

Impact of Internal Control Systems on Financial Performance of SMEs in North Western Province of Sri Lanka

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Abstract

This study examines the impact of internal control systems on the financial performance of small and medium-sized enterprises in the North Western Province of Sri Lanka. SMEs are vital to regional economic development, yet many face challenges related to financial inefficiency, limited expertise, and weak internal governance. The research evaluates five core components of internal control systems: control environment, risk assessment, control activities, information and communication systems, and monitoring, analyzing their impact on key financial performance indicators. Using a quantitative approach, structured questionnaires were distributed to 170 SME owners and managers. Data analysis employed descriptive statistics, correlation analysis, and multiple regression techniques. The results demonstrate that all internal control framework components have a positive and significant impact on financial performance. Monitoring provides the strongest contribution, while risk assessment shows the least influence among the variables studied. These findings emphasize the importance of robust internal controls for improving financial outcomes in SMEs. The study emphasizes the importance of SMEs prioritizing strategic implementation and continuous evaluation of control practices to improve their financial performance. This research provides empirical insights for policymakers, financial advisors, and stakeholders, contributing to improved governance practices within the SME sector in Sri Lanka.

Keywords: control activities, control environment, information and communication system, monitoring, risk assessment