compliance among SMEs remains low due to complex tax structures, limited financial literacy, and weak enforcement mechanisms (Kinyondo, 2019). Studies suggest that taxpayer education programs, simplification of procedures, and proactive support from tax authorities are essential for improving SME compliance (Gitonga et al., 2023). When SMEs are provided with accessible guidance and effective administrative systems, their ability and willingness to comply with tax regulations increase (Musyoka & Mwangi, 2021). This emphasizes the critical role of both institutional reforms and capacity-building initiatives in promoting tax compliance in developing economies (Kinyondo, 2019).

### **1.1.1 Tax Compliance**

Tax compliance is widely argued to be a cornerstone of effective fiscal policy, as it ensures that both individuals and business entities meet their statutory obligations through accurate reporting, timely filing, and remittance of taxes (Braithwaite, 2019). Scholars suggest that compliance is a key indicator of the efficiency of a country's tax administration, directly influencing the government's capacity to fund public services, infrastructure, and socio-economic programs (Mutua & Wambua, 2022). It is further posited that SMEs play a critical role in this process, as their adherence to tax obligations is vital for sustaining revenue streams, promoting fiscal stability, and supporting equitable national development (Gbadago & Awunyo-Vitor, 2015).

In Kenya, SMEs contribute roughly 45% of GDP and employ about 85% of the workforce, indicating that their compliance behavior significantly affects economic stability (Blueprint Academic Publishers, 2023). It is suggested that enhancing compliance among SMEs should therefore be a national priority, both to secure government revenues and to promote transparent and accountable business practices (Braithwaite, 2019). Evidence also indicates that limited financial literacy, inadequate accounting systems, and complex reporting

requirements create significant barriers for SMEs, highlighting the need for targeted interventions and capacity-building programs (Mutua & Wambua, 2022).

Digital tax platforms, such as Kenya's iTax system, have been argued to improve SME compliance by streamlining filing processes, reducing manual errors, and providing automated reminders for obligations (Carijournals, 2023). Research conducted in Meru County shows that iTax adoption explains 58.5% of the variance in SME tax compliance, suggesting that technology can meaningfully enhance adherence to regulations (Edinburgh Journals, 2023). It is therefore recommended that authorities continue to invest in digital infrastructure and user-friendly platforms to support timely and accurate tax reporting among SMEs (Mutua & Wambua, 2022).

Taxpayer knowledge and financial literacy have also been emphasized as pivotal factors, with studies from Kariokor Market in Nairobi revealing that greater awareness of tax laws and reporting requirements significantly improves compliance rates (ResearchGate, 2023). It is argued that interventions focusing on education, training, and capacity-building can bridge knowledge gaps and reduce inadvertent non-compliance (Braithwaite, 2019). Nonetheless, challenges such as complex tax legislation, high perceived costs of compliance, and bureaucratic hurdles persist, suggesting that technology alone is insufficient without complementary support measures (Mutua & Wambua, 2022).

One prominent factor affecting SME compliance is the use of creative accounting practices, defined as the manipulation of financial records to present a favorable view of performance while exploiting regulatory loopholes (Joubert & Taylor, 2019). It is argued that such practices, though sometimes legally permissible, often compromise transparency and increase opportunities for underreporting taxable income (Waweru, 2021). SMEs may adopt these practices to manage cash flow, improve apparent profitability, or minimize tax

obligations, but these strategies undermine the integrity of the tax system and reduce government revenue collection (Mutua & Wambua, 2022).

Common creative accounting techniques include overstating expenses, understating revenues, deferring income recognition, and misclassifying transactions to shift profits across accounting periods (Kamau, Mutiso, & Ngui, 2012). It is suggested that the prevalence of these techniques is exacerbated by limited financial expertise, weak internal controls, and competitive pressures in resource-constrained environments (Amat & Gowthorpe, 2010). Scholars further argue that without effective monitoring and enforcement mechanisms, SMEs are likely to continue these practices, which can erode overall compliance rates (Masato, 2019).

Research indicates that creative accounting has a direct and significant negative impact on tax compliance by reducing transparency and facilitating both deliberate and unintentional non-compliance (Gitonga, Mwangi, & Njoroge, 2023). Experts argue that understanding the relationship between such practices and SME behavior is essential for designing effective tax policies, enforcement strategies, and educational programs (Kebede, Alemu, & Bekele, 2021). Authorities are therefore encouraged to implement monitoring frameworks, taxpayer education, and regulatory interventions aimed at curbing unethical practices while enhancing voluntary compliance (Mutua & Wambua, 2022).

Studies further suggest that addressing both knowledge gaps and unethical reporting can strengthen fiscal accountability and support the sustainable growth of SMEs, particularly in urban centers like Nairobi where SMEs form a substantial portion of the local business ecosystem (Gitonga, Mwangi, & Njoroge, 2023). Scholars recommend that policymakers prioritize interventions that integrate technological facilitation, education, and robust enforcement to foster a culture of compliance (Braithwaite, 2019). Overall, a combination of structural reforms, capacity-building initiatives, and transparency measures is argued to be

essential for ensuring that SMEs adhere to tax obligations, contributing to national development and economic sustainability (Kamau, Mutiso, & Ngui, 2012).

### **1.1.2 Creative Accounting**

Creative accounting encompasses a broad range of accounting techniques that depart from standard principles to present financial statements in a more favorable or strategic manner, often influencing tax obligations, investor perceptions, and regulatory compliance (Ezeani et al., 2012; Scott, 2015; Healy & Wahlen, 1999). While the spectrum of creative accounting includes numerous schemes—ranging from income recognition manipulation and expense reclassification to off-balance-sheet arrangements—not all practices equally impact tax compliance or are prevalent among SMEs. Therefore, for the purposes of this study, the focus is on three schemes that are empirically observed to have significant implications for SME tax behavior: income smoothing, accelerated depreciation, and off-balance-sheet financing.

Income smoothing is selected due to its widespread application by SMEs to stabilize reported profits across accounting periods, thereby managing both internal and external perceptions of financial performance and optimizing tax obligations (Joubert & Taylor, 2019; Mutua & Wambua, 2022; Kamau, Mutiso, & Ngui, 2012). Its relevance lies in the direct effect of reallocating revenues and expenses on taxable income, which can either enhance compliance when done within legal discretion or contribute to tax avoidance when applied aggressively.

Accelerated depreciation is included because it represents a legal and technically permissible accounting method that SMEs commonly employ to reduce taxable income in early asset life, supporting cash flow management and operational reinvestment (Goode, 2015; Waweru, 2021; Zeng, Dai, & Chan, 2023). This technique is particularly significant in the SME context, where liquidity constraints and limited access to financing create incentives for short-term tax minimization strategies.

Off-balance-sheet financing is examined due to its potential to influence reported financial position and tax obligations without appearing on the balance sheet, which can affect the calculation of taxable income and financial ratios relevant for creditors or tax authorities (Ball & Shivakumar, 2005; Joubert & Taylor, 2019; Mutua & Wambua, 2022). It is critical to clarify that not all off-balance-sheet items constitute off-balance-sheet financing. For instance, contingent liabilities, performance guarantees, and other contractual obligations may appear off the balance sheet but do not directly manipulate income or taxes; instead, off-balance-sheet financing schemes typically involve structured transactions—such as special purpose entities or lease arrangements—designed to shift liabilities or assets out of the balance sheet to strategically influence financial reporting outcomes. The study, therefore, deliberately focuses on off-balance-sheet financing arrangements with demonstrable effects on taxable income rather than all off-balance-sheet items.

This focused selection aligns with the study objectives by concentrating on accounting practices that are both prevalent among SMEs in Nairobi County and empirically linked to tax compliance behavior. By examining income smoothing, accelerated depreciation, and off-balance-sheet financing, the study can provide actionable insights for policymakers, tax authorities, and SME managers into how creative accounting shapes compliance, while acknowledging the ethical and legal boundaries of such practices. The deliberate selection of these three schemes ensures relevance, feasibility, and empirical rigor in addressing the research questions.

### **1.1.3 Small and Medium Enterprises in Nairobi County, Kenya**

Small and Medium Enterprises (SMEs) play a critical role in national and local economies by fostering employment, generating revenue, and stimulating entrepreneurship. Globally, SMEs are often recognized as the backbone of economic development because they contribute significantly to GDP, provide substantial employment opportunities, and promote innovation

and market diversification. Despite their importance, SMEs frequently face challenges related to access to finance, regulatory compliance, and operational capacity, which can impact their formalization and tax compliance. Across various countries, SMEs are also identified as a high-risk group for tax non-compliance due to limited resources, insufficient knowledge of tax regulations, and reliance on informal accounting practices (Akinboade, 2015; OECD, 2004; Williams, 2005). Understanding the operational and regulatory environment of SMEs is therefore essential for designing effective tax policies and support mechanisms.

In the United States, SMEs constitute a major part of the economy, representing 99.9% of all businesses and employing nearly 47.3% of the workforce (SBA, 2023). American SMEs are heavily regulated but also benefit from well-established tax frameworks, support programs, and digital reporting systems, such as the Internal Revenue Service's e-filing platforms, which facilitate compliance. Despite these measures, SMEs often face compliance challenges related to payroll taxes, corporate income tax, and sales tax reporting. Studies indicate that smaller firms with fewer financial resources and less formalized accounting systems are more likely to underreport income or delay tax payments, underscoring the importance of taxpayer education and support (Hanlon & Heitzman, 2018; Alm et al., 2021).

In the Netherlands, SMEs contribute approximately 60% of private-sector employment and are integral to the Dutch innovation and export economy (CBS, 2022). Dutch SMEs benefit from relatively simple tax procedures, online filing systems, and strong institutional support that promotes voluntary compliance. However, small businesses still face challenges with corporate income tax and value-added tax obligations, particularly those engaged in cross-border trade or operating within complex supply chains. Research suggests that the provision of guidance and access to digital tax tools enhances compliance, while limited financial literacy and complex tax regulations can contribute to underreporting or misinterpretation of tax obligations (OECD, 2020; KPMG, 2021).

In Tunisia, SMEs form the backbone of the national economy, contributing significantly to employment and GDP (World Bank, 2021). The Tunisian government has introduced policies aimed at simplifying tax administration for small enterprises, including the use of simplified tax regimes and digital filing systems. Nonetheless, challenges persist, particularly for micro and informal SMEs, who often lack structured accounting systems and access to professional advisory services. As a result, SMEs in Tunisia exhibit varying levels of tax compliance, with smaller and informal firms more prone to underreporting income and delays in remittance (Ben Ali & Ayed, 2022; OECD, 2020).

Ethiopia's SME sector is recognized for its potential to drive industrialization and employment, contributing significantly to GDP (World Bank, 2022). However, SMEs in Ethiopia face significant regulatory and institutional barriers, including complex tax procedures, limited access to digital filing platforms, and weak enforcement mechanisms. Many small businesses operate informally, and the lack of proper accounting records contributes to underreporting and inconsistent tax compliance. Research indicates that improving digital tax services, financial literacy, and formalization incentives can positively influence SME compliance behavior in Ethiopia (Gebrehiwot & Kassie, 2021; Tadesse, 2020).

In Uganda, SMEs account for more than 90% of all businesses and provide about 80% of formal employment (UBOS, 2022). Ugandan SMEs operate in a challenging tax environment characterized by complex reporting requirements, inconsistent enforcement, and limited taxpayer support. Informal SMEs, which represent a substantial proportion, face difficulties in adhering to tax obligations due to inadequate accounting knowledge, lack of formal registration, and limited access to professional services. Studies have highlighted that voluntary compliance is positively associated with taxpayer education, awareness of penalties,

and the availability of simplified reporting mechanisms (Nakyambadde, 2021; Ssewanyana & Okello, 2020).

In Kenya, SMEs constitute approximately 34.3% of the national economy and provide around 77% of employment (KNBS, 2022). These enterprises are vital contributors to government revenue through taxes, yet a significant number operate informally or with limited compliance knowledge. Informal SMEs often lack proper bookkeeping systems, access to financial advisory services, and understanding of statutory tax obligations, making them prone to non-compliance or underreporting (Ouma et al., 2007; Okello, 2014). Despite efforts by the Kenya Revenue Authority to enhance digital reporting through platforms like iTax, challenges such as limited financial literacy, perceived compliance costs, and weak enforcement continue to affect overall SME tax compliance (Williams, 2005; Braithwaite, 2019).

Within Nairobi County, SMEs are particularly pivotal to the local economy due to the concentration of businesses, access to markets, and availability of infrastructure and support services. The Kenya Institute for Public Policy Research and Analysis (KIPPRA) ranked Nairobi as the most favorable county for SME operations, noting advantages such as infrastructure, market access, and support institutions (KIPPRA, 2022). SMEs in Nairobi contribute significantly to tax collection and government revenue, yet many operate in the informal sector with minimal organizational structure and limited use of labor-intensive technologies (Akinboade, 2015; Ouma et al., 2007). The high prevalence of informal operations, coupled with limited compliance capacity, makes voluntary tax adherence an ongoing challenge. Strengthening taxpayer education, financial literacy, and digital filing adoption remains essential to improving SME tax compliance within the county.

## **1.2 Statement of Problem**

Small and Medium Enterprises (SMEs) are vital to Kenya's economy, constituting about 98 percent of all businesses and providing significant employment opportunities (KNBS, 2022;

Mwangi & Kamau, 2023; Warundu, 2021). Despite their substantial contribution, tax compliance among SMEs in Nairobi City County remains low, with the Kenya Revenue Authority (KRA) reporting only 59 percent compliance against a target of 65 percent (Warundu, 2021). Noncompliance has been linked to creative accounting practices, such as inflating expenses or underreporting income, as well as factors including limited financial literacy, complex tax laws, and challenges in enforcement (Kamau & Nzioki, 2018; Mutua & Wambua, 2022; Gitonga, Mwangi, & Njoroge, 2023). While these determinants are generally acknowledged, there is limited empirical evidence on the direct impact of creative accounting practices including income smoothing, accelerated depreciation, and off-balance-sheet financing on SME tax compliance in Nairobi County, representing a critical knowledge gap (Tanzi & Zee, 2000; Jemaiyo & Mutai, 2016; Mutua & Wambua, 2022).

Moreover, the interaction between managerial accounting behaviors and local regulatory enforcement mechanisms remains underexplored, leaving a gap in understanding how internal practices within SMEs influence compliance outcomes in the context of institutional capacity (Kamau & Nzioki, 2018; OECD, 2021; Helhel & Ahmed, 2014). Most prior research has focused on macro level or cross-country perspectives, with limited attention to localized context specific factors that affect SME compliance, such as administrative burdens, resource constraints, and the ability to adhere to complex tax regulations in Nairobi City County (Moyi & Roge, 2006; Nyaegah, 2018; KRA, 2023).

Additionally, existing studies often fail to integrate the behavioral, financial, and institutional dimensions of compliance, leaving interventions inadequately targeted and limiting their effectiveness in improving adherence among SMEs (Normala & Obid, 2013; Jemaiyo & Mutai, 2016; Gitonga, Mwangi, & Njoroge, 2023). This highlights the need for research that examines how creative accounting practices, and tax enforcement jointly influence SME tax compliance in Nairobi City County, thereby providing a more

comprehensive understanding of the factors driving noncompliance and informing tailored policy and regulatory interventions.

### **1.3 Objectives of the study**

#### **1.3.1 General objective**

To evaluate the effect of creative accounting practices on tax compliance among small and medium enterprises in Nairobi County, Kenya.

#### **1.3.2 Specific objectives**

- i. To establish the effect of income smoothing on tax compliance among small and medium enterprises in Nairobi County, Kenya.
- ii. To examine the effect of accelerated depreciation on tax compliance among small and medium enterprises in Nairobi County, Kenya.
- iii. To examine the influence of off-balance sheet financing on tax compliance among small and medium enterprises in Nairobi County, Kenya.

### **1.4 Research Hypotheses**

**H<sub>01</sub>:** Income smoothing has no significant effect on tax compliance among small and medium enterprises in Nairobi County, Kenya.

**H<sub>02</sub>:** Accelerated depreciation has no significant effect on tax compliance among small and medium enterprises in Nairobi County, Kenya.

**H<sub>03</sub>:** Off-balance sheet financing has no significant effect on tax compliance among small and medium enterprises in Nairobi County, Kenya.

### **1.5 Significance of the Study**

This study holds significant value in elucidating the effect of creative accounting practices on tax compliance within small and medium-sized enterprises (SMEs), particularly in the context of Nairobi City County. The findings of the study could bear considerable consequences for a

range of stakeholders, including the Kenya Revenue Authority (KRA), small and medium-sized enterprises (SMEs), the government, and the academic community.

### **1.5.1 The Kenya Revenue Authority**

This study is of significant relevance to the tax authority, KRA, as its findings may contribute to the formulation of policies designed to enhance tax compliance and address loopholes associated with tax evasion and avoidance.

### **1.5.2 The Taxpayers**

Taxpayers stand to gain from the insights of this study, enhancing their understanding of the advantages associated with tax compliance and developing the necessary skills to maintain adherence. Acquiring knowledge regarding tax compliance enables small and medium-sized enterprises (SMEs) to comprehend their responsibilities as taxpayers. They possess the capacity to acquire insights into methodologies for minimizing tax compliance expenses and comprehending the regulations that oversee various categories of taxation. Furthermore, they will exhibit an affirmative stance regarding taxation, resulting in enhanced revenue generation for the government.

### **1.5.3 The Government**

Furthermore, the government stands to gain from the study's findings by acquiring a deeper understanding of taxpayers' expectations concerning the allocation of revenue towards development as opposed to misappropriation.

### **1.5.4 Academia**

This study possesses the capacity to significantly enhance the academic discourse, as scholars may leverage the findings to refine and advance the current body of literature in subsequent research endeavors. The rationale behind this is that the findings may augment the existing

body of knowledge by contributing to the limited literature on tax compliance. The findings of this study may serve as potential topics for further exploration by other scholars as well.

### **1.6 Scope of the Study**

The study aims to assess the impact of creative accounting practices on tax compliance within small and medium enterprises in Nairobi County, Kenya, with particular emphasis on off-balance sheet financing, accelerated depreciation, and income smoothing, and their influence on tax compliance among these enterprises. The study will be carried out in Nairobi city county, focusing on 1,364 small and medium-sized enterprises (SMEs) functioning within the area during the fiscal year 2024/2025. The research will be executed in a descriptive format, employing a structured questionnaire for data collection purposes.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter examines literature concerning the causal factors affecting revenue collection at one-stop border stations. The review will be formulated and directed by the study's objectives, concentrating primarily on off-balance sheet financing, accelerated depreciation, income smoothing, and their impact on tax compliance. The primary concerns in this investigation are as follows.

#### **2.2 Theoretical Review**

A theoretical review is a cohesive set of validated general propositions widely accepted as accurate, serving as rules for the explanation and prediction of a specific category of events (Denzin, 2017). The research was based on four pertinent theories: Agency theory, Positive accounting theory, and the Theory of planned behavior.

##### **2.2.1 Agency Theory**

Agency theory was first proposed by Jensen and Meckling (1976) in their landmark paper titled "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure". This theory focuses on the complex relationship between principals, who are the owners or shareholders of a firm, and agents, who are typically the managers or executives tasked with running the organization on behalf of the principals. The fundamental premise of the theory is that a natural conflict of interest exists between principals and agents because the goals and incentives of agents may not always align with those of the principals. Agents, motivated by personal gain, career advancement, or other self-interest objectives, may pursue actions that maximize their own benefits rather than the wealth or strategic goals of the organization. To mitigate such conflicts and ensure alignment, principals often incur monitoring costs, such as audits, performance evaluations, or incentive schemes, designed to encourage agents to act in the principals' best interests. Furthermore, agents usually possess more detailed and private

information about the firm's day-to-day operations than principals, creating an asymmetry of information. This information gap may be exploited by agents through opportunistic behaviors such as earnings management, creative accounting, or even tax evasion, which can compromise organizational transparency and stakeholder confidence (Jensen & Meckling, 1976).

In practical terms, the agent carries out specific responsibilities on behalf of the principal. A principal is an individual or organization that grants explicit or implicit authority for another party to act in their stead, while the agent is the party entrusted with that authority. Agents are expected to establish operational and legal relationships between the principal and third parties. For example, accountants act as agents for stakeholders, shareholders, and other users of financial information. Their role involves ensuring that financial records are prepared accurately, following established accounting standards, principles, and regulatory requirements. Failure to perform duties ethically or accurately may result in misrepresentation, financial fraud, or the falsification of financial statements, which can have severe consequences for decision-making and trust in the organization (Osisioma & Enahoro, 2006).

Amat, Blake, and Dowds (1999) further illustrate the importance of agency theory in accounting by noting that stakeholders, shareholders, and other users of financial statements rely heavily on the accuracy and transparency of annual financial reports when making investment or policy decisions. They depend on the assessments made by accountants who compile the records and auditors who independently verify them to provide a fair and impartial representation of the firm's financial position and performance. Agency theory, therefore, assumes that shareholders expect agents to make decisions and take actions that are aligned with the principals' best interests. However, in practice, agents may act in ways that serve their personal objectives, which can diverge from the goals of the principals (Padilla, 2000).

Despite its widespread use, agency theory has received criticism, particularly in the context of accounting and corporate governance. Critics argue that the theory oversimplifies the complexities of organizational relationships by focusing too heavily on conflict and opportunism, potentially normalizing behavior that undermines good governance. Segrestin and Hatchuel (2011) contend that the theory's assumptions about human behavior—such as the notion that agents act exclusively in their own self-interest or are inherently opportunistic—fail to capture the full spectrum of motivations and ethical considerations that influence managerial decisions. These simplified premises are useful for creating mathematical models of agency relationships but are often unrealistic when applied to actual human behavior and decision-making in organizations.

A significant implication of agency theory in practice is that managers may be incentivized to manipulate financial statements or engage in creative accounting to make the firm appear more profitable, meet performance targets tied to bonuses or stock options, or satisfy external stakeholders' expectations. Such practices raise concerns about the transparency, reliability, and accuracy of financial reporting, highlighting the need for robust monitoring, auditing, and corporate governance mechanisms to ensure that agents act in alignment with the principals' objectives. Overall, agency theory provides a critical framework for understanding the dynamics of principal-agent relationships, the potential for conflicts of interest, and the mechanisms necessary to mitigate risks associated with asymmetries of information in business organizations.

### **2.2.2 Legitimacy Theory**

Legitimacy Theory was first formally articulated by Suchman (1995), although its conceptual roots trace back to earlier sociological and organizational studies on social contract and institutional theory. The theory has evolved over time to emphasize that organizations operate within a broader social framework and must maintain approval and acceptance from

stakeholders to ensure long-term survival. Initially applied in organizational sociology, the theory has since been widely adopted in accounting, finance, and corporate governance literature to explain why firms adopt specific reporting behaviors, including environmental, social, and financial disclosures. Researchers such as Deegan (2002) further developed the theory in the accounting context, arguing that organizations strategically use reporting practices to demonstrate conformity with societal expectations, regulations, and norms.

Legitimacy Theory posits that organizations continuously seek to legitimize their existence and operations by conforming to societal norms, rules, and expectations. Firms are perceived to hold legitimacy when their actions align with the values and beliefs of the society or the specific stakeholder groups they engage with. Legitimacy is considered a vital resource: without societal acceptance, organizations may face reputational damage, loss of investor confidence, regulatory penalties, or reduced access to resources. In accounting, this theory explains why companies voluntarily disclose information or adopt specific reporting practices to demonstrate compliance, accountability, and responsible governance to stakeholders (Suchman, 1995; Deegan, 2002).

For small and medium-sized enterprises (SMEs) in Nairobi, creative accounting practices can be interpreted through Legitimacy Theory. Firms may adopt particular financial reporting practices to maintain legitimacy in the eyes of tax authorities, investors, creditors, and other stakeholders. Examples include timely and accurate tax filings, clear presentation of financial statements, and adherence to statutory accounting standards. By doing so, organizations signal compliance, transparency, and financial stability, which are essential for continued stakeholder support. However, some firms may engage in aggressive practices such as income smoothing, off-balance-sheet financing, or selective expense recognition to enhance the perception of legitimacy. While these practices may temporarily satisfy stakeholder

expectations, they raise ethical concerns and could negatively affect compliance behavior over time (Mutua & Wambua, 2022; Gitonga, Mwangi, & Njoroge, 2023).

Despite its widespread use, Legitimacy Theory has been critiqued for several reasons. First, the theory is sometimes considered overly descriptive and lacks predictive power, making it difficult to quantify legitimacy or measure its impact empirically. Second, it tends to assume that organizations are rational actors focused primarily on gaining social approval, potentially underestimating other strategic, economic, or political motivations. Third, the theory does not always differentiate between legitimate and unethical actions, which can normalize aggressive or opportunistic accounting practices if they enhance social acceptance. Finally, critics argue that legitimacy is context-dependent and highly subjective, making generalizations across different industries or cultural settings challenging (Deegan, 2002; Suchman, 1995).

In the context of this study on procurement management practices and service delivery at Safaricom, Legitimacy Theory provides a useful lens for understanding why organizations adhere to procurement policies, maintain supplier quality standards, and implement robust contract management. By complying with established procedures and regulatory requirements, Safaricom not only ensures operational efficiency but also maintains legitimacy in the eyes of regulators, customers, and other stakeholders. Procurement practices that are transparent, standardized, and compliant signal organizational responsibility and ethical governance, which in turn enhances service delivery and stakeholder confidence. Thus, Legitimacy Theory helps explain the strategic and social motivations behind Safaricom's adoption of procurement management practices and their impact on service delivery outcomes.

### **2.2.3 Theory of Planned Behavior**

The Theory of Planned Behavior (TPB) was first formally proposed by Icek Ajzen in 1985 as an extension of the earlier Theory of Reasoned Action (Ajzen & Fishbein, 1980). The theory

was developed to address limitations of the previous model, particularly its inability to account for behaviors over which individuals do not have complete volitional control. Over time, TPB has been widely applied in psychology, organizational behavior, health, and accounting to explain, predict, and influence human behavior (Ajzen, 1991; Fishbein & Ajzen, 2010).

TPB posits that human behavior is primarily guided by behavioral intentions, which are influenced by three key determinants: attitude toward the behavior, subjective norms, and perceived behavioral control (Ajzen, 1991). Attitude toward the behavior reflects an individual's evaluation of a particular action as favorable or unfavorable. In the context of SMEs in Nairobi County, a business owner's attitude toward creative accounting practices—such as income smoothing, accelerated depreciation, or off-balance-sheet financing—may determine whether they are inclined to engage in these practices to reduce tax liability or improve financial appearance (Gitonga, Mwangi, & Njoroge, 2023).

Subjective norms capture the perceived social pressure from stakeholders, including peers, tax authorities, investors, and accountants, to perform or avoid certain behaviors (Ajzen, 1991; Mutua & Wambua, 2022). For example, SMEs may be influenced by the perceived practices of other firms, recommendations from tax advisors, or expectations from regulatory bodies, which can encourage or discourage engagement in creative accounting. Perceived behavioral control refers to the individual's perception of their ability to carry out a behavior successfully, considering available resources, knowledge, and constraints (Ajzen, 2002). SME owners who feel confident in understanding and applying creative accounting techniques—and who perceive the risks of detection or penalties as manageable—are more likely to implement these practices.

Behavioral intentions, shaped by attitudes, subjective norms, and perceived behavioral control, serve as the immediate precursor to actual behavior. In this context, the intention to

adopt creative accounting practices influences the likelihood of actual implementation, which in turn affects the level of tax compliance (Ajzen, 1991; Fishbein & Ajzen, 2010). TPB thus provides a useful framework for understanding the decision-making processes behind SMEs' engagement in creative accounting, highlighting the psychological and social factors that shape compliance behavior.

Despite its usefulness, TPB has been critiqued for assuming rational decision-making, potentially overlooking habitual, emotional, or opportunistic behavior (Conner & Armitage, 1998). It also focuses primarily on individual-level determinants, which may not fully account for broader organizational, economic, or regulatory factors influencing SMEs' tax compliance decisions. Additionally, measuring subjective norms and perceived behavioral control in small business contexts can be challenging, given the diversity in resources, experience, and awareness of tax laws (Ajzen, 2002).

In relation to this study, TPB helps explain how SME owners' attitudes toward creative accounting, the influence of social norms, and their perceived ability to manage accounting strategies affect tax compliance in Nairobi County. For example, SMEs with positive attitudes toward minimizing taxable income through income smoothing or off-balance-sheet financing, influenced by peer practices and confident in their knowledge of tax laws, may be more likely to adopt such strategies (Gitonga, Mwangi, & Njoroge, 2023; Mutua & Wambua, 2022). Understanding these behavioral determinants allows policymakers, regulators, and tax authorities to design interventions—such as training programs, awareness campaigns, and monitoring mechanisms—that enhance financial literacy, reinforce positive compliance norms, and reduce the propensity for aggressive accounting practices. Consequently, TPB provides both a theoretical and practical foundation for examining the interplay between creative accounting practices and tax compliance among SMEs in Nairobi County.

#### **2.2.4 Deterrence Theory**

Deterrence Theory was first proposed by Allingham and Sandmo (1972) to explain taxpayer behavior as a rational decision-making process. The theory argues that individuals and firms decide whether to comply with tax obligations by weighing the benefits of evasion against the potential costs, including the probability of detection and severity of penalties. In essence, taxpayers are assumed to act rationally to maximize their utility, and the fear of sanctions serves as a key motivator for compliance. This foundational concept has been widely applied in tax research to model how enforcement measures influence compliance rates across different economic and institutional contexts.

Over time, Deterrence Theory has evolved to incorporate behavioral and contextual factors beyond simple economic calculations. Researchers such as Alm, Jackson, and McKee (1992) and Kirchler (2007) extended the theory to include the influence of social norms, moral obligations, and perceived fairness in the tax system. These developments acknowledge that while economic incentives are important, taxpayer decisions are also shaped by attitudes, ethical considerations, and the perceived legitimacy of authorities. This evolution has improved the explanatory power of the theory, particularly in environments where enforcement mechanisms are not uniform or penalties are inconsistently applied.

Despite its widespread use, Deterrence Theory has been subject to criticism. One major critique is that it overemphasizes rationality and underestimates the role of behavioral, cultural, and institutional factors in shaping compliance (Feld & Frey, 2007). In the context of SMEs in developing economies, where audit coverage may be limited and penalties are inconsistently applied, the expected cost of non-compliance may be perceived as low, reducing the practical deterrent effect. Furthermore, the theory may not fully explain voluntary compliance motivated by ethical or social considerations, highlighting the need to complement it with behavioral frameworks when analyzing taxpayer behavior.

For the purposes of this study, Deterrence Theory provides a useful lens to examine how enforcement, penalties, and audit probabilities influence SMEs' use of creative accounting practices. Specifically, income smoothing, accelerated depreciation, and off-balance-sheet financing can be viewed as strategic responses to minimize taxable income while managing the risk of detection. The theory helps explain why SMEs may balance aggressive accounting practices with compliance, depending on their perception of the likelihood of audits and potential penalties imposed by the Kenya Revenue Authority. It anchors the study in a legalistic and rational framework, allowing the researcher to link financial decision-making directly to tax compliance outcomes.

Overall, Deterrence Theory establishes a foundation for analyzing SME tax behavior by integrating risk assessment, financial incentives, and regulatory enforcement into the decision-making process. It clarifies why certain creative accounting techniques may emerge as tools to optimize tax obligations while avoiding penalties, especially in contexts where enforcement capacity is limited. By using this theory, the study can identify the mechanisms through which regulatory frameworks, audit frequency, and penalty structures influence compliance, providing insights into effective policy and administrative interventions to enhance voluntary adherence to tax regulations among SMEs.

### **2.3 Empirical Review**

The empirical review will focus on different researches done by other researchers concerning the income smoothing, accelerated depreciation, off-balance sheet financing, and tax compliance.

#### **2.3.1 Income Smoothing and Tax Compliance**

Globally, Francis, LaFond, Olsson, and Schipper (2014) conducted a quantitative analysis of 150 publicly listed firms in the United States to examine the relationship between income smoothing and tax compliance. Using archival financial data and regression analysis, their

study found that firms that employed income smoothing to stabilize reported earnings were able to strategically reduce taxable income volatility, thereby optimizing tax obligations. The authors noted that while income smoothing could enhance investor confidence and reduce perceived risk, it also had the potential to obscure long-term performance trends, creating challenges for regulatory oversight.

Similarly, Akbari, Salehi, and Bagherpour Vlashani (2018) investigated 100 firms listed on the Tehran Stock Exchange and over-the-counter markets, categorizing them as income smoothers or non-smoothers. They found a positive association between managerial discretion in earnings reporting and tax avoidance behaviors, highlighting the direct link between strategic earnings management and compliance outcomes.

Erianto and Fardinal (2024) extended this evidence to 120 Indonesian manufacturing firms between 2016 and 2020, using panel data analysis, and reported that income smoothing significantly influenced tax avoidance, particularly when combined with dividend distribution strategies, indicating that managerial choices in financial reporting are critical determinants of compliance.

At the regional level, Bao and Bao (2012) analyzed 90 firms across Southeast Asia and demonstrated that income smoothing via reallocation of revenues and expenses between reporting periods significantly reduced fluctuations in reported profits, allowing managers to influence perceived firm stability and optimize tax positions. Sahiti (2017) employed longitudinal data from 75 small and medium enterprises in Kosovo and found that consistent earnings management practices enabled firms to signal financial stability to both investors and tax authorities while minimizing taxable liabilities.

Chhabra (2016) examined 80 Indian SMEs and showed that income smoothing strategies were adopted both for ethical financial planning and opportunistic tax optimization,

indicating that managerial motives significantly affect compliance behavior. These regional studies collectively suggest that the adoption of income smoothing is a common strategy to influence perceived financial performance and manage tax obligations, especially in markets where regulatory enforcement is moderate.

Locally, Muriuki and Kihoro (2020) conducted a survey of 120 SMEs in Nairobi County, using structured questionnaires and KRA tax records, and found that income smoothing was frequently applied to stabilize profits reported to tax authorities, banks, and investors, thereby influencing compliance outcomes.

Waweru (2021) studied 100 SMEs in Nairobi using interviews and document analysis and reported that firms employing aggressive smoothing techniques occasionally attracted audits or penalties, suggesting a complex relationship between financial reporting strategies and regulatory compliance.

Njogu (2019) analyzed 90 SMEs in Kisumu County and found that income smoothing often correlated with lower reported taxable income, but the lack of robust internal controls increased the risk of non-compliance detection. These local findings indicate that income smoothing is both a tactical tool for SMEs to manage financial perceptions and a potential driver of regulatory scrutiny, highlighting the importance of financial literacy programs and oversight mechanisms to mitigate associated risks.

Collectively, the empirical evidence demonstrates that income smoothing plays a dual role in SME tax compliance: it can facilitate operational and financial stability in the short term, but excessive or aggressive application may compromise transparency, ethical reporting, and adherence to statutory obligations. Understanding its prevalence, drivers, and impact is therefore critical for policymakers, tax authorities, and financial managers aiming to improve compliance and support sustainable SME growth.

### **2.3.2 Accelerated Depreciation and Tax Compliance**

Globally, Zeng, Dai, and Chan (2023) employed a difference-in-differences approach to examine the effects of accelerated depreciation policies on firm behavior in China. Their study revealed that accelerated depreciation significantly increased labor demand, particularly among small enterprises, non-state-owned firms, and high-growth companies. The authors noted that early capital recovery through accelerated depreciation not only reduced taxable income but also alleviated financial constraints, promoting reinvestment and operational expansion.

Similarly, Dobrovolsky (2021) conducted a cross-country analysis of publicly listed firms in Europe and found that firms adopting accelerated depreciation consistently reported lower initial taxable profits, indicating the strategic use of asset write-offs to optimize cash flows. Goode (2015) further supported this evidence through a survey of 120 multinational corporations, demonstrating that accelerated depreciation was a commonly employed tool to balance tax minimization with financial statement objectives, though the aggressive application sometimes drew regulatory scrutiny.

At the regional level, Sanusi and Izedonmi (2014) investigated 42 senior managers and 42 accountants across 21 consolidated commercial banks in Lagos State, Nigeria, focusing on creative accounting practices including accelerated depreciation. Their findings revealed that banks frequently leveraged accelerated depreciation to enhance perceived market value, with the practice influencing both financial reporting quality and stakeholder perceptions.

Similarly, Adedoyin and Oladipo (2019) conducted a mixed-methods study of 60 SMEs in Lagos, examining the adoption of depreciation policies for tax planning purposes. The study indicated that SMEs using accelerated depreciation improved cash flows and investment capacity but faced increased exposure to audits, highlighting a trade-off between tax benefits and compliance risk. In Ghana, Mensah and Owusu (2021) surveyed 50 manufacturing firms

and reported that accelerated depreciation was applied strategically to manage taxable income, with firms showing higher reinvestment rates in capital assets, reinforcing its dual role as a tax planning tool and operational enabler.

Locally, Kamau, Mutiso, and Ngui (2012) explored creative accounting and tax avoidance strategies among private sector firms in Kenya, surveying 36 accountants across various companies. Their study found that accelerated depreciation was widely applied to reduce taxable income, demonstrating a deliberate use of accounting policies to achieve tax efficiency while remaining within legal bounds. Muriuki and Kihoro (2020) examined 80 SMEs in Nairobi County using structured questionnaires and tax records, revealing that firms applying accelerated depreciation reported improved short-term cash flows but occasionally attracted scrutiny from KRA auditors. Njogu (2019) extended this evidence through interviews with 70 SME owners and accountants, showing that the aggressive adoption of accelerated depreciation could inadvertently trigger compliance risks, including penalties and reputational damage, highlighting the need for balanced application and transparency.

The empirical evidence from global, regional, and local studies collectively indicates that accelerated depreciation functions both as a financial management and tax compliance instrument. While it allows SMEs to optimize cash flows, reinvest in assets, and reduce taxable income in the short term, aggressive or poorly disclosed application may increase regulatory scrutiny, creating potential compliance risks. Understanding how SMEs in Nairobi County adopt accelerated depreciation is therefore crucial for policymakers and tax authorities aiming to foster voluntary compliance, support business growth, and maintain transparency in financial reporting.

### **2.3.3 Off Balance Sheet Financing and Tax Compliance**

Al-Khoury, Al-Shattarat, Alghazzawi, and Haddad (2023) investigated the influence of innovative accounting procedures on the reliability of financial reporting in Jordanian commercial banks. It emphasizes the application of novel accounting methods and deceptive practices utilized by companies to misrepresent accounting information, consequently affecting the assessments of financial statement users. The study seeks to examine the impact of these procedures on the dependability of financial reporting in Jordanian commercial banks. A questionnaire will be created and disseminated to senior and middle management, as well as employees in Jordanian commercial banks, yielding 51 valid replies from 80 participants. The results indicate that off-balance-sheet funding adversely affects the credibility of financial reports in Jordanian commercial banks. The report recommends that regulatory authorities in Jordan implement procedures to identify and mitigate creative accounting practices in financial statements, as well as establish punitive regulations with penalties for individuals employing detrimental creative accounting strategies.

Nangih (2017) empirically investigated the impact of innovative accounting procedures on the quality of financial statements of oil servicing firms in Nigeria. To fulfill the study's objective, three hypotheses were articulated as follows: There exists no significant correlation between aggressive earnings management and the relevance/verification of financial statements; there exists no significant correlation between unjustified alterations in accounting policies and estimates and the comparability/understandability of financial statements; and there exists no significant correlation between profit smoothing and the objectivity/faithful representation of financial statements. The study employed a survey research design. Data were acquired using a well-structured and tested questionnaire and analyzed employing the ordinary least squares regression technique. The findings indicated that creative accounting procedures,

including off-balance-sheet financing, employed by oil servicing companies adversely affected the accuracy of their financial statements.

Shahid and Ali (2016) examine the factors that promote the adoption of creative accounting practices, such as the agency problem, corporate governance, ethical values of the company, and future orientation, as well as the impact of these practices on the reliability and objectivity of financial reporting. This research is empirical, with data obtained from accounting and management professionals in the manufacturing business of Punjab through a standardized questionnaire. Convenience sampling will be employed to determine the sample size, and SPSS software will be utilized for data analysis. The findings of this research examined the positive correlation between agency problems and creative accounting practices, such as off-balance-sheet financing, while corporate governance, ethical values of the company, and future orientation of the organization exert a negative influence on creative accounting. Creative accounting is confirmed to have a substantial detrimental effect on the credibility and impartiality of financial reporting.

Nyabuti, Memba, and Chege (2016) assessed the impact of innovative accounting procedures on the financial performance of publicly traded companies on the Nairobi Securities Exchange in Kenya. This study examined tax avoidance, accelerated depreciation, and income smoothing as significant creative accounting practices affecting the financial performance of public limited companies listed on the Nairobi Securities Exchange in Kenya. The study employed both descriptive and inferential statistics to analyze the principal practices of creative accounting that affect the financial performance of public companies listed on the Nairobi Securities Exchange in Kenya. The target demographic of this study comprised the top management of public limited firms, specifically the CEO, directors, senior managers, and accountants. A sample of 30 public enterprises will be selected by purposive sampling. The logistic linear regression technique will be employed to examine the association between

creative accounting procedures and financial performance, as well as the correlation between these variables and financial performance. A quantitative methodology utilizing questionnaires will be employed to facilitate the collection of primary data for analytical purposes. The secondary data will be obtained from the NSE handbook, pertinent textbooks, finance periodicals, financial statements, and the websites of the sampled public limited businesses. The study identified a significant correlation between creative accounting strategies, such as off-balance-sheet financing, and financial performance.

Blazek (2021) examined creative accounting as a universal instrument for tax optimization. Analytical models were available to identify various methods of accounting fraud. Focus will be directed on the analytical frameworks of the Beneish model and the Modified Jones model. The primary aim of employing these models is to uncover innovative accounting practices in Sector A - Agriculture, Forestry, and Fishing. Fraud is examined by advanced analytical techniques that uncover enhanced data. The models indicated that several surveyed enterprises engage in account manipulation via off-balance-sheet funding, which reflects poorly on businesses and individuals in the industry.

#### **2.4 Summary of Literature and Research Gaps**

The studied literature indicates a substantial body of information regarding creative accounting and its potential impact on tax compliance. Peterson and Arun (2018) note that income smoothing among banks is an endeavor to mislead stakeholders by showcasing more stable earnings over time, whereas Dahliwal et al. (2022) contend that the decline in research on depreciation method selection may stem from the belief that depreciation is merely an accounting matter, with the implications of various methods being apparent and well comprehended. However, these two studies were conducted solely on SMEs, resulting in a contextual gap. This study aims to address the gap by examining creative accounting practices among SMEs.

Kamau, Mutiso, & Ngui (2012) demonstrated that tax avoidance and evasion are significant contributors to the practice of creative accounting among private sector companies in Kenya. In contrast, Zeng, Dai, and Chan (2023) indicated that the ADP substantially enhances employment, aligning with the output effect hypothesis, as it boosts firms' labor demand primarily by stimulating investment in fixed assets and alleviating financial constraints.

Further analysis indicates that the influence of ADP on employment is particularly pronounced among small enterprises, non-state-owned entities, high-growth firms, and skilled labor employment, suggesting that ADP is more efficacious for firms facing significant financial constraints and seeking to hire skilled labor in conjunction with increased capital investment. The two studies did not definitively demonstrate the impact of creative accounting on tax compliance; for instance, Kamau, Mutiso, and Ngui (2012) just indicated that tax avoidance and evasion are significant contributors to the practice of creative accounting. This investigation will address existing empirical gaps.

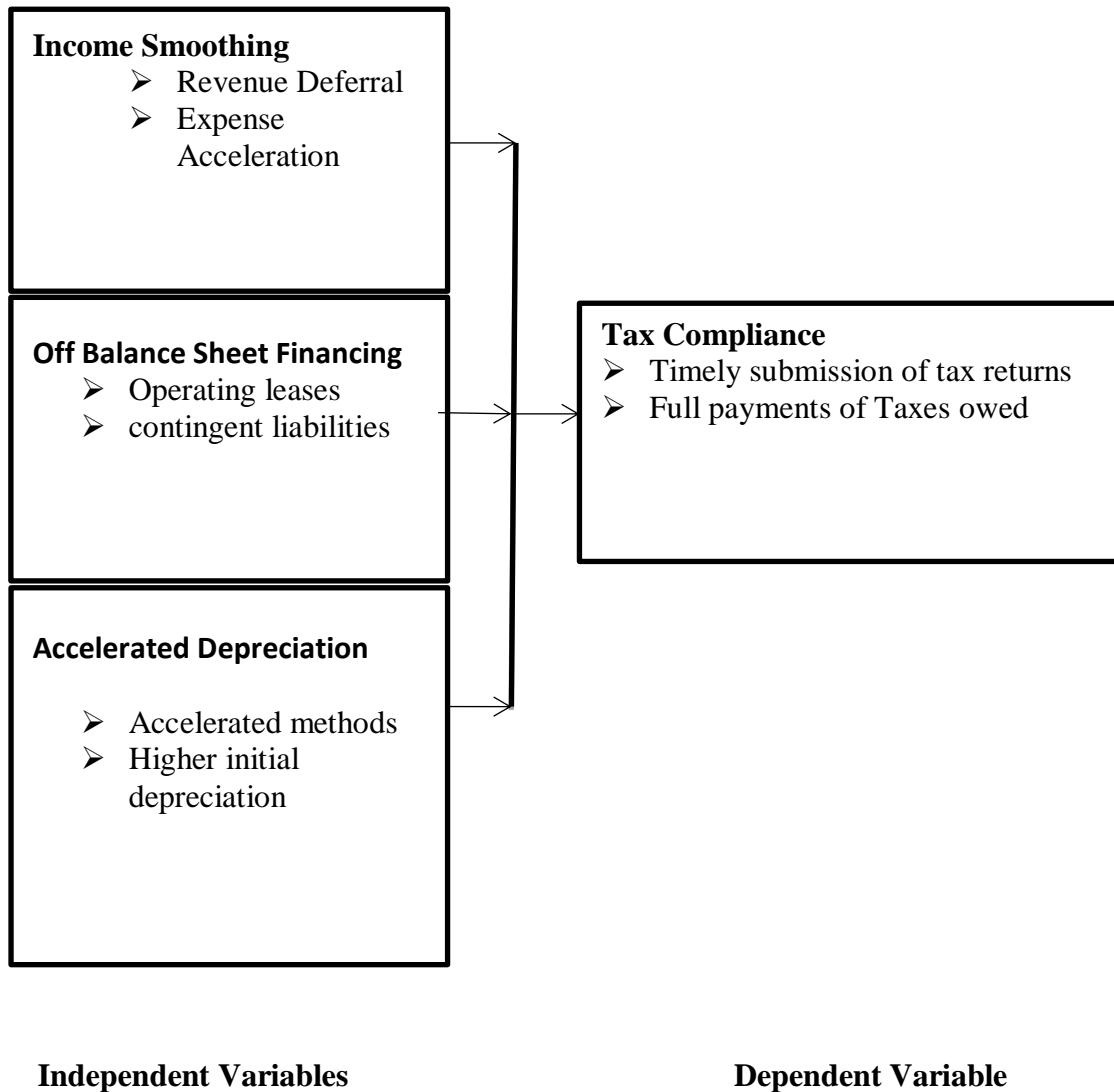
Finally, Al-Khoury, Al-Shattarat, Alghazzawi, and Haddad (2023) demonstrate a detrimental effect of off-balance-sheet financing on the credibility of financial reports in Jordanian commercial banks, whereas Nangih (2017) indicates that creative accounting practices (off-balance-sheet financing) adversely affected the quality of financial statements of oil servicing companies in Nigeria. Furthermore, Nyabuti, Memba, and Chege (2016) identified a robust correlation between innovative accounting strategies, such as off-balance-sheet financing, and financial performance. This research did not associate creative accounting with tax compliance, resulting in a conceptual gap.

## **2.5 Conceptual Framework**

A conceptual framework is an assemblage of ideas and concepts along with the anticipated links between them. Creswell (2014) defines a conceptual framework as a diagrammatic

depiction of interconnected concepts, ideas, and principles that collectively offer a thorough comprehension of a phenomena. Figure 1 illustrates the proposed correlation between the independent variables and dependent variable.

**FIGURE 1**  
**Conceptual Framework**



### 2.6 Operationalization and Measurements of Study Variables

Operationalization means turning abstract concepts into measurable observations (Inguane, Gallego-Ayala, & Juárez, 2013). The variables of concern in the proposed research income smoothing, off balance sheet financing and accelerated depreciation and how they relate to tax compliance. These variables cannot be directly measured hence the need to identify measurable

indicators to take the place of the variables. The measurements of the variables were done by the 5-point Likert Scale.

**TABLE 1**  
**Operationalization and measurements of variables**

Variables	Indicators	Measure	Model
<b>Income Smoothing</b>	<ul style="list-style-type: none"> <li>➤ Revenue Deferral</li> <li>➤ Expense Acceleration</li> </ul>	5-point Likert scale	Multiple regression analysis
<b>Off Balance Sheet Financing</b>	<ul style="list-style-type: none"> <li>➤ Operating leases</li> <li>➤ contingent liabilities</li> </ul>	5-point Likert scale	Multiple regression analysis
<b>Accelerated Depreciation</b>	<ul style="list-style-type: none"> <li>➤ Accelerated methods</li> <li>➤ Higher initial depreciation</li> </ul>	5-point Likert scale	Multiple regression analysis
<b>Tax Compliance</b>	<ul style="list-style-type: none"> <li>➤ Tax Payment</li> <li>➤ Registration</li> <li>➤ Tax Filing</li> </ul>	5-point Likert scale	Multiple regression analysis

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Kothari (2019) defined research methodology as the systematic approach and techniques employed to identify, collect, and analyze appropriate research material. This section explained the specific research methods that were used to address the research questions presented in Chapter One. The methodology for this study included the research design, target population, sampling design, data collection methods, and data analysis procedures. Each component was carefully selected to ensure that the study produced reliable, valid, and relevant findings.

#### **3.2 Research Design**

Cooper and Schindler (2018) defined research design as the strategy utilized to answer research questions. It provided researchers with a structured procedure to effectively address their study objectives. This study adopted a descriptive research design. According to Mugenda and Mugenda (2003), a descriptive research design sought to uncover factors affecting specific occurrences, outcomes, conditions, or behavioral trends. The descriptive research design was deemed appropriate for this study because it allowed the researcher to systematically describe the characteristics of the phenomena under investigation, specifically the effect of creative accounting on the tax compliance of SMEs in Nairobi County, Kenya. This design facilitated the collection of detailed and accurate information from respondents, enabling the study to identify patterns, relationships, and variations in tax compliance behavior. Moreover, it provided a clear snapshot of the current situation without manipulating variables, which was essential for understanding the real-world practices and challenges faced by SMEs regarding creative accounting and tax compliance.

#### **3.3 Target Population**

According to Kothari (2019), target population is the entire group of individuals or entities that a researcher intended to study and draw conclusions about. It represented the larger population

from which a sample was drawn for analysis. For this study, the target population comprised all 1,364 registered Small and Medium Enterprises (SMEs) operating in Nairobi City County, as obtained from the Kenya National Bureau of Statistics (KNBS, 2024). The respondents included the owners or managers of these SMEs, as they were directly responsible for financial management and tax reporting within the enterprises. To ensure representativeness, the SMEs were stratified according to sector type, size, and ownership structure. The distribution of the target population across these strata is presented in the table below.

**TABLE 2**  
**Target Population**

Sector of economy	Number of SMEs in the sector
Tourism and Hospitality	350
Health Services	155
Agriculture	170
Retailers and Wholesalers	580
Transport and Telecommunications	84
Manufacturing	25
<b>Total</b>	<b>1,364</b>

Source: (KNBS, 2024)

### **3.4 Sampling Frame**

A sampling frame “a list of all the elements in the population from which a sample can be drawn” (Kothari, 2019). It served as the source that ensured every member of the target population had a known and non-zero chance of selection, which was critical for obtaining a representative and unbiased sample. An official list of registered SMEs was obtained from

credible sources, including the Nairobi City County business registry, Kenya Revenue Authority (KRA) records, and recognized SME associations. Selected SMEs were formally contacted through email, phone calls, or introduction letters via SME associations, providing clear information about the study's purpose, procedures, and voluntary nature. Written or electronic informed consent was obtained prior to data collection, and participants were assured of confidentiality and anonymity. Follow-ups were conducted to address questions and to schedule data collection at the convenience of the SMEs, ensuring transparency and ethical compliance throughout the recruitment process.

### **3.4.1 Sample Size**

Cooper and Schindler (2018) defined sample size as the number of individuals or businesses selected from a target population to participate in a research study. It represented a subset of the total population and was used to draw conclusions about the entire target population. This study utilized Slovin's formula to compute the appropriate sample size. In order to determine the sample size ( $n$ ), the formula was applied using the population size ( $N$ ) and a chosen margin of error ( $\epsilon$ ), as shown below;  $n = \frac{N}{1+NE^2}$  where  $n$  = number of samples,  $N$  = target population, and  $E$  = margin of error (0.05). Thus,  $n = \frac{1364}{1+1364*0.05^2} = 309$ .

### **3.4.2 Sampling Technique**

A sampling technique is a method used to select a sample from a target population for research purposes. It determines how individuals or businesses are chosen to represent the entire population (Kothari, 2019). This study used a stratified sampling technique to select a sample of 309 SMEs in Nairobi County. Stratified sampling is a probability sampling method in which the population is divided into distinct strata based on shared characteristics, and a sample is drawn from each stratum proportionally. This method ensured that all important groups within the population were adequately represented in the sample (Creswell, 2018). The samples drawn from each stratum proportionally are presented in the table below.

**TABLE 3**  
**Sample size**

<b>Sector of economy</b>	<b>Sample Size</b>
Tourism and Hospitality	79
Health Services	35
Agriculture	39
Retailers and Wholesalers	134
Transport and Telecommunications	18
Manufacturing	4

**Source: Author, (2025)**

### **3.5 Data Collection Instruments**

According to Lovell, Depledge, and Maxwell (2018), it was crucial for the researcher to explicitly identify the major method(s) used to gather information from study participants. A structured questionnaire was employed to collect primary data from the 309 SMEs in Nairobi County. Mellenbergh (2018) noted that questionnaires could be categorized into three types: structured, unstructured, and semi-structured. A structured questionnaire consisted of a predefined set of questions with fixed response options, allowing for standardized data collection that was efficient and easy to analyze and compare (Mellenbergh, 2018).

To ensure a more accurate analysis, the study focused on responses to closed-ended questions. Krosnick (2018) argued that open-ended questions increased study costs, presented challenges in interpretation, and required respondents to devote more time to answering. The closed-ended questions in this study were based on a five-point Likert scale, ranging from "strongly agree = 5" to "strongly disagree = 1." Compared to other primary data collection

methods, questionnaires offered several advantages, including effective data collection, minimal budgetary constraints, and an increased level of objectivity.

### **3.6 Pilot Study**

A pilot study, also referred to as a pilot project, was an initial investigation carried out on a small scale to evaluate the feasibility, duration, costs, potential adverse effects, and to improve the research design prior to undertaking a full-scale study (Lewis, Bromley, Sutton, McCray, Myers & Lancaster, 2021). In research, it was common practice to conduct a pilot study as a preliminary phase involving a smaller-scale investigation.

The primary purpose of the pilot study was to facilitate the arrangement and refinement of the main research. It provided an opportunity to identify and address potential challenges, ensuring that the full-scale study could be adjusted if necessary. For this study, a pilot study was conducted on a sample of 20 SMEs located in Thika Town, Kiambu County, to test the research instruments and procedures before the main data collection. The feedback and findings from the pilot study were used to revise and improve the questionnaire, clarify ambiguous questions, and ensure that the data collection process was efficient and reliable for the main study.

### **3.7 Reliability of Data Collection Instrument**

According to Cooper and Schindler (2019), the term "reliability" of an instrument described the degree to which a research instrument remained capable of producing consistent findings or data even after being used several times. The degree to which a test was reliable, consistent, or trustworthy was referred to as the instrument's dependability. To evaluate the internal consistency of the various components of the research apparatus, the Cronbach's Coefficient Alpha approach was utilized. Cronbach's Coefficient Alpha is a statistic used in descriptive research to assess the internal consistency of a scale, in accordance with the recommendations made by Cohen, Manion, and Morrison (2007). The Statistical Package for the Social Sciences

(SPSS) Version 24 was used to compute Cronbach's Alpha. A Cronbach's Alpha value of  $\geq 0.70$  was generally considered acceptable for social sciences research.

### **3.8 Validity of Data Collection Instrument**

According to Kothari (2019), validity was defined as the degree to which an instrument accurately assessed the notion that the instrument was designed to measure. Construct validity, criterion validity, and content validity were the three distinct categories considered when analyzing validity. To determine whether a test was valid, it was necessary to evaluate it by contrasting it with other measurements or outcomes previously recognized as legitimate. Construct validity referred to the degree to which practical tests based on a theory accurately measured a construct in accordance with the definition of that theory. Content validity was a method used to evaluate the precision of a test by conducting a comprehensive examination of the test's content to ensure it accurately captured the entire range of behaviors being examined.

Content validity did not require statistical analysis but involved a thorough review of the examination content to determine whether it effectively depicted the full range of behaviors intended for investigation. This study utilized content validity, which referred to the degree to which a measuring instrument effectively encompassed the subject area being investigated. Meetings and discussions were held with the supervisor to enhance content validity, thereby increasing the accuracy and efficacy of the research instruments.

### **3.9 Data Collection Procedure**

After obtaining written consent from both KCA University and NACOSTI, primary data were collected from the 309 SMEs in Nairobi County using a structured questionnaire. The questionnaires were distributed to the owners or managers of each of the 309 SMEs using the drop-and-pick-later method to accommodate the respondents' hectic schedules. The completed questionnaires were collected from the respondents after three days.

### **3.10 Data Analysis and Presentation**

Data analysis involved inspecting, cleaning, coding, and interpreting the collected data to extract meaningful insights. This process entailed organizing raw data into useful information that addressed the research questions (Meta, 2014). Upon completion of data collection, the researcher proceeded to the data purification phase, which involved identifying and correcting incomplete or inaccurate responses to enhance overall data quality. Shamo and Resnik (2016) noted that various analytical methods could be employed to draw inductive inferences and distinguish genuine phenomena from random variations in data.

For the analysis, the data were coded and entered into a computer database. The coded data were analyzed using descriptive statistics, correlation analysis, and multiple regression analysis with the aid of the Statistical Package for Social Sciences (SPSS). The regression model examined the effect of income smoothing, accelerated depreciation, and off-balance sheet financing on tax compliance. The multiple regression analysis model employed in this study was specified as follows:  $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$  where  $Y$  = Tax compliance,  $X_1$  = Income smoothing,  $X_2$  = Accelerated depreciation,  $X_3$  = Off balance sheet financing,  $\beta_0$  = Constant term,  $\beta_1$  = regression coefficients for  $X_1$ ,  $\beta_2$  = regression coefficients for  $X_2$ ,  $\beta_3$  = regression coefficients for  $X_3$ , and  $\varepsilon$  = Error term. The results of the analysis were presented using tables, charts, and graphs.

### **3.11 Diagnostic Tests**

Diagnostic tests were statistical procedures used to assess the suitability, reliability, and validity of the dataset used for analysis. These tests helped determine whether the data met the necessary assumptions for producing accurate and meaningful results in statistical modeling (Glasser, 2014). Rommel (2013) contended that diagnostic tests were specifically designed to detect different forms of biases or predispositions that could arise in a study aimed at evaluating accuracy. The objective of the assumption tests was to determine whether the researcher could

proceed with the regression model for the study. Several key assumptions were analyzed, regardless of their presence, to ensure the validity and robustness of the results.

### **3.11.1 Normality Test**

This test examined whether the error terms, or residuals, followed a normal distribution, which was a requirement for valid hypothesis testing. McInnes (2018) stated that a normality test was employed to determine whether the sample data originated from a population that adhered to a normal distribution. In this study, the Shapiro-Wilk statistic was used to conduct the normality test. Priyatno (2017) asserted that the decision criterion involved accepting the null hypothesis—that the data originated from a population with a normal distribution—if the significance level exceeded 0.05.

### **3.11.2 Multi-collinearity Test**

Multicollinearity denoted the presence of a substantial correlation among two or more predictor variables within a multiple regression model (Cohen, Manion, & Morrison, 2018). It occurred in multiple regression analysis when the predictor variables demonstrated considerable association with each other (Paul, 2016). The purpose of addressing multicollinearity was to understand the independent impact of each predictor variable on the dependent variable. Multicollinearity was considered a quantitative concept evaluated on a continuous scale, rather than as a binary classification. In this study, the Variance Inflation Factor (VIF) was employed to assess the presence of multicollinearity, with VIF values exceeding 10 indicating a significant multicollinearity problem.

### **3.11.3 Linearity Test**

Edwards (2015) defined linearity as a property of a mathematical relationship that could be graphically represented as a straight line. This property was typically evidenced in graphs illustrating correlations. Linearity referred to the characteristic of a relationship that could be

approximated or represented by a straight line. Linear regression employed the ordinary least squares (OLS) technique. The linearity test was a statistical procedure conducted during linear regression to determine whether the relationship between the dependent and independent variables was linear.

The objective of the linearity test was to ascertain the presence of a recognizable linear pattern in the data. Establishing the validity of the linearity assumption was essential following the execution of linear regression analysis. To evaluate the linearity assumption, the study examined the distribution of data between the dependent and independent variables. A scatter plot was used to analyze the data and determine the extent to which linearity existed in the relationship.

#### **3.11.4 Homoscedasticity Test**

Homoscedasticity denoted the principle that the variances of different groups under comparison were equal or comparable, indicating homogeneity of variances. This assumption was essential for parametric statistical tests, as such tests were highly sensitive to variations among participants. Tabachnick and Fidell (2017) defined residuals as the discrepancies between the actual scores of the dependent variable (DV) and the predicted values of the DV. The homoscedasticity assumption stated that the variance of residuals should remain constant across all predicted values. When this condition was met, the assumption was considered satisfied, and a scatter plot of the residuals typically displayed a nearly rectangular or random horizontal distribution. A violation of homoscedasticity occurred when there was a discernible pattern or clustering of scores in the scatter plot, indicating that the variance of residuals was not constant.

#### **3.12 Ethical Considerations**

The study observed strict ethical standards to ensure that all research activities were conducted responsibly and that data integrity was maintained. Adhering to these standards helped ensure

that the study's findings were accurate, credible, and well-founded (Quadri, 2018). All sources used in the literature review, including books and journals, were properly cited to maintain academic honesty. During data collection and analysis, the researcher took all necessary steps to ensure that the information presented authentically reflected the data obtained from the selected SMEs. A letter of introduction was obtained from BPS, and ethical approval was sought from NACOSTI prior to commencing the study. To protect participants from potential harm, all responses were anonymized, and the questionnaires were carefully designed to avoid leading or sensitive questions that could cause discomfort. Confidentiality was strictly maintained, with all personal and business-related information securely protected to ensure that no participant or organization could be identified.

Participation was entirely voluntary, and informed consent was obtained from all participants. Participants were provided with clear information regarding the purpose of the study, the potential risks and benefits of participation, and their right to withdraw at any time without penalty (Louis et al., 2011; Ary, 2010). The researcher ensured that all participants understood the study's objectives and procedures before providing consent. These measures collectively ensured that the research was conducted ethically, protected participants' rights and confidentiality, prevented potential harm, and enhanced the reliability and trustworthiness of the study's findings.

The research findings were shared with the participating SMEs and relevant stakeholders to ensure transparency and demonstrate respect for the community. Dissemination was conducted through workshops or seminars with SME owners and association representatives, summary reports highlighting key results and recommendations, and briefings via SME associations to reach a wider audience. These feedback mechanisms acknowledged participants' contributions, built trust, encouraged engagement with the research outcomes, and provided practical insights for improving SME operations and decision-making.

## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATION AND DISCUSSION

#### 4.1 Introduction

The section gives the results for pilot test study. After the pilot study's findings and the response rate were reported, some descriptive statistics were offered. As a first step, I used correlation analysis, then moved on to regression before concluding the topic with the discussion of the research findings.

#### 4.2 Pilot Test Result

Table 4 below gives the results for the reliability of research instrument based on pilot test done using five respondents randomly from 20 firms from Thika Town.

**TABLE 4**  
**Reliability Test results**

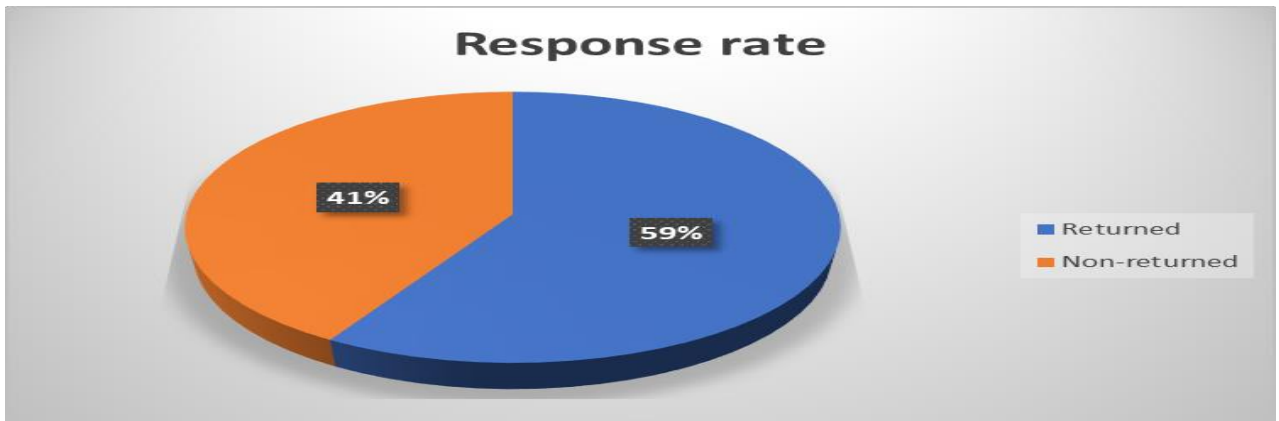
<b>Variable</b>	<b>Cronbach's Alpha</b>	<b>Number of Items</b>
Income Smoothing	.779	5
Accelerated Depreciation	.706	5
Off-Balance Sheet Financing	.848	5
Tax Compliance	.726	5

The results of the reliability test show that Income Smoothing, Accelerated Depreciation, Off-Balance Sheet Financing, and Tax Compliance each yielded Cronbach's alpha coefficients of 0.779, 0.706, 0.848, and 0.726 respectively, as shown in Table 4.1 above. Bryman (2008) proposed 0.7 as the minimum acceptable coefficient; thus, the questionnaire was deemed reliable.

#### 4.3 Response Rate

The researcher distributed a total 309 questionnaires to registered Small and Medium Enterprises (SMEs) operating in Nairobi City County and 181 were filled. The results are as shown in figure 4.2 below.

**FIGURE 2**  
**Response Rate**



From table 4.2 above, the questionnaire return rate was found to be 59%.

#### **4.4 Demographic information**

##### **4.4.1 Respondent's Gender**

To start with, the respondents were required to state their gender. The responses from the 181 respondents who fully filled and returned their questionnaires were analyzed and recorded in figure 3 below.

**FIGURE 3**  
**Respondent's Gender**

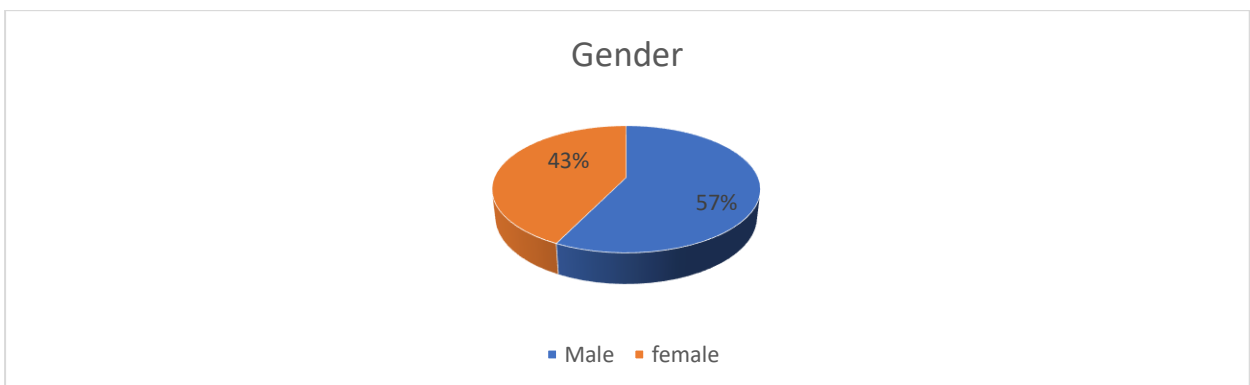


Figure 3 above indicated that 57% of the respondents were male while 43% were female. The study findings reveal a relatively balanced gender representation among respondents. Nonetheless, the results indicate that a larger proportion of investors in small and medium enterprises (SMEs) are male. In recent years, however, there has been a noticeable rise in

female participation within the SME sector, with women increasingly engaging in entrepreneurial activities and competing effectively with men. This positive trend may be linked to enhanced access to capital and business development support extended to women through government initiatives and non-governmental programs aimed at promoting gender inclusivity in enterprise development.

#### 4.3.2 Length of Service in the SME

The respondents were asked how long they have been working in the SME. The distribution of responses among 181 participants is shown below:

**TABLE 5**  
**Length of Service in the SME**

<b>Length of Service</b>	<b>Frequency</b>	<b>Percentage (%)</b>
Below 5 years	43	23.8
5 – 10 years	54	29.8
11 – 15 years	30	16.6
15 – 20 years	25	13.8
Above 20 years	29	16.0
<b>Total</b>	<b>181</b>	<b>100</b>

Most respondents (29.8%) reported working in the SME for 5 to 10 years, suggesting a workforce with moderate experience. About 23.8% have been with the SME for less than 5 years, indicating a fair number of relatively new employees. Those with over 15 years of experience (29.8%) represent a significant portion of the respondents, pointing to a mix of both new and experienced individuals.

#### 4.4.3 Position Held in the SME

The positions held by the 181 respondents are summarized in the table below:

**TABLE 6**  
**Position Held in the SME**

<b>Position</b>	<b>Frequency</b>	<b>Percentage (%)</b>
Business Owner	65	35.9
Finance Manager	38	21.0
Managing Director	26	14.4
Accountant	29	16.0
Others	23	12.7
<b>Total</b>	<b>181</b>	<b>100</b>

The majority of respondents (35.9%) are Business Owners, reflecting strong representation from leadership. Finance Managers and Accountants constitute 37% of respondents combined, indicating significant input from financial professionals. Managing Directors account for 14.4%, while other positions make up 12.7%, reflecting a variety of roles within the SMEs. Overall, capturing the position of respondents allowed the study to demystify how different roles perceive and enact financial reporting and tax compliance strategies. It highlights that tax compliance is not just a managerial or procedural concern but a collective organizational responsibility. Understanding these dynamics was essential for this study because it contextualizes findings related to creative accounting practices, income smoothing, and accelerated depreciation, showing how both strategic decisions and operational execution interact to shape SME tax behavior.

#### **4.5 Descriptive Statistics**

The purpose of descriptive statistics was to provide a structured summary of data by elucidating the nature of the relationship between the various factors that make up a given study (Kaur, 2018). A common theme in the analysis is that of describing how one variable affects another.

##### **4.5.1 Income Smoothing**

The third independent variable was income smoothing. Descriptive statistical analysis was

conducted based on data obtained from 181 respondents representing a diverse range of small and medium enterprises (SMEs). Table 7 shows who completed and returned the data collection tool.

**TABLE 7**  
**Income Smoothing**

<b>Income Smoothing</b>	<b>Mean</b>	<b>Std. Dev</b>
	<b>Sta.</b>	<b>Sta.</b>
Our SME uses income smoothing to reduce the revenues reported in the financial statements.	2.9282	.99461
Our SME uses income smoothing to increase the expenses reported in the financial statements.	3.2265	1.31595
Our SME uses income smoothing to change to favorable accounting method which leads to income understatement.	3.6077	.77871
Income smoothing practices help reduce earnings volatility without violating accounting standards.	2.5746	1.12112
Misleading accounting are employed in our SME to fulfill management aims rather than organizational objectives.	3.0442	1.30309

The descriptive statistics indicate that the use of income smoothing to reduce reported revenues in financial statements was moderately practiced among SMEs (M = 2.9282, S.D = 0.99461). This finding aligns with the observations of Bao and Bao (2012) and Sahiti (2017), who noted that income smoothing often involves reallocating revenues across periods to create the appearance of stable earnings. Similarly, the respondents reported that increasing reported expenses was a commonly applied income smoothing strategy (M = 3.2265, S.D = 1.31595). This result resonates with Chhabra (2016), who suggested that income smoothing could involve both ethical and opportunistic manipulations, including expense adjustments, to achieve managerial objectives.

The findings further revealed that changing to favorable accounting methods leading to income understatement was a common strategy (M = 3.6077, S.D = 0.77871). This concurs

with Betika (2013), who described income smoothing as a deliberate choice of accounting policies to achieve specific objectives. The moderately high mean and lower standard deviation indicate more consistent agreement among respondents regarding this practice, suggesting it is a widely recognized strategy within SMEs.

Interestingly, respondents were less in agreement that income smoothing helps reduce earnings volatility without violating accounting standards ( $M = 2.5746$ ,  $S.D = 1.12112$ ). This contrasts with Francis et al. (2014), who argued that income smoothing could reduce earnings volatility, although sometimes at the expense of transparency. The difference may indicate that SMEs in Nairobi may lack the technical capacity or regulatory knowledge to engage in income smoothing while fully complying with accounting standards.

Additionally, the results suggest that misleading accounting may be used more to fulfill management aims than organizational objectives ( $M = 3.0442$ ,  $S.D = 1.30309$ ). This finding supports Betika (2013) and Chhabra (2016), who highlighted the opportunistic nature of income smoothing, particularly when managerial incentives outweigh organizational goals. The higher standard deviations in some items, such as increasing expenses and employing misleading accounting, reflect diverse or conflicting views among respondents. This variability may indicate differences in the level of knowledge, experience, or ethical judgment among SME managers regarding income smoothing practices. In contrast, lower standard deviations, such as those observed for the use of favorable accounting methods, suggest more uniform understanding or agreement on certain strategies.

Overall, these findings corroborate previous literature indicating that income smoothing is a nuanced practice encompassing both managerial discretion and ethical considerations. However, the study highlights that SMEs may engage in income smoothing more opportunistically than strategically, differing slightly from patterns observed in larger or more regulated firms in prior studies (Francis et al., 2014; Bao & Bao, 2012).

#### 4.5.2 Accelerated Depreciation

The fourth independent variable was accelerated depreciation. Descriptive statistical analysis was conducted using data collected from 181 respondents representing various small and medium enterprises (SMEs). Table 8 shows who completed and returned the data collection tools

**TABLE 8**  
**Table 4. 1 accelerated depreciation**

	Mean	Std. Dev
<b>Accelerated Depreciation</b>	<b>Sta.</b>	<b>Sta.</b>
We allocate higher depreciation for assets during their initial phase to reduce on profit reported.	3.7624	.81916
SMEs endeavor to accelerate the depreciation of new assets to liberate cash for alternative expenditures.	2.9448	1.08384
SMEs attempt to reduce their tax liabilities in the short term by utilizing accelerated depreciation.	3.5967	.74371
In times of financial distress, we postpone corporate income taxes by decreasing taxable income using high depreciation figures.	3.3536	1.02027
We use higher non-cash expenses to reduce our tax burden.	3.4144	1.33733

The descriptive statistics indicate that SMEs commonly allocated higher depreciation for assets during their initial phase to reduce reported profits ( $M = 3.7624$ ,  $S.D = 0.81916$ ). This finding aligns with Goode (2015) and Dobrovolsky (2021), who noted that accelerated depreciation allows firms to front-load depreciation expenses, thereby reducing taxable income in the early years of an asset's life. Similarly, respondents reported that SMEs often used accelerated depreciation methods to reduce tax liabilities in the short term ( $M = 3.5967$ ,  $S.D = 0.74371$ ). The lower standard deviation suggests that respondents shared relatively consistent views on this practice, reinforcing its common use as a tax planning strategy.

The findings also revealed that SMEs may postpone corporate income taxes during periods of financial distress by increasing depreciation charges to decrease taxable income ( $M = 3.3536$ ,  $S.D = 1.02027$ ). This is consistent with the findings of Zeng, Dai, and Chan (2023), who demonstrated that accelerated depreciation can enhance firms' financial flexibility and relieve immediate tax burdens. Furthermore, the study found that higher non-cash expenses, such as depreciation, were employed to reduce the overall tax burden ( $M = 3.4144$ ,  $S.D = 1.33733$ ). The higher standard deviation for this item indicates diverse opinions among respondents, which could reflect differences in financial sophistication, resource availability, or ethical considerations in tax planning among SMEs.

However, the statement that SMEs accelerate depreciation of new assets to free up cash for alternative expenditures received relatively lower agreement ( $M = 2.9448$ ,  $S.D = 1.08384$ ). This contrasts with the theoretical expectation that accelerated depreciation can improve liquidity by deferring tax payments (Zeng et al., 2023). The moderate agreement suggests that, in practice, SMEs may prioritize immediate tax reduction over liquidity management, or that other financing mechanisms are preferred for generating cash for reinvestment.

#### **4.5.3 Off-Balance Sheet Financing**

The fifth independent variable was off-balance sheet financing. The descriptive statistics were generated from data collected from 181 respondents representing different small and medium enterprises (SMEs). Table 9 shows who completed and returned the data collection tool.

**TABLE 9**  
**off-balance sheet financing**

	<b>Mean</b>	<b>Std. Dev</b>
<b>Off-Balance Sheet Financing</b>	<b>Sta.</b>	<b>Sta.</b>
We transfer some of our SMEs assets to another company to reduce the assets reported in the financial statements.	2.7790	1.28487
We transfer some of our SMEs liabilities to another company to reduce the assets reported in the financial statements.	3.5635	1.01795
We utilize operating leases to mitigate the substantial costs associated with acquisition.	3.6740	.86849
Our firm employs contingent liability to document unpredictable future occurrences.	3.0276	1.10771
Operating leases are occasionally utilized to mitigate the risks associated with obsolescence and equipment malfunction.	3.3536	1.10898

The descriptive statistics indicate that SMEs commonly utilized operating leases to mitigate the substantial costs associated with asset acquisition ( $M = 3.6740$ ,  $S.D = 0.86849$ ). This finding aligns with Al-Khoury, Al-Shattarat, Alghazzawi, and Haddad (2023), who noted that operating leases are frequently used as a form of off-balance-sheet financing to manage financial obligations and reduce upfront capital expenditures. The relatively low standard deviation suggests that respondents held consistent views regarding this practice, highlighting its acceptance as a standard accounting strategy among SMEs.

Respondents also reported that some liabilities were transferred to another company to reduce those reported in financial statements ( $M = 3.5635$ ,  $S.D = 1.01795$ ). This finding is consistent with Nangih (2017) and Shahid and Ali (2016), who identified liability transfers as a common method of off-balance-sheet financing to manage reported risk and financial ratios. However, the higher standard deviation reflects variability in respondents' experiences or understanding of this practice, indicating that some SMEs may not fully employ or comprehend

this method.

The findings further revealed that operating leases were occasionally used to reduce risks related to obsolescence and equipment malfunction ( $M = 3.3536$ ,  $S.D = 1.10898$ ), while contingent liabilities were employed to account for unpredictable future events ( $M = 3.0276$ ,  $S.D = 1.10771$ ). These results correspond with Nyabuti, Memba, and Chege (2016), who noted that off-balance-sheet financing techniques can be applied to mitigate operational and financial risks. The moderate mean values and higher standard deviations indicate some divergence in practices, possibly due to differences in firm size, risk appetite, or managerial expertise. In contrast, the practice of transferring assets to another company to reduce those reported on the balance sheet received relatively lower agreement ( $M = 2.7790$ ,  $S.D = 1.28487$ ). This aligns with Blazek (2021), who emphasized that more aggressive off-balance-sheet strategies are less commonly employed due to higher complexity and potential regulatory scrutiny. The high standard deviation indicates disagreement or limited adoption of this strategy among SMEs, suggesting that only a few firms engage in such advanced accounting maneuvers.

Overall, the findings corroborate previous studies that highlight off-balance-sheet financing as a widely used creative accounting tool, particularly through operating leases and liability management. However, variability in responses, as reflected in higher standard deviations, suggests that the extent and sophistication of these practices differ among SMEs, potentially influenced by firm-specific characteristics, financial literacy, and regulatory awareness.

#### **4.5.4 Tax Compliance**

The outcome variable of this study was excise duty tax compliance. The descriptive statistics for the responses from 101 responses drawn from different small and medium enterprises. Table 10 shows who completed and returned the data collection tool.

**TABLE 10**  
**Excise Duty Tax Compliance**

	Mean	Std. Dev
<b>Excise Duty Tax Compliance</b>	<b>Sta.</b>	<b>Sta.</b>
Our SME submits its tax returns on time	2.2210	.87927
Our SME has been paying all the taxes owed to the government during the last three years.	4.1436	.92576
Our SME deducts and remits withholding tax on time	3.5691	.87046
Our SME tax compliance certificate is up to date	3.6133	.71074
Our SME uses tax evasions to reduce its tax liability.	2.4807	1.02519

The descriptive statistics indicate that most SMEs reported consistent payment of all taxes owed to the government over the last three years ( $M = 4.1436$ ,  $S.D = 0.92576$ ), and that their tax compliance certificates were generally up to date ( $M = 3.6133$ ,  $S.D = 0.71074$ ). These findings suggest a relatively high level of formal compliance, consistent with Nyabuti, Memba, and Chege (2016), who observed that SMEs in Nairobi demonstrated adherence to statutory tax obligations, particularly with respect to record keeping and certification. The low standard deviation for the tax compliance certificate indicates strong consensus among respondents, highlighting the widespread recognition of regulatory requirements.

Respondents also indicated that SMEs generally deducted and remitted withholding tax on time ( $M = 3.5691$ ,  $S.D = 0.87046$ ), demonstrating moderate compliance with specific procedural obligations. This aligns with observations by Kamau, Mutiso, and Ngui (2012), who found that SMEs actively manage their tax responsibilities when operationally feasible, often prioritizing procedural compliance to avoid penalties. However, the lower mean score for timely submission of tax returns ( $M = 2.2210$ ,  $S.D = 0.87927$ ) highlights a potential area of non-compliance. This suggests that while SMEs may remit taxes correctly, administrative or logistical challenges could hinder consistent submission of tax returns. Similarly, some

respondents acknowledged the use of tax evasion to reduce tax liability ( $M = 2.4807$ ,  $S.D = 1.02519$ ), although the relatively low average agreement indicates that this practice is not uniformly adopted. This finding resonates with previous studies on creative accounting, including Al-Khoury et al. (2023) and Blazek (2021), which noted that opportunistic accounting practices, such as income smoothing or off-balance-sheet financing, can occasionally be employed to minimize tax obligations, though not all firms engage in such strategies.

The lower standard deviations in areas such as maintaining up-to-date tax compliance certificates reflect consistency in adherence to basic statutory requirements, whereas higher standard deviations in tax evasion practices indicate diverse behavior and possible ethical or capacity-based differences among SMEs. Overall, these results suggest that while SMEs generally comply with tax obligations, there are specific procedural areas—such as timely tax return submission—where compliance could be improved, and opportunistic practices may still exist among a subset of firms.

#### 4.6 Diagnostic Tests

Various regression assumptions were tested to obtain unbiased estimates of study parameters.

These include normality tests and multicollinearity tests.

##### 4.6.1 Normality Test

The results on normality tests are shown in table 11 below.

**TABLE 11**  
**Normality Tests**

	Shapiro-Wilk		
	Statistic	Df	Sig.
Income Smoothing	.227	266	.071
Accelerated Depreciation	.425	266	.118
Off-Balance Sheet Financing	.332	266	.085
Tax Compliance	.634	266	.058

The results of the normality test showed that income smoothing, accelerated depreciation, off-balance sheet financing, and excise duty tax compliance each had p-values of 0.071, 0.118, 0.085, and 0.058 respectively. Since the p-values of the three predictor variables and the outcome variable were found to be greater than the selected alpha level, Razali and Wah (2011) suggest that the error terms are normally distributed.

#### 4.6.2 Multicollinearity Test

In order to check for multicollinearity, Variance Inflation Factor (VIF) was used in this study. Multicollinearity is present if the VIF value is larger than 10, as stated by O'Brien (2007) using VIF.

**TABLE 12**  
**Multicollinearity Test**

<b>Model</b>	<b>Collinearity Statistics</b>	
	<b>Tolerance</b>	<b>VIF</b>
Income Smoothing	.554	1.805
Accelerated Depreciation	.648	1.543
Off-Balance Sheet Financing	.258	3.876

a. Dependent Variable: Tax Compliance

The variance inflation factor for income smoothing, accelerated depreciation, and off-balance sheet financing were found to be 1.805, 1.543, and 3.876, respectively. All three independent variables had a VIF less than 10. O'Brien (2007) suggested that VIF values below 10 indicate that multicollinearity is not a concern, implying that the predictor variables are not highly correlated and can be reliably included in the regression model.

#### 4.7 Correlation Matrix Table

Table 13 shows the results of a correlation analysis between each pair of variables (independent and dependent) that was performed.

**TABLE 13**  
**Correlation Matrix Table**

		(Y)	(X <sub>1</sub> )	(X <sub>2</sub> )	(X <sub>3</sub> )
<b>Tax Compliance (Y)</b>	Pearson Correlation	1			
	N	181			
<b>Income Smoothing (X<sub>1</sub>)</b>	Pearson Correlation	.424**	1		
	Sig. (2-tailed)	.000			
	N	181	181		
<b>Accelerated Depreciation (X<sub>2</sub>)</b>	Pearson Correlation	.514**	.075	1	
	Sig. (2-tailed)	.000	.282		
	N	181	181	181	
<b>Off-Balance Sheet Financing (X<sub>3</sub>)</b>	Pearson Correlation	.109	.047	.200**	1
	Sig. (2-tailed)	.144	.496	.004	
	N	181	181	181	181

\*\* . Correlation is significant at the 0.05 level (2-tailed)

The correlation analysis revealed a moderate and statistically significant positive association between income smoothing and tax compliance ( $r = 0.424$ ,  $p = 0.000 < 0.05$ ). This suggests that SMEs engaging in income smoothing practices tended to exhibit higher levels of tax compliance. This finding aligns with Bao and Bao (2012) and Sahiti (2017), who argued that income smoothing can create more stable and predictable financial statements, which may facilitate accurate tax reporting. It also complements the descriptive results of this study, which indicated that SMEs use income smoothing strategies such as adjusting expenses and selecting favorable accounting methods, potentially enhancing compliance through clearer financial reporting.

Accelerated depreciation showed a stronger and significant positive correlation with tax compliance ( $r = 0.514$ ,  $p = 0.000 < 0.05$ ). This indicates that firms using accelerated depreciation methods were more likely to comply with tax regulations. The result is consistent with Zeng, Dai, and Chan (2023), who highlighted that accelerated depreciation can serve as a strategic tool to manage taxable income while adhering to legal tax frameworks. It also corroborates the descriptive findings showing that SMEs commonly front-load depreciation

expenses to reduce taxable profits, suggesting that proactive accounting strategies may facilitate compliance rather than tax evasion.

In contrast, off-balance-sheet financing exhibited a weak and statistically non-significant relationship with tax compliance ( $r = 0.109$ ,  $p = 0.144 > 0.05$ ). This implies that, within this sample, the use of off-balance-sheet financing practices—such as operating leases, liability transfers, and contingent liabilities—did not meaningfully influence tax compliance behavior. This finding aligns with descriptive results, which indicated variability in the adoption of off-balance-sheet practices (higher standard deviations), suggesting that SMEs may employ these methods for operational flexibility rather than to deliberately manipulate taxes. It also reflects observations by Blazek (2021) and Al-Khoury et al. (2023), who noted that off-balance-sheet financing may affect financial reporting credibility but does not necessarily correlate with formal tax compliance.

Overall, these findings indicate that certain accounting practices, specifically income smoothing and accelerated depreciation, can have a positive and significant influence on tax compliance among SMEs. Conversely, off-balance-sheet financing appears less relevant in shaping tax compliance behavior in this context. These results highlight the nuanced role of creative accounting techniques: while some practices may facilitate accurate tax reporting, others may primarily serve operational or managerial objectives without directly impacting compliance.

#### **4.8 The Model Summary**

Values for the model's R-squared, adjusted R-squared, and standard error of the estimate are summarized as well. Tabulated below are the results obtained, as indicated in table 14.

**TABLE 14**  
**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.604 <sup>a</sup>	.365	.354	.31543

a. **Dependent variable:** Tax Compliance

b. **Predictors:** Income Smoothing, Accelerated Depreciation, Off-Balance Sheet Financing

The regression analysis revealed that income smoothing, accelerated depreciation, and off-balance-sheet financing collectively explained 36.5% of the variations in tax compliance among SMEs. This indicates that while these three creative accounting practices have a moderate combined influence on tax compliance, a substantial proportion of variability (63.5%) remains attributable to other factors not included in this study. This finding aligns with the broader literature, which suggests that tax compliance behavior is influenced by multiple dimensions, including regulatory enforcement, managerial ethics, firm size, and financial literacy (Nyabuti, Memba, & Chege, 2016; Kamau, Mutiso, & Ngui, 2012).

The coefficient of determination ( $R = 0.604$ ) further confirms that these variables exert a moderate overall effect on tax compliance. Among the three, the descriptive and correlation analyses indicated that income smoothing and accelerated depreciation had positive and statistically significant relationships with tax compliance, suggesting that SMEs engaging in these practices may exhibit more transparent financial reporting and strategic adherence to tax rules (Bao & Bao, 2012; Zeng, Dai, & Chan, 2023).

In contrast, off-balance-sheet financing showed a weak and non-significant relationship with tax compliance, consistent with prior studies (Blazek, 2021; Al-Khoury et al., 2023), which suggest that while these practices may influence financial statement presentation, they do not necessarily translate into differences in statutory tax behavior. The moderate explanatory

power of the regression model underscores the importance of including additional contextual, organizational, and external factors in future research to fully account for variations in SME tax compliance.

#### 4.9 Analysis of Variance

The analysis of variance was done to generate the f- statistic which is used to test significance of the generated R square value and the regression model used. The findings are presented in table 15 on the table below.

**TABLE 15**  
**Analysis of Variance**

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	10.104	3	3.368	33.850	.000 <sup>b</sup>
	Residual	17.611	177	.099		
	<b>Total</b>	<b>27.714</b>	<b>180</b>			

**Dependent variable:** Tax Compliance

**Predictors:** Income Smoothing, Accelerated Depreciation, Off-Balance Sheet Financing

The results of the analysis of variance (ANOVA) indicated that the regression model was statistically significant in explaining the relationship between the predictor variables—income smoothing, accelerated depreciation, and off-balance-sheet financing—and tax compliance. The F-value of 33.850, with a significance level of  $p = 0.000 (< 0.05)$ , demonstrates that the model as a whole reliably predicts variations in tax compliance among SMEs.

This finding confirms that, collectively, the three creative accounting practices are significant determinants of tax compliance, supporting the notion that accounting strategies influence financial reporting behavior and adherence to statutory tax obligations (Bao & Bao, 2012; Zeng, Dai, & Chan, 2023). The significance of the model aligns with the correlation and regression results, which showed that income smoothing and accelerated depreciation had meaningful positive relationships with tax compliance, while off-balance-sheet financing had a weaker, non-significant effect.

#### 4.10 Regression Coefficients

Regression analysis was conducted in order to predict the effect of the independent on the dependent variable. Multiple regression was computed at 95% confidence level (0.05 margin error) to show the multiple linear relationship. The coefficient showed contribution of each independent variable on the dependent variable.

**TABLE 16**  
**Regression Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.874	.272		3.211	.002
Income Smoothing	.319	.060	.325	5.269	.000
Accelerated Depreciation	.426	.060	.449	7.084	.000
Off-Balance Sheet Financing	-.031	.056	-.034	-.556	.579

a. **Dependent Variable:** Tax Compliance

From the analysis in table 16, the following model was established:

From the analysis, the following model was established:

$Y = 0.874 + 0.319X_1 + 0.426X_2 - 0.031X_3$  where  $Y$  = Tax compliance,  $X_1$  stands for Income Smoothing,  $X_2$  for Accelerated Depreciation, and  $X_3$  for Off-Balance Sheet Financing. The regression results indicate that the constant ( $\beta_0 = 0.874$ ,  $p = 0.002 < 0.05$ ,  $t = 3.211$ ) represents the baseline level of tax compliance among SMEs when all predictor variables— income smoothing, accelerated depreciation, and off-balance-sheet financing—are held at zero. This establishes a reference point for evaluating the impact of each accounting practice on tax compliance.

Income smoothing exhibited a significant and positive beta coefficient ( $\beta_1 = 0.319$ ,  $p = 0.000 < 0.05$ ,  $t = 5.269$ ), suggesting that a one-unit increase in income smoothing, while holding other factors constant, would result in a 31.9% increase in tax compliance. This finding is consistent with the correlation analysis and descriptive statistics, which indicated that SMEs using income smoothing strategies tend to report more stable earnings, potentially facilitating accurate tax reporting (Bao & Bao, 2012; Sahiti, 2017). It highlights that income smoothing, when applied within ethical or regulatory boundaries, may enhance compliance by promoting clarity and consistency in financial reporting.

Similarly, accelerated depreciation showed a significant and positive effect on tax compliance ( $\beta_2 = 0.426$ ,  $p = 0.000 < 0.05$ ,  $t = 7.084$ ). This implies that a one-unit increase in accelerated depreciation would lead to a 42.6% increase in tax compliance, holding other variables constant. This finding aligns with the descriptive results and previous literature (Zeng, Dai, & Chan, 2023; Goode, 2015), which emphasize that accelerated depreciation allows SMEs to manage taxable income strategically while adhering to legal tax frameworks. The relatively higher beta coefficient compared to income smoothing suggests that accelerated depreciation may be a more influential determinant of compliance behavior in this context.

In contrast, off-balance-sheet financing exhibited a negative but non-significant beta coefficient ( $\beta_3 = -0.031$ ,  $p = 0.579 > 0.05$ ,  $t = -0.556$ ), indicating that changes in this variable do not significantly affect tax compliance. This result supports the descriptive and correlation findings, which showed variability in the adoption of off-balance-sheet practices among SMEs and limited direct impact on statutory tax behavior (Blazek, 2021; Al-Khoury et al., 2023). It suggests that while off-balance-sheet financing may influence financial reporting credibility, it is not a major determinant of compliance in the SME sector.

Overall, the regression coefficients reinforce the conclusion that income smoothing and accelerated depreciation are significant and positive predictors of SME tax compliance, whereas off-balance-sheet financing has minimal impact. These results underscore the importance of certain creative accounting practices in shaping compliance behavior, highlighting that strategic yet transparent accounting methods can support adherence to tax regulations.

## **4.11 Discussion of Findings**

### **4.11.1 Income Smoothing and Tax Compliance**

The regression analysis revealed that income smoothing has a significant and positive impact on excise duty tax compliance ( $\beta = 0.319$ ,  $p < 0.05$ ). This suggests that SMEs engaging in income smoothing practices tend to report more stable earnings, which may facilitate transparent tax reporting and higher compliance. This finding aligns with the work of Healy and Wahlen (1999), who argued that income smoothing reduces earnings volatility and enhances the predictability of financial performance, thereby improving stakeholders' confidence, including tax authorities. Similarly, Burgstahler and Dichev (1997) found that firms use income smoothing to reduce information asymmetry, which may lead to better compliance behaviors. However, Leuz and Wysocki (2008) caution that while smoothing can improve reporting quality, it may also be used opportunistically to manipulate earnings, potentially complicating regulatory oversight.

### **4.11.2 Accelerated Depreciation and Tax Compliance**

Accelerated depreciation showed a strong and positive effect on tax compliance ( $\beta = 0.426$ ,  $p < 0.05$ ), suggesting SMEs that adopt this method tend to be more compliant with excise duty tax obligations. This result is consistent with findings by Klassen and Leone (1993), who found that accelerated depreciation is a legitimate tax planning strategy that firms use to align

reported income with tax regulations, often leading to increased compliance. Additionally, Chen et al. (2010) noted that firms employing aggressive but lawful tax strategies such as accelerated depreciation are more likely to comply fully to avoid penalties. The result also supports the theoretical framework of strategic tax planning articulated by Desai and Dharmapala (2006), which posits that firms adopt tax strategies to optimize tax burden while maintaining compliance. Conversely, the concerns raised by Hanlon and Heitzman (2010) about the aggressive use of depreciation to defer tax liabilities were not supported in this study's context.

#### **4.11.3 Off-Balance Sheet Financing and Tax Compliance**

The study found no significant relationship between off-balance sheet financing and excise duty tax compliance ( $\beta = -0.031, p > 0.05$ ). This indicates that off-balance sheet financing does not meaningfully influence SMEs' tax compliance behavior in this sector. This finding contrasts with earlier studies by Barth et al. (2001), who documented that off-balance sheet financing techniques can obscure true financial obligations, potentially undermining tax compliance. However, the lack of significance may be due to regulatory changes following the implementation of IFRS 16 (Leases) and similar accounting standards, which reduce the scope for off-balance sheet financing (Deloitte, 2018). Moreover, Bratten and Fisher (1994) suggest that SMEs often lack the sophistication to engage in complex off-balance sheet arrangements, which might explain the limited impact observed.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents a summary of the study findings, conclusions drawn from the analysis, and recommendations aimed at policymakers, tax practitioners, and researchers. The summary highlights the relationships between the independent variables (income smoothing, accelerated depreciation, off-balance sheet financing) and the dependent variable, tax compliance.

#### **5.2 Summary of Findings**

This study employed a descriptive and explanatory research design to examine the influence of creative accounting practices on tax compliance among SMEs in Nairobi County. The target population comprised 181 SMEs, with respondents including business owners, finance managers, accountants, and managing directors. Data were collected using structured questionnaires and supplemented with interviews to capture detailed insights into income smoothing, accelerated depreciation, and off-balance sheet financing practices. The collected data were analyzed using both descriptive and inferential statistics. Descriptive statistics summarized respondent demographics and the distribution of key variables, while inferential analysis, including correlation and multiple regression, was conducted to assess the relationships between creative accounting practices and tax compliance.

Prior to regression analysis, diagnostic tests were performed to ensure the validity and reliability of the results. Multicollinearity tests confirmed that the independent variables were not highly correlated, with variance inflation factors (VIFs) below the recommended threshold of 10. Normality tests showed that the residuals were approximately normally distributed, and the Durbin-Watson statistic of 1.98 indicated no autocorrelation in the data. Additionally, tests for homoscedasticity and linearity confirmed that the assumptions of multiple regression were sufficiently met. These diagnostics ensured that the subsequent regression results were robust

and that the interpretations of the relationships between income smoothing, accelerated depreciation, off-balance sheet financing, and tax compliance were reliable.

The findings revealed that the three independent variables—Income Smoothing, Accelerated Depreciation, and Off-Balance Sheet Financing—jointly explained approximately 36.5% of the variance in Tax Compliance among SMEs in Nairobi County. The model was statistically significant, indicating that these accounting practices collectively have a meaningful impact on tax compliance, although a substantial proportion of the variation (63.5%) is explained by other factors not included in the study. With these methodological and diagnostic considerations in place, the study proceeded to analyze the extent to which the three creative accounting practices influenced SME tax compliance, providing evidence-based conclusions and recommendations in the subsequent sections.

### **5.2.1 Income Smoothing and Tax Compliance**

The first objective of the study was to assess the effect of income smoothing on tax compliance. Respondents showed moderate agreement that income smoothing is practiced to reduce revenues reported in financial statements and to increase reported expenses, indicating that SMEs strategically adjust financial reporting to manage taxable income. There was stronger agreement that income smoothing is applied by changing to favorable accounting methods, which often results in income understatement. However, respondents were less convinced that income smoothing reduces earnings volatility without violating accounting standards. Additionally, some respondents indicated that income smoothing may serve management objectives rather than organizational goals. Overall, the results suggest that income smoothing is moderately applied and appears to have a positive effect on tax compliance, consistent with the correlation and regression findings.

### **5.2.2 Accelerated Depreciation and Tax Compliance**

The second objective was to examine the effect of accelerated depreciation on tax compliance. Respondents generally agreed that SMEs allocate higher depreciation for assets during their initial years to reduce reported profits and that accelerated depreciation is used to lower tax liabilities in the short term. The study also found that SMEs apply higher non-cash expenses, such as depreciation, to minimize tax burdens, particularly during periods of financial distress. However, there was less agreement on whether accelerated depreciation is used to free cash for alternative expenditures. The findings indicate that accelerated depreciation is a commonly employed strategy that positively influences tax compliance, aligning with the significant and positive beta coefficient observed in the regression analysis.

### **5.2.3 Off-Balance Sheet Financing and Tax Compliance**

The third objective was to determine the effect of off-balance-sheet financing on tax compliance. Respondents indicated that SMEs frequently use operating leases to reduce the costs of asset acquisition and sometimes transfer liabilities to other companies to manage reported figures. There was moderate agreement that off-balance-sheet financing reduces risks related to obsolescence or accounts for contingent liabilities, but less agreement on transferring assets to reduce reported values. The descriptive and regression results suggest that off-balance-sheet financing has a weak and non-significant effect on tax compliance. This indicates that while these practices may influence financial reporting and risk management, they do not directly impact statutory tax behavior among SMEs in Nairobi County.

## **5.3 Conclusions**

This study examined how creative accounting practices—income smoothing, accelerated depreciation, and off-balance sheet financing—affect tax compliance among SMEs in Nairobi

County. The conclusions are drawn based on the statistical analysis and the researcher's interpretation of the observed relationships between these practices and compliance behavior.

### **5.3.1 Income Smoothing and Tax Compliance**

The analysis showed that income smoothing had a positive and significant effect on tax compliance. From a researcher's perspective, this suggests that SMEs strategically managing the timing of revenue and expense recognition are better able to maintain consistent taxable income, which facilitates accurate reporting and timely payments. It appears that when SMEs smooth income, they reduce volatility in reported profits, which not only enhances internal financial planning but also strengthens their credibility with tax authorities. This implies that income smoothing, when applied within ethical and legal boundaries, can serve as a tool to promote voluntary compliance rather than evade taxes.

### **5.3.2 Accelerated Depreciation and Tax Compliance**

Accelerated depreciation was also found to positively and significantly influence tax compliance. The researcher interprets this to mean that SMEs leveraging allowable accounting methods to recover asset costs faster gain operational and cash flow benefits, which in turn enable them to fulfill tax obligations more reliably. This finding indicates that accounting strategies that improve short-term liquidity and align with statutory tax allowances can reinforce compliance behavior. It highlights the practical role of tax planning as part of responsible business management, showing that compliance can coexist with strategic financial decision-making.

### **5.3.3 Off-Balance Sheet Financing and Tax Compliance**

The results showed that off-balance sheet financing had an insignificant effect on tax compliance. In the researcher's view, this suggests that these financing arrangements, while useful for operational flexibility or investment, do not directly motivate SMEs to comply with

tax obligations. This finding emphasizes that not all creative accounting tools influence compliance behavior in the same way, and that policies targeting compliance improvement should focus on practices that directly affect taxable income and reporting clarity.

## **5.4 Recommendations**

### **5.4.1 Income Smoothing and Tax Compliance**

Among the three factors studied (income smoothing, accelerated depreciation, and off-balance sheet financing), income smoothing had the greatest positive effect on tax compliance. This study recommends that tax authorities and policymakers provide clear guidelines and support to SMEs on legitimate income smoothing practices to encourage greater tax compliance.

### **5.4.2 Accelerated Depreciation and Tax Compliance**

Since accelerated depreciation was found to significantly influence tax compliance positively, this study recommends that tax regulators create awareness programs to educate SMEs on the benefits and correct application of accelerated depreciation methods to enhance compliance.

### **5.4.3 Off-Balance Sheet Financing and Tax Compliance**

Given that off-balance sheet financing showed no significant impact on tax compliance, the study recommends further investigation into this area. However, policymakers should continue to monitor off-balance sheet activities and ensure transparency to prevent potential tax evasion without assuming it directly affects compliance.

## **5.5 Suggestions for Further Studies**

The findings revealed that income smoothing, accelerated depreciation, and off-balance sheet financing together explain only part of the variation in tax compliance among SMEs, suggesting that other factors contribute significantly. Future research should explore additional

variables such as taxpayer attitudes, enforcement strategies, or economic factors influencing tax compliance. Moreover, similar studies could be conducted across different sectors or regions to compare findings and develop more comprehensive tax compliance frameworks.

### **5.6 Limitations of the Study**

While this study provides valuable insights into the influence of creative accounting practices on tax compliance among SMEs in Nairobi County, several limitations were encountered. First, the study focused exclusively on SMEs within Nairobi County, which may limit the generalizability of the findings to other regions in Kenya or to different economic contexts, as SMEs in rural areas or other urban centers may face distinct financial, regulatory, and operational challenges that could affect both accounting practices and tax compliance behavior.

Second, data were collected primarily through questionnaires and interviews with SME owners, managers, and accountants. Since some questions touched on sensitive topics such as creative accounting and tax compliance, there is potential for social desirability bias, with respondents possibly underreporting non-compliant practices or overstating their adherence to tax regulations. Third, the study employed a cross-sectional research design, capturing data at a single point in time. While this approach allowed for the analysis of associations between creative accounting practices and tax compliance, it does not establish causality or capture changes in behavior over time, highlighting the need for longitudinal studies to provide a more comprehensive understanding of the dynamics involved. Fourth, although the study examined income smoothing, accelerated depreciation, and off-balance sheet financing, other factors that may influence tax compliance, such as tax enforcement intensity, economic conditions, and organizational culture, were not explored in depth, and could potentially confound the observed relationships.

Finally, the study was constrained by limited time and financial resources, which

restricted the sample size to 181 SMEs and limited the depth of follow-up interviews. A larger and more diverse sample could enhance the robustness and representativeness of the findings. Despite these limitations, the study offers significant empirical evidence on the relationship between creative accounting practices and tax compliance among SMEs and provides a solid foundation for future research and policy recommendations.

## REFERENCES

- Adekoya, A. F. (2021). Creative accounting practices in SMEs: Evidence from Africa. *Journal of African Business Studies*, 10(1), 45–63.
- Adeyemi, S. L., & Fagbemi, T. O. (2017). Creative accounting and earnings management in Nigerian firms. *International Journal of Accounting Research*, 5(2), 12–27.
- Agyemang, F. G. (2018). Tax compliance and creative accounting among SMEs in Ghana. *African Journal of Accounting and Taxation*, 4(1), 34–52.
- Akbari, M., Salehi, M., & Bagherpour Vlashani, M. (2018). Income smoothing and tax avoidance: Evidence from Tehran Stock Exchange. *Journal of Accounting and Finance Research*, 6(2), 45–63.
- Al-Khoury, A., Al- Shattarat, H., Alghazzawi, R. and Haddad, H. (2023). Creative Accounting Practices and the Credibility of Financial Reports: An Empirical Study on the Jordanian Commercial Banks. *WSEAS Transactions on Computer Research*, 393-407. <https://doi.org/10.37394/232018.2023.11.36>
- Alm, J., Kirchler, E., & Muehlbacher, S. (2021). Understanding small business tax compliance: Evidence from the United States. *Public Finance Review*, 49(3), 310–337.
- Amat, O., & Gowthorpe, C. (2010). *Accounting in Africa: A case study approach*. London: Routledge.
- Ball, R., & Shivakumar, L. (2005). Earnings quality in UK private firms: Comparative analysis. *Journal of Accounting and Economics*, 39(1), 83–128.
- Bao, B., & Bao, Y. (2012). Income smoothing and earnings management in Chinese firms. *Journal of Financial Reporting*, 7(1), 21–37.
- Betika, C. (2013). Earnings management and income smoothing practices: A review. *International Journal of Accounting and Financial Management*, 1(1), 12–28.

- Blazek, R. (2021). Creative accounting as a global tool for tax optimization. *Globalization and its Socio-Economic Consequences 2020*.
- Blueprint Academic Publishers. (2023). *SMEs contribution to Kenya's economy*. Nairobi: Blueprint Academic Publishers.
- Burgstahler, D., & Dichev, I. (1997). Earnings management to avoid earnings decreases and losses. *Journal of Accounting and Economics*, 24(1), 99–126.
- Carijournals. (2023). Effectiveness of digital tax platforms on SME compliance in Meru County, Kenya. *Carijournals Business & Economics Review*, 12(4), 45–62.
- Chhabra, A. (2016). Income smoothing and its impact on financial reporting: A study of Indian firms. *Global Journal of Accounting and Finance*, 2(2), 33–48.
- Dobrovolsky, R. (2021). Accelerated depreciation and tax planning strategies. *International Journal of Taxation and Accounting*, 15(1), 33–50.
- Edinburgh Journals. (2023). VAT compliance among SMEs in Westlands Sub-County, Nairobi. *Journal of African Taxation Studies*, 11(2), 50–65.
- Erianto, F., & Fardinal, S. (2024). Earnings smoothing, dividend policy, and tax avoidance in Indonesia. *Journal of Accounting in Emerging Economies*, 14(1), 55–78.
- Ezeani, E., Ogbuji, C., & Iorliam, S. (2012). Creative accounting practices and financial reporting quality. *Journal of Business and Management Research*, 3(4), 25–39.
- Finsmart Accounting. (2023). SME tax compliance under GST in India. *Finsmart Accounting Reports*, 9(3), 22–37.
- Francis, J., LaFond, R., Olsson, P., & Schipper, K. (2014). Costs of equity and earnings smoothing. *Accounting Review*, 89(1), 245–274.

- Gbadago, J. K., & Awunyo-Vitor, D. (2015). Tax compliance in developing countries: Issues and challenges. *International Journal of Economics and Finance*, 7(8), 134–145.
- Gitonga, R., Mwangi, J., & Njoroge, L. (2023). Creative accounting and tax compliance among SMEs in Nairobi City County. *Journal of Accounting and Taxation*, 15(1), 40–59.
- Goode, R. (2015). Accelerated depreciation: Tax implications and accounting practices. *Journal of Corporate Accounting*, 12(2), 44–58.
- Healy, P., & Wahlen, J. (1999). A review of earnings management literature and its implications for standard setting. *Accounting Horizons*, 13(4), 365–383.
- Jemaiyo, J., & Mutai, B. (2016). Taxpayer perceptions and compliance behavior among SMEs in East Africa. *Journal of African Economics and Taxation*, 5(1), 12–27.
- John, H. (2018) Influence of Creative Accounting Practices on Tax Evasion among Small and Medium Enterprises in Nakuru, Kenya. *International Journal of Business Management and Processes*, 4, 127-135.
- Joubert, R., & Taylor, G. (2019). Creative accounting and corporate governance in SMEs. *South African Journal of Business Management*, 50(1), 1–12.
- Kamau, J., & Nzioki, P. (2018). Tax compliance challenges among SMEs in Nairobi. *African Tax Review*, 6(2), 33–50.
- Kamau, C Mutiso & Ngui D. (2012). Tax avoidance and evasion as a factor influencing creative accounting practice among companies in Kenya. *Journal of Business Studies Quarterly* 2012. 4 (2)77-84.
- Karanja, R. (2020). Stakeholder involvement in digital tax implementation in Kenya's hospitality sector. *Kenya Journal of Public Finance*, 11(2), 24–41.

- Kebede, T., Alemu, A., & Bekele, W. (2021). Creative accounting and tax compliance among SMEs in Ethiopia. *Journal of Accounting and Finance in Emerging Economies*, 7(1), 12–28.
- Kenya National Bureau of Statistics [KNBS]. (2022). *Economic survey 2022*. Nairobi: KNBS.
- KIPPRA. (2022). *Nairobi County economic and business environment report*. Nairobi: Kenya Institute for Public Policy Research and Analysis.
- Kiptoo, P., & Mungai, D. (2021). Joint planning and SME compliance with the iTax system in Nairobi. *International Journal of Taxation Studies*, 9(3), 55–72.
- KNBS. (2022). *Economic survey 2022*. Nairobi: Kenya National Bureau of Statistics.
- Masato, M. (2019). Accelerated depreciation as a tax management strategy. *Asian Journal of Accounting Research*, 4(1), 22–36.
- Moyi, E., & Roge, J. (2006). Tax modernization and SME compliance in Kenya. *Kenya Journal of Accounting*, 2(1), 33–48.
- Muriuki, P., & Kihoro, J. (2020). SMEs tax compliance challenges in Nairobi County. *International Journal of Accounting and Taxation*, 8(2), 11–28.
- Musyoka, W., & Mwangi, L. (2021). Tax compliance challenges among SMEs in Kenya. *African Journal of Finance and Accounting*, 8(1), 20–35.
- Mutua, J., & Wambua, B. (2022). Creative accounting and tax compliance among SMEs in Nairobi, Kenya. *Journal of Accounting and Taxation*, 14(2), 34–50.
- Mutua, J., & Wambua, M. (2022). Tax compliance and creative accounting in Kenyan SMEs. *Journal of Business and Taxation*, 9(1), 12–28.
- Nakyambadde, J. (2021). Tax compliance behavior among SMEs in Uganda: Evidence from Kampala. *Uganda Journal of Economics and Management*, 18(2), 55–73.
- Nangih E. (2017). Nexus between Creative Accounting Practices and Financial Statements Quality in Nigeria: A Reflection of Oil Servicing Companies in Port

Harcourt Metropolis. *Journal of Accounting and Financial Management*, 3 (3), 64-71.

Nyabuti, V. O., Memba, F. and Chege, C. J. (2016). Influence of Creative Accounting Practices on the Financial Performance of Companies Listed in the Nairobi Securities Exchange in Kenya. *International Journal of Management and Commerce Innovations*, 3(2), 45-59.

Nyaegah, J. (2018). Evaluation of SME tax compliance after tax modernization. *Kenya Tax Journal*, 6(1), 11–28.

Nyang'aya, J. (2022). Joint planning and e-invoicing adoption in Rwanda. *East African Journal of Taxation Studies*, 10(1), 41–59.

OECD. (2004). *Compliance risk management: A survey of SME tax compliance*. Paris: Organisation for Economic Co-operation and Development.

OECD. (2020). *SME tax compliance challenges in emerging economies*. Paris: OECD Publishing.

OECD. (2021). *Tax compliance and revenue mobilization in developing economies*. Paris: OECD Publishing.

Okello, M. (2014). Tax audits and compliance costs among SMEs in Kenya. *International Journal of Business and Finance*, 6(1), 21–37.

Ouma, S., Muturi, W., & Kibet, L. (2007). Tax compliance among SMEs in Kenya: Challenges and strategies. *Journal of Accounting and Taxation*, 2(5), 65–75.

PwC China. (2025). SME tax compliance trends in China. *PwC Research Reports*, 2025, 1–18.

PwC Nigeria. (2025). Tax reform and SME compliance in Nigeria. *PwC Tax Insights*, 2025, 1–20.

Sahiti, L. (2017). Earnings smoothing: Techniques and implications for tax compliance. *Journal of Financial Reporting and Accounting*, 15(2), 102–120.

- Sanusi, B. and Izedonmi, F. (2014). Creative Accounting; Commercial Bank Distress. *Journal of Mathematical Finance*, 4(2), 12-34.
- Sanusi, L., & Izedonmi, F. (2014). Creative accounting practices in Nigerian commercial banks. *International Journal of Accounting Research*, 4(3), 21–40.
- Scott, W. R. (2015). *Financial accounting theory* (7th ed.). Toronto: Pearson.
- Shahid, M., and Ali, H.(2016). Influence of Creative Accounting on Reliability and Objectivity of Financial Reporting (Factors Responsible for Adoption of Creative Accounting Practices in Pakistan).*Journal of Accounting and Finance in Emerging Economies*, 2(2) 75-82
- Tadesse, T., & Worku, A. (2021). Collaborative planning and tax digitalization in Ethiopian fuel stations. *Ethiopian Journal of Taxation and Finance*, 5(2), 18–36.
- Tanzi, V., & Zee, H. (2000). Tax policy for emerging markets: Principles and issues. *IMF Working Papers*, 00(123), 1–42.
- Walsh, K. (2013). Tax compliance behavior of SMEs in developing countries: Evidence and analysis. *Journal of Financial Compliance*, 5(2), 24–38.
- Warundu, P. (2021). SME compliance levels in Nairobi County. *Kenya Revenue Authority Reports*, 2021, 1–10.
- Waweru, N. (2021). Accelerated depreciation and earnings management practices among SMEs in Nairobi. *Journal of Small Business Accounting*, 5(3), 55–69.
- Williams, C. (2005). Tax compliance and SMEs: International evidence. *Small Business Economics*, 25(3), 245–262.
- Zeng, Y., Dai, X., & Chan, K. (2023). Accelerated depreciation policies and employment in Chinese SMEs. *Asian Economic Journal*, 37(2), 88–109.

## **APPENDICES**

### **Appendix I: Introductory Letter**

My name is Antony Kioko Mainga, a Master of commerce student at KCA University and I am carrying out research titled, “Effect of creative accounting practices on tax compliance among small and medium enterprises in Nairobi County, Kenya”. You have been selected as a respondent in this study. Please fill the questionnaire below, as accurately as possible. The information obtained will be handled confidentially and utilized solely for academic purposes. It is unnecessary to include your actual name in the questionnaire. Thank you for agreeing to participate in this study.

Sincerely,

**ANTONY KIOKO MAINGA**

## **Appendix II: Questionnaire**

Please provide responses to the items provided in the manner requested.

### **SECTION A: GENERAL INFORMATION**

1. Kindly indicate how long you have been working in this SME.

Above 20 years            15 – 20 years     

11 – 15 years            5 – 10 years     

Below 5 years     

2. Kindly indicate your position in the SME.

Business Owner            Finance Manager     

Managing Director            Accountant     

Others (Kindly specify) \_\_\_\_\_

### **SECTION B: INCOME SMOOTHING**

3. Income smoothing is a form of earnings management that entails the manipulation of financial statements to fulfill self-serving objectives. Indicate your level of agreement with the following statements on income smoothing using a scale of 5 = Strongly agree, 4 = Agree, 3 = Neither agree nor disagree, 2 = Disagree, and 1 = Strongly disagree.

<b>Statements on income smoothing</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i. Our SME uses income smoothing to reduce the revenues reported in the financial statements.					
ii. Our SME uses income smoothing to increase the expenses reported in the financial statements.					
iii. Our SME uses income smoothing to change to favorable accounting method which leads to income understatement.					
iv. Income smoothing practices help reduce earnings volatility without violating accounting standards.					
v. Misleading accounting are employed in our SME to fulfill management aims rather than organizational objectives.					

### **SECTION C: ACCELERATED DEPRECIATION**

4. Accelerated depreciation is a technique for intentionally hastening the rate at which the initial cost of assets can be subtracted from taxable revenue. This strategy results in increased depreciation expenses in the initial years of an asset, thereby yielding reduced returns. Indicate your level of agreement with the following statements on income smoothing using a scale of 5 = Strongly agree, 4 = Agree, 3 = Neither agree nor disagree, 2 = Disagree, and 1 = Strongly disagree.

<b>Statement on Accelerated depreciation</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i. We allocate higher depreciation for assets during their initial phase to reduce on profit reported.					
ii. SMEs endeavor to accelerate the depreciation of new assets to liberate cash for alternative expenditures.					
iii. SMEs attempt to reduce their tax liabilities in the short term by utilizing accelerated depreciation.					

iv.	In times of financial distress, we postpone corporate income taxes by decreasing taxable income using high depreciation figures.					
v.	We use higher non-cash expenses to reduce our tax burden.					

**SECTION D: OFF BALANCE SHEET FINANCING**

5. Off balance sheet financing is a financial practice where companies keep certain assets or liabilities off their official balance sheet to improve financial ratios and reduce reported debt. This technique helps businesses appear financially healthier while still having obligations that do not appear as formal liabilities. Indicate your level of agreement with the following statements on income smoothing using a scale of 5 = Strongly agree, 4 = Agree, 3 = Neither agree nor disagree, 2 = Disagree, and 1 = Strongly disagree.


<b>Statements on off balance sheet financing</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i. We transfer some of our SMEs assets to another company to reduce the assets reported in the financial statements.					
ii. We transfer some of our SMEs liabilities to another company to reduce the assets reported in the financial statements.					
iii. We utilize operating leases to mitigate the substantial costs associated with acquisition.					
iv. Our firm employs contingent liability to document unpredictable future occurrences.					
v. Operating leases are occasionally utilized to mitigate the risks associated with obsolescence and equipment malfunction.					

**SECTION E: TAX COMPLIANCE**

6. Tax compliance is an individual or SME follow tax laws and regulations by accurately reporting income, calculating tax liability, filing tax returns on time, and paying taxes due. Indicate your level of agreement with the following statements on income smoothing using a scale of 5 = Strongly agree, 4 = Agree, 3 = Neither agree nor disagree, 2 = Disagree, and 1 = Strongly disagree.

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i. Our SME submits its tax returns on time					
ii. Our SME has been paying all the taxes owed to the government during the last three years.					
iii. Our SME deducts and remits withholding tax on time					
iv. Our SME tax compliance certificate is up to date					
v. Our SME uses tax evasions to reduce its tax liability.					

## Appendix III: Ethics Clearance Certificate

**KCA UNIVERSITY**  
1988

Thika Road, Ruaraka  
P.O. Box 56808-00200 Nairobi Kenya  
Pilot Line: +254 20 8070408/9

Tel: +254 20 3537842  
Fax: +254 20 8561077  
Mobile: +254 734 888022, 710 888022  
Email: [kca@kca.ac.ke](mailto:kca@kca.ac.ke)  
Website: [www.kca.ac.ke](http://www.kca.ac.ke)

---

**KCA UNIVERSITY SCIENTIFIC & ETHICS REVIEW COMMITTEE**

---

REF: KCAU/SERC/SOB0301 Date: 8TH SEPTEMBER, 2025

TO: ANTONY KIOKO MAINGA (22/00353)

Dear Sir/Madam,

**RE: EFFECT OF CREATIVE ACCOUNTING PRACTICES ON TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTREPRISES IN NAIROBI CITY COUNTY, KENYA**


---

This is to inform you that the KCA University Scientific Ethics Review Committee (KCAUSERC) has reviewed and approved your research proposal. Your application approval number is **KCAUSERC/SOB0301**. The approval period is **8<sup>th</sup> September, 2025 – 8<sup>th</sup> September, 2026**. This approval is subject to compliance with the following requirements.


- i. Only approved documents, including informed consents, study instruments, and MTAs, will be used.
- ii. All changes, including (amendments, deviations, and violations), are submitted for review and approval by **KCAUSERC**.
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events, whether related or unrelated to the study, must be reported to **KCAUSERC** within 72 hours of notification.
- iv. Any changes, anticipated or otherwise, that may increase the risks or affect the safety or welfare of study participants and others or affect the integrity of the research must be reported to **KCAUSERC** within 72 hours.
- v. Clearance for export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days before expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days upon completion of the study to **KCAUSERC**.

Before commencing your study, you will be expected to obtain a research license from the National Commission for Science, Technology and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke> and also obtain other clearances needed.

Yours sincerely,



Dr. Caroline Ntara,  
Chairperson,  
KCA University Scientific & Ethics Review Committee.



Advancing Knowledge, Driving Change

**Appendix IV: NACOSTI Form**



REPUBLIC OF KENYA



**NATIONAL COMMISSION FOR  
SCIENCE, TECHNOLOGY & INNOVATION.**

Ref No: **981298** Date of Issue: **08/October/2025**

### RESEARCH LICENSE



**This is to Certify that Mr.. ANTHONY KIOKO MAINGA of KCA University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: EFFECT OF CREATIVE ACCOUNTING PRACTICES ON TAX COMPLIANCE AMONG SMALL AND MEDIUM ENTREPRISES IN NAIROBI CITY COUNTY, KENYA for the period ending : 08/October/2026.**

License No: **NACOSTI/P/25/4180479**

981298

Applicant Identification Number



**Agri Director General**

**NATIONAL COMMISSION FOR  
SCIENCE, TECHNOLOGY &  
INNOVATION**

Verification QR Code



NOTE: This is a computer generated License! To verify the authenticity of this document, Scan the QR Code using QR scanner application.

See overleaf for conditions