

**THE RELATIONSHIP BETWEEN INTERNAL CONTROL SYSTEMS  
AND FINANCIAL PERFORMANCE OF MICRO AND SMALL  
ENTERPRISES (MSEs) IN ANGELES CITY, PAMPANGA,  
PHILIPPINES**

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**ABSTRACT**

The study explored the interplay of internal control systems (ICS) and the financial performance of Micro and Small Enterprises (MSEs) in Angeles City, Pampanga. This research used a quantitative, descriptive-correlational approach that used a COSO-Based Questionnaire to collect data from 100 MSEs owners, managers, and finance officers. The data was statistically analyzed through SPSS, employing descriptive statistics, correlation, and regression to evaluate the relationships between the variables. Overall, results indicate that MSEs exhibit strong ethical governance, effective monitoring, and control activities, as well as high financial performance overall. Weaknesses in the management controls include limited external communication and lack of a formal internal audit function. However, understanding and improving these weaknesses will further improve MSEs overall stability and competitiveness.

**Keywords:** Internal Control Systems, Financial Performance, Micro and Small Enterprises, COSO Framework, Angeles City

**1.0 INTRODUCTION**

The worldwide economic development base uses micro and small enterprises (MSEs) as the main foundation which generates sustainable economic growth and provides vocational opportunities through its employment. MSEs constitute 99.5% of all registered enterprises in the Philippines, and account for 62.4% of total jobs. For this reason, MSEs are viewed as the main contributors to development through innovation, job creation and enhancing the rate of economic growth. However, while MSEs play such a vital role, a majority of small businesses are either informally established or recently formed without sufficient organization or internal controls. The results of a recent study indicate that some of the low productivity and limited growth experienced by MSEs can be attributed to issues with management practices. To improve financial performance and reduce instances of fraud, structured frameworks like that of the Committee of Sponsoring Organization of the Treadway Commission (COSO) are available; however, the challenge remains to effectively implement those systems among

MSEs operating in rapidly developing urban areas. A strong internal monitoring system is essential for an MSE to reach its goals of producing accurate financial statements and achieving operational effectiveness.

Taguinod (2025) conducted an extensive study to examine how three specific demographic factors of companies which included their operational history and revenue level and their corporate leadership organization system acted as moderating factors between their internal control systems and their financial outcomes. The connection between internal control systems (ICS) and company performance had attracted continuous research interest since the beginning of time. Small enterprises operate as partnerships or sole proprietorships despite their registration as limited liability companies. Adedeji and Olubodun (2018) presented their findings which showed that the organization operated with characteristics of basic management systems and informal employment relationships and work methods that required high labor input and basic technology and staff members who held both managerial and ownership positions and faced difficulties in obtaining financial resources.

The prevailing research demonstrates a positive link between internal control systems and MSE financial performance, however, there are substantial gaps in scholarly work. The research studies investigate specific urban areas and regional zones of the Philippines while they fail to present findings that demonstrate how different economic and geographical factors affect study results. Important moderating variables such as industry classification and ownership structure and management style and digital adoption need to be recognized. The majority of studies use small sample sizes where they concentrate on profitability metrics—disregarding other financial performance metrics which include growth and sustainability and risk resilience. A comprehensive and methodologically strong research study needs to be conducted to determine how internal control systems affect MSE performance in the Philippines.

This study aims to gain an understanding on how internal control systems correlate on the financial performance of micro and small enterprises in Angeles City, Pampanga, Philippines. It emphasizes the components of control environment, risk assessment, control activities, information and communication, and monitoring. The internal control systems are based on the COSO framework and are very important for businesses to function properly as well as report finances correctly and comply with rules. Other studies such as Ibrahim et al., (2017) and Batocael et al., (2022) suggest that the role of internal internal control systems help in generating profits and managing risks better. The study of internal control systems and financial performance of small enterprises is important because it helps us to know more about micro and small enterprises, in Angeles City, Pampanga, and may provide useful insights to people who make policies to make programs to support these businesses.

## 2.0 RESEARCH DESIGN

To assess the relationship between internal control systems and the financial performance of MSEs in Angeles City, Pampanga, this study uses the quantitative descriptive-correlational research design. Data was collected from MSE owners, managers, and finance officers using validated and pilot-tested questionnaires, then the responses were analyzed using SPSS software. The design ensures reliable data collection, accurate statistical analysis, and significant findings that may help improve financial management practices in MSEs (Koirala,

2025). It also aims to contribute to the existing understandings or information on financial management and MSEs development.

## 2.1 Respondents and Sampling Technique

The survey participants were selected through the application of a random selection method. The research sample included 100 participants who held the positions of owners, managers, and finance officers in MSEs located within Angeles City, Pampanga according to established inclusion requirements. The method of random sampling allows every eligible member of the target population to have an equal probability of selection which results in less bias and better sample representation. Through this method the researchers achieved accurate population representation by selecting their study participants. This research method follows quantitative research methods which combine controlled selection methods with numerical data collection to enable statistical analysis for identifying patterns and correlations within specific population groups.

## 2.2 Research Instruments

The study evaluated the connection between internal control systems and the financial performance of MSEs in Angeles City, Pampanga, using a structured survey questionnaire. Business profiles, including legal structure, number of workers, years of operation, industry, and location, were gathered in the first section of the questionnaire. This data helped examine how these attributes influence the implementation and effectiveness of internal control systems and allowed the findings to be interpreted across different business contexts.

Using a 5-point Likert scale, the second section evaluated the application of internal controls based on the five elements of the COSO framework: control environment, risk assessment, control activities, information and communication, and monitoring. To ascertain the effect of these controls, the third section assessed financial performance using important metrics. A standardized questionnaire derived from Oyedokun et al. (2023) was utilized to ensure reliability and accuracy, enabling a more consistent and structured analysis of the relationship between internal controls and financial performance.

## 2.3 Data Processing and Statistical Treatment

The researchers applied a systematic method for their data processing and analysis of all collected data. The main method for data collection used a structured questionnaire which included a 5-point Likert scale that measured respondents' perceptions regarding the level of implementation of internal control systems and the financial performance of micro and small enterprises (MSEs). The researchers encoded the collected data and conducted their analysis through the Statistical Package for the Social Sciences (SPSS) software.

The researchers used simple linear correlation analysis to examine the relationship between internal control systems and financial performance. The statistical method determined how strong and which direction independent variables correlates the dependent variable, which measured financial performance. Responses were measured using a 5-point Likert scale, and weighted mean scores were computed and translated into corresponding verbal descriptions. The interpretation of these scores is presented in table below for reference.

Weighted Mean Scores	Verbal Interpretation	Level of Implementation	Level of Financial Performance
4.21 - 5.00	Strongly Agree	Fully Implemented	Very High
3.41 - 4.20	Agree	Highly Implemented	High
2.61 - 3.40	Neutral	Moderately Implemented	Moderate
1.81 - 2.60	Disagree	Slightly Implemented	Low
1.00 - 1.80	Strongly Disagree	Not Implemented	Very Low

The researchers used the correlation coefficient, known as r-value, to measure how strong and which way two variables were related to each other. The relationship strength was measured with values that ranged from +1.00 to -1.00, where positive values showed direct relationships and negative values showed inverse relationships. The relationship strength increases as the value approaches ±1.00 while values that approach 0 show minimal to no relationship. The statistical framework established a definite method for researchers to study and understand how internal control systems affect financial results.

### 3.0 PRESENTATION AND DISCUSSION OF FINDINGS

#### 3.1 Internal control system

(5-Strongly Agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly Disagree)

**Table 1 Level of Internal Control System of MSEs**

Item	Mean	SD	Interpretation
CONTROL ENVIRONMENT	4.51	.58	Fully Implemented
RISK ASSESSMENT	4.16	.63	Highly Implemented
CONTROL ACTIVITY	4.37	.58	Fully Implemented
INFORMATION AND COMMUNICATION	4.12	.57	Highly Implemented
MONITORING	4.26	.77	Fully Implemented
GRAND MEAN	4.28	0.65	Fully Implemented

Table 1 exhibited the computed grand mean was 4.28 with a standard deviation of 0.65 interpreted as fully implemented and implies that the majority of the respondents agreed that they have implemented an internal control system. The table shows that MSEs maintain the highest level of Internal control system in terms of control environment, with the highest mean 4.51. MSEs also generally implement information and communication but not to the highest level with the lowest mean of 4.12, interpreted as highly implemented. This suggests that information systems and communication channels may not be as reliable or all-encompassing as other internal control elements.

**3.2 Financial performance**

(5-Strongly Agree, 4-Agree, 3-Neutral, 2-Disagree, 1-Strongly Disagree)

**Table 2. Level of Financial Performance of MSEs**

Item	Mean	SD	Interpretation
1) My organization’s profit has increased.	4.23	.73	Very High
2) Shareholders’ return in my organization has increased.	3.67	1.12	High
3) There is an increased source of revenue in the organization.	4.01	.77	High
4) There has been consistent patronage of customers to the organizations.	4.21	.76	Very High
5) There is an increase in ROA in my organization.	4.15	.74	High
OVERALL	4.05	.73	High

Table 3.1 illustrates the level of Financial Performance of MSEs. Based on the collected data, the highest mean item was “My organization’s profit has increased” with a mean of 4.23, interpreted as a very high level of financial performance. The outcome shows that the existence of internal control systems is responsible for the high degree of financial performance among (MSEs), especially the reported growth in profit.

The lowest mean item was “Shareholders’ return in my organization has increased.” which has a mean of 3.67, interpreted as a high level of financial performance. It indicates that, in comparison to other financial measures like profit growth, MSEs may not emphasise on or perceive this component of financial performance. The idea of "shareholder return" may be less defined or tracked directly because MSEs are frequently owner-managed or family-run, which lowers its priority or makes it less obvious to respondents.

**3.3 Correlation Analysis**

**Table 4. Correlation Analysis**

	Financial Performance	Decision on Hypothesis
	Pearson Correlation (r)	.377**
Control Environment		Alternative Hypothesis (Ha1) Accepted
	Sig. (2-tailed) (p)	.000

Risk Assessment	Degree of Correlation Pearson Correlation (r)	Weak to Moderate Positive .541**	Alternative Hypothesis (Ha1) Accepted
	Sig. (2-tailed) (p)	.000	
Control Activity	Degree of Correlation Pearson Correlation (r)	Moderate Positive .466**	Alternative Hypothesis (Ha1) Accepted
	Sig. (2-tailed) (p)	.000	
Information and Communication	Degree of Correlation Pearson Correlation (r)	Moderate Positive .474**	Alternative Hypothesis (Ha1) Accepted
	Sig. (2-tailed) (p)	.000	
Monitoring	Degree of Correlation Pearson Correlation (r)	Moderate Positive .590**	Alternative Hypothesis (Ha1) Accepted
	Sig. (2-tailed) (p)	.000	
	Degree of Correlation	Moderate to Strong Positive	

\*\**. Correlation is significant at the 0.01 level (2-tailed).*

The Pearson correlation analysis results, which Table 4 displays, demonstrate that internal control systems maintain a significant positive relationship with financial performance for MSEs operating in Angeles City, Pampanga ( $p = 0.000 < 0.05$ ; significance at 0.01 level). The monitoring component ( $r = 0.590$ ,  $p = 0.000$ ) and risk assessment component ( $r = 0.541$ ,  $p = 0.000$ ) demonstrated a moderate to strong positive relationship between the two components, which suggests that continuous control activity monitoring is associated with financial success alongside proper risk management practices. The two elements of information and communication ( $r = 0.474$ ,  $p = 0.000$ ) and control activities ( $r = 0.466$ ,  $p = 0.000$ ) demonstrated moderate positive relationships, which indicate that organizations tend to report better financial outcomes when they have clearer communication and consistent policy implementation. The control environment ( $r = 0.377$ ,  $p = 0.000$ ) exhibited a weak to moderate positive relationship with organizational culture and ethical climate, which suggests that these factors are associated with financial performance, although to a lesser extent than other elements.

The numerical data shows that stronger internal control systems are associated with higher financial performance, while monitoring and risk assessment systems demonstrate the strongest relationships. MSEs tend to exhibit higher operational efficiency and lower exposure to operational risks when internal control systems are more developed, which is also associated with improved financial stability.

#### 4.0 DISCUSSION OF FINDINGS

The results demonstrate that MSEs usually fully implement internal control systems, with the control environment being the most extensively practiced component. According to Odoru et al. (2019), the control environment significantly improves the efficacy of internal control systems, highlighting it as a highly practiced element. The findings are supported by Yurniwati and Afdhal (2015), who stated that a strong control environment influences internal control awareness and sets the tone for governance. In the study of Mokono and Njogu (2022), monitoring and the control environment have a stronger effect on financial performance measures than other control components, according to a 2021 study of banks registered on the Nairobi Stock Exchange. In contrast, Information and communication is the least emphasized area despite being widely utilized. This implies that while internal controls are well-established, communication system enhancements are required to further increase efficacy and risk management. Information and communication have an impact on internal control performance, according to Purwanto & Nurhidayah (2024). However, some principles are still not used consistently, which suggests that there is room for development.

In line with these findings, MSEs also exhibit a high level of financial performance, particularly in terms of increasing profit, which reflects strong business growth and sustainability. This suggests that effective internal control systems contribute positively to financial outcomes. According to Agyemang et al. (2022), putting internal controls in place boosts business profitability and helps small businesses perform better financially. The least emphasized aspect of financial performance was the shareholder returns, hence MSEs may give less attention to this area which is likely due to their owner-managed structure. This is corroborated by research by Pindado and De la Torre (2021), which explains that ownership in small businesses is typically very concentrated among the founder or a select few closely related people. Because of this, formal shareholder structures, corporate governance procedures, and shareholder return expectations might not be as important or prominent in MSEs as they are in bigger companies. The results imply that while MSEs perform well financially, their focus is more on profit growth than on shareholder-related measures.

The study results demonstrate a significant positive relationship between internal control systems and the financial performance of MSEs. Nguyen and Le (2022) found that an internal control system significantly improves company profit, based on panel data from Vietnamese SME. Financial performance increases with every aspect of the internal control system because monitoring and risk assessment systems provide the strongest effect while the control environment delivers the least but still important impact. According to Hanoon et al. (2021), risk assessment and monitoring have a greater impact on financial performance than the control environment, although all internal control components have a substantial impact. The results show that organizations which implement strong internal control systems achieve better financial performance. The respondents reached strong agreement on both internal control systems and financial performance, which demonstrated their belief in the systems' effectiveness. The research showed that an internal control system does help MSEs to achieve financial effectiveness and operational sustainability. (singit ako na nag align sya sa hypothesis, Thank youuu).

Overall, the results indicate that stronger internal control systems are associated with higher financial performance among MSEs. This relationship may reflect how structured processes, oversight, and risk awareness align with better financial management practices. However, it is

important to note that these findings describe an association rather than a direct cause-and-effect relationship.

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