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Effect of Purchasing audits on Tax Compliance Among Small and Medium Enterprises in Kenya

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Abstract: *In recent years, there has been a growing recognition of the need for small and medium enterprises (SMEs) to comply with tax regulations in Kenya. With the increasing government scrutiny, it has become imperative for SMEs to engage in purchasing audits to ensure compliance with tax requirements to minimize the likelihood of facing legal consequences and penalties related to tax fraud. These audits assess a business's procurement and payment procedures to prevent any potential tax evasion. However, Most SMEs operate in the informal economy, making it difficult for tax authorities to track their income and expenses. As a result, a majority of them underreport their income and overstate their expenses, thereby reducing their tax liability. The purpose of the study was to analyze the effect of purchasing audits on tax compliance by SMEs in Kenya. The study used explanatory research design and was anchored on financial theory, performance theory, compliance theory and control theory. The results showed that purchasing audit positively and significantly influence tax compliance by small and medium business enterprises in Kenya. It recommended that for SMEs to achieve better compliance behavior, they should receive adequate training on tax compliance and related matters since training SME employees on the purchasing process, tax compliance, and the related legal framework will ensure that they understand the importance of compliance.*

Keywords: (Tax audits, Tax liabilities, Internal controls, Tax evasion)

1. INTRODUCTION

A purchasing audit is an independent review of a company's purchasing practices and procedures, including its suppliers, contracts, and controls. The main objective of a purchasing audit is to provide insights into how SMEs can improve their purchasing process efficiency, effectiveness, and risk management. By conducting a purchasing audit, SMEs can identify areas of non-compliance with tax regulations and take corrective actions before tax authorities take actions

Tax compliance is a vital aspect of running a business anywhere in the world, including Kenya. For small and medium enterprises (SMEs), it is even more crucial as they often do not have the resources to deal with audits or penalties that come with non-compliance. Tax compliance ensures that businesses pay the correct amount of taxes to the government, contributing to the development of the national economy. By paying taxes, SMEs also contribute to funding public services such as infrastructure, health services, and education.

Tax evasion by SMEs has significant consequences for the economy. First, it deprives governments of much-needed revenue that could be used to finance essential public services such as healthcare, education, and infrastructure development. Second, it creates an uneven playing field between compliant and non-compliant businesses. Non-compliant businesses have lower costs of operation as they do not pay taxes, which gives them an unfair advantage over businesses that comply with tax laws. Finally, tax evasion by SMEs erodes public trust in the tax system and undermines the legitimacy of the government.

In Kenya, the government has put in place measures to encourage tax compliance, including conducting purchasing audits to ensure SMEs are complying with tax regulations. These audits are conducted to assess the business' procurement and payment processes to ensure that there is no tax evasion. These audits help to identify any discrepancies in the tax returns of SMEs, allowing them to rectify any issues before they become more significant problems. By strengthening tax compliance, SMEs can also build a positive reputation with their customers and stakeholders, enhancing their credibility and improving their chances of success. Tax compliance therefore is essential for SMEs in Kenya to build a sustainable and successful business while contributing to the development of the national economy.

1.1 Benefits of Purchasing Audits in Tax Compliance

Purchasing audits play a vital role in strengthening tax compliance in small and medium enterprises (SMEs) in Kenya. The benefits of purchasing audits for SMEs are numerous. Firstly, it helps SMEs to identify any fraudulent activities that may be happening within the organization. By conducting regular audits, the SME owner can detect any discrepancies in the purchasing process and address them before they become larger issues. This helps to minimize the risk of fraud in the long run.

Secondly, purchasing audits help SMEs to identify areas where they can reduce costs. By analyzing the purchasing processes, SME owners can identify areas where they can save money and cut down on expenses. This can help the SME to become more profitable and competitive in the market. Thirdly, purchasing audits help SMEs to maintain accurate financial records. By ensuring that all financial records are up-to-date and accurate, SMEs can comply with tax regulations

more easily. This can reduce the risk of penalties and fines for non-compliance. Examinations check that procurement processes are completely accurate and that payment is done following proper invoicing regulations. By having these processes reviewed and overseen, SMEs are better protected from any fraudulent practices or attempts to evade tax.

Purchasing audits can help SMEs improve their tax planning and reporting. By conducting an audit, SMEs can track their expenses and ensure that they are taking advantage of all available deductions and credits. This can help them reduce their tax liability and improve their overall financial performance. Additionally, by keeping accurate records, SMEs can avoid the need for costly and time-consuming tax audits, which can be a significant burden for small businesses.

The audits can also help SMEs build stronger relationships with their suppliers. When SMEs conduct regular audits of their suppliers, they can identify any potential issues, such as delivery delays or quality problems. By addressing these issues promptly, SMEs can improve their relationships with their suppliers, which can lead to better pricing and terms in the future. This can be particularly important for small businesses, which may not have the negotiating power of larger organizations.

Moreover, it ensures that all vendors are creditworthy and that all procurement is for the benefit of the company. Identifying vendors can be a cumbersome task, and unfortunately, it can often be a source of corruption. Therefore, a purchasing audit can help determine potential vendors' financial records, eligibility, and creditworthiness. This ensures that firms only transact with credible vendors, limiting the risk of tax evasion and fraudulent practices. Moreover, purchasing audits help SMEs to build trust with their customers and suppliers. By demonstrating a commitment to compliance and transparency, SMEs can build stronger relationships with their stakeholders. This can lead to increased sales, better supplier relationships, and an overall improvement in the SME's reputation.

Another advantage of conducting purchasing audits is that it helps SMEs to monitor expenditures accurately. By carrying out a purchasing audit, they can spot any unauthorized or incorrect payments and take corrective action. For instance, pursuing any refunds, revising supplier contracts and agreements. This helps SMEs to safeguard against internal fraud attempts or external fraudulent suppliers' practices, preserving the company's revenue.

Finally, the audits can help SMEs identify opportunities for cost savings. By reviewing their purchasing practices, SMEs can identify areas where they may be overspending or paying more than necessary. By renegotiating contracts or finding new suppliers, SMEs can reduce their costs and improve their profitability. This can be particularly important for small businesses, which often operate on tight margins.

1.1 Statement of the Problem

Small and medium-sized enterprises (SMEs) are the backbone of most economies. Their contribution to the creation of jobs, wealth, and innovation is significant. However, tax evasion remains a prevalent problem among SMEs, and it has negative consequences for the entire economy. The problem of tax evasion by SMEs is a major challenge for governments and tax authorities across the world. Most SMEs operate in the informal economy, making it difficult for tax authorities to track their income and expenses. As a result, many SMEs underreport their income and overstate their expenses, thereby reducing their tax liability. In Kenya, most SMEs tend to overlook compliance with tax regulations. Unfortunately, this could result in severe consequences such as heavy penalties, negative media coverage, customer attrition, and loss of reputation. Studies have focused on tax audits among large tax payers ignoring the small and medium taxpayers who form the majority of taxpayers in Kenya. Conducting purchasing and payment audits are viable preventive measures that SMEs can take to steer clear of fraud activities and, consequently, tax cheats. Doing so also upholds a company's integrity, honesty, and transparency, enhancing customer trust in the firm.

2. LITERATURE REVIEW

Purchasing audits and tax compliance are two crucial aspects of any business operations. There are four main theories that explain the reasons behind conducting a purchasing audit.

2.1 The financial Theory

This theory according to Feld & Frey, (2007) suggests that the primary reason for conducting an audit is to improve the company's financial performance by identifying cost-saving measures. The focus of a financial-based purchasing audit is to identify non-value adding activities and reduce expenses where possible.

One of the fundamental principles of financial theory is the concept of incentives. People respond to incentives, and if the incentives are aligned with their interests, they are more likely to behave in a particular way. This principle applies to taxation and compliance. For example, if the government imposes high tax rates on individuals and businesses, they may be less inclined to pay their taxes and may look for ways to avoid them. On the other hand, if the tax rates are reasonable, and people believe that the government is using their tax money effectively, they are more likely to comply with the tax laws and pay their fair share. In other words, the incentives for tax compliance are closely linked to the tax policies of the government.

Financial theory also helps to explain why some people are more compliant than others. People with a high level of trust in the government and its institutions are more likely to comply with the tax laws. They believe that the government is using their tax money effectively, and they are more likely to see the benefits of paying their taxes. Similarly, people who have a

strong sense of morality or social responsibility may see tax compliance as their duty to contribute to society.

On the other hand, people who have a low level of trust in the government and its institutions may be less compliant with tax laws. They may view taxes as a burden, and they may question the effectiveness of the government in using their tax money. Additionally, people who have a strong interest in maximizing their own financial gain may look for ways to avoid paying taxes, even if it means breaking the law.

Financial theory can also help to identify the most effective ways to encourage tax compliance. One approach is to simplify the tax code, so people understand the rules and their obligations. This can reduce confusion and uncertainty, which are some of the factors that can lead to non-compliance. Additionally, governments can provide education and information about tax policies and their impact on society. This can help to increase people's understanding of the importance of paying taxes and their role in supporting public services.

There is a direct link between purchasing audits and tax compliance. According to this theory, when a business undertakes a purchasing audit, it is able to identify any procurement practices that may be contributing to non-compliance with tax regulations. For instance, the audit may reveal instances of inadequate record-keeping, failure to properly account for VAT, or undervaluation of imports. By addressing these issues, businesses can reduce the risk of non-compliance and potential penalties. Therefore, purchasing audits can be used as a tool for improving tax compliance.

2.2 The performance theory

This theory according to Chen & Huang,(2017) proposes that the performance of a supply chain can be analyzed and improved by identifying key drivers of performance and enhancing them. It assumes that purchasing audits aim to improve the performance of the purchasing department. This theory emphasizes the evaluation of procurement processes based on factors such as delivery time, the quality of goods and services, and customer satisfaction.

Similarly, when it comes to tax compliance, businesses can use the same theory to improve their tax activities such as filing and paying taxes on time, and accurate reporting. By identifying key drivers of tax compliance performance, businesses can improve their compliance processes, minimize the risk of fines and penalties, and optimize their tax responsibilities.

Wang, Shi & Li, (2018) contends that one of the key drivers of tax compliance performance is risk management. Tax compliance risks arise from various factors such as tax legislation changes, complexity of the tax system, and internal mismanagement. Businesses need to identify and manage such risks to ensure that they comply with tax requirements. With the application of purchasing performance theory, businesses

can analyze their tax risks and develop strategies to minimize them.

Another key driver of tax compliance performance is process efficiency. Tax compliance processes can be complex, time-consuming, and prone to errors. In order to optimize their tax activities, businesses need to identify processes that are inefficient, and implement more efficient ones. This may involve automating the tax process, reducing manual input, and incorporating technology.

The application of purchasing performance theory also emphasizes the importance of performance measurement. Businesses need to measure their tax compliance performance to identify areas of improvement. This can involve measuring the accuracy of their tax reporting, the timeliness of their tax payments, and their overall compliance rate. By measuring their performance, businesses can identify areas that require improvement and implement strategies to address them.

2.3 The compliance Theory

This theory according to Kirchler, Hoelzl & Wahl, (2008) assumes that the primary reason for conducting a purchasing audit is to ensure that the purchasing department conforms to legal and ethical guidelines. This theory emphasizes the need to assess procurement operations to ensure that they align with applicable laws, regulations, and industry standards.

Purchasing compliance theory is based on the idea that individuals are more likely to comply with rules when they view them as fair and legitimate. In the context of taxation, this means that taxpayers are more likely to pay their taxes when they believe that the tax system is fair and equitable. This theory suggests that taxpayers are more likely to comply with tax laws when they perceive that the tax system is transparent, predictable, and consistent.

Murphy, (2014) emphasized that an important aspect of purchasing compliance theory is the concept of trust. When taxpayers trust the government and believe that their tax dollars will be used in a responsible and fair manner, they are more likely to comply with tax laws. However, if taxpayers feel that the government is corrupt or inefficient, they may be less willing to pay their taxes. This is why transparency and accountability are so important for tax compliance: they help to build trust between taxpayers and the government.

Another key element of purchasing compliance theory is the notion of incentives. When taxpayers receive clear and specific incentives to comply with tax laws, such as tax credits or deductions, they are more likely to comply. This is because they perceive that the tax system is fair and that they will be rewarded for their compliance. On the other hand, when taxpayers face only negative incentives, such as penalties or fines for non-compliance, they may be less motivated to comply.

According to Kogler *et al.*, (2013), the application of purchasing compliance theory to tax compliance has important implications for taxpayers and policymakers. For taxpayers, it

highlights the importance of trust and transparency in the tax system. If taxpayers feel that the government is not using their tax dollars wisely or fairly, they are less likely to comply with tax laws. This can lead to a vicious cycle in which non-compliance erodes trust further, making it even harder to achieve compliance in the future.

For policymakers, purchasing compliance theory provides insights into how to design effective tax policies. By focusing on transparency, predictability, and consistency, policymakers can create a tax system that is viewed as fair and legitimate by taxpayers. This, in turn, can help to build trust and encourage compliance. In addition, policymakers can use incentives to motivate compliance, such as tax credits or deductions for responsible behavior.

2.4 The control theory

This theory according to Rakshit, Choudhury & Kumar,(2019) assumes that the focus of a purchasing audit is to ensure that there is an effective control system in the procurement department. This theory emphasizes the importance of internal controls to prevent fraud and corruption, reduce risks, and promote accountability. This theory postulates a set of principles and practices that organizations use to manage their procurement processes.

Firstly, purchasing control theory can help organizations to comply with tax regulations. By implementing rigorous procurement processes, firms can prevent the occurrence of fraudulent activities such as tax evasion. For instance, if a company implements a three-way matching process where all invoices are compared to purchase orders and goods received notes, it becomes difficult for employees to create fictitious transactions that could lead to tax evasion. By ensuring that all procurement transactions are valid and documented, organizations can make it easy for auditors to verify tax returns and ensure that all tax obligations are met.

Secondly, purchasing control theory can help organizations to avoid tax penalties. By implementing robust procurement controls, companies can ensure that they only purchase goods and services from reputable suppliers who comply with tax laws. For instance, if a company verifies that all its suppliers have tax clearance certificates before awarding them contracts, it can reduce the risk of engaging with unscrupulous suppliers who could lead to tax penalties if found to be non-compliant. By ensuring that all suppliers comply with tax laws, organizations can protect themselves from tarnished reputations, legal penalties, and long-term financial losses.

Thirdly, purchasing control theory can help organizations to optimize their tax positions. By implementing cost-effective procurement processes, companies can reduce their costs and increase their profitability. For instance, if a company buys goods and services at the lowest possible prices, it can reduce its tax base and lower its tax liabilities. By optimizing its procurement processes, organizations can ensure that they make smart purchasing decisions that are both cost-effective and compliant with tax laws.

In summary, the link between purchasing control theory and tax compliance is crucial for organizations that want to minimize their risks, avoid penalties, and optimize their tax positions. By implementing robust procurement processes, companies can ensure that they only engage with reputable suppliers, verify all transactions, and document all procurement activities. By doing so, organizations can make it easy for auditors to verify tax returns, comply with tax laws, and reduce their tax liabilities. As organizations strive to remain competitive in today's dynamic business environment, it is critical to have robust procurement processes that are compliant with tax law.

2.5 Measures of Purchasing Audit

McIvor & Humphreys, (2004) contend that purchasing audit is a systematic process of evaluating the effectiveness of procurement processes within an organization. It involves assessing and reviewing procurement activities and transactions to ensure that they comply with organizational policies, legal requirements, and ethical standards. The main objective of purchasing audit is to identify areas of improvement and opportunities for cost savings in the procurement process. According to Carter & Rogers, (2008), the measures of purchasing audit applicable to large businesses in ensuring effective procurement management include:

2.5.1 Contract Management

Contract management is a critical aspect of purchasing audit as it ensures that contractual obligations are met. It involves reviewing contracts, purchase orders, and other procurement documents to ensure that they are accurate, complete, and comply with legal requirements. The purchasing auditor verifies that the terms and conditions of the contract are being adhered to and that the contract is providing the intended value for the organization.

2.5.2 Supplier Management

Supplier management is another measure of purchasing audit as it ensures that the organization is working with reliable and trustworthy suppliers. It involves evaluating supplier performance, including delivery times, quality of goods or services, and compliance with contractual obligations. The purchasing auditor checks that the organization is adhering to ethical sourcing practices and avoiding suppliers involved in unethical practices such as child labor or human rights abuses.

2.5.3 Inventory Management

Inventory management as a measure of purchasing audit as ensures that there is an optimum level of inventory to meet the organization's needs. It involves reviewing the procurement process from purchasing to the storage to the delivery of goods and services. The purchasing auditor verifies that there is an efficient inventory tracking system in place to prevent overstocking or stockouts.

2.5.4 Cost Management

Cost management is a measure of purchasing audit that ensures that the organization is getting the best value for money from procurement activities. It involves evaluating the procurement process to identify areas of cost savings and negotiate better prices with suppliers. The purchasing auditor should check if the organization is using appropriate cost allocation methods for different costs associated with procurement activities.

2.5.5 Compliance Management

Compliance management is a measure of purchasing audit that verifies if the organization is adhering to legal requirements and ethical standards. It involves reviewing procurement activities to verify that they comply with organizational policies and procedures, legal requirements, and ethical standards. The purchasing auditor check if there is a robust compliance management system in place to prevent the organization from incurring legal or reputational risks.

2.6 Purchasing audit Practices applicable to SMEs in Kenya

According to Baudoin, (2008), the primary objective of the purchasing audit is to ensure that SMEs are tax compliant. The audit helps in identifying errors, omissions, and discrepancies in the procurement process. It also ensures that the procurement process adheres to the tax laws and regulations of the jurisdiction in which the business operates. He argues that tax compliance in the procurement process involves various aspects, including the following:

Verification of Vendor Information: The purchasing audit helps in verifying the vendor information, such as tax identification number, business registration number, address, and contact details. This information is crucial for the tax authorities to identify the vendors and track their transactions with the SMEs.

Verification of Purchase Orders: The audit verifies the purchase orders and ensures that they comply with the tax laws and regulations. For instance, the purchase orders should reflect the correct tax rates, and the tax amount should be calculated accurately.

Verification of Invoices and Receipts: The audit checks the accuracy of invoices and receipts related to procurement. It ensures that the invoices and receipts contain the mandatory information and that the tax amount is calculated correctly.

Verification of VAT Returns: The audit verifies the VAT returns filed by the SMEs. It checks the accuracy of the VAT returns, including the calculation of the input and output VAT.

2.7 Empirical Literature Review

This encompasses the review of past studies done both in Kenya and globally related to purchasing audit and tax compliance. Khan, & Akhtar, (2020) investigated the relationship between tax compliance and purchasing controls

of Pakistani firms. The aim of the study was to analyze the relationship between tax compliance and public services in developing countries, using Pakistan as a case study. The results indicated that tax compliance had a positive impact on public services, as higher compliance levels lead to better service provision by the government. The study also highlighted the need for effective tax administration and corruption control mechanisms to improve compliance and public service delivery in developing countries.

Coker & Akinyemi, (2019) did a review to examine the role of control and performance measurement in procurement management. The authors provided a comprehensive overview of procurement control mechanisms and their impact on procurement performance. The study emphasized that effective purchasing control requires a balance between risk management and supplier relationship management.

Shaban & Othman, (2020) explored the effectiveness of purchasing control strategies in Malaysian manufacturing companies. The authors assessed the adoption of five control strategies, including price control, supplier certification, and inventory control, among others. The study concluded that implementing multiple control strategies can significantly improve procurement performance.

Gong, Dubelaar & van der Vorst, (2019) evaluated the impact of purchasing control on supplier performance in China. The authors found that price control and performance evaluation are the most effective control strategies for improving supplier performance. The study suggested that strategic partnership with suppliers can be strengthened by engaging in joint efforts towards performance enhancement.

Alm, Bloomquist & McKee, (2015) did a study to investigate the effects of audits and enforcement on taxpayer compliance in Minnesota. The study found that audits are more effective than enforcement in increasing compliance, and that both types of intervention are more effective for corporations than individuals.

Arnold, (2019) did a study titled "Purchase audits and tax compliance. This article analyzed the importance of implementing a purchase audit system to ensure tax compliance in the business environment. The study highlighted the best practices that organizations should adopt to implement a successful purchase audit system. It suggested that businesses should develop a comprehensive purchase audit plan that outlines the goals and objectives of the audit process, identifies the key stakeholders, and provides guidelines on the auditing process. The article also emphasized conducting a risk analysis to identify potential areas of concern and determine the level of audit scrutiny required. Finally, the author emphasized the importance of having qualified personnel to conduct purchase audits.

Khan & Akhtar, (2020) conducted a study to determine the relationship between tax compliance and purchasing controls in Pakistani firms. The researchers aimed to investigate whether firms with stronger purchasing controls have a better

compliance rate with tax laws. The study surveyed 310 medium to large-scale Pakistani firms, using a structured questionnaire that covered variables such as purchasing controls, tax law compliance, and firm-specific information. The results showed that compliance with tax laws is positively associated with stringent purchasing controls, suggesting that strong purchasing controls can improve tax compliance in Pakistani firms.

A recent study conducted by Shafique and Sheikh (2021) aimed to explore the relationship purchasing controls and tax compliance and provide evidence based on data collected from Pakistani firms. The study found that firms with better purchasing controls tend to have higher tax compliance. This correlation can be explained by the fact that firms with better control over their purchasing processes are more likely to keep accurate records of their transactions and payments. As a result, they are better equipped to comply with tax regulations and avoid penalties for not doing so. The study also found that larger firms tend to have better purchasing controls and higher tax compliance. It explained that this is likely due to the fact that larger firms have more resources and expertise to develop and implement effective purchasing controls. Additionally, larger firms have more at stake when it comes to tax compliance, as the penalties for noncompliance can be much higher.

Sainz & Madariaga, (2018) provided an overview of the key elements that are essential to conducting a successful purchasing audit. The authors demonstrated that conducting a purchasing audit can greatly benefit an organization in terms of identifying opportunities for improving procurement practices. The article outlined the importance of identifying the objectives of the audit and defining its scope. The authors suggested that the focus of the audit should be on evaluating the effectiveness and efficiency of the purchasing process. It further stated that defining the scope of the audit is also critical to ensure that the audit covers all relevant areas and processes.

Mwangi (2014) conducted research to investigate the factors that affect tax compliance among Small and Medium Enterprises (SMEs) located in the industrial area of Nairobi. The author administered questionnaires to 120 SMEs, which revealed that tax education, audit function, and penalties significantly influence SMEs' tax compliance behavior. The study found that adequate tax education leads to higher tax compliance, as it increases tax awareness and understanding among SME owners and managers. Audit function was also found to be a significant factor as SMEs that were frequently audited showed higher tax compliance behavior than those that were not audited. Therefore, the study recommended that tax authorities should consider increasing audit frequency and coverage among SMEs to improve their compliance behavior

2.8 Summary of Literature and gaps

According to the literature reviewed, no linkage has been observed in Kenya between tax compliance and purchasing audit. However, various attempts to establish a relationship

between tax compliance and purchasing or procurement controls have been made (Khan & Akhtar, 2020). Other studies have primarily focused on the relationship between purchasing controls, control effectiveness, and procurement performance. Nevertheless, Arnold (2019) agrees that engaging qualified personnel in conducting purchase audits can promote tax compliance. In general, research indicates that the audit function can drive tax compliance, although there is insufficient understanding regarding how conducting audits on purchasing activities may contribute to tax compliance in Kenya.

3 METHODOLOGY

3.1 Research Design

The study utilized explanatory research design. This research design according to Jackson, (2016) is appropriate because it is used to explore the relationship between two or more variables. In this type of research, the researcher seeks to explain a phenomenon or predict an outcome based on the interplay between two or more variables. This is done by collecting data and analyzing it with the aim of uncovering a causal relationship between the variables in question. By using an explanatory research design, a researcher is able to gain a more comprehensive understanding of these underlying causes and how they are related to one another.

3.2 Target Population and Sampling

The research focused on small and medium-sized businesses registered across Kenya's 47 counties. The study utilized a stratified sampling approach, treating each county as a distinct stratum. From each stratum, five SMEs were selectively chosen by the researcher to form the sample for the study. As per Trochim & Donnelly (2008), this approach proves relevant where the population size is extensive, and sampling the entire population isn't practical. It also serves as a suitable technique to regulate sampling errors and heighten sample representativeness. The study had a total of 235 respondents.

3.3 Reliability of Research Instrument

The research instrument's reliability was evaluated using the test-retest method. Koo & Li, (2016) argues that this method consisted of administering the same instrument twice to the same participants at different intervals. The time span between the two administrations was adequate to avoid participants recalling their initial responses. A reliability coefficient (Pearson correlation) was used to compare the scores obtained from both administrations. A substantial correlation was observed, demonstrating a high level of consistency.

4 RESULTS AND DISCUSSION

The aim of the research was to investigate the effect of procurement auditing practices on tax compliance in small and medium-sized businesses registered in Kenya. To conduct a basic linear regression analysis, the constructs of procurement

auditing were recognized as checking of vendor information, checking of purchase orders, checking of invoices and receipts, and verification of vendor information. Tax compliance was considered as the dependent variable.

4.1 Extent of Purchasing audit by KRA on SMEs in Kenya

A descriptive analysis was done to determine the extent of purchasing audit by the Kenya Revenue authority to ensure tax compliance in that sector and the following results were attained:

Table 1: Extent of purchasing audit activities

Purchasing audit activity	N	Mean	SD
Verification of vendor information	235	2.1064	1.21659
Verification of purchase orders	235	2.2128	1.08084
Verification of invoices	235	2.2894	1.15899
Verification of VAT returns	235	3.7064	1.32488
Valid N (listwise)	235		

Source Survey Data, (2023)

The table above shows that in a scale of 1-5 where 1 implies no extent at all while 5 implies to a very great extent, the audit of purchasing activities by SMEs in Kenya is very low. Surprisingly, the Kenya Revenue authority field officers tasked with the duty of checking tax compliance by SMEs only focus on verifying Vat returns (mean-3.7064, SD-1.32488) and ignoring other checks like verification of vendor information, verification of purchase orders and verification of invoice which have means below 3.0 i.e. 2.1064,2.2128, and 2.2894 respectively. This data shows that tax compliance in the informal sector is below par, a scenario that is attributed to the laxity on the side of revenue officers who overlook other purchasing audit measures.

Table 2: Effect of Purchasing Audit on Tax Compliance

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	6.253	.746		8.382	.000
	Verification of vendor information	.307	.133	.253	2.304	.002
	Verification of purchase orders	.205	.108	.150	1.906	.008
	Verification of invoices & receipts	.469	.083	.368	5.668	.000

Verification of VAT returns	.323	.138	.290	2.340	.000
R square	.150				
Adjusted R ²	.136				
a. Dependent Variable: Tax compliance					

Source: Survey data, (2023)

The results show that verification of vendor information, verification of purchase orders, verification of invoices and receipts and verification of VAT returns had beta standardized coefficients and p values of $\beta = 0.253, p < .05; \beta = 0.150, p < .05$ $\beta = 0.368, p < .05$ and $\beta = 0.290, p < .05$ respectively. These imply that all the beta coefficients, β , which are the degrees to which the independent variables each explain the dependent variable, are positive and significant.

For the un-standardized coefficients, the results mean that a unit % age change in verification of vendor information is likely to result in a positive change in SMEs tax compliance by 0.133% while a unit % age change in verification of purchase orders is likely to lead to change in SMEs tax compliance by 0.108% in the positive direction. Similarly, a unit % age change in verification of invoices and receipts and verification of VAT returns is likely to lead to change the tax compliance by SMEs by 0.083% and 0.138% respectively.

R² is 0.150 and is significant while the adjusted R² is 0.136 and also significant. The shrinkage for this matter is 0.014 (0.150-0.136) which is below the level of 5%-10% suggested by Montgomery, Peck,& Vining,(2012).They argue that this range is appropriate since additional independent variables tend to increase the R-squared value, even if they are not relevant to the dependent variable. This level of shrinkage indicates that the model is valid, has stability in its predictions, and can predict variance of tax compliance at 15.0%. It also suggests that the measures of purchasing audit utilized in this study collectively explain 15% of SMEs tax compliance.

The results also show that verification of VAT returns has the highest effect on tax compliance by SMEs in Kenya with unstandardized beta coefficient of 0.469 followed by verification of VAT returns, verification of vendor information and verification of purchase order with unstandardized coefficients of 0.323,0.307 and 0.205 respectively.

These results concur and contradict the results of some previous investigations. It concurs with the work of Shafique and Sheikh (2021) who found out that that firms with better purchasing controls tend to have higher tax compliance. Similarly, Mwangi (2014) in his research to investigate the factors that affect tax compliance among Small and Medium Enterprises (SMEs) located in the industrial area of Nairobi, established that tax education, audit function, and penalties significantly influence SMEs' tax compliance behavior. He further recommended that tax authorities should consider

increasing audit frequency and coverage among SMEs to improve their compliance behavior.

5 CONCLUSIONS OF THE STUDY

From the findings of this study, it can be concluded that purchasing audit, as a measure to enhance tax compliance by small and medium business enterprises has not been fully exploited by the Kenya Revenue Authority. This can be seen from the fact that tax authorities only focus on verification of VAT returns by the SMEs and putting little or no emphasis on other purchasing audit measures. As a result, revenue collection in this informal sector cannot reach the targets set for the year as many loopholes are still available for the players in the sector to evade their tax obligations.

It can also be concluded that purchasing audit is an effective tool in evaluating the effectiveness of procurement processes within an organization. It helps to identify areas of improvement and opportunities for cost savings in the procurement process. Further, it ensures that the organization is working with reliable and trustworthy suppliers. It involves evaluating supplier performance, including delivery times, quality of goods or services, and compliance with contractual obligations. Finally, it can be deduced that the audit helps in identifying the gaps and inefficiencies in the procurement process since the examination includes an analysis of purchase orders, invoices, receipts, and other documents related to procurement.

6 RECOMMENDATIONS

The results of a purchasing audit are not found to be satisfactory, according to this study as it accounts for only 15% of tax compliance by the SMEs and they continue to face tax-related issues. Therefore, there is a critical need to enhance the effectiveness of auditing purchasing procedures by SMEs in Kenya. The study proposes the following recommendations:

- [i]. One way to make purchasing audits an effective tool for tax compliance among SMEs is by conducting them regularly. Conducting periodic purchasing audits will assist SMEs in identifying non-compliance in a timely manner. By doing so, SMEs can rectify them before they become an issue with the tax authorities. In addition, regular audits will promote transparency and accountability in the SMEs' purchasing process, eliminating the possibility of any fraudulent activity.
- [ii]. SMEs in Kenya need to have a dedicated and experienced audit team. The team should comprise individuals with competence in auditing and taxation processes. A competent and dedicated audit team will be more perceptive and diligent. They will be able to identify gaps in the purchasing process and advise SME management on the corrective measures to be applied. Moreover, the audit team should be independent of the purchasing process. This independence will foster objectivity in

identifying non-compliance and recommending the corrective actions required.

- [iii]. SMEs to introduce automation and digitization in the purchasing process. The use of technology in auditing and taxation will enhance efficiency and eliminate human error. Robust software for monitoring and tracking the purchasing process will increase the accuracy of data and improve its quality. Digitization will promote transparency and help SMEs maintain tax compliance, making the auditing process more efficient and less time-consuming.
- [iv]. It is crucial for SMEs to have standardized procedures. A standardized procedure will facilitate continuity of the audit process and ensure consistency in the findings. This will enable the firms to compare their performance over time and improve in areas they repeatedly underperform. A well-defined audit procedure document will also reduce confusion among the audit team on what needs to be audited and how.
- [v]. SMEs should receive adequate training on tax compliance and related matters. Training SME employees on the purchasing process, tax compliance, and the related legal framework will ensure that the SMEs understand the importance of compliance. This will facilitate better compliance behavior, leading to fewer issues and more effective implementation of auditing purchases.

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