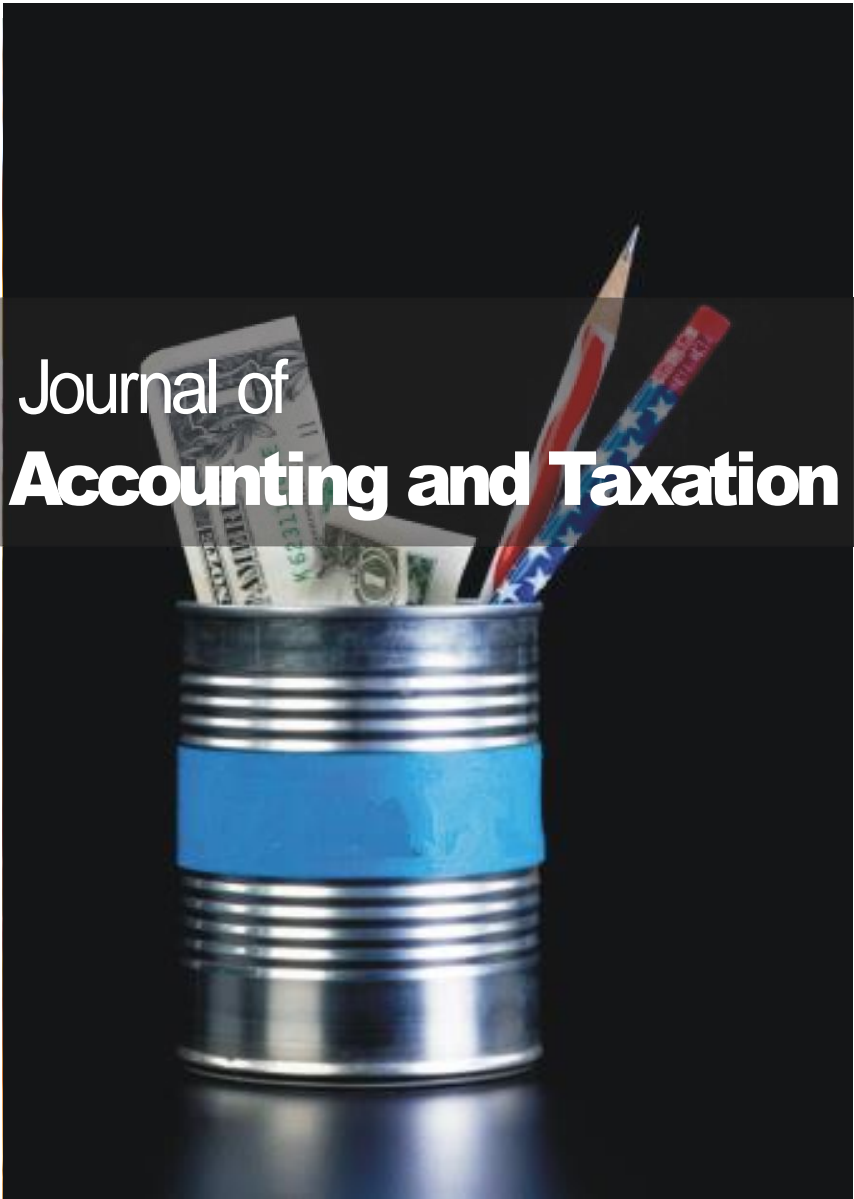


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*Full Length Research Paper*

## **Expectation – performance of internal auditors: Examining views from Ghana**

**Babonyire Adafula<sup>1\*</sup>, Nicholas Asare<sup>1</sup>, Williams Abayaawien Atuilik<sup>2</sup> and Christopher Jwayire Adafula<sup>3</sup>**

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**The study examines the audit expectation-performance gap from the standpoint of the internal audit function from the perspective of a developing economy. It evaluates the audit expectation-performance gap from the perspective of internal audit with the view to providing useful insights, interesting dimensions and innovative perspectives to the Audit Expectation Gap (AEG) debate. A questionnaire survey method was used to elicit and analyze the views of four main stakeholders in the financial reporting supply chain. These were; (1) external auditors, (2) Senior Management, (3) Audit Committee Members and (4) Professional Bodies. The independent sample t-test technique was used. This technique compares the means of two independent groups, (the users of internal auditors reports group and the internal auditors group) so as to determine whether or not there was statistical evidence that their associated population means were significantly different, relative to questions of responsibility of internal auditors; proactiveness of internal auditors; and professionalism and quality of internal audit work. The results show that the views of stakeholders (that is, users of financial information) on the expectation-performance of internal auditors do not differ significantly from those of internal auditors on the issues of responsibility of internal auditors, proactiveness of internal auditors, the level of professionalism of internal auditors and the quality of internal audit work. As demonstrated in the findings and discussions section of this paper, the paper evinces that the application of the agency theory to issues concerning internal auditing is practicable and supported in the context of the economic environment of developing countries. The paper provides some empirical evidence based on the survey on stakeholder perceptions on the expectation-performance of internal auditors from an AEG perspective. The study thus rekindles and adds to the myriad of discourses on the longstanding AEG phenomenon as it relates to the internal audit function from the viewpoint of different stakeholders.**

**Key words:** Audit, expectation-performance gap, internal audit, agency, corporate governance, Ghana.

### **INTRODUCTION**

Internal auditing has become an ever-present feature in corporate governance discourses and practice. In nearly

all organizations, be they private or public, profit or not-for-profit, large or small, local or international, internal

audits are instituted as functions in support of the operational activities of management and/or those in charge of governance. According to Sarens and De Beelde (2006), senior management expects internal audit to; (1) make amends for managements loss of control over organizational activities due to complexity, (2) be the vanguards of corporate culture, (3) monitor and improve risks management processes and internal control systems, (4) train future managers and (5) act as an effective conduit and collaborator in external audits. In addition, internal auditing is expected to provide assurance on operational efficiency of organisations and secure the integrity of operating and financial systems (Cooper et al., 1996). Internal auditors achieve these by applying a systematic and disciplined approach to evaluate and improve the effectiveness of the organisation's risk management, control and governance processes (IIA-USA, 2000). Due to the foregoing, many advocates of good corporate governance practices have acclaimed the IA functions as one of the most efficacious component of any system of internal controls. Accordingly, for the internal audit function to remain relevant, its performance should satisfy the expectations of stakeholders. The expectations of stakeholders usually come in the form of demand for assurance of operational efficiency, integrity of financial reporting, sound risk control and management protocols etc. In cases where expectation-performance mismatch occurs, then a gap arises. This gap is generally termed audit expectation-performance gap (Porter, 1993). Research on this issue of audit expectation-performance gap tends to focus nearly exclusively on external audits. This assertion is evident from the myriad of works on AEG across jurisdictions of the world (Humphrey et al., 1993 in the UK; Porter, 1993 in New Zealand; Best et al. 2001 in Singapore; Frank et al., 2001; and Epstein and Geiger, 2004 in the USA; Monroe and Woodliff, 1993 in Australia; Dixon et al., 2006 in Egypt; Onumah et al., 2009 in Ghana etc.). This is the case in spite of the fact that internal audit is relatively broader in scope and concerns employees, actions and inactions in the adherence to corporate policies and procedures and the development and evaluation of sound internal controls. It directly deals with activities such as auditing for fraud; ensuring compliance with legal, ethical and operational standards etc. This apparent exclusivity of attention on expectation-performance gap in external audits tends to ignore the potential of an expectation-performance gap in internal audits.

It was argued that in view of the similarity in nature of the internal audit function and external audit, and insofar as both audits employ similar techniques and processes in the delivery of assurance services, the potential for a

similar gap if not, a wider one is highly plausible. The proposition of a gap existing in internal audit seems justifiable given the fact that internal audit is relatively broader in scope, CIAGFS, (2013) and concerns employees, actions and inactions in the adherence to corporate policies and procedures and the development and evaluation of sound internal controls. It directly deals with activities such as auditing for fraud and ensuring compliance with legal, ethical and operational standards (Mihret and Yismaw, 2007) among other activities. Internal audit provides assurance to top management about the efficiency and effectiveness of almost any aspect of the reporting entity. Thus the performance of internal audit could engender expectations from the viewpoint of internal auditors and other stakeholders and is thus worthy of empirical examination. This paper therefore examines the views of stakeholders (users of financial information) in the financial reporting supply chain regarding the expectations-performance match of internal auditors. The main objective is to ascertain and examine the dimensions, if any, of potential gaps and to evaluate the potential areas in which this gap may manifest. It is believed that this could contribute to unearthing useful insights pertaining to the discourses in the field of audit expectation-performance gaps. In particular, this could provide added bases for assessing some of the concerns that seek to suggest that internal auditing is just an additional operational cost, which duplicates all that the external auditor would have otherwise done at no extra costs. Thus, the finding could assist in evaluating the perceptions of the performance and value relevance of the internal audit function. The rest of the paper is organized as follows: the next section deals with the literature and theoretical overview of internal auditing. The research methodology employed in the study is expatiated in detail in the following section. The penultimate section deals with the analysis and discussions of the key findings. The last section gives conclusions, including policy implications and suggestions for further research.

## LITERATURE AND THEORETICAL OVERVIEW

Several theories have been employed in the auditing literatures to justify the need for the conduct of audits. Some of these are the agency theory, stakeholder theory, the policeman theory, the expectations theory, the lending credibility theory, etc. This paper relies on the agency and expectations theories as the frameworks to examine the internal audit expectation- performance gap. These two theories have been blended for this study due to the 'third party objective assurance' role of internal

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auditing on the one hand and the conception of internal auditing as a value-adding function on the other. Internal auditors are placed as checks on corporate activities, and to police the actions of managers as a first-hand feedback mechanism to the board in the detection and prevention of fraud (Michael, 1994). Internal auditing from this point of view can be conceived of as a mechanism to partly curtail the agency problem, by being a deterrent or internal whistleblower on managerial corruption, fraud and general maladministration. Internal auditors are agents of the Board/Audit Committee, and are expected to represent its conscience and eye over managers. The user community of the work of internal auditors is not limited to senior management or those in charge of governance.

External auditors in the performance of audit procedures also rely on the work of IA (IFAC, 2013). In consequence, external auditors have some expectations of the level of performance of internal auditors in discharging their duties. It would thus be apt to gauge the continuous relevance of the IA function by examining the performance of internal auditors as compared to the expectations of users. There is also the need for attempts at understanding the extent to which the quality of performance of internal auditors measures up to the standard envisioned by the main professional regulatory body (The Institute of Internal Auditors), as laid down in the Code for the Professional Practice of Internal Auditing. Especially relevant will be evidence of practice from a developing country viewpoint. Michael (1994) has aptly captured these assertions when he opined, "agency theory can provide for richer and more meaningful research in the internal audit discipline". This thinking grounds and motivates the application of the agency and expectation theories for the study.

Berle and Means (1933) were the first to systematically analyse and apply agency theory in the context of the modern corporation. In their view the modern corporation is composed of two main stakeholder groups; the owners (principals) and the managers (agents) with each group pursuing their self interest in the performance of their designated functions. These functions are 'that of having interests in an enterprise, that of having power over it, and that of acting with respect to it (Berle and Means, 1933: 119). In the modern corporate system the function of having power over an enterprise has become separated from that of having interests in it. As a result, the position of owners has been reduced to that of having a set of legal and factual interests in the enterprise whilst that of managers (controllers) are in the position of having legal and factual power over it (Berle and Means, 1933: 120). This separation accordingly creates a parallelism of interests that need to be contained, through various contractual arrangements. Another condition associated with the agency theory is information asymmetry which adversely affects the ability of the principals to monitor the opportunistic behaviour of agents (Michael, 1994).

Agents are assumed to have more information than principals, and in the pursuit of their self interests, agents may fail to act for the benefit of their principals. The problem of asymmetric information further breeds the problem of 'adverse-selection'. Adverse selection occurs when principals are unable to determine the propriety of management actions due to their inability to access all available information known to managers at the time a decision is to be made (Berle and Means, 1933: 9). In all these cases, the containment of the conflict by the principals is not only considered necessary but it is also deemed rational (Kren and Kerr, 1993). Containing the agency problem could be done through an assortment of contractual arrangements between agents and principals, (Schanze, 1987) or a more direct independent monitoring mechanism such as audits (Messier et al., 2006).

Internal audit provides assurance to top management about the efficiency and effectiveness of almost any aspect of the reporting entity. The need for an effective internal audit function has been recognized by a panoply of studies, as a fundamental tenet of good corporate governance (Cadbury Committee Report, 1992; COSO Framework, 1992; Jackson, 2000.). Chambers and Odar (2015) recognised the pivotal role of the IA in governance, by asserting that 'internal audit needs to move firmly into the corporate governance space to provide more dependable assurance to boards'. The IIAF (2013) in conceptualising the IA function defined it as "*...an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*" This definition radically shifts the focus of internal auditing from the traditional adjunct function of 'audit for management' to a strategic value-adding activity with an eye over management (Ramamoorti, 2003), and as an activity in the pursuit of corporate objectives (Lenz and Ulrich, 2015). In the discharge of their monitoring functions, the board of directors often form committees composed of independent non-executive directors. Following the leads of Watts (1988) and Michael (1994) reconceptualised internal auditing as coming within the ambit of agency and raised substantive areas of research within that milieu. He contended that agency-theory perspective to the internal audit research could have substantive benefits for both academics and practitioners. It was submitted that being employees of management (the principals), internal auditors (the agents) are expected to meet the performance expectations of the various stakeholders given the ever complexifying dimensions of operational risks that businesses face in a globalised world and the increasing reliance on the internal audit function by to provide assurance on risk management.

Mat-Zain and Subramanian (2007) examined the

relationship of IA to the audit committee in Malaysian public sector corporations. That study revealed among other things that audit committees enjoyed unquestionable authority. Audit committees are expected to take leading roles in inquiring into management decisions and support internal audits via both formal and informal means [ibid]. Sarens and De Beelde (2006) also investigated the relationship between IA and senior management, in which they concluded that both internal audit and senior management have expectations of each other.

Senior management's expectations has a significant influence on internal audits. Internal auditors usually meet senior managements' expectations, but IA's also expected senior management to take a leading role in the formalisation of risk management systems. This position seems to be in line with both the Cadbury Committee's Report (1992) and the COSO Framework (1992) as both of these reports directly charge directors to institute and report on the effectiveness of internal controls. Similarly, Nagy and Cenker (2002) assessed the internal audit function in terms of four factors viz; audit scope, organisational structure, risk management and audit committees. They found a general shift in focus of the internal audit function towards an operational or consulting orientation. Unlike Mat-Zain and Subramanian (2007) and Nagy and Cenker (2002) found that audit committees contributed little-to-no effort in determining internal audit plans. Other studies evaluated the role of internal audits in governemnet financial management. Notably, Diamond (2002) conducted an international comparison of internal audit practices. This work revealed marked differences in IA practices, but found that there was a general acceptibility in the public sector regarding the critical monitoring role internal audits could play in achieving sound public sector financial management.

From the review of the literature, the evidence of expectation-performance of internal auditors appears to be skewed towards the public sector. There seems to be a pausity of empirical work on the subject matter in the context of private sector entities. Given the growing recognition and acceptance and in some cases institutionalisation of the internal audit function, an investigation of the expectation-performance of internal auditors could unearth useful and intererstring insights. It is particularly aserted that such knowedege could have useful practical appliaction from the perspective of professional practice as well as policy dimensions. Therefore, with the view to investigating the existence of any potential performance gap in internal audits from the view points of its stakeholders.

Following from the literature, three broad measures were developed and tested on the emerging thematic areas. These include, the levels of implementation of internal audit recommendations (quality of IA work serving management expectations), perception of levels of proactiveness of internal auditors in the area of risk

assessment, and the perceptions regarding professionalism of internal auditors. Thus, expectation-performance revolves around these key issues. Examining views on these issues could thus be useful in providing insights into the subject matter. In the light of the foregoing, the following hypothesis are formulated and evaluated.

H<sub>1</sub>: The views of users on the expectation-performance of internal audit do not differ significantly from those of internal auditors regarding the responsibility of internal auditors.

H<sub>2</sub>: The views of users on the expectation-performance of internal audit do not differ significantly from those of internal auditors regarding proactiveness of internal auditors.

H<sub>3</sub>: The views of users on the expectation-performance of internal audit do not differ significantly from those of internal auditors regarding professionalism and quality of internal audit work.

## MATERIALS AND METHODS

The study uses the survey strategy. Questionnaires containing statements on the three broad issues were administered. Responses were rated on a five-point Likert-scale, ranging from strongly disagree (1) to strongly agree (5). It was administered to two groups of respondents (users of financial information) and internal auditors. The users of financial information comprises external auditors, senior management of companies, audit committee members, professional regulatory bodies. The internal auditors are sampled from among heads of internal audit units of companies. They were purposively selected given their direct and/or indirect involvement with the internal audit function. The sampling method was judgemental in nature because the study seeks to obtain relevant information from persons considered competent in that regard, so as to facilitate a meaningful evaluation of the phenomenon at hand. The views of respondents on some specific performance related statements bordering on the responsibility of internal auditors; proactiveness of internal auditors; as well as professionalism and quality of internal audit work were tested. Descriptive statistics were computed from the responses obtained. Inferential statistical analysis was also conducted testing the significance of the differences in the mean responses of the users in comparison with those of internal auditors concerning the expectation-performance of internal auditors using the independent sample t-test.

Two hundred questionnaires were hand delivered by a team of 4 research assistants at from the University of Professional Studies Accra-Ghana, to 2 categories of respondents for eliciting views on the thematic areas of perceptions. Out of the administered questinnaires, 123 were returned completed, representing about 61.50% response rate. This is considered useful for the analysis. The details of the composition of the various Stakeholder groups and respective response rates are shown in Table 1. The external auditors class of respondents consisted of accountants in practice drawn from the Big4 accountancy firms (these are transnational in nature) and selected Small and Medium Size Practitioners - SMPs (these are local based practioners). On the average the auditors class of respondents had at least 8 years of professional practice. They therefore consist of persons with fairly good degree

**Table 1.** Stakeholder groups and response rate.

Stakeholder group	Number sampled	Number responding	
<b>Users:</b>			%
External Auditors	25	20	80.00
Senior Management <sup>*</sup>	25	14	56.00
Audit Committees	25	14	56.00
Professional Bodies <sup>**</sup>	25	18	72.00
<b>Internal Auditors</b>	100	57	57.00
<b>Total</b>	<b>200</b>	<b>123</b>	<b>61.50</b>

<sup>\*</sup>Senior management group were composed of CEO's/Managing Directors and Chief Financial Controllers.

<sup>\*\*</sup>Professional bodies included members of The Institute of Internal Auditors, Ghana and The Institute of Chartered Accountants Ghana, the Securities and Exchange Commission.

Source: Fieldwork and Authors' Computation (2016).

of experience. Thus, their views could conveniently proxy the views of the accounting profession regarding the expected performance of internal auditors. Also, out of the 14 senior management respondents, 10 of them, representing 71.43% of that class of respondents have had experience within a multinational corporation context. They have also held their current positions for not less than 3 years. Therefore, they could be deemed to have the relevant exposure to the issues being examined with respect to the internal audit function. Audit committee members were also persons with diverse work experiences ranging from banking, insurance, and law. All the internal auditors who responded to the questionnaires were Chartered Accountants with an average of 9 years of post qualification experience. They could thus demonstrate a fairly good understanding of the framework for the professional practice of internal auditing. In view of their multisectoral background, they can be considered as well placed to express valid opinions, including but not limited to the ethical principles and demands of the internal auditing function.

## ANALYSIS OF RESULTS AND DISCUSSION

### Respondents views on the responsibilities of internal auditors

Internal auditors have specific responsibilities that they execute within the financial reporting supply chain. Using the respective mean responses in Table 2 the following analysis are made on statements concerning responsibilities of internal auditors. The respondents (that is both users and internal auditors) indicated their disagreement to the following statements that: It is the internal auditors' duty to institute internal controls in a firm; and the scope of internal audit work should be independently determined devoid of management's inputs. They thus sought to articulate clearly that internal auditors do not have a duty to institute internal controls; and that the scope of internal audit work should not be independently determined without management's inputs. By this response, users and internal auditors alike are of the view that the soundness of internal controls and the scope of the internal audit function are not under the purview of only internal auditors. All respondents agree

that it is the responsibility of management to establish and maintain a sound internal control system and the duty of internal auditors is to continuously monitor and evaluate they control system and report whether or not it is working throughout. All respondents also agree that management has a duty to make inputs into the scope of the internal audit function. Interestingly, both users and internal auditors agree that internal auditors shall ensure their own professional development through training; internal auditors should certify all annual financial statements before they are subjected to external auditing; and internal audit reports should guarantee the soundness of operating policies and procedures. Accordingly, there has been some allusion to some of the statements as enumerated, but they are quite uncertain as regards the internal auditors' duty to monitor and evaluate all possible risks the entity may face; and internal auditors should be held accountable when external auditors detect fraud.

However, there seem to be no significant differences in expectations between users of internal audit work and the internal auditors. This is regarding the expectation – performance of internal auditors in the design and implementation of controls, monitoring and evaluation of risks, responsibility on fraud detection, the guarantee of internal audit reports on the soundness of operating policies and procedures, responsibility for professional development and the scope of internal audit work. This is reflected in the respective summarised t-test shown in Table 3. Even though per their mean responses respondents agree that internal auditors should certify all annual financial statements before they are subject to external auditing, there were significant difference in their average responses.

### Respondents views on the proactiveness of internal auditors

Risk anticipation or 'risk alertness' and the development

**Table 2.** Descriptive Statistics and t-test: Performance Expectations of Internal Auditors

Statement	Stakeholder	N	Mean	Std. deviation	Std. error mean	t-test for Equality of Means		
						T	Df	Sig. (2-tailed)
(i) Internal audit reports should guarantee the soundness of operating policies and procedures	Internal auditors	57	3.95	1.32	0.17	-1.64	121.00	0.10
	Users	66	4.30	1.10	0.13	-1.61	109.36	0.11
(ii) Internal auditors shall ensure their own professional development through training.	Internal auditors	57	3.74	1.37	0.18	-0.55	121.00	0.58
	Users	66	3.86	1.19	0.15	-0.54	111.77	0.59
(iii) It is the internal auditors' duty to monitor and evaluate all possible risks the entity may face	Internal auditors	57	3.19	1.39	0.18	1.50	121.00	0.14
	Users	66	2.80	1.47	0.18	1.51	119.91	0.13
(iv) It is the internal auditors' duty to institute internal controls	Internal auditors	57	1.72	0.75	0.10	-0.63	121.00	0.53
	Users	66	1.82	0.96	0.12	-0.64	119.87	0.52
(v) Internal auditors should be held accountable when fraud is detected by external auditors.	Internal auditors	57	2.61	1.56	0.21	1.33	121.00	0.19
	Users	66	2.29	1.16	0.14	1.30	102.39	0.20
(vi) The scope of internal audit work should be independently determined devoid of management's input	Internal auditors	57	1.82	1.20	0.16	0.60	121.00	0.55
	Users	66	1.71	0.87	0.11	0.59	100.91	0.56
(vii) Internal auditors should certify all annual financial statements before they are they are subject to external auditing	Internal auditors	57	3.67	0.97	0.13	-1.77	121.00	0.08*
	Users	66	3.98	1.02	0.12	-1.78	119.75	0.08*

Note: (a) (1) = Strongly Disagree (2) = Disagree (3) = Uncertain (4) = Agree (5) = Strongly Agree, (b) \*\*\*, \*\* and \* denotes significance levels of 1, 5 and 10%, respectively

Source: Fieldwork and Authors' Computation (2016).

of counter measures remain a fundamental prerequisite in the risk management role of internal auditors (Spira and Page, 2003). In effect the 'value added' element of internal audits could best be justified if the internal audit function helps the corporation to mitigate risks which would otherwise derail the company's short and long term goals. In view of this, how stakeholders' perceive the IA function in Ghana was evaluated (Table 3). The mean responses of the users and Internal auditors appeared to be in agreement; that Internal auditing methodologies should be appropriate in identifying corporate risks; Internal audit input should always be taken during all corporate planning processes; and Internal auditors should be relied upon to accurately and timely evaluate present and future risks of the firm. On the other hand, they are quite evasive on whether internal auditors deserve a role in top-management. The results of the t-test shown in Table 3 shows that there are no significant statistical differences in views regarding the extent to

which internal auditors in Ghana are perceived to be proactive, as all p-values > 10%. There is an indication from the analysis that users and internal auditors have similar opinion on the proactiveness of the internal audit function. Generally, per this analyses, the internal audit function as pertains in Ghanaian corporate circles is quite proactive and hands-on.

#### **Respondents views on professionalism and quality of internal audit work**

Conformance with professional standards is a vital element in all professional and consultancy engagements. A more effective internal audit activity would therefore seek to apply and promote the highest level of professionalism in the conduct of audit activities, as this would enhance the organisational support for the function (Ridley, 2004). Six statements are used to evaluate the

**Table 3.** Descriptive statistics and t-test: Views on proactiveness of internal auditors.

Statement	Stakeholder	N	Mean	Std. deviation	Std. error mean	t-test for equality of means		
						T	Df	Sig. (2-tailed)
(i) Internal auditing methodologies should be appropriate in identifying corporate risks	Internal auditors	57	4.30	1.30	0.17	0.23	121.00	0.82
	Users	66	4.24	1.40	0.17	0.23	120.46	0.82
(ii) Internal audit input should always be taken during all corporate planning processes	Internal auditors	57	3.70	1.25	0.17	-0.30	121.00	0.76
	Users	66	3.77	1.35	0.17	-0.30	120.29	0.76
(iii) Internal auditors should be relied upon to accurately and timely evaluate present and future risks of the firm	Internal auditors	57	3.84	1.45	0.19	-0.99	121.00	0.32
	Users	66	4.09	1.33	0.16	-0.99	114.89	0.33
(iv) Internal auditors deserve a role in top-management	Internal auditors	57	3.28	1.97	0.26	0.66	121.00	0.51
	Users	66	3.05	1.99	0.24	0.66	118.70	0.51

Note: (a) (1) = Strongly Disagree (2) = Disagree (3) = Uncertain (4) = Agree (5) = Strongly Agree, (b) \*\*\*, \*\* and \* denotes significance levels of 1, 5 and 10% respectively

Source: Fieldwork and Authors' Computation (2016).

views of respondents on the professionalism of internal auditors (Table 4). The respondents (that is users and internal auditors) came to an agreement that internal auditors should conform to professional standards most of the time. In addition, that professional standards should generally promote and support a good corporate governance culture, internal auditors should demonstrate objectivity and independence always, and internal audit recommendations always add value even if they relate to negative aspects of management decisions. On the issue of whether internal audit recommendations must suitably address all control risk factors, users are uncertain whilst internal auditors agree. Furthermore, on whether internal auditors should report directly to the Audit Committee, users agreed, while internal auditors appear uncertain. The t-test results in Table 4 indicate that there is no significant statistical differences in the opinion of internal auditors and users on the Professionalism and Quality of Internal audit work, as the p-values are not significant at the various significant levels, for all the statements except the last statement. Therefore, users and internal auditors' views differ on whether internal auditors should report directly to the Audit Committee. There appears to be AEG in the context of the latter.

## Conclusion

This study critically examines the expectation-performance of internal auditors from the perspective of the Audit Expectation Gap (AEG) concept. The study

uses data collected from two classes of respondents (users of financial information and internal auditors) in the financial reporting supply chain in Ghana. Specifically, this study analyses the extent to which the views of internal auditors on the Internal audit function differs from those of other stakeholders (that is users).

There is apparently no significant differences in expectation-performance between users and the internal auditors regarding the expectation-performance of internal auditors in the design and implementation of controls, monitoring and evaluation of risks, responsibility on fraud detection, the guarantee of internal audit reports on the soundness of operating policies and procedures, responsibility for professional development and the scope of internal audit work. Also, both users and internal auditors seem to articulate clearly that internal auditors do not have a duty to institute internal controls of the entity; and that the scope of internal audit work should not be independently determined devoid of management's inputs. Users and Internal Auditors opined that Internal Auditors shall ensure their own professional development; should certify all annual financial statements before they are subjected to external auditing; and internal audit reports should guarantee the soundness of operating policies and procedures. On the other hand, they are quite uncertain about whether it is the internal auditors' duty to monitor and evaluate all possible risks the entity may face and should be held accountable when external auditors detect fraud.

This means that in the minds of users and Internal Auditors, internal controls are to be instituted by



**Table 4.** Descriptive statistics and t-test: views on professionalism and quality of internal audit work.

Statement	Stakeholder	N	Mean	Std. deviation	Std. error mean	t-test for equality of means		
						T	df	Sig. (2-tailed)
(i) Internal auditors should conform to professional standards most of the time.	Internal auditors	57	3.72	1.53	0.20	0.45	121.00	0.66
	Users	66	3.59	1.65	0.20	0.45	120.29	0.66
(ii) Professional Standards should generally promote and support a good corporate governance culture.	Internal auditors	57	3.65	1.41	0.19	-1.32	121.00	0.19
	Users	66	3.98	1.41	0.17	-1.32	118.43	0.19
(iii) Internal auditors should demonstrate objectivity and independence always.	Internal auditors	57	3.70	1.25	0.17	-0.30	121.00	0.76
	Users	66	3.77	1.35	0.17	-0.30	120.29	0.76
(iv) Internal audit recommendations must suitably address all control risk factors.	Internal auditors	57	2.30	1.86	0.25	-0.94	121.00	0.35
	Users	66	2.62	1.95	0.24	-0.94	119.79	0.35
(v) Internal audit recommendations always add value even if they relate to negative aspects of managements decisions.	Internal auditors	57	4.30	1.30	0.17	0.23	121.00	0.82
	Users	66	4.24	1.40	0.17	0.23	120.46	0.82
(vi) Internal auditors should report directly to the Audit Committee	Internal auditors	57	3.44	1.55	0.20	-2.13	121.00	0.03**
	Users	66	4.00	1.37	0.17	-2.12	112.92	0.04**

Note: (a) (1) = Strongly Disagree (2) = Disagree (3) = Uncertain (4) = Agree (5) = Strongly Agree, (b) \*\*\*, \*\* and \* denotes significance levels of 1, 5 and 10%, respectively.

Source: Fieldwork and Authors' Computation (2016).

management as it is enshrined in corporate governance codes. In that regard, institutions should continue to allow Internal Auditors to contribute to determining the kinds of management and internal controls in a firm. It is believed that this could help free the control system in the firm and secure its independence from the persons who purport to assess and report on it for the perusal of management/board of directors.

The scope of the Internal audit work should be determined with direct management inputs as it could possibly be comprehensive than it would be without their inputs. In the Ghanaian setting, internal auditors are expected to be responsible for their own professional development. Internal Auditors are thus to attend practitioner based conferences, seminars, workshops and symposiums when they are confronted with such opportunities. In the particular context of Ghana, the ICAG could be a focal point for organizing training on contemporary issues in accounting and auditing that aimed at strengthening the professional competencies of Internal Auditors.

Certification of all annual financial statements before they are subjected to external auditing could facilitate the

work of the external auditor. Similarly, it is now clear that stakeholders advocate that internal audit reports should guarantee the soundness of operating policies and procedures, which is not contrary to the stance in the extant literature. Once stakeholders are reasonably uncertain about whether it is the Internal Auditors' duty to monitor and evaluate all possible risks an entity faces and should be held accountable when external auditors detect fraud. It can be inferred that there is a need for the accounting profession to find ways and means of ironing out these issues to ensure that the value creation purpose of the Internal audit function is improved for the satisfaction of all stakeholders.

The results also show that there were no statistically significant differences in the views of the users and internal auditors regarding the extent to which internal auditors in Ghana have been perceived to be proactive. The stakeholders had consensual agreement on the issues that Internal auditing methodologies should be appropriate in identifying corporate risks; Internal audit input should always be taken during all corporate planning processes; and Internal auditors should be relied upon to accurately and timely evaluate present and

future risks of the firm. On the other hand, they are quite evasive on whether internal auditors deserve a role in top-management. This is in line with Spira and Page (2003) assert that risk anticipation and the development of counter measures remain a fundamental prerequisite in the risk management role of internal auditors. In effect the 'value added' element of internal audits could best be justified if the internal audit function helps the corporation to mitigate risks which would otherwise derail the company's short and long term goals.

Furthermore, the results indicate that the views of users and Internal Auditors on professionalism and quality of internal audit work are not diverse. For instance, as to the question of whether or not internal audit recommendations must suitably address all control risk factors and the internal auditors reporting directly to the audit committee, the views of internal auditors and users varied significantly. The two stakeholder groups largely agreed that internal auditors should conform to professional standards most of the time; professional standards should generally promote and support a good corporate governance culture; internal auditors should demonstrate objectivity and independence always; and internal audit recommendations always add value even if they relate to negative aspects of managements decisions. This aspect of the findings is consistent with Ridley (2004), which indicates that a more effective internal audit activity would therefore seek to apply and promote the highest level of professionalism in the conduct of audit activities. There is thus a subtle AEG among the stakeholders in Ghana concerning comprehensiveness of recommendations of Internal Auditors and lines of reportage regarding their work. This is likely to raise eyebrows concerning the work of internal auditors in the Ghanaian context.

By and large, the AEG concerning these issues of internal auditing reflecting the responsibility of internal auditors; proactiveness of internal auditors; and professionalism and quality of internal audit work is not wide in the financial reporting supply chain in Ghana. The study concludes that there is much evidence to support the agency and expectation theories in the Ghanaian corporate environment in respect of the Internal Audit function. It can be argued that the main motive behind these results seems to be a synthesis of internal audit functions, instigated by an absence of legislative backing to deliver uniformity in the implementation of best practices in the corporate world.

## LIMITATIONS OF THE STUDY

When interpreting the findings of this study, a number of limitations need to be taken into account. First and consistent with general trends in questionnaire-based research, is the limited number of respondents could be an impediment to the generalisation value of the results, thereby necessitating careful interpretation of the

findings.

Second, the questionnaires were sent to certain selected stakeholders and internal auditors. Thus, the views may not be representative of the perceptions of all actors in the financial reporting supply chain of the Ghanaian business and economic environment. Notwithstanding the limitations outlined in the preceding paragraphs, the study could have value relevance in its context, time and space. First, as one of the few studies to examine the concept of the expectation-performance gap of internal auditors in the context of an emerging developing economy in Subsaharan Africa, this study could open new avenues for future research in Ghana and in simialar other business and economic environments.

Second, it would be interesting and insightful, for example, to identify variables to explain AEG in the context of Internal audit from other contexts to facilitate both local and international comparative analyses.

Lastly, findings consistent with this study could provide bases and insights to professional, regulatory and training institutions and agencies to initiate policies and programmes supportive of improving theory and practice in Internal auditing. Future research is thus recommended on specific aspects to iron out the differences identified in the views of the stakeholder groups.

## CONFLICT OF INTERESTS

The authors have not declared any conflict of interests.

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## INTRODUCTION

The theory behind using tax incentives to promote small and medium-sized enterprises (SMEs) is at its core from the finance theory of net present value (NPV) decision rule. The rule implies that firms continue to spend on capital assets and R&D as long as the present value from an additional unit of capital or R&D is equal to or exceeds the cost of the additional unit. Consequently, it is assumed that businesses would consider tax implications in their calculation of the value of their expenditure decisions since any reduction in the cost of capital caused by tax policy leads to an equal increase in expenditure (Hansson and Brokelind, 2014).

SMEs play a vital role in the economic development of a country. Studies have indicated that SMEs contribute more than 50% of the gross domestic product (GDP) in many developing countries. More still, SMEs are the largest employers where by more than 90% of the working force is employed by SMEs.

In a bid to stimulate growth of SMEs, a number of countries have used tax incentives, for both investors and listing firms, to promote activity on SME boards. Tax incentives for investors are the more common approach, particularly in advanced markets (Mintz and Chen, 2011). For instance, Poland adopted the policy of encouraging investment in shares of SMEs through removing so-called “back-end” taxes, which are the taxes applied to profits made when selling a security.

In South Korea and India, investors benefit from reduced capital gains taxes on SME equity investments. This is done via the cutting of short-term capital gains tax in half, from 30 to 15%, for shares listed of SMEs. The UK and Spain adopted a tax incentive policy where the retail investors may deduct a set percentage of the value they invest in shares of SME equity. This happens via offering tax offsets only for acquiring shares in new SME equity offerings. In France, the investors can get a tax credit of 18% of the value invested in innovation mutual funds French acronym. The latter invest at least 60% of their portfolios in SME equity. Though these policies have been adopted the possible outcome may not significantly affect entrepreneurs as their interest rather lies with the capital influx from equity offerings in SMEs (Broersma and Gautier, 2017).

Belgium offers several investment allowances. The general investment deduction for SMEs amounts to 10.5% of the depreciation taken on assets. The rate varied between 10.5 and 12.5% since 2009. The incentive is restricted to companies with fewer than 20 employees. Unused amounts can be used in subsequent years with a maximum carry-forward of € 946,800 (or 25% if the unused part exceeds € 3,787,210). Additionally, an allowance of 20.5% is granted to SMEs for investments in safety measures either in the year of the investment or the following year. Concerning carry-forwards the same rules apply as for the aforementioned deductions. A national interest deduction is available for all Belgian companies. It amounts to 4% of qualifying equity. SMEs, however, are allowed to deduct an additional 0.5%. Since 2012, carry-forwards are no longer possible (De-Wit and De-Kok, 2014).

Austria does not offer special tax incentives for SMEs on the firm level. There is only an adjusted minimum tax for newly founded companies of € 1,092 that merely benefits low-income companies. On the shareholder level, Austria grants full exemption to income from participations in unlisted European SMEs (that is, dividends, capital gains and interest payments) for so-called intermediary investors. Intermediary investors must be corporate entities financed with equity capital. For individual investors, dividends from such intermediary investors are exempt from income taxation up to € 25,000. Enterprises are exempt from the value-added tax (VAT) if their turnover is lower than € 35,000. Moreover, enterprises with less than € 100,000 of turnover in the preceding year only have to file VAT returns and make VAT payments on a quarterly basis (instead of monthly). Suppliers with a turnover of less than € 110,000 may pay VAT on a cash basis (De-Wit and De-Kok, 2014).

Bulgaria does not have special tax incentives for SMEs. Small companies are subject to administrative reliefs, though. Enterprises whose net sales in the previous year were below BGR 300,000 (≈€ 150,000) do not have to make advance tax payments and those with net sales below BGN 3,000,000 (≈€ 1,500,000) only have to make quarterly advance payments (instead of monthly). In addition to that, simplified accounting standards apply for SMEs. VAT registration is only required for enterprises with more than BGN 50,000 of turnover (De-Wit and De-Kok, 2014).

Croatia provides comprehensive investment incentives for new undertakings. Income from new investments (also by existing enterprises) can be subject to corporate income tax rates that are reduced by up to 100% for 10 years. The exact amount of the reduction depends on the size of the investment and on the number of newly created jobs related to the investment: 100% reduction if investment of at least € 3 million and related to 15 new employees; 75% reduction if investment of at least € 1 million and related to 10 new employees; and 50% reduction if investment of less than € 1 million and related to 5 new employees (De-Wit and De-Kok, 2014).

Finland does not provide tax incentives specifically targeted at SMEs. There is a regime of accelerated depreciation for fixed assets being used in production activities (200% of the usual depreciation rate on machinery, equipment and industrial buildings). The regime used to be restricted to SMEs until 2013 but is now available for all enterprises. Moreover, with the super deduction of 100% of salary costs incurred for R&D projects being capped at € 400,000, SME should benefit more than large enterprises. Businesses with less than € 8,500 of turnover are exempt from VAT. If turnover is below € 25,000, only yearly VAT payments need to be made, if it is below € 50,000, only quarterly payments are required (instead of monthly). Moreover, SMEs are subject to reduced documentation requirements with regard to transfer prices (De-Wit and De-Kok, 2014).

Zimbabwe provides investment incentives with six objectives in mind: Employment creation; small business development; industrial development; export promotion; spatial development; and “upliftment” of the disadvantaged. Many of the incentives take the form of financing arrangements, which operate through the Ministry of Industry and International Trade, the Industrial Development Corporation and the Zimbabwe Investment Centre. The most extensive tax incentives accrue to exporters. Under the Export Processing Zone Act of 1995, enterprises in manufacturing, processing or services that are licensed by an Export Processing Zones (EPZ) (Kaplan, 2001). Authority to operate in an EPZ is related to obtaining a 5-year tax holiday, followed by a rate of 15 percent. EPZ companies also receive the standard duty-free access to imports and refunds on sales tax for domestically procured goods and services. In addition, they are exempt from capital gains tax, shareholder’s taxes and non-resident taxes on interest, fees, royalties and remittances. Other exporters outside EPZs qualify for a rebate or drawback of certain duties on imported inputs. Since January 2003, manufacturers that export 50% or more of their volume are taxed at 20%. Finally, exporters can take a double deduction for export marketing costs. Tax holidays apply to other activities as well. Tourism operators in approved tourist development zones benefit from a 5 year holiday, followed by a 15% tax rate. The same provisions apply to industrial park developers. Build-own-operate-transfer projects obtain a 5 year holiday, followed by 15% for 5 years, 20% for 5 years, and then the normal tax rate. In growth point areas, approved manufacturers get a 10% tax rate, while certain infrastructure projects get a 15% rate. Special investment allowances also apply to a limited set of beneficiaries (Kaplan, 2001).

The aim of Tanzania’s tax incentive programs is to attract productive investment, create employment and enhance exports. The Tanzania Investment Act of 1997 provides the basic framework for investment promotion, though associated tax measures are incorporated into the respective tax legislation. The main change in 1997 was to end income tax holidays outside of export processing zones, in favour of expensing of capital assets and remission from customs duty on capital goods for holders of a Certificate of Investment from the Tanzania (Zee et al., 2002).

Tax incentives in Kenya can be grouped into either investment promotion incentives or export promotion incentives. Investment Promotion Incentives include Investment Deduction Allowance which was introduced in 1991 to encourage investment in physical capital such as industrial buildings, machinery and equipment, industrial building allowances which was introduced in 1974 with the objective of encouraging investment in buildings used for industrial purposes like hotels and manufacturing plants, mining deductions allowance which was introduced to encourage investors to venture into the mining industry which is very capital intensive and farm works deductions which was introduced in 1985 to encourage investment in the agricultural sector. Export promotion incentives program has three main schemes which include the EPZ, Manufacture Under Bond (MUB) and the Tax Remissions and Exemption Office (TREG). The objective of EPZ’s is to generate and encourage economic activity and foreign direct investments while MUB and TREG regimes were meant to encourage investors to manufacture for export within the country (Githaiga, 2013).

The Rwanda fiscal policy provides various tax incentives with the aim of enhancing business and foreign direct investment. The Rwanda investment board provides tax incentives such as accelerated depreciation of 50% for investment in new or used assets, preferential corporate income tax rate of 0 and 15% for the registered investors, tax holidays of seven and five years. In addition to tax incentives provided in the investment, there are number of tax incentives provided in the fiscal tax law. These include loss carried forward for a period of five years, exemption of some income and allowance of some expenses like research and development. All these incentives are aimed at promoting businesses in Rwanda (MINECOFIN, 2012).

SMEs play a very important role in many developing countries. Young (2009) observes that especially in the developing countries the health of the economy as a whole has a strong relationship with the health and nature of SMEs. In Rwanda for example, the SMEs contribute more than 60% of new jobs created. Due to the importance of SMEs to the Rwandan economy, the Government of Rwanda has made notable intervention by putting in place measures like the Umurenge SACCOs that are geared towards promotion of and development of SMEs (MINICOM, 2016).

The study by MINICOM, NISR, MIFOTRI, and PSF indicated that 99.9% of the population are employed by small and medium enterprises and only 0.1% by large enterprises. This implies that a large number of work force is employed by SMEs. Despite their significance and the financial support given to them, the SMEs are faced with the threat of failure

with the past statistics indicating that three out of five fail within the first few months of operation. According to MINCOM et al. (2017), only a fraction of the establishment started in 2010-17 remained in operation. The effect of SMEs discontinuation is very dangerous and devastating as it leads to loss of jobs and assets as well as the GDP.

However, despite of the importance of sustainability and continuity of SMEs, studies solely focusing on whether tax incentives affect the growth of SMEs in developing countries particularly Rwanda seem to be very limited and scarce. It is within this context, that researchers want to investigate the effect of tax incentives on the growth of SMEs in Rwanda.

The study answered the following two questions:

- (1) Does the tax laws in Rwanda provide tax incentives in the support of SME growth
- (2) There is a significant effect between tax incentives and SME growth.

## **THEORETICAL AND CONCEPTUAL FRAMEWORK**

### Neo-classical theory

Neo-classical economic theory argues that providing tax incentives to one group of investors rather than another violates one of the principal tenets of a good tax system, that of horizontal equity. This inequality distorts the price signals faced by potential investors and leads to an inefficient allocation of capital (Comanor, 1967). The justification most often given for special incentives is that there are market failures surrounding the decision to invest in certain sectors and locations, which justify government intervention.

Market failures result in either too much or too little investment in certain sectors or locations. The key market failure most often cited is positive externalities not internalized in the project's rate of return that are higher in certain sectors than in others. An example is research and development where investment yields a higher social than private rate of return because not all the technological knowledge can be effectively patented and as such there exists an exalted justification for subsidizing research and development investment (Kaplan, 2001).

Colmar (2005) points out that there are other purported benefits of tax incentives, such as symbolic signalling effects and the need to compensate for inadequacies in the investment regime elsewhere. Provision of investment incentives is in the form of either tax relief or cash grants. International experience shows that such incentives play only a minor role in investment decisions. Firms make investment decisions based on many factors including projections of future demand, certainty about future government policy, prevailing interest rates and moves by competitors. In general, neo-classics see incentives as 'nice to have' but not deal-breaking. Yet incentives remain a popular policy for both developed and developing countries.

### Agency theory of tax incentives

According to Zee et al. (2002), despite the lack of evidence to support the efficacy or efficiency of fiscal incentives, governments continue to offer them. Tax incentives offer an easy way to compensate for other government-created obstacles in the business environment. In other words, fiscal incentives respond to government failure as much as market failure. It is far harder, and takes far longer, to tackle the investment impediments themselves like low skills base, regulatory and compliance cost than to put in place a grant or tax regime to help counterbalance these impediments. Although it is a second-best solution to provide a subsidy to counteract an existing distortion, this is what often happens in practice.

Agency problems also exist between government agencies responsible for attracting investment and those responsible for the more generic business environment. Whilst investment-promotion agencies can play an important role in coordinating government activities to attract investment, they also often argue for incentives without taking account of the costs borne by the economy as a whole (Zee et al., 2002).

### Tax incentives theory

UNCTAD (2003) defines tax incentives as instruments that reduce the tax burden of any party in order to induce them to invest in particular projects or sectors. They are exceptions to the general tax regime and may include, reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market. The Kenya Revenue Authority (KRA) defines tax incentive as a provision that grants any person or activity favourable conditions that deviate from the normal provisions of the tax legislation. Tax expenditures refer to revenue

losses that a government incurs by providing tax exemptions, deductions or allowances, tax credits, preferential tax rates or deferral of tax payments legally to any party in the economy (Gravelle, 2013).

The budget deficit of a government is a form of a negative saving and a reduction in the deficit can positively influence the net national savings more than any feasible changes in tax policies and encourage savings within an economy which will then stimulate investments (Goolsbee, 2004). Keen (2013) defines tax incentives as all measures and strategies which provide for more favourable tax treatment to a certain activities or sector, and he went on to describe the following to be typical tax incentives:

- (1) Tax holidays: is defined as the temporal exemption of business investment from certain specified taxes, typically at least corporate income tax. Partial tax holidays offer the reduced obligations rather than full exemption.
- (2) Special zones: are placed in geographically limited areas where qualified companies can locate and hence benefit from the exemption of various scopes of taxes or administrative requirements.
- (3) Investment tax credit: this is the deduction of some fraction of an investment from the tax liability
- (4) Investments allowance/Accelerated depreciation: is the deduction of some fraction of an investment from taxable profits (in addition to depreciation).
- (5) Reduced tax rates/Preferential tax rates: are the reductions in a tax rate, specifically the corporate income tax rate.
- (6) Exemptions from various taxes: are the exemptions from certain taxes, most of the time those collected at the border such as tariffs, excises and VAT on imported inputs.
- (7) Financing incentives: are the reductions in tax rates for the funds' providers for example: the reduced withholding taxes on dividends.
- (8) Loss carried forward: when the business makes a loss, the loss can be carried forward to offset the future profits of the business.

### Growth of SMEs

Countries that have tax incentives for SMEs claim that preferential tax treatment creates a large number of jobs and enhances the level of entrepreneurship that is associated with flexibility, speed, risk taking and innovation (Chen et al., 2002). Berger and Udell (1998) emphasize the fact that SMEs are key drivers of economic success, because they are job creators, sales generators and the source of tax revenue. These authors base their assertion on the facts that a large percentage of SMEs contribute to the various countries' gross domestic product, they employ a large percentage of the workforce and the high ratios of small businesses to large businesses in the countries concerned.

According to Berger and Udell (1998), SMEs represent fertile ground for the development of large, profitable, tax-paying employers and SMEs experience high growth rates in comparison to large enterprises. However, tax policies that are aimed at promoting the economic growth of small businesses should be evaluated judiciously, because the inherent characteristics of small businesses can make a specific differentiated tax policy undesirable. Studies undertaken in this regard have produced the following findings: the majority of SMEs have limited growth potential small businesses vary in terms of productivity, job growth, wages, innovation and export performance within the same industry subgroups. Small business also do not all follow the same growth pattern. Certain small businesses will remain small for most of their existence and it is for this reason that it is not obvious why a tax system should influence the growth process. Such intervention, to the extent that it does not act in a lump-sum way, influences marginal decisions and could lead to excessive risk taking and over investment (Heshmati, 2001).

### Business environment in Rwanda

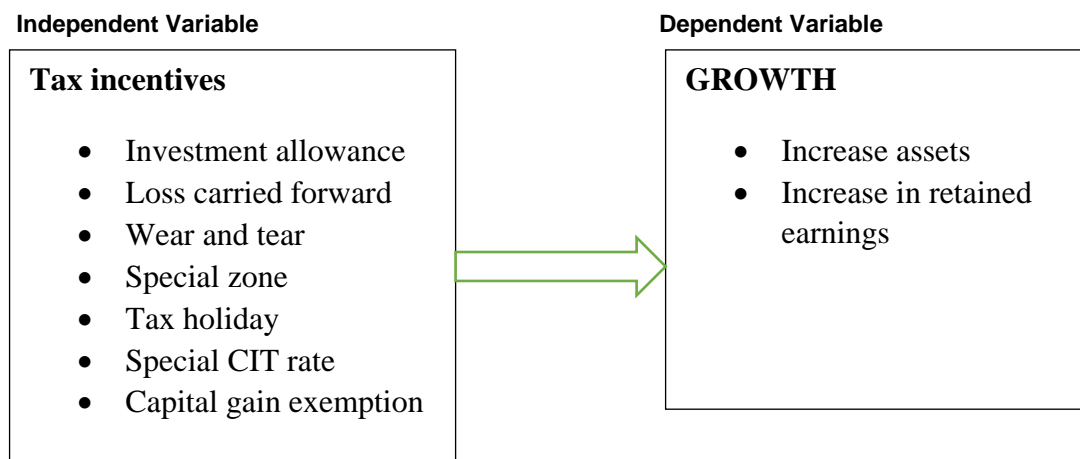
The World Bank Doing Business Report (2013) ranked Rwanda 32nd out of 189 countries, which is a significant jump up by 22 positions from the previous year. It excels in registering property and starting a business by entering the top 10 worldwide. In Rwanda, it takes only 12 days to register property and two days to start a business, which are far less than the regional averages and even the averages of OECD countries.

Several reforms have contributed to improving the business environment. For example, in the recent years, Rwanda reduced the time required to obtain a registration certificate for starting a business. It also eased transferring property by eliminating the requirement for a tax clearance certificate and by implementing the web-based Land Administration Information System for processing land transactions. Privatization of state-owned enterprises and reformation to pro-investment policy has actively taken place to attract foreign direct investment (FDI). However, despite no limits on foreign investment, participation, or control of enterprises, FDI levels are still low.

Businesses in Rwanda are categorised into four depending on the levels of sales. If the annual turnover ranges from Frw 2,000,000 to 12,000,000 the business is classified as a micro. From the annual turnover of 12,000,001 to 20,000,000 it is classified as a small business and from Frw 20,000,001 to 200, 000,000 it is a medium business and

Frw 200,000,000 is classified under large business. The micro and small business are taxed under a lump sum tax regime whereas the medium and the large businesses are under a real tax regime.

The authors of this paper have developed a conceptual framework which represents the synthesis of literature on how to explain a phenomenon. It illustrates actions required in the course of the study given his previous knowledge of other researchers' point of view and his observations on the subject of research. It shows the relationship between variables. It is composed as follows (Figure 1).



**Figure 1.** Conceptual framework of the study.  
Source: Researcher's Own Impression (2019).

As illustrated in the Figure 1, the independent variables, that is, those which are believed to play a role in the growth of SME as measured by increase in the assets, retained earnings and sustainable growth rate are: investment allowance, loss carried forward and wear and tear. However, for the relationship to hold, government policy and economic conditions must be put into consideration. Therefore, they are here defined as intermediate variables.

## RESEARCH METHODOLOGY

The research methodology adopted in the study is discussed here. It shows the description of the research methods and instruments that was employed in the study. It covers the research design, survey population, sample size, sampling procedures, sources of data, data collection instruments, validity and reliability of the research instrument, measure of research variables, and measure of research instruments. It also shows how the research was processed, analysed and presented.

### Research design

The study design was based on a multi-method strategy which used both qualitative and quantitative research approaches. A case study and a survey strategy were used in this study. This helped the researcher to have a triangulation of different strategies. According to Bell (1993), a multi-method strategy occurs when more than one research approach and data source are used in a study of social phenomena. A multi-method approach can be undertaken within a single research strategy by using multiple sources of data or across research strategies (Bell, 1993). The combination of qualitative and quantitative design approach has been recommended and used by researchers in situations where one of the approaches is insufficient to reveal all that is required to be known about a phenomenon (Bell, 1993).

### Study population

A study population is a group of element/items/or people in which the study interested. The study population of this study was 49000 SMEs in Nyarugenge district registered with the RRA. However, the study targeted the managers/owners and the accountant/director of finance of each SME.

### Sample size and sampling procedure



In selecting a sample an optimum sample size was considered. According to Kothari (2000), an optimum sample is the one which fulfils the requirement of efficiency, representativeness, reliability and flexibility. To determine the sample size, the researchers used the Solvin and Yamen's formula ( $n = N/(1 + N(e)^2$  where 136 SMEs were determined.

#### Source of data and research instruments

Both primary and secondary data were used in this study. The primary data were sourced by using a questionnaire and documentary techniques were utilized to collect secondary data. The questionnaires were closed ended and self-administered. The closed ended questionnaires have been recommended in social science research due to its advantages over open ended questionnaires (Sekaran and Bougie, 2016).

#### Data processing and analysis

Data were first collected from the primary survey and then a secondary survey was compiled, sorted, edited, coded in order to have the required quality accuracy and was analysed statistically using the statistical package for social scientist (SPSS). Principal component analysis approach and varimax rotation methods were used to determine those factors that explain tax incentives. The result of the analysis was presented in form of tables for the interpretation. Pearson's correlation was used to establish the relationship between tax incentives and growth of SMEs. A multiple regression analysis was used to examine the model on tax incentives and growth of SMEs. T-test was used to examine the variability of each variable of tax incentive. The model equations are:

Growth (G) = F (tax incentives (TI))

$$G = \beta_0 + \beta_1TI + \alpha \quad (1)$$

where TI = F(accelerated depreciation (AD), loss carried forward (LC), wear and tear (WT), Special zone (SZ), tax holiday (TH), special CIT rate (ST), capital gain exemption (CE)).

Capital gain exemption:

$$TI = \beta_0 + \beta_1AD + \beta_2LC + \beta_4WT + \beta_5SZ + \beta_6TH + \beta_7ST + \beta_8CE + \alpha$$

Substituting in the first equation gives:

$$G = \beta_0 + \beta_1AD + \beta_2LC + \beta_4WT + \beta_5SZ + \beta_6TH + \beta_7ST + \beta_8CE + \alpha$$

## RESULTS AND DISCUSSION

**Table 1** shows the type of industry of the responding SMEs, where respondents in the sector of agriculture constitute 0%, commerce constitutes 47.8%, service constitutes 36%, consultancy constitutes 10.3%, and education constitutes 0%. As seen, the majority of respondents are involved in commerce sector.

**Table 2** shows the result of the enquiry on the understandability of the tax laws in Rwanda, where 30.9% of the respondents said that they strongly agree, 44.8% agreed and 24.3% disagreed when asked if they understand the tax laws in Rwanda. The results from the survey revealed that the majority of the respondents understand the tax laws as evidenced by 75.7% of the answers. The result from the survey conforms to the findings from the study carried out by Vann and Holland (1998). These findings show that taxation means in other words the contribution imposed by the government to its people or to an individual or to companies for the use of services or facilities provided by the government (Vann and Holland, 1998).

**Table 3** shows what came out when respondents were asked whether there are aware of the tax incentives that are available in the tax laws. The results from the survey indicated that 28.7% of the respondents strongly agreed, 50% agreed and 21.3% disagreed. So, a large number of respondents are aware of the tax incentives available in the tax laws. The results from the survey relates to the findings from the study carried out by Keen (2013). According to Keen (2013), tax incentives are seen as measures and strategies which provide for more favourable tax treatment to a certain activities or sector.

**Table 1.** Type of industry.

Type of industry	Frequency	Percent	Valid percent	Cumulative percent
Valid	Agriculture	0	0	0
	Commerce	73	53.7	53.7
	Service	49	36	83.8
	Consultancy	14	10.3	94.1
	Education	0	0	100.0
	Total	136	100.0	-

Source: Primary Data (2019).

**Table 2.** Respondents' views on understanding the tax laws in Rwanda.

Respondents' views	Frequency	Percent	Valid percent	Cumulative percent
Valid	Strongly agree	42	30.9	30.9
	Agree	61	44.8	75.7
	Disagree	33	24.3	100.0
	Total	136	100.0	-

Source: Primary Data (2019).

**Table 3.** Respondents' views on awareness of the tax incentives available in the tax laws.

Respondents' views	Frequency	Percent	Valid percent	Cumulative percent
Valid	Strongly agree	39	28.7	28.7
	Agree	68	50	78.7
	Disagree	29	21.3	100.0
	Total	136	100.0	-

Source: Primary Data (2019).

**Table 4** shows the tax incentives enjoyed by SMEs in Rwanda, where 42.6% of respondents mentioned that they accelerated depreciation; 100% of respondents mentioned wear and tear; 94.1% of respondents mentioned loss carried forward; none of the respondents mentioned tax holiday, special CIT and special zones and listed shares as a tax incentive; 58.8% of respondents mentioned research and development and capital gain exemptions. The results from the survey revealed that various tax incentives are enjoyed by SMEs. However, the most ones include wear and tear loss carried forward and accelerated depreciation as evidenced in the Table 4. The results relate to the findings of the study carried out by UNCTAD (2003). The UNCTAD study revealed that there are various tax incentives that are available in the tax laws that support SMEs. The study defines tax incentives as any incentives that reduce the tax burden of any party in order to induce them to invest in particular projects or sectors. They are exceptions to the general tax regime and may include reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market.

**Table 5** shows the level of sales and profit of SMEs from 2013 up to 2018, where the sales and profit had been increasing year to year. Based on these results from their financial statements the financial performance of the SMEs is good. As profitability is a measure of the amount by which a company's revenues exceeds its relevant expenses, the results reveal that an increase in the sales has raised profitability of the SMEs during the study period. This means that tax incentives have an effect on the sales and profitability of SMEs. The findings relates to the study carried out by Külter and Demirgüneş (2007) who point out that revenue and profitability of SMES are affected by tax incentives.

**Table 6** shows the level of investment in assets SMEs from 2013 up to 2018. As shown, the level of investment in asset SMEs was increasing, which indicates that the performance of the SMEs is good. The findings conform to findings from

previous studies, e.g. by Goolsbee (2004), that assets are probable future economic benefits obtained or controlled by particular entity as a result of past transactions or events.

**Table 4.** Distribution of respondents with tax incentives enjoyed by SMEs.

<b>Tax incentive</b>	<b>Frequency</b>	<b>Percentage</b>
Accelerated depreciation/investment allowance	58	42.6
Wear and tear	136	100
Loss carried forward	128	94.1
Tax holiday	0	0
Listed shares	0	0
Research and development	80	58.8
Special zone	0	0
Special CIT	0	0
Capital gain exemption	58	42.6

Source: Primary Data (2019).

**Table 5.** Level of sales and profit of SMEs.

<b>Year</b>	<b>Sales</b>	<b>Profits</b>
2013	6,765,146,070	135,302,934
2014	14,710,080,125	323,621,763
2015	19,052,671,910	476,316,798
2016	23,462,405,030	610,022,531
2017	31,050,521,520	838,364,081
2018	40,050,935,745	1,241,579,000

Source: Primary Data (2019).

**Table 6.** Level of investment in assets SMEs.

<b>Year</b>	<b>Assets</b>
2013	29,471,200,000
2014	38,901,984,000
2015	44,673,981,200
2016	49,451,730,600
2017	57,321,545,100
2018	68,345,217,000

Source: Primary Data (2019).

#### Relationship between tax incentives and growth of SMEs in Rwanda

Considering the effect of tax incentives on the growth of SMEs in Rwanda, the research established the statistical relationship between tax incentives and promotion of SMEs in Rwanda. The relationship was established through Pearson correlation analysis using Pearson Moment correlation coefficient as depicted in [Table 7](#).

Table 7 provides both the coefficient of determination which is Adjusted R Square and the coefficient of correlation which is R. The coefficient of determination ( $R^2=0.788$ ) explains the explanatory power of the model and indicates that 78.8% of the variation in the growth of SMEs is explained by the variation in the explanatory variables of investment allowance, loss carried forward, listing shares, and tax holiday. However, the adjusted R square of 62.2% indicates that there are other variables that affect the growth of SMEs such as government policy, economic conditions which are not captured by the model formulated in the study that account for about 37.8% variation not explained by the model.

The coefficient of correlation ( $R=0.888$ ) is greater than 0.5. This indicates that there is a strong positive and moderate relationship between tax incentives and growth of SMEs. The result from survey relates to findings from previous studies. Colmar (2005) identified a strong relationship between tax incentives and growth of SMEs. Similar findings are also seen in the study carried out by Chukwumerije and Akinyomi (2011).

Table 8 shows the estimated coefficients of the regression model of this study. From the findings, all the coefficients are statistically significant considering the positive value of the coefficients and a significance level great than 0.05. Specifically, there is a correlation between investment allowance and growth of SMEs ( $b=0.636$ ,  $sig=0.037$ ) indicating that the investment allowance itself explains 63.6% of the variation in the effectiveness of the growth of SMEs. Moreover, there is a significant and strong positive relationship between loss carried forward and evaluations with growth of SMEs ( $b=0.773$ ,  $sig=0.000$ ) indicating that the 77.3% of the variation in the growth of SMEs is explained by loss carried forward. Tax holiday has a significant and positive relationship with the growth of SMEs ( $b=0.664$ ,  $sig=0.056$ ) indicating that 66.4% of the variation in the growth of SMEs is explained by tax holiday. Wear and tear has a significant and positive relationship with the growth of SMEs ( $b=0.686$ ,  $sig=0.001$ ) indicating that 68.6% of the variation in the growth of SMEs is explained by listing shares. Preferential CIT Rate has a significant and positive relationship with the growth of SMEs ( $b=0.715$ ,  $sig=0.057$ ) indicating that 71.5% of the variation in the growth of SMEs is explained by Preferential CIT Rate. The results from the survey relates to the findings of the study carried out by Chukwumerije and Akinyomi (2011) which revealed a significant effect of investment allowances, loss carried forward, tax holiday, listing shares and preferential tax rate.

**Table 7.** Model summary.

Model	R	R square	Adjusted R square	Std. error of the estimate
1	0.888 <sup>a</sup>	0.788	0.622	0.24618

<sup>a</sup>Predictors:(constant), Investment allowance, Loss carried forward, wear and tear, Tax holiday.

Source: Primary Data (2019).

**Table 8.** Estimated coefficients of the model.

Model	Unstandardized coefficients		Standardized coefficients	T	Sig.	
	B	Std. Error	Beta			
1	(Constant)	0.821	0.301	-	2.727	0.004
	Investment allowance	0.636	0.216	0.822	2.941	0.037
	Loss carried forward	0.773	0.289	386	2.674	0.000
	Tax holiday	0.664	0.234	0.469	2.874	0.056
	Wear and tear	0.686	0.272	0.356	2.522	0.001
	Preferential CIT rate	0.715	0.281	0.427	2.544	0.057

<sup>a</sup>Dependent Variable: growth of SMEs.

Source: Primary Data (2019).

## Conclusion

This research work clearly confirms that tax incentives are germane to the growth, development and continued sustenance of small and medium enterprises. However, most of the tax incentives that are available in the tax law are not enjoyed by SMEs. It is only the large taxpayers that enjoy most of the tax incentives. Tax incentives play a vital role in ensuring that small and medium enterprises thrive because the government has made available tax holidays for pioneer companies, and the government also grants a number of general and industry specific incentives. Finally, for many SMEs, the decision to remain informal is deliberate because of the cost and procedural burden of joining the formal sector out weight the benefit of staying in the informal sector. Informal sectors make large contributions to nation economies, in both human and financial terms. But being visible to government agencies and formal sector companies, they can be easily reached with capacity building improvement schemes. However, they cannot compete for business

with larger companies and thus there is a need for governments to accelerate their growth by creating an enabling environment for them via appropriate tax incentives to enhance their sustenance and growth.

## **Recommendations**

On the basis of the findings in this research work the recommendations are as follows:

- (1) Government can address the direct need for start-up fund for SMES by providing incentives for SMEs funding.
- (2) People should enlighten themselves appropriately on the form of business they want to embark upon by going for entrepreneurial training programs to make them better equipped before venturing into it.
- (3) There is a need for the government to employ tax holiday as a major tax incentive for newly established small and medium enterprises because it stimulates their investing power thereby exempting them from other tax liabilities.
- (4) Government should promote the growth of small and medium enterprises by creating the necessary enabling frameworks and relax the burden of regulating measures and ensure that their efforts are geared towards granting tax incentives to micro, small and medium enterprises.
- (5) Building SMEs capacity through the localization of supply chains requires the leadership from the top. Localizing values creation through engagement with SMEs is a key achievement that large corporations can contribute, and this would bolster their license to operate by creating a positive local impact, considering partnership across segments, sharing business planning skills, etc
- (6) Small and medium enterprise should emphasize on tax incentives, so that their operations continue to be more efficient and effective.
- (7) Government should make campaigns to explain the role of taxation on development of countries and help small and medium enterprises to understand tax law in Rwanda.

Putting all these measures in place will go a long way, but it will ensure that tax incentives granted to SMEs have a significant impact on their growth.

## **CONFLICT OF INTERESTS**

The authors have not declared any conflict of interests.

**Related Journals:**

