Firm Value Effect of Managerial Ability and External Control Mechanism: Mediation Role of Financial Reporting Quality

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Abstract. The aim of this study is to prove that managerial ability and external control as proxied by audit quality are predictors of financial reporting quality which in turn affect firm value. The empirical model of this research is constructed on the basis of Stakeholder Theory and Agency Theory. The population was all companies listed on the Indonesia Stock Exchange (IDX) with a research period of 2017–2019 with a sample of 210 companies each year selected by purposive sampling method. Data analysis was carried out by regression and path analysis. The results prove that managerial ability has a positive and significant influence on the quality of financial reporting. The quality of financial reporting has a positive and significant effect on firm value. Further testing shows that the quality of financial reporting has a mediating role in the relationship between managerial ability and audit quality on firm value.

Keywords: Audit Quality · Financial Reporting Quality · Firm Value · Managerial Ability

1 Introduction

The primary objective of profit organizations is to maximize stakeholder value. The value of the company describes the investor's perception of the level of success of the company which is often reflected by the stock price. Previous research related to predictors of firm value was mentioned, among others, by disclosure of social responsibility and ownership structure [1]; structure ownership [2, 3]. On the other hand, [4] revealed that one of the direct predictors of firm value is the quality of financial reporting.

How important is the quality of financial reporting, at least as demonstrated by PT Garuda Indonesia in 2018, namely that there is a discrepancy between the financial statements of PT Garuda Indonesia and the Statement of Financial Accounting Standards (PSAK). Reporting from okezone.com, Garuda Indonesia Group posted a net profit of USD 809.85 thousand or equivalent to Rp. 11.33 billion (assuming an exchange rate of Rp. 14,000 per US dollar). This figure jumped sharply compared to 2017, where they recorded a loss of USD 216.5 million. This resulted in a 4.4% decline in the value of Garuda Indonesia Group shares on the Indonesia Stock Exchange (IDX), where the previous share price was around Rp 500 per share and fell to Rp 478 per share.

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The pivotal message is that the quality of financial reporting is a vital predictor in predicting firm value. However, achieving the quality of financial reporting requires a managerial process that is proxied through managerial ability and external control that is proxied by audit quality. The level of managerial ability possessed by managers in a company shows the manager's level of knowledge about business conditions and company clients, so that mistakes can be minimized. [5] stated that managerial ability plays a pivotal role in the presentation of quality financial reporting. Managers with good managerial skills can afford to process company resources efficiently, meaning that they use minimal resources to achieve maximum results [6, 7].

The more proficient the manager is, the more capable the manager is to run an effective and efficient business and make the right decisions that create added value for the company. The selection of auditors is influenced by parties with an interest in the company, namely shareholders and creditors [8, 9]. Audit Quality as an external control mechanism ensures that the reports provided by management are free from material misstatement, so that they can be used as a basis for making investment decisions.

Thus, the aim of this study is how the mechanism for the formation of quality financial reporting will affect the value of the company. In contrast to previous studies related to predictors of company value which built a partial model [2–4], this study built a comprehensive series of models related to predictors of the formation of financial reporting quality and further impact on firm value. In other words, this study aims to examine the model of how managerial ability and audit quality can affect firm value either directly or through financial reporting quality.

2 Literature Review and Hypothesis Development

2.1 Literature Review

Firm value is a condition that has been achieved by the company which is an illustration of public trust in the company through activity processes for some time, starting from the company's establishment until now [11]. [12] stated that firm value can be interpreted as the price that prospective buyers are willing to pay if the company is sold.

If the company offers shares to the public, the company's value will be reflected in its share price. Therefore, an increase in stock prices makes the value of the company higher and the impact is not only on the company's current performance but also on the company's prospects in the future, as well as on market confidence. According to [13], the higher the stock price, the higher the level of return to investors, which will increase the value of the company in relation to the company's goal to maximize the prosperity of shareholders.

On the other hand, financial statements are part of the financial reporting process. Financial reporting is a process for providing and conveying financial information which consists of various aspects, such as applicable principles, regulations, and related institutions (*e.g.* reporting entities, professional organizations, and regulatory bodies from the government or other institutions). Financial reporting can be considered as financial information provided by the company as an effort to assist the allocation of the company's capital to its users. Statement of Financial Accounting Concept (SFAC) No. 1 paragraph 34, the Financial Accounting Standards Board (FASB) states that one of the

objectives of financial reporting is to inform current and potential investors in making rational investment decisions and in assessing the company's expected cash flows. Financial reporting should provide information about the company's financial performance and how the company's management uses its authority to manage as well as possible the company's resources entrusted by the owner or shareholder to the manager.

The next point is related to managerial ability. A manager is someone who runs and coordinates an activity, task, or job in order to achieve company goals or objectives. According to Furnham, managers are individuals who perform management functions (planning, organizing, directing, and controlling) in a company [14]. Managers play a prominent role in a company, because managers are parties who have knowledge about the company as a whole. Demerjian et al. define managerial ability as the ability of managers to manage the company to generate maximum revenue based on the company's resources [6]. [15] state that a manager is considered as capable if the manager has adequate expertise in the field that is his responsibility. The more proficient a manager is, the more capable the manager is to run an effective and efficient business and make decisions that create value for the company. Through company efficiency, the manager's ability to process company resources into income, by maximizing the use of these resources can be proxied.

The last point is related to Audit Quality. Auditing is a form of corporate accountability to stakeholders. The audited financial report aims to assess the feasibility or fairness in the presentation of financial statements made by a company. An audit report can be regarded as a communication tool for the auditor with related parties so it must be prepared based on applicable principles and standards, such as audit standards and quality control standards. According to [16], users of financial statements are more confident and trust the financial statements audited by auditors with high quality compared to auditors who are not qualified. Users of financial statements assume that high-quality auditors can be more effective in carrying out the audit process in conducting audits.

2.2 Hypothesis Development

Increasing the value of the firm is an achievement that every company wants to achieve. According to [17], firm value is the company's performance which is reflected in the stock price formed by the demand and supply in the capital market which reflects the public's assessment of the company's performance. One of the things that investors, both local and foreign, pay attention to before investing in a company is to look at the financial statements. Financial reports are used as one of the reliable and useful decision-making tools, a financial report must have high-value information content for its users [18].

Quality financial reporting cannot be separated from the intervention of managers in managing company resources which will increase revenue in the company's financial statements. Managers with good managerial skills can afford to process company resources efficiently, meaning that they use minimal resources (inputs), but maximum results (outputs). The higher the managerial ability of a manager, the better the manager's management in making decisions and running a business efficiently that creates added value for the company.

Agency theory states that there is an efficient contract in which the principal or owner assigns responsibility to the agent or manager [19]. The owner plays a prominent

role in monitoring and controlling the performance of management and the company's financial condition, while the manager is in charge of coordinating activities within the company. Weston and Copeland state that it is difficult to believe that agents (managers) in carrying out their duties will always be in accordance with the interests of the principal (shareholders), therefore monitoring is needed. Monitoring can minimize the possibility of losses or irregularities made by agents. The principal also needs to do controlling to ensure that activities and performance are in accordance with the company's plans and the interests of the principal.

Audit quality is part of the monitoring mechanism. Foreign ownership acts as a monitoring mechanism that aims to ascertain whether the manager (agent) has acted in accordance with the company's objectives. The audit process is one of the corporate governance mechanisms that provide guarantees for stakeholders in the financial reporting process [20]. The function of the auditor is to ensure that the financial information presented meets accounting standards. Transparent and quality information is certainly more attractive to investors or potential investors.

Based on the theoretical framework above, the hypotheses of this research are:

1. H1: Managerial ability has a significant effect on the quality of financial reporting.
2. H2: Audit quality has a significant effect on the quality of financial reporting.
3. H3: The quality of financial reporting has a significant effect on firm value.
4. H4: The quality of financial reporting mediates the effect of managerial ability on firm value.
5. H5: The quality of financial reporting mediates the effect of audit quality on firm value.

3 Research Methods

The population in this study are non-financial companies listed on the Indonesia Stock Exchange during the period 2017–2019. The sample was selected by the purposive sampling method, where the researcher selects samples that meet certain criteria according to the research objectives. The data source in this study comes from the annual report that has been published in the Indonesia Stock Exchange database (www.idx.co.id) during 2017–2019. The data collection method is through document tracking, namely analyzing the contents of the financial statements and annual reports of companies listed on the IDX in 2017–2019.

3.1 Measurement of Variables

3.1.1 Firm Value

Firm value is a value that can be determined from the comparison of the results of the company's performance, the value of the company can be seen from the maximization of shareholder wealth which is intended to maximize the company's share price [21]. The firm value used in this study is measured using Tobin's Q which has been modified by Gaio and Raposo in the form of Simple Q [22]. This modification was made because

of the difficulty in estimating the market value of debt and replacement costs. Tobin's Q calculation formula is:

$$Q_{it} = \frac{BVA_{i,t} + MVE_{i,t} - BVE_{i,t}}{BVA_{i,t}}$$

Description:
Qi,t = value of Tobin's Q for firm i in year t.
BVAi,t = book value of total assets for company i in year t.
MVEi,t = market value of equity for firm i in year t.
BVEi,t = book value of equity for company i in year t.

3.1.2 Quality of Financial Reporting

The quality of credible and informative financial reporting can reduce the incidence of miscommunication between stakeholders and reduce user skepticism related to manager decisions such as agency costs. The quality of financial reporting is measured by the quality of accruals from the regression model developed by [23, 26] with the formula, as follows:

$$\Delta \mathrm{WC_t} = \alpha + \beta 1\,\mathrm{CFO_{t-1}} + \beta 2\,\mathrm{CFO_t} + \beta 3\,\mathrm{CFO_{t+1}} + \varepsilon_\mathrm{t}$$

Description:
ΔWC = Working Capital,
CFO_{t-1} = operating cash flow year $t-1$.
CFO_t = operating cash flow year t.
CFO_{t+1} = operating cash flow year $t+1$.
t = residual.
**The variables of the above formula components are divided by the company's average assets.*

3.1.3 Managerial Ability

Managerial ability is the manager's expertise in taking and implementing decisions that can lead the company to a high level of efficiency [6]. Efficiency is the use of minimal resources (input) to achieve maximum results (output). The DEA calculation formula refers to [6], as follows:

$$MAX_v\theta = \frac{Sales}{v_1 CoGS + v_2 SG\&A + v_3 PPE + v_4 OpsLease + v_5 R\&D + v_6 Goodwill + v_7 OtherIntan}$$

The larger the $\mathrm{Max_v}\theta$ value, the better the manager's ability to manage inputs to produce outputs. θ is the degree or value of the company's efficiency. θ will have a value between 0 to 1, a company whose value is 1 describes its managers have been efficient in using company resources. Then, Demerjian et al. apply the second stage of the analysis of the efficiency generated by the DEA to ascertain the measurable value of

the company's capabilities – specific characteristics that affect the efficiency value [6]. They estimated the Tobit regression model, as follows:

$$\begin{aligned} \textit{Firm Efficiency} &= \propto_0 + \beta_1\, ln(\textit{Total Assets}) + \beta_2\, \textit{Market Share}_i \\ &+ \beta_3\, \textit{Free Cash Flow Indicator}_i + \beta_4\, ln(\textit{Age})_i \\ &+ \beta_5\, \textit{Business Segment Concentration}_i \\ &+ \beta_6\, \textit{Foreign Currency Indicator}_i + \varepsilon_i \end{aligned}$$

3.1.4 Quality Audit

The Government Accountability Office defines audit quality as a condition in which the audit is conducted in accordance with auditing standards in order to provide reasonable assurance that the audited financial statements and related disclosures are presented in accordance with generally accepted accounting principles (SAK) and are not materially misstated, whether due to error or fraud. In this study, it will be measured using a multidimensional measurement, namely the Audit Quality Metric Score (AQMS). AQMS consists of 5 proxies, namely [24]:

1. The size of the Accountant Firm (Big 4), measured by a dummy variable.
2. Accountant Firm Industry Specialization (SPCL), is given a number 1 if it has the largest industry share and is given a number 0 (zero) otherwise.
3. Audit Assignment Period (Tenure), if the KAP assignment period is in the interval >3 years and <9 years, it is given a number 1 and 0 if otherwise.
4. Client Importance (CI). According to Chen et al. [25], the measurement of client importance is measured by the following formula:

$$CI = \frac{SIZE_{it}}{\sum_{i=1}^{n} SIZE_{it}}$$

Description:
$SIZE_{it}$ = natural logarithm of the client's total assets i.
$\sum_{i=1}^{n} SIZE_{it}$ = natural logarithm of the total assets of n clients audited by a certain Accountant Firm in a certain year t. If the value of the CI ratio of the company audited by a particular Accountant Firm is in the interval $\mu - \sigma \le CI \le \mu + \sigma$, it will be given the number 1 and 0 otherwise.

Willingness and Accuracy of Reporting Audit Opinions Going Concern (RQA), given a score of 1, if the KAP provides a GC opinion in the current year, and in the next year the client experiences financial distress; given a score of 0 (zero) otherwise (reporting error type 1) and given a score of 1, if the KAP does not provide a GC opinion in the current year and the client in the next year does not experience financial distress; given a score of 0 (zero) (reporting error type 2). Reynolds and Francis [26], stated that the client's financial distress condition must meet at least one of the following conditions, namely first, experiencing negative operating cash flow (CFO) and second, net loss.

4 Result and Discussion

4.1 Descriptive Statistical Result

Descriptive statistics provide an overview or description of data that make information clearer and easier to understand, as seen from the mean, minimum, maximum, and standard deviation, variance, sum, range, kurtosis and skewness (Table 1).

Based on the results of the ANOVA test or F test listed in Table 2, it was found that the substructure equation 1, which examines the effect of managerial ability and audit quality on financial reporting quality, has a significance of 0.000 (less than 0.05). This shows that there is an effect between managerial ability and audit quality simultaneously on the quality of financial reporting. Thus, it can be concluded that the model built on substructure equation 1 is good. The results of the ANOVA test or F test on substructure equation 2, which examines the effect of financial reporting quality on firm value, have a significance of 0.000 (less than 0.05). This shows that there is an effect of the quality of financial reporting together (simultaneously) on firm value. Thus, it can also be concluded that the model built on substructure equation 2 is good.

4.2 Coefficient of Determination (R^2)

The coefficient of determination (R^2) essentially measures how much the model's ability to explain or explain the variation of the dependent variable. The coefficient of determination used in this research is Adjusted R Square for substructure model 1 and substructure model 2.

The value of the coefficient of determination (R^2) for the substructure equation 1 shown in Table 3 is 0.119, which means that 11.9% of the variability of financial reporting

Table 1. Descriptive Statistical Results

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Managerial Ability	549	1,650	1,826	1,774	0,031
Audit Quality	549	0,000	5,000	2,780	1,277
Financial Reporting Quality	549	0,977	1,202	1,075	0,039
Firm Value	549	0,312	3,670	1,138	0,527

Source: SPSS 20 Data Processing Results (2021)

Table 2. Model Fit Test (F)

Endogenous Variable	Exogenous Variable	F	Sig.
Quality of Financial Reporting	Managerial Ability Audit Quality	25,592	0,000
Firm Value	Quality of Financial Reporting	85,430	0,000

Source: SPSS 20 Data Processing Results (2021)

Table 3. Coefficient of Determination (R^2)

Model Structure	R	R Square	Adjusted R Square
Substructure 1	0,351	0,123	0,119
Substructure 2	0,368	0,135	0,134

Source: SPSS 20 Data Processing Results (2021)

quality (Y1) is explained by the variability of managerial ability (X1) and audit quality (X2). 88.1% of the variability of financial reporting quality (Y1) is explained by other variables that are not included in the research model. The value of the coefficient of determination (R^2) for the substructure equation 2 shown in Table 2 is 0.134, which means that 13.4% of the variability of firm value (Y2) is explained by the variability of financial reporting quality (Y1). 86.6% of the variability of firm value (Y2) is explained by other variables that are not tested in the research model.

4.3 Path Analysis Results

Hypothesis testing is done by using a regression model in path analysis to predict the relationship between exogenous and endogenous variables. Based on the results of data processing that has been obtained for this research model, it can be described as a path diagram model as follows:

The structural equations that can be formulated based on the path analysis model described above are:

$$\text{Substructure equation 1: } y1 = 0.121x1 + 0.308x2 + 0.939$$

$$\text{Substructure equation 2: } y2 = 0.368y1 + 0.931$$

Description:

$$\varepsilon_1 = \sqrt{(1 - Adjusted\ R^2} = \sqrt{(1 - 0{,}119)} = 0{,}939$$

$$\varepsilon_2 = \sqrt{(1 - Adjusted\ R^2 = \sqrt{(1 - 0{,}134)}} = 0{,}931$$

Based on the structural equation that has been formulated, substructure equation 1 shows that the managerial ability and audit quality variables have a positive influence on the financial reporting quality variable. This means that the variables of managerial ability and audit quality will statistically improve the quality of financial reporting. Substructure equation 2 shows that the financial reporting quality variable has a positive effect on the firm value variable. This means that the financial reporting quality variable will statistically increase firm value.

4.4 Partial Test Results (t-Test)

The t-test is used to determine whether the independent variables partially have an effect on the dependent variable in the regression. If the calculation results show a

Table 4. Hypothesis Testing Results

Model Structure	Standardized Coefficients	Probability Value	Description of significance
Substructure 1 (Effect of Managerial Ability and Audit Quality on Financial Reporting Quality)			
Managerial Ability	0,121	0,003	Accepted
Audit Quality	0,308	0,000	Accepted
Substructure 2 (Effect of Financial Reporting Quality on Firm Value)			
Financial Reporting Quality	0,368	0,000	Accepted

Source: SPSS 20 Data Processing Results (2021)

probability value of <0.05, it means that there is a partially significant influence between the independent variable and the dependent variable.

The discussion of the results of the t-test in Table 4 is as follows:

a. Managerial ability has an effect of 0.121 with a significant probability of 0.003; less than 0.05; on the quality of financial reporting. This means that managerial ability has a positive and significant influence on the financial reporting quality variable. Thus, the researcher's first hypothesis (H1) which states that managerial ability has a significant effect on the quality of financial reporting, is accepted.
b. Audit quality has an effect of 0.308 with a significant probability of 0.000; less than 0.05; on the quality of financial reporting. This means that audit quality has a positive and significant effect on the financial reporting quality variable. Thus, the second hypothesis (H2) which states that audit quality has a significant effect on the quality of financial reporting, is accepted.
c. The quality of financial reporting has an effect of 0.368 with a significant probability of 0.000; less than 0.05; to the value of the company. This means that the quality of financial reporting has a positive and significant effect on the firm value variable. Thus, the third hypothesis (H3), which states that the quality of financial reporting has a significant effect on firm value, is accepted.

4.5 Sobel Test Results

The Sobel test was conducted to test the strength of the indirect effect or the significance of the indirect effect of the independent variable (X) on the dependent variable (Y) through the mediating variable (M) [27, 28].

Based on the results of the Sobel test above, the effect of managerial ability (X1) on firm value (Y2) through financial reporting quality (Y1) has a significant probability of 0.004, less than 0.05. This shows that the quality of financial reporting can afford

Table 5. Sobel Test Results

Effects between Variables	A	B	SE_a	SE_b	Probability Value	Description of significance
X1 to Y2 through Y1	0,139	3,948	0,047	0,427	0,004	Accepted
X2 to Y2 through Y1	0,009	3,948	0,001	0,427	0,000	Accepted

Source: Processed Data using Sobel Calculator (2021)

to mediate the managerial ability variable on firm value. Thus, the researcher's fourth hypothesis (H4) which states that the quality of financial reporting mediates the effect of managerial ability on firm value, is accepted.

The results of the second Sobel test in Table 5, for the effect of audit quality (X2) on firm value (Y2) through financial reporting quality (Y1) obtained a significant probability of 0.000, less than 0.05. This shows that the quality of financial reporting can afford to mediate the audit quality variable on firm value. Thus, the fifth hypothesis (H5) of the researcher which states that the quality of financial reporting mediates the effect of audit quality on firm value, is accepted.

4.6 Discussions

4.6.1 The Effect of Managerial Ability on the Quality of Financial Reporting

The results of the research on the effect of managerial ability on the quality of financial reporting show the regression coefficient value of 0.121 with a significance probability value of 0.003 (smaller than 0.05), so it can be said that managerial ability has a positive and significant effect on the quality of financial reporting. This indicates that high managerial ability tends to improve the quality of financial reporting. The higher the ability of a manager in a company, the more quality the reporting will be presented.

Managerial abilities possessed by managers include knowledge and experience of the company's business processes. Managers with their abilities can afford to organize, coordinate, and move all company resources efficiently to achieve company goals. Efficient means that managers can afford to manage the use of minimal input consisting of Cost of Goods Sold, selling and administrative expenses, company fixed assets, operating leases, research and development, goodwill, and other intangible assets to achieve maximum output. A manager needs to utilize company resources efficiently in order to be able to create a broad market share for the company by paying attention to the business segment concentration which compares the largest segment sales with total sales, use of free cash flow, and also changes in currency exchange rates. The managers, who can afford to process company resources efficiently, will increase the company's income in the financial statements to satisfy stakeholders.

Fama states in agency theory there is an efficiency contract in which the owner hands over responsibility to the manager and the manager is in charge of coordinating activities within the company and positioning it appropriately in a competitive environment [19].

Principals play a prominent role in monitoring and controlling the work and economic decision-making of managers. Managers (agents) must have good managerial skills in order to fulfill common interests in efficient contracts by reducing the elements of discretion in the financial statements presented in an effort to realize quality financial reporting.

4.6.2 The Effect of Audit Quality on Financial Reporting Quality

The results of the research on the effect of audit quality on financial reporting quality show a regression coefficient of 0.308 with a significance probability value of 0.000 (smaller than 0.05), so it can be concluded that audit quality has a positive and significant effect on financial reporting quality. This indicates that high audit quality tends to improve the quality of financial reporting. The higher the level of audit quality, the better the quality of financial reporting in the eyes of investors.

Audit quality is the probability that the auditor will not report an audit report with an unqualified opinion for financial statements that contain material errors. Auditors are said to be qualified if they have standardization including in the Big Four, have a level of specialization, tenure, client importance, as well as the willingness and accuracy of going concern audit opinions. Investors as stakeholders see the development of a company that leads to the numbers listed in the financial reporting of a company. In an effort to increase stakeholder trust, a supervisory mechanism is needed, namely from the independent auditor. The financial reports produced by management need to go through an audit process in order to be free from material misstatements and show the actual state of the company.

[29] stated that audit is a form of monitoring used by companies in order to reduce agency costs. Agency theory can be applied in the separation between ownership and control in a company. In this case, management wants its performance to always look good in the eyes of the principal (owner). But on the other hand, the principal (owner) wants the auditor to report the situation that exists in the company honestly. It shows a different interest between users of financial statements and management. This agency problem can be reduced by the presence of an independent party, namely the auditor. An independent auditor or public accountant in carrying out an audit for a client company has a strategic position as a third party within the client company environment, namely when the auditor carries out the duties and responsibilities of the agent (management) to audit the financial statements of the company he manages.

4.6.3 The Effect of Financial Reporting Quality on Firm Value

The results of the research on the effect of financial reporting quality on firm value show the regression coefficient value of 0.368 with a significance probability value of 0.000 (smaller than 0.05), so it can be concluded that the quality of financial reporting has a positive and significant effect on firm value. This indicates that high-quality financial reporting tends to increase firm value. The higher the quality of the company's financial reporting, the higher the value of the company.

Financial reporting is a means of providing the main financial information that aims to determine the overall financial condition of the company. Financial reporting can

help users of financial statements in making decisions through evaluation and prevention quickly and precisely if business conditions are experiencing problems. Quality financial reporting can be seen from the quality of accruals which is the quality of accounting information presented by the company by comparing accruals with the company's cash flows in the previous year, current year, and the year ahead [10]. The quality of accruals is said to be good if the accruals have a close relationship with the company's future cash flows.

The results of this study state that the quality of financial reporting has a positive and significant effect on firm value. This indicates that the value of the company will increase if the financial reporting presented is of high quality. This is because the quality of financial reporting is a benchmark or reference for users of financial statements through which financial reporting can identify the weaknesses and strengths or achievements of the company, so that users can use them as study material in making economic decisions. In addition, external monitoring carried out by independent auditors can help minimize policy elements that may exist in financial reporting.

4.6.4 Mediating Role of Financial Reporting Quality on the Effect of Managerial Ability on Firm Value

The results of testing the mediating role of financial reporting quality on the influence of managerial ability on firm value through the Sobel test in Table 5 show that the p-value of the Sobel test is 0.004 (less than 0.05). This means that the quality of financial reporting plays a role in mediating the effect of managerial ability on firm value. Financial reporting provides information about how companies procure and use company resources. Through financial reporting, managers provide information regarding their responsibilities related to the use and management of company resources to meet company goals. High managerial ability can be seen in the way the manager attains his responsibilities in managing company resources efficiently.

In general, companies have resources in the form of assets, labor, and capital, to produce output in the form of income and profit. The value of high income and profit is a sign that the company produces high output. Company efficiency is achieved when the company can afford to produce output in the form of sales (revenue) that is greater than the input used. In addition, managers also need to pay attention to assets, market share, firm age, business segment concentration, and changes in foreign currency transactions. This will increase investor confidence in a company. The higher the level of investor confidence, the higher the value of the company. The increase in the value of the company in the form of an increase in share prices is supported by the ability and integrity of management in processing resources, financial information, and the quality of financial reporting, which is a reference for investors in decision-making.

[19] stated that high managerial ability can be measured by reducing the elements of action that contain information asymmetry and discretionary policies in each report to shareholders so that they can present quality financial reporting in order to achieve common interests in fulfilling efficient contracts. Thus, it will increase investor confidence in the company. So increasing investor confidence tends to increase the value of the company.

4.6.5 Mediating Role of Financial Reporting Quality on the Effect of Audit Quality on Company Value

The results of testing the mediating role of financial reporting quality on the effect of audit quality on firm value through the Sobel test in Table 5 show that the p-value of the Sobel test is 0.000 (less than 0.05). This means that the quality of financial reporting plays a role in mediating the effect of audit quality on firm value. Financial reporting through the audit process is valuable because it can reduce the possibility of misreporting accounting information. [30] states that large KAPs (big four accounting firms) are assumed to provide higher audit quality than small KAPs (non-big four accounting firms). This is because Big Four KAPs tend to provide higher quality and invest more time in reputation and experience and are motivated to get a return on their investment. Auditor industry specialization is also one way to measure audit quality. Industry specialist auditors will conduct a high-quality audit process on their clients, thereby producing quality accounting information [31].

Agency theory states that the need for independent auditor services can be explained with this theory, namely the relationship between the owner (principal) and management (agent). Auditors are considered as independent parties between agents as providers of information in the form of financial reports and stakeholders (stakeholders) as users of the information to reduce the incidence of misalignment of information. Auditing has a function as a process to reduce the misalignment of information contained between managers and shareholders by using outside parties to provide validation of financial statements. Users of financial statements, especially shareholders, will make decisions based on reports that have been made by the auditor. This means that the auditor has an important role in ratifying the financial statements of a company. Therefore, the auditor must produce a high-quality audit report to reduce the misalignment that occurs between management and owners.

This great trust from users of audited financial statements and/or other services provided by public accountants is what ultimately requires public accountants to pay attention to the quality of the audits they produce. This audit quality is important because a high-quality audit will produce reliable financial reporting as a basis for decision-making. In addition, quality financial reporting can erode users' concerns about the financial reporting presented. The value of the company can be seen in how the company provides quality financial reporting information that can increase investor confidence to invest in the company.

5 Conclusion

This study aims to investigate the effect of managerial ability and audit quality on firm value with financial reporting quality as a mediating variable. Based on the results of data analysis and discussions that have been carried out, it can be concluded as follows:

1. Managerial ability has a positive and significant influence on the quality of financial reporting. This indicates that managerial ability tends to improve the quality of financial reporting. With good managerial skills of a manager, the implementation and decision-making by managers can lead the company to a high level of efficiency.

Efficiency means the minimum use of resources to obtain optimum results. Therefore, to create high-quality financial reporting, it is necessary for managers to intervene in managing company resources which will also improve the quality of financial reporting.

2. Audit quality has a positive and significant impact on the quality of financial reporting. This indicates that audit quality tends to improve the quality of financial reporting. Basically, the audit has a function as a process to reduce the misalignment of information that exists between managers and shareholders by hiring an outside party, namely the auditor, to provide validation of the financial statements. Auditors also play a role in ensuring that the financial information presented by the company meets accounting standards. Users of financial statements, especially shareholders, will make decisions based on reports that have been made by the auditor. This means that audit quality plays an important role in producing reliable financial reporting as a basis for decision-making.
3. The quality of financial reporting has a positive and significant impact on firm value. This indicates that the quality of financial reporting tends to increase firm value. High-quality financial reporting will further increase the confidence of users of financial statements. This is because the quality of financial reporting is one of the benchmarks for users of financial statements in decision-making because financial reporting reflects weaknesses or strengths, as well as the achievements of the company. Therefore, the higher the quality of financial reporting, the higher the value of the company will be, because the process of creating company value is reflected in financial reporting.
4. The quality of financial reporting plays a crucial role in mediating the effect of managerial ability on firm value. This indicates that the quality of financial reporting can afford to mediate managerial ability to firm value. Financial reporting is the main and important source of information for users of financial statements. Managers play a prominent role in providing information about their responsibilities through financial reporting related to the use and management of company resources. So managerial competence is an option that cannot be ruled out. The quality of financial reporting must contain information that is factual so that investor confidence in the company becomes high and affect the creation or increase of company value.
5. The quality of financial reporting plays a role in mediating the effect of audit quality on firm value. This indicates that the quality of financial reporting mediates the effect of audit quality on firm value. Quality financial reporting is financial reporting that contains complete, objective, and transparent information. Quality financial reporting can be achieved because the reporting presented by management has passed the audit process to be free from material misstatement and can show the actual financial condition of the company. Audit quality plays a pivotal role because with high audit quality, reliable financial reporting will be produced as a basis for decision making. In addition, quality financial reporting can erode users' concerns about the financial reporting presented. The value of the company can be seen in how the company provides quality financial reporting information that can increase investor confidence to invest in the company.

The theoretical implication of this study strengthens the stakeholder theory proposed by [32] which explains that stakeholder theory is related to management in recommending attitudes, structures, and practices that are conducted simultaneously to form stakeholder management. Managers as agents having sufficient experience and ability in planning and implementing business activities, are expected to present quality financial reporting without containing elements of policy and information asymmetry to satisfy all interested groups in a company. The theoretical implication in this study strengthens the agency theory proposed by [19] which explains that there is an efficient contract in which the principal or owner assigns responsibility to the agent or manager to coordinate activities within the company and position it appropriately in a competitive environment. So that managers in this case make every effort to fulfill their responsibilities. To ensure that managers do not apply policy elements in financial reporting, monitoring and controlling are required by the supervisory structure. Monitoring and controlling are carried out in order to minimize the possibility of irregularities and ensure that activities and performance are in accordance with company plans and the interests of the principal.

This research is expected to provide benefits for the company/management to pay more attention to the presentation of information to improve the quality of financial reporting within the company. For investors, the results of this study are expected to provide an overview for estimating the value of the company that will be obtained through managerial ability, audit quality, and financial reporting quality. The results are also expected to be useful for investors in considering the elements of the policies taken by the company before making investment decisions. In addition, for regulators, the results are expected to be useful in developing applicable standards or rules in order to achieve good reporting quality to increase company value.

Recommendations for future research are to consider different proxies for measuring reporting quality, such as value relevance, conservatism, and earnings persistence. Researchers suggest considering using other mediating variables such as corporate social responsibility or earnings quality in testing the effect of managerial ability and supervisory structure on firm value.

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