

The Effect of Internal Controls on Financial Performance; Special Reference to Western Province in Sri Lanka

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Abstract

The secret to SMEs' success is the effective management of their financial performance, which is a complex undertaking. The creation and maintenance of a strong internal control framework become crucial tools in this endeavor. The purpose of the study was to establish the effect of internal controls on financial performance; special reference to Western Province, Sri Lanka. The study was guided by the following research questions; To what extent does the control environment influence the financial performance of SMEs in Sri Lanka? How does risk assessment affect the financial performance of SMEs in Sri Lanka? What is the impact of control activities on the financial performance of SMEs? How does information and communication impact the financial performance of SMEs in Sri Lanka? What is the relationship between monitoring and the financial performance of SMEs in Sri Lanka? The study specifically investigates the influence of internal control components, including the control environment, risk assessment, control activities, information and communication, and monitoring, on the financial performance of SMEs. Financial performance is measured using Return on Assets (ROA). The study employs a cross-sectional research design, which limits the ability to establish causal relationships. While it can identify associations between internal controls and financial performance, it may not conclusively demonstrate causation. Assistants, Executives, and Managers at SME make up the target population for this study, which is only focused on the Western Province, Sri Lanka. A sample length of 100 respondents has been chosen for this examination. For the purpose of gathering survey data, this study uses a quantitative strategy over a cross-sectional time period. Data was systematically gathered using a structured questionnaire with Likert scale questions. Primary data was collected using a structured questionnaire. The Study used SPSS 26 to analysis the data. Quantitative data was analyzed, and the output presented using descriptive statistics namely: mean, standard deviation, percentages. A multiple linear regression model was used to assess whether internal controls have an effect on the performance of SMEs. the data presentation and analysis of the study which covered the exploratory data analysis, illustrations of demographic factors and descriptive statistics of the sample. Validity and reliability of data has been tested. Further this chapter elaborated the correlation coefficient between Internal control systems and financial performance in Sri Lankan SMEs and evaluated the regression of the model using statistical means to arrive at the outcome to test the hypotheses.

Keywords: Internal Controls, Financial Performance, SMEs, Western Province