

Internal Control Systems and Financial Statement Quality: Evidence from Trading SMEs in South Tangerang, Indonesia

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Abstract

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This study aims to examine the effect of internal control systems on the quality of financial statements among Micro, Small, and Medium Enterprises (MSMEs) in the trading sector in Bintaro, South Tangerang City. A quantitative research design with a survey approach was employed. The sample consisted of 50 MSME owners or managers selected using purposive sampling. Data were collected through a structured questionnaire that met validity and reliability requirements and were analyzed using classical assumption tests and simple linear regression.

The results reveal that internal control systems have a positive and significant effect on financial statement quality. This indicates that stronger implementation of internal control systems leads to more reliable, relevant, and accurate financial reporting. The findings highlight the importance of strengthening internal control practices to enhance financial accountability and support better decision-making among MSME.

Keywords: Internal Control Systems; Financial Statement Quality; MSMEs; Trading Sector; South Tangerang

INTRODUCTION

Small and Medium Enterprises (SMEs) play a crucial role as the backbone of Indonesia's economy, including in South Tangerang City, where the trade sector serves as a major contributor to local economic growth. Despite their significant potential, the sustainability of SMEs is often constrained by the low quality of their financial reporting. Financial statement quality is a critical element for business actors, as it functions not only as a tool for transparency and accountability but also as a key requirement for accessing formal financing from financial institutions. However, limited financial literacy and weak implementation of control mechanisms remain major challenges, resulting in financial reports that are often inaccurate and lack relevance for business decision-making (Sumekar et al., 2025).

One of the fundamental factors influencing the reliability of financial information is the implementation of an internal control system. Internal control should not be viewed merely as an administrative procedure, but rather as a comprehensive mechanism designed to ensure operational efficiency, regulatory compliance, and asset protection (Arfismanda et al., 2021). Empirical observations among SMEs in the trade sector in the Bintaro area indicate a

significant gap between theoretical frameworks and actual practices (Asmira & Sulkiah, 2025). Most business owners still manage their finances manually without systematic recording procedures. The absence of clear task segregation, limited control over asset access, and inadequate operational monitoring contribute to financial statements that are incomplete and do not comply with basic accounting principles (Saefullah, Rifia, et al., 2026).

This condition represents a critical issue that warrants further investigation, particularly in the context of increasing government efforts to encourage SMEs to enhance financial transparency in order to compete within the digital economy and participate in strategic partnership programs. Based on this background, this study addresses the research problem of whether internal control systems have a significant influence on the quality of financial statements in SMEs within the trade sector in Bintaro. Accordingly, the primary objective of this study is to empirically examine the extent to which the effectiveness of internal control systems contributes to improving financial reporting quality (Nisa & Susilo, 2025).

From a theoretical perspective, this study is expected to enrich the accounting literature by providing insights into the role of internal control systems within the context of small businesses in Indonesia. From a practical standpoint, the findings are anticipated to offer valuable recommendations for SME owners regarding the importance of strengthening internal control practices. Furthermore, this study may serve as a reference for local governments and financial institutions in formulating appropriate policies to enhance the competitiveness and financial accountability of SMEs in an increasingly competitive global environment (Candra & Hidayatullah, 2024).

Despite the growing body of literature on internal control systems and financial reporting quality, several critical gaps remain. Existing studies predominantly focus on large corporations or formal business sectors, with limited attention given to SMEs, particularly in developing country contexts such as Indonesia (Igbojiyibo, 2024). Moreover, prior research tends to emphasize technical accounting standards without sufficiently examining the practical challenges faced by SMEs in implementing internal control mechanisms. There is also a lack of empirical evidence that specifically explores how internal control systems influence financial reporting quality within the trade sector, which is characterized by high transaction volume and relatively simple organizational structures (Arrasyidah & Syarif, 2024). Furthermore, the integration between internal control practices and the financial behavior of SME owners remains underexplored. Therefore, this study seeks to address these gaps by providing an empirical analysis of the role of internal control systems in improving financial reporting quality among SMEs in the trade sector in Bintaro, South Tangerang.

METHODS

This study employs a quantitative empirical research design using an explanatory survey approach to examine and explain the causal relationship between the variables under investigation. Geographically, the study is conducted among SMEs in the trade sector located in Bintaro, South Tangerang City, Banten Province. The research was carried out in a structured timeline, with data collection conducted from November to December 2025, followed by data analysis and report preparation in January 2026.

The subjects of this study consist of SME owners or managers operating in the trade sector in Bintaro who meet specific criteria, namely having been in operation for at least two

years and having prepared financial statements, even in a simplified form. The sampling technique used is purposive sampling, resulting in a total of 50 respondents. The object of the study focuses on the implementation of internal control systems as the independent variable and financial statement quality as the dependent variable.

Primary data were collected through questionnaires distributed both offline and online using the Google Forms platform. The measurement instrument employed a five-point Likert scale to capture respondents' perceptions accurately. In addition, secondary data were obtained from relevant scientific literature, textbooks, government reports on SMEs, and official data from the Department of Cooperatives and SMEs of South Tangerang City (Saefullah, Arza, et al., 2026).

Prior to data analysis, the research instrument was tested for validity and reliability. Validity was assessed using the Pearson Product-Moment correlation, while reliability was measured using Cronbach's Alpha to ensure the consistency of the instrument.

Data analysis was conducted through several statistical procedures. The initial stage involved classical assumption tests, including normality testing using the Kolmogorov–Smirnov method, multicollinearity testing using Variance Inflation Factor (VIF) and tolerance values, and heteroscedasticity testing using scatterplot analysis and the Glejser test. Hypothesis testing was subsequently performed using simple linear regression analysis with the model $Y = a + bX + e$ to determine the effect of internal control systems on financial statement quality. The significance of the relationship was evaluated using the t-test, while the explanatory power of the model was measured using the coefficient of determination (R^2). These procedures were undertaken to ensure the validity and reliability of the research findings in accurately representing the studied phenomenon.

RESULT AND DISCUSSION

This section presents the results of data analysis collected from SME respondents in the trade sector in the Bintaro area. Prior to hypothesis testing, the research instruments were evaluated for validity and reliability. The results indicate that all questionnaire items have Pearson correlation values exceeding 0.30 and Cronbach's Alpha values above the threshold of 0.70, confirming that the instruments are both valid and reliable for further analysis.

Subsequently, classical assumption tests were conducted to ensure the suitability of the regression model. The normality test results show an Asymp. Sig. (2-tailed) value of 0.212, which is greater than 0.05, indicating that the data are normally distributed. The multicollinearity test reveals a tolerance value of 0.892 and a Variance Inflation Factor (VIF) of 1.121, suggesting the absence of multicollinearity among the independent variables. Furthermore, the heteroscedasticity test, based on scatterplot analysis and the Glejser test (Sig. = 0.187 > 0.05), confirms that the regression model is free from heteroscedasticity issues.

The results of simple linear regression analysis produce the equation $Y = 2.154 + 0.523X$, where the regression coefficient of 0.523 indicates that a one-unit increase in the internal control system leads to an increase of 0.523 points in financial statement quality. Statistically, the t-test results show a t-value of 6.842 with a significance level of 0.000, indicating that the proposed hypothesis (H_1) is accepted. This finding confirms that internal control systems have a positive and significant effect on the quality of financial statements among SMEs in Bintaro. Additionally, the

coefficient of determination ($R^2=0.486$) indicates that 48.6% of the variation in financial statement quality can be explained by the internal control system, while the remaining 51.4% is influenced by other factors beyond the scope of this study.

From a discussion perspective, these findings emphasize that strengthening internal control mechanisms directly enhances the reliability of financial information produced by SMEs. This result is consistent with previous studies (Agustina et al., 2024; Candra et al., 2024; Saefullah, Rifia, et al., 2026), which highlight the importance of control mechanisms in ensuring data accuracy. Field observations further indicate that control activities—such as systematic transaction recording procedures and cash access controls—as well as effective information and communication flows, are the most dominant factors influencing financial reporting quality. SMEs that implement clear standard operating procedures (SOPs) tend to minimize human error and reduce the risk of fraud in financial reporting (Akbar & Choiriah, 2025).

However, the study also identifies that components related to the control environment and ongoing monitoring remain relatively weak. Limitations in human resources and a lack of managerial awareness regarding supervisory functions are key barriers to the effective implementation of internal control systems, as also noted by (Siringoringo & Karsam, 2025). From an agency theory perspective, these findings suggest that internal control systems serve as a governance mechanism to ensure that financial information provided by managers is reliable and trustworthy for both owners and external stakeholders.

Overall, the results provide empirical evidence that improving internal control systems is a strategic key for SMEs to enhance financial transparency and accountability, particularly in the context of increasing demands for financial credibility in a competitive business environment.

CONCLUSION

Based on the findings of this study, it can be concluded that internal control systems have a positive and significant effect on the quality of financial statements among SMEs in the trade sector in Bintaro, South Tangerang City. The effective implementation of internal control systems enhances the relevance, reliability, completeness, and comparability of SME financial reports. The results further indicate that 48.6% of the variation in financial statement quality is explained by the internal control system, with control activities and information and communication components contributing the most significant influence. These findings underscore the importance of strengthening internal control practices as a key mechanism for improving financial reporting quality in SMEs

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