

Impact of Internal Control System on Financial Performance of Listed Manufacturing Firms in Sri Lanka

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Abstract

An internal control system consists of a set of rules, policies, and procedures implemented by an organization to provide assurance and direction, increase efficiency and adherence to policies. Nowadays an internal control system has become a need for manufacturing organizations to increase efficiency and safeguarding assets. Even though many firms have internal control systems, in some firms, it is not efficient. There are studies conducted to investigate the impact of internal control system on financial performance, but the findings of those studies contradict each other. Therefore, this study aimed at investigating the impact of internal control system on the financial performance of listed manufacturing firms. Independent variables of the study are the components of the internal control system namely control environment, risk assessment, control activities, information communication system, and monitoring while financial performance is considered as the dependent variable. A self-structured questionnaire was used to collect data from the managerial level employees of 40 listed manufacturing firms. Snowballing technique was executed at the data collection process and accordingly, one hundred nine responses were forwarded to the analysis purpose where correlation and regression analyses were used as main analytical tools. As per the results of correlation analysis, all the components of the internal control system have a positive relationship with financial performance. Multiple regression analysis shows that the impact of control activities and monitoring on financial performance are significant while control environment, risk assessment and information communication system reveal the insignificant impact on the financial performance. Based on the findings, it could be concluded that maintaining an effective internal control system in an organization is vital to sustaining its financial performance. This study contributes to enhancing our understanding of the internal control systems implemented in manufacturing organizations and their importance in increasing financial performance.

Keywords: Financial performance, internal control system, listed manufacturing firms