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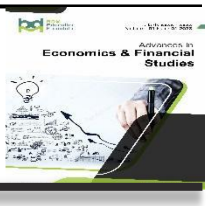

Reflective Study on Financial Statement Quality Capability to Influence Firm Performance: Literature Review

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ABSTRACT

Purpose: The study explores factors affecting financial statement quality in MSMEs and their impact on performance. It investigates how financial literacy, technology, control, and governance enhance MSMEs' financial statements.

Research Design and Methodology: The study uses a quantitative method with surveys and questionnaires to collect data from MSME owners and managers. Data includes financial literacy, technology use, internal control, and governance. Statistical analysis examines the relationship between variables and financial statement quality. In-depth interviews provide insights into financial reporting challenges and best practices among SMEs.

Findings and Discussion: The study found that MSMEs' financial statements quality affects business performance significantly. Better financial statements quality, influenced by financial literacy, technology use, internal control, and governance, helps SMEs manage finances efficiently, access capital, and make strategic decisions. Training in financial statement preparation and digital tools usage can enhance accounting understanding and financial management efficiency. Quality financial statements improve MSMEs' competitiveness, transparency, accountability, and reputation, supporting overall business performance.

Implications: Improving MSMEs' financial statements can enhance business performance. Financial literacy, information system adoption, internal control, and corporate governance benefit MSMEs. Training and mentoring on financial statements and digital tools enhance financial management efficiency. Policies supporting SME financial statement quality are crucial for competitiveness and sustainability.

Introduction

Economic activities encompass various sectors that contribute to their functioning, including firms, factories, and industries. The presence of these elements fosters coherence by facilitating employment opportunities and fostering specialization, thereby broadening the array of job prospects. The greater the number of industries operating within economic sectors, the higher the number of employment prospects they offer. Nonetheless, not all companies exhibit this capacity; for instance, companies with high production capabilities require increased output to meet quotas. Consequently, the demand for input factors rises, necessitating a larger workforce. However, in this process, there is an evaluation phase; certain companies, for instance, may have the potential to generate the same volume of products by utilizing technology rather than human resources. The production capacity of an industry or factory mirrors its efficacy, which is constructed upon a myriad of factors. Assessing performance is crucial across various domains, not only within companies but also in small firms or in functions like self-management. Evaluations typically materialize in the form of reports, which constitute a fundamental component of industries, factories, and firms. Reports not only gauge financial performance and conditions but also highlight the imperative to optimize numerous facets of the industry, encompassing operational, financial, and output planning. Nearly every aspect necessitates evaluation to ascertain effectiveness and efficiency, particularly within a company's operational framework involving production, marketing, and distribution. Consequently, reports are deemed indispensable instruments capable of heightening overall firm performance.

Financial reports serve as a crucial element within a company or industry, particularly for Micro, Small, and Medium Enterprises (MSMEs). Roviyantie (Utami et al., 2021) defined financial reports as the culmination of various aspects of a firm's activities related to financing. The quality of these reports depends on multiple factors, with human resources standing out as one of the most significant. These reports encompass financial elements such as revenue, expenses, workforce, assets, liabilities, and receivables, among others. As a tool, financial reports have specific parameters for assessing their quality. They hold great importance in the public sector, where they are mandated as a reflection of capability and self-evaluation. Furthermore, financial reports play a key role in determining a company's tax obligations to the government. Assessing a financial report's quality involves various criteria, including accountability and transparency. These aspects are vital for guiding a firm towards its vision, mission, and organizational objectives (Herindraningrum & Yuhertiana, 2021). A high-quality financial report offers numerous benefits, such as enhancing performance, optimizing financial resource allocation, building public trust, minimizing potential losses, and supporting product and service development through efficient financial resource management(Nirwana & Haliah, 2018).

Financial statements are a crucial component that should be possessed and utilized by all companies, including MSMEs, regardless of their size, as highlighted by (Haliah & Nirwana, 2019). The assessment of financial statements' quality encompasses adherence to regulations, given the numerous instances of non-compliance, delayed financial reporting, lack of transparency, and statements that do not facilitate accountability. Moreover, stakeholders play a significant role in influencing the quality of financial statements. The demands of stakeholder's prompt companies to enhance the quality of their financial statements to prevent a decline in performance and potential damage to relationships. The high quality of financial statements is evidenced by their capacity to mitigate information disparities and risks, as well as their potential to enhance a company's performance (Alsmady, 2022). The precision of the financial reports will function as a point of reference for estimating future financial circumstances, thereby enabling the organization to make precise decisions and devise the most suitable strategies for implementation. The significance of the financial dimension within the organization is elucidated by (Kiymaz et al., 2024) as capital management being crucial for optimizing financial resources and enhancing operational effectiveness, encompassing the oversight of short-term assets and liabilities. These various elements are documented in the financial statements, allowing companies to analyze where errors were made, or losses were incurred. Furthermore, this crucial data influences how organizations can cultivate trust among their partners to encourage ongoing participation or affiliation with the company's activities, providing them a sense of reassurance regarding their contributions to the organization.

Financial statements and their core components within the realm of MSMEs are not as elaborate as those found in large companies that operate on a national or multinational scale. MSMEs represent a type of enterprise encompassing a range of company sizes, commencing with the level of accumulated capital ownership and the fluctuating number of employees. Despite the relatively modest scale of these enterprises compared to national corporations, it is imperative for them to maintain financial statements as a crucial tool. This practice is essential for evaluating various facets of the business, particularly its financial components. By having well-structured financial statements in place, MSMEs are equipped with a framework to identify their operational shortcomings, areas for enhancement, and underlying business potentials. Financial reporting plays a pivotal role in enhancing firm performance by furnishing indispensable data for decision-making among diverse stakeholders. Creditors, for instance, leverage financial reports to evaluate a firm's creditworthiness, while tax authorities depend on them for tax-related matters and shareholders for determining dividend allocations (Höglund & Sundvik, 2016). The provision of high-caliber financial reporting guarantees transparency and precision, both of which are essential for upholding stakeholder confidence and facilitating well-informed business judgments.

High-quality financial reporting diminishes inaccuracies within the accounting measurement framework, diminishes the potential for manipulation of financial information, and guarantees the prompt revelation of positive and negative developments. This level of transparency is crucial for upholding investor trust and has the potential to result in a decreased cost of capital, given that investors require a diminished rate of return in exchange for assuming lower information-related risks (Ghosh & Tang, 2015). Additionally, enhanced financial reporting excellence is frequently correlated with improved corporate performance. Meanwhile according to (Duréndez & Madrid-Guijarro, 2018) financial reporting plays a critical role in maximizing firm performance by offering transparency and accountability, key elements necessary for well-informed decision-making among both internal and external stakeholders. Enhanced financial reporting quality diminishes information asymmetry, consequently boosting the credibility of the firm and facilitating more sound credit and investment choices by stakeholders. Optimal firm performance heavily relies on high-quality financial reporting, as it nurtures trust, mitigates risks, and promotes sustainable growth through the alignment of interests among all stakeholders.

High-quality financial reporting provides various advantages for firm performance. Firstly, it reduces the cost of capital as accurate reports decrease information asymmetries between companies and investors. Secondly, it enhances investment efficiency by presenting projects clearly, attracting more investment, and improving resource allocation in the capital market. Thirdly, it boosts market efficiency by reducing information gaps between company management and capital market participants, leading to better investor decisions. Fourthly, it enables better forecasting and decision-making through relevant and reliable financial reports. Fifthly, it ensures compliance with regulations and enhances transparency and credibility. Lastly, accurate financial reporting reflects current performance and aids in predicting future performance, crucial for assessing value and sustainability (Zhou et al., 2022). These benefits collectively contribute to a more robust and transparent financial environment, fostering trust and confidence among investors and stakeholders. Possessing high-quality financial statements can have a positive influence on the performance of a company in various ways. Primarily, precise and dependable financial reports have the capacity to increase transparency and responsibility, resulting in heightened trust from investors and potentially attracting more financial backing. Additionally, superior financial statements can offer valuable insights for decision-making, aiding management in making well-informed strategic decisions that can enhance operational effectiveness and profitability (Wiralestari et al., 2021). Lastly, top-notch financial reports can streamline adherence to regulatory standards and enhance connections with stakeholders, thereby contributing to the overall sustainability of the organization.

The advantages stemming from high-quality financial statements or well-managed financial records in a business are delineated in various empirical assessments, including a study by (Susetyo et al., 2023) which posits that the benefits derived from sound financial statements encompass an enhancement in the company's reputation, serving as a basis for more informed decision-making, and functioning as a tool for evaluating the business's performance and financial status. Another perspective on this matter, as expounded by (Firnanda, 2023), is that the advantages of quality financial statements encompass transparency and robust accountability concerning the financial facets of the enterprise, serving as pertinent references for decision-making, and fostering trustworthiness, all of which contribute to bolstering the company's appeal to investors, serving as an effective resource management tool, and ultimately, a proficient financial report can be a catalyst in steering the company towards its long-term objectives. Further emphasized by (Iryanti & Munandar, 2023) is the notion that well-prepared financial statements are comparable, possess relevance, and can be comprehended in straightforward terms; the data encapsulated in such financial statements also exude reliability, signifying that the recorded information accurately depicts the transpired events, a critical element for performance appraisal and business analysis. Financial reports play a crucial role for various types of enterprises, with Micro, Small, and Medium Enterprises (MSMEs) being significant contributors to the economy by fostering employment opportunities and alleviating poverty. This research aims to assess the influence of financial statements on the performance of MSMEs. Additionally, it will delve into strategies for enhancing the quality of financial reports and emphasize the importance of MSMEs possessing such statements, not solely limited to large corporations on a domestic or global level.

Literature Review

Financial Statements

Financial statements are a crucial tool for conveying a company's financial information to external entities, particularly those with limited insight into the internal workings of the organization. These statements serve as the primary means for external parties to evaluate a company, providing a basis for decisions regarding investments and business engagements (Tanjaya & Kwarto, 2022). By transforming financial data into a structured format, financial statements offer a comprehensive view of a company's financial health, which is critical for decision-making processes related to securing capital, expanding production resources, and assessing the viability of investments in the company's assets (Heni & Payamta, 2023). The quality of financial statements is paramount, as they must provide reliable and relevant information to be useful for decision-making. Several key elements contribute to the creation of high-quality financial statements, including the robustness of the accounting information system, the effectiveness of the internal control framework, and the competence of the personnel involved in the financial reporting process. Moreover, financial statements must meet certain qualitative characteristics, such as reliability, relevance, comparability, and comprehensibility, to fulfill their intended purpose.

The integrity of financial statements begins with the quality of the underlying accounting information system. A robust accounting information system ensures that financial data is accurately captured, processed, and reported. This system facilitates the systematic collection and processing of financial transactions, which are then reflected in the financial statements. A well-implemented accounting information system enhances the reliability of financial information by reducing the likelihood of errors and ensuring that financial data is consistently recorded and processed (Romney et al., 2012). Additionally, a strong internal control framework is essential for ensuring the accuracy and completeness of financial statements. Internal controls are mechanisms, policies, and procedures that companies put in place to safeguard assets, ensure the accuracy of financial reporting, and prevent fraud. Effective internal controls include segregation of duties, authorization procedures, and regular audits, all of which contribute to the credibility of financial statements (COSO, 2013). When internal controls are weak or poorly implemented, the risk of material misstatements in financial statements increases significantly (Lobo et al., 2020). The proficiency and ethical standards of the personnel involved in the preparation of financial statements are also critical to their quality. Well-trained and knowledgeable accounting staff are better equipped to handle complex financial transactions and ensure that financial statements comply with relevant accounting standards and regulations. Continuous professional development and adherence to ethical guidelines are essential for maintaining high standards in financial reporting (Libby & Luft, 1993).

Effective financial statements must exhibit key qualitative characteristics to be valuable for decision-making. They must be reliable, meaning they are free from material errors and biases and accurately reflect the company's financial position, allowing users to make informed decisions. Relevance is also critical, as the information provided should help stakeholders predict future outcomes or confirm past evaluations (Kujala et al., 2022). Comparability is essential, enabling users to assess the company's financial performance across different periods or in comparison with other companies, facilitating trend analysis (Tsianaka & Dimitra, 2023). Lastly, comprehensibility ensures that financial statements are clear and understandable, even for users without extensive accounting knowledge (FASB, 2010). High-quality financial statements are crucial for various stakeholders. For investors, they provide reliable and relevant data for assessing a company's financial health and growth potential. Creditors use them to evaluate creditworthiness, while regulators rely on them for compliance with legal standards. Management uses them to make strategic decisions aimed at enhancing performance and achieving long-term goals. Moreover, such statements foster transparency and accountability, build trust among stakeholders, and contribute to a company's reputation by demonstrating adherence to ethical financial reporting practices, thereby attracting investment and maintaining positive relationships with external parties.

Firm Performance

The performance of a company is generally viewed as the cumulative outcome of various business activities, reflecting the overall success achieved by the business entity. Corporate performance is often described as a combination of operational efficiency and the company's ability to meet shareholder expectations (Nguyen & Dao, 2023). Several critical factors contribute to enhancing business performance, covering a wide range of elements. Firstly, the size of the company and its historical performance play a significant role in driving innovation within the organization. Factors such as cash flow, growth trajectory, historical performance metrics, and market dominance all positively influence a company's performance. For example, larger companies with strong cash flows are often better positioned to invest in research and development, leading to greater innovation and competitive advantage (Zhao et al., 2024). This innovation, particularly technological innovation, not only improves financial performance but also boosts overall productivity, making it a key driver of enhanced company performance.

Secondly, cultivating a positive reputation is crucial for improving consumer perceptions and goodwill towards a company. A strong reputation can lead to increased customer loyalty, reduced marketing costs, and the ability to command higher prices for products or services. This, in turn, can reduce production costs and improve overall performance (Katenova & Qudrat-Ullah, 2024). The rational use of a company's reputation can therefore serve as a strategic asset that directly impacts its financial outcomes. Innovation within production processes and product development is another critical intermediary that can significantly enhance company performance. The integration of cutting-edge technologies and innovative practices in production not only improves operational efficiency but also aligns the company with evolving market demands. Technological advancements enable companies to produce goods more efficiently, reduce waste, and improve product quality, which can lead to increased market share and profitability (Orr & Orr, 2014).

The financial dimension of corporate performance is indispensable, serving as both a measure of productivity and a foundation for other business initiatives. Sound financial management practices are essential for ensuring that resources are allocated efficiently and effectively. Companies with robust financial management are better equipped to invest in new opportunities, manage risks, and sustain long-term growth. Financial health also enables businesses to engage in social initiatives, contributing to broader societal goals while enhancing the company's reputation and stakeholder relationships (Katenova & Qudrat-Ullah, 2024). Good corporate performance is closely tied to effective operational management strategies. Companies that excel in managing their operations typically see improvements in productivity, cost control, and overall efficiency. This operational excellence is often reflected in the quality of financial statements, which provide a transparent and accurate view of the company's financial position. High-quality financial statements are characterized by reliability, relevance, comparability, and comprehensibility, all of which are crucial for stakeholders to make informed decisions (Tanjaya & Kwarto, 2022). Reliable financial statements free from material errors or biases are essential for maintaining stakeholder trust, while relevant information helps stakeholders predict future outcomes and confirm past evaluations (DiPiazza Jr & Eccles, 2002).

The Relationship between Financial Statement Quality and Company Performance

The quality of financial statements and company performance are closely intertwined in the business world. High-quality financial statements provide relevant, reliable, comparable, and understandable information, which is critical for various stakeholders, including management, investors, creditors, and regulators. These stakeholders rely on financial statements to assess a company's financial health and make informed decisions. Relevance in financial statements means that the information presented must be useful for users in making economic decisions, such as predicting future outcomes or confirming past performance. Reliability refers to the accuracy and honesty of the information, ensuring that it is trustworthy and free from material bias (Cypress, 2017). Comparability allows users to evaluate the company's performance over time or compare it with other companies in the same industry, which is crucial for assessing the company's competitive position. Understandability emphasizes that the information in financial statements should be organized and presented in a way that is accessible even to those without extensive accounting knowledge (FASB, 2010). Company performance is typically defined as the culmination of various business activities that reflect the company's success in achieving its objectives. Key performance indicators often include profitability, operational efficiency, and company growth. Profitability measures how effectively a company generates profit from its assets, while operational efficiency demonstrates how well the company utilizes its resources to produce output. Company growth indicates the company's ability to expand its operations and increase its market share over time. Together, these indicators provide a comprehensive view of the company's health and competitiveness in the market (Nguyen & Dao, 2023).

Accounting theories play a crucial role in understanding and supporting the relationship between financial statement quality and company performance. Financial Reporting Theory, for instance, emphasizes the importance of accurate and transparent financial reporting for decision-making. This theory posits that financial statements should faithfully represent the company's economic conditions, enabling decision-makers to make informed decisions based on accurate information (Zhao et al., 2024). Contingency Theory is another relevant accounting theory, suggesting that there is no one-size-fits-all approach to financial reporting. Instead, the best practices depend on various factors such as the size of the company, the complexity of its operations, and the business environment (Katenova & Qudrat-Ullah, 2024). High-quality financial statements result from applying accounting principles that align with the company's specific circumstances. The quality of financial statements significantly influences managerial decision-making. High-quality financial statements provide a solid foundation for management to make better strategic decisions, such as resource allocation, expansion planning, and investment decisions. Conversely, poor-quality financial statements can lead to resource misallocation, inappropriate risk-taking, or even detrimental strategic decisions, ultimately harming the company's overall performance (Menicucci, 2019).

Investor confidence in a company is heavily influenced by the quality of its financial statements. Investors rely on these reports to assess the company's financial health and potential returns. High-quality financial statements, prepared according to applicable accounting standards, tend to increase investor confidence by providing a clearer and more accurate picture of the company's condition. This increased confidence can enhance the company's market value and facilitate access to capital. On the other hand, poor-quality financial statements can erode investor confidence, hindering the company's access to external funding and potentially lowering its stock price (Yiosese, 2020). Additionally, financial statements that lack transparency or accuracy can damage the company's relationships with other stakeholders, including creditors and regulators. Research consistently shows that companies with high-quality financial statements tend to perform better. Good financial reporting enables management to more effectively identify and capitalize on market opportunities and better manage risks. Studies also indicate that companies with high-quality financial statements are more likely to attract investment, which can be used to fund further growth and expansion (Akisik, 2020).

The Role of Accounting Information Systems and Internal Controls

Accounting Information Systems (AIS) are critical components of modern financial management, consisting of a set of procedures and processes that organizations use to collect, store, and process financial data (Gelinas et al., 2018). These systems are essential for producing information that supports decision-making. AIS typically includes hardware, software, human resources, procedures, and the financial data itself. Hardware refers to the physical devices used for data processing, while software includes applications designed to manage accounting information. The human resources component involves individuals who interact with the system, and procedures represent the steps followed in collecting and processing data. AIS plays a vital role in supporting various managerial functions, such as planning, control, and decision-making (Arifin & Sinambela, 2021). It enables companies to efficiently gather and store accounting data in a format that is easily accessible and analyzable. Moreover, AIS facilitates the generation of accurate and timely financial reports, which are crucial for evaluating financial performance, planning strategies, and making informed business decisions. Common software applications used in AIS, such as SAP, Oracle Financials, and QuickBooks, help automate accounting processes and enhance the accuracy and reliability of the data produced (Romney et al., 2012).

Internal controls within AIS are essential for ensuring the integrity and reliability of financial reports. These controls include procedures designed to safeguard company assets, ensure the accuracy and completeness of financial information, and prevent and detect errors and fraud. Frameworks such as COSO (Committee of Sponsoring Organizations of the Treadway Commission) provide guidelines for designing and assessing internal controls. The COSO framework highlights five key components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring (COSO, 2013). The relationship between AIS and the effectiveness of internal controls is closely intertwined. An effective AIS strengthens internal controls by ensuring consistent and traceable financial information processing. AIS enables management to monitor transactions in real-time, identify potential issues early, and take corrective actions to prevent significant losses. This interaction between AIS and internal controls creates a robust protection layer, preventing errors and enhancing confidence in the company's financial system (Louwers et al., 2018). Research demonstrates that implementing AIS significantly improves the effectiveness of internal controls. Companies effectively adopting AIS tend to have lower error rates in their financial reports and are better equipped to detect and prevent fraud. A well-functioning AIS is a critical component of the company's internal control structure, contributing to increased transparency, accountability, and trust in the company's financial system.

AIS and internal controls also have a significant impact on company performance. A robust AIS, supported by effective internal controls, enhances operational efficiency by reducing errors in transaction recording, accelerating financial reporting, and lowering costs associated with manual controls. Additionally, sound internal controls ensure that the financial reports generated by AIS are accurate and reliable, crucial for gaining the confidence of external stakeholders such as investors and creditors. This increased confidence can boost the company's market value and ease access to capital (Friedman, 2019). Research also shows that high-quality AIS and internal controls are positively correlated with a company's financial performance. Companies with effective AIS tend to have better risk management, enabling them to navigate market uncertainties with greater confidence and flexibility. Moreover, transparent and accurate financial reports generated by a well-functioning AIS can enhance the company's reputation, increasing stock prices and strengthening its competitive position (Abed et al., 2023).

Research Design and Methodology

This research endeavor represents a qualitative exploration characterized by a literature review research design. The scrutiny in this particular inquiry unfolds in a descriptive manner towards the body of literature that delves into the realm of financial statements in a comprehensive manner. The data under scrutiny within this investigation were meticulously gathered from a multitude of reputable scientific research repositories including but not limited to ScienceDirect, Emerald, JsTOR, Google Scholar, and Semantic Scholar. The analytical process is meticulously executed through the employment of deductive reasoning mechanisms which intricately involve the systematic extraction of data that pertains to the subject matter under investigation. The forthcoming findings emanating from this scholarly pursuit are poised to delineate the intricate ways in which financial statements within the context of Small and Medium Enterprises (SMEs) specialized enterprises can exert a discernible impact on the operational performance metrics of these entities.

The investigation is grounded on empirical substantiation, therefore, the data in this particular investigation were amassed through an examination of various research and review documents sourced from a variety of databases including but not limited to ScienceDirect, Emerald, JStor, Google Scholar, and Semantic Scholar. The process involved utilizing specified keywords namely (1)

Financial Statements; (2) Company Performance; and (3) Human Resources, which subsequently yielded the following outcomes: 101,000 findings on Google Scholar, 5,130 findings on Semantic Scholar, 10,406 findings on Emerald, 854 findings on JStor, and 11,757 findings on ScienceDirect. The findings acquired were also subject to a filtration process, specifically focusing on research articles and review articles released between 2020 and 2024, resulting in the identification of 24 pertinent articles contributing to the discourse within this study. Upon contemplation of the empirical research harnessed in this investigation, the primary aim is to scrutinize and elucidate the impact of financial statements' quality on companies' performance. To enhance the lucidity of this investigation's depiction, the framework is delineated through a fishbone diagram showcasing both facets of company performance and financial statements, drawing upon the antecedent studies referenced within this research.

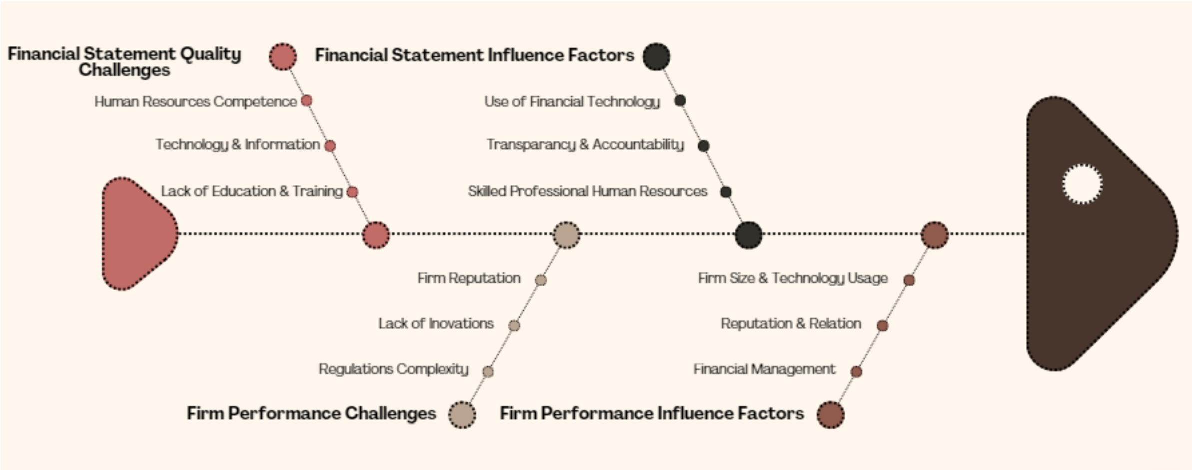

Image 1. Fishbone Diagram Research Framework

Fishbone diagram explanation will begin with financial statement barriers, focusing on Human Resources' competence. Insufficient accounting knowledge may hinder high-quality financial reports. Information Technology understanding is crucial for enhancing financial statement quality. Training and Education deficiency can be a barrier, while adequate training enhances accuracy. Organizations can improve financial statement quality by overcoming these obstacles, boosting stakeholder confidence. Human Resources' competence is crucial for high-quality financial statements. Proficiency in knowledge and skills is vital for compliance with standards. Accounting Information Technology enhances efficiency and accuracy in financial statement preparation. Transparency and Accountability are essential for stakeholder confidence in financial reporting. Focusing on these factors enhances financial statement quality, improving decision-making and company performance. Various barriers exist in the corporate performance realm, including Reputation which can affect consumer favorability and production costs. Challenges arise without a robust reputation strategy or during a crisis. Technological Innovation in production and product development is crucial. Companies may struggle to adapt or invest in innovation. Regulation and prudence also pose hurdles, as non-compliance can lead to penalties and financial losses. Overcoming these obstacles can enhance company performance, fostering trust and sustainable growth. Factors like Company Size and Reputation contribute to performance, with past performance and cash flow playing significant roles. A favorable reputation can reduce production costs and cultivate consumer goodwill. Technological Innovation boosts company performance by enhancing financial aspects and productivity. Good Financial Management and Management practices are key for proficient corporate performance. Sound financial management contributes to resource efficiency and enables social initiatives. Focusing on these factors can support business objectives and long-term prosperity.

Findings and Discussion

Financial statements hold a pivotal and indispensable role within the realm of business, functioning as a fundamental instrument that underscores the crucial importance of establishing and maintaining these financial documents. The influence exerted by financial statements on the operational efficacy of Small and Medium Enterprises (SMEs) is of paramount significance, given that the caliber of these statements directly impacts the overall performance and outcomes of a business entity. It is imperative to acknowledge that an amelioration in the quality of financial statements is intricately linked to a commensurate enhancement in the operational efficiency and effectiveness of SMEs, thereby establishing a definitive and unmistakable correlation between these two vital components. More specifically, the adept preparation of financial statements empowers Micro, Small, and Medium Enterprises (MSMEs) to access vital capital funding from esteemed financial institutions such as banks, leveraging specialized initiatives like the People's Usaha Credit program to bolster their financial standing and prospects. These financial documents also function as crucial barometers that illuminate a business's fiscal well-being, providing valuable insights into its sustainability and feasibility in the long run. Moreover, a meticulously crafted financial report assumes a pivotal role as a benchmark for evaluating and assessing the triumphs and accomplishments of a business venture, as eloquently underscored by (Pakpahan, 2020) in their scholarly investigations and analyses. As underscored by the scholarly works of (Abdallah & Maryanto, 2020), the significance of financial statements transcends mere documentation, encompassing the indispensable facets of meticulous recording and systematic bookkeeping that are intrinsic to the seamless and uninterrupted functioning of a business enterprise. Despite the undeniable significance of these financial records, a discernible cohort of entrepreneurs operating on a smaller scale tend to overlook the critical import of adhering to established accounting practices, often resorting to maintaining subpar records that fail to meet the requisite standards and benchmarks. The value of a comprehensive financial report extends far beyond the realms of mere documentation, offering SMEs invaluable insights and perspectives that can be leveraged to adeptly manage their financial resources and undertakings. By adopting such prudent financial management practices, these enterprises can actively contribute to fostering economic growth, catalyzing job creation, and ultimately elevating the income levels and standards of living within the broader community. Furthermore, as cogently articulated by (Widiastoeti & Sari, 2020), financial statements are veritable cornerstones for facilitating accurate and informed decision-making processes, furnishing stakeholders with a holistic and comprehensive overview of a business's financial performance and standing. These financial documents represent indispensable components that buttress sound financial management practices, thereby playing an instrumental role in fortifying the overall sustainability and prosperity of business enterprises.

The performance of SMEs has been examined in various empirical studies, such as the one conducted by (Arum & Nuraini, 2021). Financial statements play a crucial role in influencing SMEs' performance. Through financial statements, MSMEs can access essential financial information necessary for their operations, aiding in business development. High-quality financial statements empower SMEs to make informed and strategic decisions, thereby enhancing their business performance. Additionally, as highlighted by (Arisandi et al., 2022), financial statements are vital for determining the company's profitability, assets, liabilities, and capital management, as well as assessing expense efficiency. These statements serve as instrumental tools for decision-making in business growth. Inadequate standardized financial statements often hinder MSMEs from securing bank financing due to the inability of basic financial records to accurately represent the business's financial standing. The quality of MSMEs' financial statements is shaped by their understanding of the statements' purpose, accounting knowledge, and utilization of information technology. A positive perception of financial statements' purpose and strong accounting knowledge among MSMEs contribute to the production of high-quality financial reports, as noted by (Erawati & Fajriati, 2023).

Small and Medium Enterprises (SMEs) necessitate financial reports, which play a crucial role in this context. As indicated by (Sularsih & Wibisono, 2021), high-quality financial statements can enhance the ability of SMEs to acquire funding from banks, serving as an indicator of the financial statements' quality. A comprehension of information system technology can enhance the quality of financial statements, thereby supporting SMEs in navigating intense competition, particularly in the era of Industry 4.0. This notion is further elucidated by (Erawati & Setyaningrum, 2021), who define financial statements as documents that encompass the financial data of an organization within a specific accounting period, enabling the depiction of the entity's performance throughout business operations. Superior financial statements can aid users in making informed decisions by ensuring a thorough understanding, absence of significant errors, and reliability in the information presented.

Improving the performance of Small and Medium-sized Enterprises (SMEs) through financial reporting necessitates a strategic approach, one of which involves imparting training in financial statement preparation to enhance comprehension of these statements, as well as tax reporting and financial element reporting in a standardized manner, requiring collaboration among various stakeholders, particularly experts (Rostiani et al., 2021). Enhancing financial statements for SMEs encompasses crucial measures. SMEs need to enhance their capacity to produce precise financial statements. Adhering to proper accounting principles is advised for business owners and managers. Many SMEs still handle their finances manually, neglecting accounting standards. Proficiency in accounting among Micro, Small, and Medium-sized Enterprise (MSME) stakeholders is pivotal for financial statement preparation. Sound financial management practices mediate the impact of financial statement preparation skills on the financial performance of MSMEs (Hutauruk et al., 2024). Furthermore, this endeavor can be facilitated by utilizing user-friendly tools like Microsoft Excel, APIK, and Lamikro for generating statements of significance. Aspiring entrepreneurs should receive online guidance to enhance their grasp of accounting. Providing monthly mentoring to MSME startups via WhatsApp groups is essential for the effective application of acquired knowledge (Solikin et al., 2021).

The utilization of digital financial reports is beneficial in accurately documenting all transactions such as sales, purchases, and expenses in a methodical manner. This practice leads to enhanced efficiency and effectiveness in financial management for small and medium enterprises (Sinaga et al., 2022). To enhance micro, small, and medium enterprises (MSMEs) by elevating the quality of financial reports, training sessions focusing on comprehending financial accounts and conducting SWOT analysis are crucial for offering sufficient knowledge transfer. Such training can be integrated into actual business operations, thereby aiding in fostering the growth of SMEs and contributing to a more robust Indonesian economy in the long run (Rahmadiane et al., 2022). Further elaborated by (Paendong et al., 2022), the enhancement of competencies in business management governance, particularly in basic financial reporting in alignment with standard protocols, is aimed at providing precise financial information regarding the company's financial status, performance, pricing strategies, inventory management, and changes in equity over time. These measures are pivotal in facilitating decision-making processes and are expected to bolster the autonomy and competitiveness of MSMEs.

Financial statements play a crucial role in enhancing the performance of MSMEs. The accuracy of financial statements has a direct impact on the enhancement of SMEs' performance, enabling them to secure capital loans from banks through programs like the People's Business Credit initiative, and indicating the overall well-being of the business. Moreover, well-prepared financial statements aid SMEs in better financial management, leading to economic growth, increased employment opportunities, and higher incomes for individuals. Utilizing digital financial statements also improves efficiency and accuracy in recording transactions, thereby facilitating the financial management of SMEs. Strengthening skills in business management governance, including adherence to standard financial reporting practices, aims to provide precise insights into financial status, performance, and support decision-making processes. Consequently, high-quality financial statements are imperative for MSMEs to enhance business performance, efficiently manage finances, and make well-informed decisions.

Conclusion

This research endeavor seeks to examine the impact of financial statements on the operational efficacy of enterprises, particularly Micro, Small, and Medium Enterprises (MSMEs). Financial statements play a crucial role in diverse business sectors, encompassing SMEs that play a pivotal role in the economy by facilitating job creation, reducing unemployment rates, and alleviating poverty. The findings of this investigation indicate a noteworthy correlation between financial statements and the performance of SMEs. Through the utilization of financial statements, MSMEs can access vital financial data essential for their operations, thereby aiding in the enhancement of their enterprises.

High-quality financial statements empower SMEs to make informed and strategic decisions, thereby enhancing their operational efficiency. The advantages of possessing well-crafted financial statements for a business encompass enhancing its credibility, serving as a benchmark for precise decision-making, and functioning as a tool for evaluating the business's financial health and performance. Proficient financial statements promote transparency and accountability, attract potential investors, and facilitate efficient resource management. Furthermore, well-prepared financial statements can be compared, possess relevance and clarity, and affirm the reliability of the documented data. In conclusion, this study underscores the pivotal role of financial statements in enhancing the performance of SMEs and delivering a multitude of significant advantages for business expansion.

Current research demonstrates the significant influence of financial statements on the performance of Small and Medium Enterprises (SMEs), consequently impacting various crucial facets of business administration. Through the utilization of high-quality financial statements, Micro, Small, and Medium Enterprises (MSMEs) can enhance their financial management efficiency, secure capital loans from financial institutions, and enhance competencies in managing business governance. This enhancement not only bolsters the autonomy and competitiveness of SMEs but also elevates business standing, transparency, accountability, and investor appeal. Moreover, sound financial statements facilitate more precise decision-making processes and the formulation of efficient long-term strategies, ultimately diminishing potential losses and optimizing fund allocation efficiency. Variables such as accounting information systems, internal controls, and human resources proficiencies are additionally pivotal in shaping the caliber of financial statements, subsequently influencing overall company performance.

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