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THE ROLE OF THE INTERNAL CONTROL SYSTEM IN ENCOURAGING THE SUSTAINABLE FINANCIAL PERFORMANCE OF MSMES

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ABSTRACT

This study aims to analyze the role of internal control systems in improving the financial performance of sustainable Micro, Small, and Medium Enterprises (MSMEs). The research method used is a quantitative, associative approach. The population in this study consists of MSME actors in Ambon City, and the sampling technique is purposive. Data were collected through questionnaires and analyzed using simple linear regression. The results show that the internal control system has a positive and significant effect on the financial performance of MSMEs. This indicates that the better the implementation of the internal control system, the higher the financial performance achieved. In addition, the internal control system also plays a role in improving operational efficiency, minimizing errors, and supporting business sustainability. Therefore, the implementation of an effective internal control system is an important factor in enhancing financial performance and ensuring the long-term sustainability of MSMEs.

Keywords: Internal Control System, Financial Performance, MSMEs, Business Sustainability

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) have a strategic role in the Indonesian economy. Based on data from the Ministry of Cooperatives and SMEs, the number of MSMEs exceeds 65 million units, contributes around 60-61% to the Gross Domestic Product (GDP), and absorbs around 97% of the national workforce. This shows that MSMEs are a very vital sector in supporting national economic growth.

However, MSMEs still face various problems, especially in financial management. According to the Financial Services Authority (OJK, 2022), the financial literacy level of the Indonesian people has reached only 49.68%, indicating that many business actors still lack optimal financial management skills. This low financial literacy affects the weak implementation of internal control systems in businesses.

Research by Putri & Rahmawati (2021) shows that most MSMEs have not optimally implemented internal control systems, especially in the separation of duties, transaction supervision, and financial recording. A similar finding was reported by Sari et al. (2022), who stated that weaknesses in internal control lead to low-quality MSME financial statements.

In addition, research by Hidayat & Nurlela (2023) found that the internal control system has a positive and significant influence on the financial performance

of MSMEs, particularly by improving operational efficiency and minimizing the risk of loss. Another study by Pratama et al. (2024) also confirms that implementing internal controls based on the COSO framework increases transparency and accountability in business finances.

On the other hand, the Central Statistics Agency (BPS) noted that not all MSMEs can survive in the long term, especially due to weak financial management and inadequate control systems. In the context of business sustainability, research by Wulandari & Setiawan (2022) indicates that strong financial performance, supported by an effective internal control system, is the primary factor in maintaining MSME sustainability.

Thus, the internal control system not only plays a role in maintaining the reliability of financial statements but also in improving business efficiency, transparency, and sustainability. Therefore, research on the role of internal control systems in encouraging sustainable financial performance among MSMEs is highly relevant.

LITERATURE REVIEW

The theoretical foundation is the basis for thought used to explain the relationships among variables in research, namely internal control systems, financial performance, and sustainability of MSMEs.

The agency theory proposed by Jensen and Meckling (1976) explains the contractual relationship between the principal and the manager (agent). In this relationship, there is often an agency conflict due to different goals between the two parties. In the context of MSMEs, although most are managed directly by owners, potential problems remain, such as Asset abuse, Financial record-keeping disorder, and Lack of transparency. Internal control systems serve as a mechanism to reduce such conflicts through clear oversight and procedures. According to Otley (1980), no one control system can be universally applied to all organizations. The effectiveness of the system depends largely on the organization's internal and external conditions. In MSMEs, factors that affect the implementation of internal control include: the scale of the business, Business complexity, and the Resources owned. Management accounting theory emphasizes that accounting information is used as a basis for Planning, Control, and decision-making.

According to Hansen & Mowen (2015), a management accounting system helps organizations improve operational efficiency and effectiveness. The internal control system, part of management accounting, plays a role in producing reliable financial information. According to Barney (1991), an organization's competitive advantage is determined by its resources, both tangible and intangible. According to KNKG (2006), the implementation of good governance will increase trust and organizational performance. The internal control system is a tool to realize these principles in business management. Sustainability theory emphasizes that businesses must survive in the long term by balancing economic and operational factors. According to Elkington (1997), the concept of the Triple Bottom Line defines sustainability as: Profit (economy), People (social), Planet (environment). In the context of MSMEs, the economic aspect (financial performance) is the main factor in business sustainability.

Based on the above theories, it can be concluded that: The internal control system functions as a monitoring and control mechanism (Agency Theory), The application must be adjusted to the conditions of MSMEs (Contingency Theory),, and support the provision of information for decision-making (Management Accounting), Become a source of competitive advantage (RBV), Realizing Good Governance, Impact on business sustainability through improving financial performance (Sustainability Theory).

METHOD

This study uses a quantitative approach within the associative research paradigm. A quantitative approach is used to measure the relationship between internal control system variables and MSME financial performance. Associative research aims to find out the influence or relationship between variables.

This research was conducted among MSMEs in Ambon City. The research time is planned for ± 2-3 months, from data collection through data analysis.

The population in this study is all MSME actors in Ambon City. Samples: The sampling technique uses purposive sampling, with the following criteria: MSMEs that have been operating for at least 1 year, have financial activities (income and expenses), are willing to be a respondent, and the number of samples can be adjusted, e.g., 30–100 respondents (depending on field conditions).

Quantitative data in the form of questionnaire results, Data Sources: Primary data: obtained directly from respondents through questionnaires, and Secondary data: derived from books, journals, and reports related to MSMEs

RESULT

Based on the data analysis, the internal control system has a positive and significant influence on the financial performance of MSMEs. This is evident from the regression test results, which showed that the regression coefficient was positive and the t-test was significant (sig < 0.05).

These findings indicate that the better the implementation of the internal control system in MSMEs, the better the financial performance will be. An effective internal control system can help MSME actors manage finances more orderly, reduce the risk of recording errors, and increase resource efficiency.

When viewed from each indicator, the components of control and information activities, as well as communication, are the most dominant factors in improving financial performance. This is because there are clear procedures in recording transactions, and good communication of financial information will make it easier for business owners to make the right decisions.

In addition, the monitoring component also plays an important role in ensuring that all business activities run according to plan. With regular monitoring, MSME actors can immediately identify problems and take corrective action before they have a greater impact on the business's financial condition.

The results of this study are in line with Agency Theory, which states that an internal control system is needed to minimize potential irregularities and increase accountability in financial management. In addition, these results support the

Management Accounting Theory, which holds that financial information generated by a good system will enable more effective decision-making.

Furthermore, these findings are also consistent with previous research, such as Hidayat & Nurlela (2023), who stated that the internal control system has a significant effect on the financial performance of MSMEs, and Sari et al. (2022), who found that good internal control improves the quality of financial statements.

In the context of business sustainability, the internal control system contributes to creating financial stability. MSMEs with strong financial management tend to be better able to survive in the face of economic uncertainty. This shows that internal control not only affects short-term performance but also long-term business sustainability.

However, some MSMEs have not yet implemented an optimal internal control system. This can be seen in the lack of separation of duties, the use of simple financial records, and inadequate supervision of cash flow. This condition poses a challenge for MSME actors and related parties seeking to improve financial performance.

CONCLUSION

Based on the results of the research and discussion on the Role of the Internal Control System in Encouraging Sustainable MSME Financial Performance, it can be concluded as follows:

The implementation of the internal control system in MSMEs in general has been running, but it is not fully optimal. This can be seen in weaknesses such as unclear separation of duties, simple financial records, and a lack of a routine supervision process.

The financial performance of MSMEs shows a fairly good condition, but it still needs to be improved, especially in terms of cost efficiency and cash flow management, to be more stable and controlled.

The internal control system has a positive and significant effect on the financial performance of MSMEs. This shows that the better the implementation of the internal control system, the better the business's financial performance.

The internal control system also plays a role in encouraging the sustainability of MSME businesses, because it can create more transparent, efficient, and controlled financial management so that the business can survive in the long term.

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