# Valuation of financial reporting quality: is it an issue in the firm's valuation?

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## Abstract

**Purpose** – The purpose of this study is to test the determinant of financial report quality and its consequences to the company values.

**Design/methodology/approach** – This research is using a quantitative approach and testing a theory by formulating some hypotheses. The sample of this study is 85 go public companies listed in the Indonesia Stock Exchange, for a 5-year observation period from 2016 to 2020. Hence, it has a total of 425 observations. Data were analyzed using path analysis.

**Findings** – The results found that innate factors from financial reporting quality (FRQ) consists of dynamic factors (operation cycle and sales volatility) as well as static factors (firm's size, FS). These factors help to achieve FRQ and are able to provide a positive response to the market. On the other hand, static factors (firm's age, FA) and institution risk factors (leverage) are not able to produce FRQ. Thus, it cannot be considered as an economic decision maker for an investor.

**Practical implications** – Research implications include theoretical and practical implications. Theoretical implications prove that the valuation of clean surplus theory, which shows the market value of the company, is reflected in the components of the financial statements. This study also uses more than one quality of financial reporting. The practical implication of the research is that the research results are expected to provide information for the company's management, to fulfill quality financial reporting and so that the market or investors will respond positively to these conditions. In addition, quality financial reporting information provides benefits for investors and capital market analysts (consisting of investors, brokers and market securities analysts) in determining investment decisions. The Financial Services Authority is also able to improve the implementation of corporate governance practices in Indonesia, through reform of the framework supervision of the financial services sector.

**Originality/value** – This research examines the determinants of FRQ and its consequences on firm's value (FV). Innate factors proxies from FRQ include dynamic factors (operation cycle and sales volatility), static factors (FS and FA) and institution risk factors (leverage). A follow-up study on the value of the company because it shows the magnitude of the market response (financial statement users) on the quality of financial reporting, which is reflected in FV, the originality of this research is that the object of research is carried out in developing countries, specifically in Indonesia, because most of the previous research was carried out in developed countries.

**Keywords** Dynamic factors, Static factor, Institution risk factor, Financial reporting quality, Firm value

**Paper type** Research paper



*Note:* Supplementary materials that are included in the article are available online.

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## 1. Introduction

The general overview on the financial report quality had been studied by many researchers. Therefore, an agreement had been created to support the convergence of accounting standard harmonization that will be impacted within the financial reporting. Some phenomena occurred in an accounting scandal in the early 21st century, which showed us the weakness in the financial reporting quality (FRQ). The financial report quality depends on the value on the accounting report; hence, it is important for a company to provide a high-quality financial report. Research shows that a quality financial report will be both impactful and useful in making an investment decision. The concept of a quality financial report is not only for containing financial information but also non-financial, which will be useful in making an economic decision (Herath *et al.*, 2017; Asyik *et al.*, 2022).

The quality of financial reports will be studied from two distinct aspects. First, the quality of a financial report shows the company's performance, which reflected on the profit information. It can be said that financial report information has a high quality if the profit obtained in the current year can be used as an indicator to generate profit in the future (Dang *et al.*, 2020) or as cash revenue in the future (Noury *et al.*, 2020). Second, the quality of financial reporting is related to the company's market performance, which is listed in the stock exchange. The strong relationship between profit and a stock's market price proved that financial reporting information will be responded to positively by either the market or investors (Dang *et al.*, 2020).

The purpose of financial reporting is to provide financial statement users with financial information that is useful for making economic decisions (Kaawaase *et al.*, 2021). A valid decision can be made if the information in the financial statements meets the quality of financial information, including being presented in an appropriate, relevant, comparable, understandable, timely and verifiable manner. In addition, the quality of financial reporting is also useful in making decisions regarding the allocation of resources owned by the company. Fulfillment of the quality of financial reporting will be able to inform the company's ability to manage both internal and external sources of funds, and meet the right elements of accountability (Lin *et al.*, 2016).

Studies related to the quality of the financial reporting can be done by using two different approaches. The first approach is to evaluate the causes of the financial report quality. This approach is to examine the company's internal causes or characteristics. Those are dynamic innate (operational cycle and sales volatility), static (company's size and its age) and institution risk factor (leverage). The second approach is the external market's response to determine the majority of which is using the financial reporting. This response will be determined by the value of the company (Al-Dmour and Al-Dmour, 2018). Lonkani (2018) stated that the company's value is not merely related to the external stakeholders' relationship or the users of financial reporting such as investors and creditors, however, it is also considering an implicit relationship to be evaluated in the valuation process. Besides that, the meaning of the company's valuation is not solely for one group of people (in this case investors), who will obtain the maximum level of gain from company's operational activities.

This study is to examine the determinant of the quality of financial reporting and its consequences to the company's valuation. The proxy of innate factors involves dynamic factors (operational cycle and sales volatility), static factors (firm's size, FS and its age) and, lastly, institutional risk factors (leverage). This study contributes both theoretically and practically. Theoretically, this research shows that valuation of clean surplus theory which determines the firm's market value reflected in the financial report component (Asyik *et al.*, 2023). This study has employed more than one FRQ. Practically, the findings of this study will provide information to management in order to produce a quality financial report, which will then be responded to positively by the market and investors. Furthermore, a quality financial report will benefit investors and stock market's analysts (investors, brokers and market security analyst) in making an investment decision.

## 2. Literature review and hypothesis development

### 2.1 Theoretical foundation

*2.1.1 Quality of financial report.* According to (IASB, 2018), the information quality revealed in the firm's financial report can help users evaluate the benefit of the financial report. Therefore, financial reports must be presented accurately, comparably, be verifiable, on time and understandable. Hence, it must be transparent and error-free. It is important that the financial report must be on time and predictable as an indicator to produce high-quality financial report (Mbawuni, 2019).

The IASC, which was established in 1973, published the first IAS in 1975. Since then, the process for establishing IAS has undergone significant change, culminating in the reorganization of the IASC into the IASB in 2001. The IASC changed to the IASB to answer the challenge of how financial reporting should be carried out and further develop high-quality and global accounting standards, namely IFRS (International Financial Reporting Standard). The world's great demand today is to be oriented towards one reporting standard that applies globally so as to increase the credibility and usefulness of financial reports as well as financial transparency. In 2000, the International Organization of Securities Commissions recommended that global securities regulators permit foreign issuers to use IAS for cross-border offerings (IOSCO, 2000). IOSCO facilitates the offering of these securities with high quality, internationally accepted accounting standards used by multinational issuers through collaboration with the International Accounting Standards Committee (IASC) to develop a set of accounting standards. Since 2005, nearly all publicly traded companies in Europe and numerous other nations have been required to produce financial statements in accordance with International Financial Reporting Standards (IFRS). In addition, the Financial Accounting Standards Board has begun an extensive initiative to converge IFRS and US accounting standards (Barth *et al.*, 2008).

*2.1.2 Information usefulness of accounting.* An organization which organized the accounting standards fully support that financial reports have the purpose of presenting financial information which will benefit users. The purpose is to have a better understanding of the firm's financial position (IASB, 2018; Rusdiyanto *et al.*, 2021). Thus, users can make economic decisions. Accounting information is used to evaluate the business performance, and it is also useful for owners to do some analysis in evaluating business operation. Financial ratios can be used as an indicator to compare its performance against other firms within the same business or industry standard (Vitez and Seidel, 2019). This can help owners to understand how good its company is, compared to others.

*2.1.3 Clean surplus theory.* Clean surplus theory is a foundation theory that is relevant to the accounting information value. This theory mentions that the firm's value (FV) is reflected in the accounting data, which is shown on the financial report (Ohlson, 1995). Clean surplus theory has an impact on the development of financial accounting theory, especially as it can demonstrate that the FV has an equal value with dividend financial accounting variable or cash flow. This was then followed by more research in predicting profit (Scott, 2015, p. 233; Schroeder *et al.*, 2020). According to (Djaballah, 2019), financial information has the function of forecasting and analysis which describe the firm's condition. It shows that financial reports are not only used as an information perspective for users but also have the benefits to evaluate the usage of the financial report.

### 2.2 Conceptual framework

Figure 1 is available online at: https://docs.google.com/document/d/1KSEZkWquw4GNfSRkOPvi8G6UxxMsMsGM/edit?usp=sharing&ouid=111957436118476234935&rtpof=true&sd=true

*2.3 Hypothesis development*

*2.3.1 Testing of the dynamic factors of financial reporting quality and its impact on the firm's value.* To achieve this objective, the IASC and IASB have issued principle-based accounting standards and taken measures to eliminate allowable accounting alternatives and mandate accounting measurements that more accurately reflect a company's economic position and performance. Accounting amounts that more accurately reflect a company's underlying economics, whether because of principle-based accounting standards or required accounting measurements, can improve accounting quality because they provide investors with information to assist them in making investment decisions. The relationship between these two sources of higher accounting quality is that limiting managers' opportunistic discretion increases the extent to which accounting quantities reflect a company's underlying economics. According to Ewert and Wagenhofer (2005), developing a rational expectations model that demonstrates that accounting standards that limit opportunistic discretion results in accounting earnings that are more reflective of a firm's underlying economics and, therefore, are of higher quality (Barth *et al.*, 2008).

Innate factors of the quality financial reporting consist of an operation cycle, sales volatility, firms' size and firms' age. In this case, a firms' operation cycle is the most important variable to operate a company. Hence, it needs a firm's operation cycle, which can be understood by all employees (Arachchi *et al.*, 2017). High sales volatility shows that sales information has the wrong estimation, which can cause un-persistent results (Nezami *et al.*, 2018; Prasetyo *et al.*, 2023). The unstable sales proxied by high sales volatility will make lower firms' valuation and vice versa. The quality of financial reporting is especially important in maintaining the efficiency of financial markets because market participants, such as investors, lenders and regulators, rely on financial reporting information to make decisions. A series of studies have discussed the impact of the 2008 financial crisis on the quality of financial reporting (Prasetyo *et al.*, 2023). Like those of the 2008 financial crisis, coronavirus disease 2019 (COVID-19) has caused significant disruption to financial markets and the global economy, but the impact of COVID-19 on the quality of financial reporting is unclear. To date, only a few studies have successfully investigated this issue, but none have focused on settings with strong country-level governance (Prabowo *et al.*, 2020). Our study uses data from the UK where country-level governance is strong and will add to the current literature. Furthermore, corporate governance has always been a major concern in studies of financial crises (Hsu and Yang, 2022; Agustia *et al.*, 2020).

The results of the study show that there is a positive relationship between managerial ownership, institutional ownership and financial reporting transparency. These results indicate that corporate governance has a significant relationship with financial reporting transparency. This is because the transparency of the financial reporting of companies whose shares are attractive to investors who are active in financial markets, is one of the main elements of the contemporary economy. Enhancing the transparency and accountability of the activities of economic organizations requires the principle of organizational social responsibility and thereby monitoring its implementation. The findings of this study indicate a positive relationship between corporate governance and transparency. This study is unique in that it emphasizes the importance of financial reporting transparency, and the impact of Islamic State of Iraq and Syria (ISIS) on corporate governance attributes (Salehi *et al.*, 2022).

A firm's operational cycle will determine the quality of the financial report, either good or bad. A firm with a longer operational cycle shows unexpected things, as inaccurate estimation will occur. Some errors of estimation will produce low accrual value as a result it will have low quality of financial reporting (Dechow and Dichev, 2002). Sales volatility shows the ability to forecast the cash flow in the future. High sales volatility will produce low financial report performance, and it is due to some noises in the firm's profit (Cohen, 2008).

Based on the study of dynamic factors of the valuation of financial reporting on the FV, thus, hypotheses can be formulated as follows:

*H1*. The longer of a firm's operational cycle is resulted in low quality of financial report, hence, low firm's valuation.

*H2*. The higher sales volatility of a firm is resulted in low quality of financial report, hence, low firm's valuation.

*2.3.2 Testing of the static factors of financial reporting quality and its impact on the firm's value*. Most of the research found that the size and age of a firm influence the value of a company. Big firms have stable financial condition (Rouf, 2018). It is, therefore, increasing the company's value; hence, it attracts investors. As a result, increasing the stock market price will affect and increase the value of one firm. According to accounting theory, the primary goal of reporting is to offer useful information to those who are most interested in financial reports. Data derived from the accounting information system represent one of the most reliable resources at the disposal of users to make decisions about business entities. The ultimate outcome of accounting information systems is financial reporting. All users rely on these financial reports to assess business entities. If financial reporting is of standard quality, it will allow users to make accurate decisions. Major users of such information include investors, creditors, employees, customers, commercial creditors and government. These sound decisions will lead to systematic allocation of resources, which will have a significant impact on the optimum allocation of resources in the economy of a country. In this respect, one of the determining factors that enhance the quality of information and reduce the information risk of corporate reports is provision of higher quality audit services (Shiri *et al*., 2018).

Fraud in accounting refers to an intentional action that results in the incorrect presentation of financial statements, so it is of immense importance in the accounting literature. Numerous studies on contributing factors to the chance of fraudulent reporting outbreak showed that one of the factors is the knowledge-based economy that provides useful information about the firm's financial performance. Hence, a knowledge-based economy plays a significant role in enhancing the performance of business firms and improving FRQ. In this study, using various knowledge-based economy criteria, we attempted to assess the relationship between the knowledge-based economy and the chance of fraudulent reports in listed firms on the Tehran Stock Exchange. The results show that knowledge-based economy indicators (including innovation, training and human resources, information infrastructure and communication infrastructure and institutional and economic regimes) lower firms' chance of fraudulent reporting. In other words, by lowering the information asymmetry between managers and investors and subsequently increasing financial reporting transparency, a knowledge-based economy can lead to the decline of opportunistic behavior of managers and fraudulent reports. The obtained results in this paper confirm that of concerning a negative relationship between financial statements fraud (Koolivand *et al*., 2021).

Furthermore, the firm's size shows that a firm with a larger scale is more stable with better operational conditions. Thus, it is unlikely to have some errors on the estimation. Besides that, a larger firm will have the ability to do some diversifications as it will reduce errors on the estimation (Arif *et al*., 2016). The longer firm's existence will have stronger operation. As a result, the financial performance will have small accrual variability (Arif *et al*., 2016). Shin and Kim (2018) as well as Dempster and Oliver (2019) emphasized that the high compliance on the accounting standard consistently will show the factual condition of one firm. This research will use the accrual value as proxy in the fundamental ability of a firm to sustain its existence. By using the higher standard accrual size quality is resulted in low accrual usage. The higher number of quality financial reporting is resulted in high prediction of the market value in the future (Siladjaja and Anwar, 2020).

The financial report includes financial statements and informative instruments or procedures. These instruments, either directly or indirectly, are associated with accounting information such as a firm's resources, assets, debts and profits. Financial reporting's main objective is to reveal the economic effects of commercial units' financial performance.

According to the Financial Accounting Standards Board, this objective presents valuable information concerning the investors' expected cash flow to make wise decisions. Features of corporate governance and structure affect the quality of financial reporting (Salehi *et al.*, 2021).

Based on the study of static factors of the valuation of financial reporting on the FV, thus, hypotheses can be formulated as follows:

*H3.* The larger of a firm's size is resulted in high quality of financial report, hence, high firm's valuation.

*H4.* The older of a firm's age is resulted in high quality of financial report, hence, high firm's valuation.

*2.3.3 Testing of the risk factor of financial reporting quality and its impact on the firm's value.* A firm is more trusted in regard to the leverage. Hence, creditors will be more confident in providing debts and also, a firm will have some privileges in paying its debts (Cohen, 2008). As discussed earlier, there are two approaches in studying FRQ. Elayan *et al.* (2016) found that there is some phenomenon in the stock exchange to see high-quality financial report performance. It is obviously to help investors to predict a firm's financial performance in the future. Eskandari and Foumani (2016) show that a high-quality financial report will influence the management's ability to predict the market reaction. Based on the arguments about risk factors of the financial report quality and its impact on a FV, hypotheses can be formulated as follows:

*H5.* The higher the leverage of a firm is resulted in high quality of financial report, hence, low firm's valuation.

## 3. Methodology

*3.1 Research design, population and sample*

This research is using a quantitative approach and testing a theory by formulating some hypotheses. Then, data are collected to support or argue the hypotheses that had been formulated. The population in this research is all of the companies listed in Indonesia Stock Exchange. The purposive sampling is applied in this research, only companies which had been doing their Initial Public Offering (IPO) in the Indonesia Stock Market before 2016 with completed data will be included in the sample. Therefore, 85 companies with 5 years observations from 2016 to 2020 are included. Thus, a total of 425 observations.

*3.2 Research variables*

*3.2.1 Innate factors.* Dynamic factors:

(1) **Operation cycle (OC)**

Operation cycle (OC) is measured by using the time average between purchasing inventory, and the cash flow received by the seller. It is the whole business transaction from the customer (Dechow *et al.*, 1994).

Description: $AR_{it}$ = Account Receivables $i$ year $t$, $AR_{it\text{-}1}$ = Account Receivables $i$ in the previous year, $Inv_{it}$ = Inventory $i$ year $t$, $COGS_{it}$ = Cost of Goods Sold $i$ year $t$.

(2) **Sales Volatility (SV)**

Sales volatility (SV) is the degree of sales spread or spread index distribution of sales (Dechow and Dichev, 2002).

Description: Sales of 5 $Year_{it}$ = Sales firm $i$ since 2016–2020, Total Asset $Year_{it}$ = Total Asset firm $i$ since year $t$.

Static Factor:

(3) **Firm's Size (FS)**

FS is the scale of one company (Dechow and Dichev, 2002).

Firm Size$_{it}$ = Logaritma Total Assets.

(4) **Firm's Age (FA)**

Firm's age (FA) is the length of the operation of a firm (Arif *et al.*, 2016).

Firm age = Year observation – Year founded.

Institution Risk Factor:

(5) **Leverage (L)**

Leverage (L) is funding for operational or investment from external (DeAngelo *et al.*, 1994).

Description: Liability Total$_{it}$ = Total debt firm *I* year *t*, Asset Total$_{it}$ = Total assets firm *i* year *t*.

*3.2.2 Financial reporting quality (FRQ).* FRQ is measured by using accrual quality, which is revenue that is acknowledged at the time of a firm's existence. Due to the hand-over of goods to external and some expenses or liabilities from the purchase of goods.

Description: TA$_{it}$ = Firm's Net Income minus cash flow of firm *i* year *t*, CFO$_{it-1}$ = Cash flow from operations firm *i* year *t*, Asset Total$_{it}$ = Total Assets firm *i* year *t*, Sales$_{it}$ = Sales firm *i* year *t*, Equity Book Value = Stock price * number of stock shares firm *i* year *t*, Equity Market Value = Equity total * number of stock shares firm *i* year *t*.

*3.2.3 Firm's value (FV).* FV is measured by using Tobin's Q ratio, which represents the FV by combining both book value and market equity's value. This measurement is better, as it summarized future information which relevant to investment decision. Furthermore, it provides information about market's perception toward firm's valuation from many different factors such as investors. According to (Suhadak *et al.*, 2018), the larger ratio of Tobin's Q shows that a firm has good and positive prospect.

### *3.3 Statistics analysis*

Data were analyzed using path analysis. One of the important components in doing path analysis, is path diagram. Path diagram is produced to represent causal relationship among research variables.

$$\text{Structural Model I: FV} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \varepsilon_{it}$$

$$\text{Structural Model II: FRQ} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \varepsilon_{it}$$

$$\text{Structural Model III: FV} = \beta_0 + \beta_1 \text{FRQ}_{it} + \varepsilon_{it}$$

Hypothesis Model:

$$\text{FV} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \beta_5 \text{FRQ}_{it} + \varepsilon_{it}$$

## 4. Research results and discussion

### *4.1 Descriptive statistics*

The descriptive statistic can show the company's sample variable mean (average), standard deviation, minimum and maximum. The data of the firms listed from 2016 to 2020 are displayed in the following:

Table 1 is available online at: https://docs.google.com/document/d/1KSEZkWquw4GNfSRkOPvi8G6UxxMsMsGM/edit?usp=sharing&ouid=111957436118476234935&rtpof=true&sd=true

There are 425 observations in total, as explained by the following: the minimum value of the OC is 0.00, the maximum value is 4861.52, the standard deviation (std-dev) is 426.09, and the mean value of all data is 144.77. The minimum value of the SV is 0.00, the maximum value is 58,526.67, the mean score/value of all data is 1,119.39, and the std-dev is 5,133.43. The minimum value of the FS is 5.89, the maximum value is 15.97, the mean value of all data is 11.59, and the std-dev is 1.68. The minimum score of the FA is 0.00, the maximum value of the FA is 0.63.00, the std-dev is 1.52, and the mean value of all data is 31.48. The minimum score of FRQ is 0.00, and the maximum score is 3.32; the mean score of all data is 0.41, and the standard deviation is 0.39. For the FV, the minimum value is 0.00, the maximum value is 301,331.46, the mean value is 7,253.63, and the standard deviation is 24,311.82.

*4.2 Structural model testing*

*4.2.1 Structural model test I (direct effect of independent variables on firm's value).* The following is the result of direct effect of independent variables on FV (Table 2) based on the structural model I:

$$\text{Structural Model I: FV} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \varepsilon_{it}$$

Table 2 is available online at: https://docs.google.com/document/d/1KSEZkWquw4GNfSRkOPvi8G6UxxMsMsGM/edit?usp=sharing&ouid=111957436118476234935&rtpof=true&sd=true

*4.2.2 Structural model test II (direct effect of independent variables on financial reporting quality).* Table 3 shows the result of direct effect of independent variables on FRQ with significance level 0.05 ($\alpha = 5\%$). Hence, the formula for the structural model II is as follows:

$$\text{Structural Model II: FRQ} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \varepsilon_{it}$$

Table 3 is available online at: https://docs.google.com/document/d/1KSEZkWquw4GNfSRkOPvi8G6UxxMsMsGM/edit?usp=sharing&ouid=111957436118476234935&rtpof=true&sd=true

*4.2.3 Structural model test III (direct of financial reporting quality on firm's value).* Table 4 is the result of the structural model test III with significance level of 0.05 ($\alpha = 5\%$). The formula is as follows:

$$\text{Structural Model III: FV}_{it} = \beta_0 + \beta_1 \text{FRQ} + \varepsilon_{it}$$

Table 4 is available online at: https://docs.google.com/document/d/1KSEZkWquw4GNfSRkOPvi8G6UxxMsMsGM/edit?usp=sharing&ouid=111957436118476234935&rtpof=true&sd=true

*4.2.4 Structural model test IV (Hypothesis 1 until Hypothesis 5).* Table 5 is the result of the structural model test III with significance level of 0.05 ($\alpha = 5\%$). The formula is as follows:

$$\text{Structural Model IV: FV} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \beta_5 \text{FRQ}_{it} + \varepsilon_{it}$$

*4.3 Hypothesis testing (Hypothesis 1 until Hypothesis 5)*

Table 5 is the result of the structural model test with significance level of 0.05 ($\alpha = 5\%$). The formula is as follows:

$$\text{FV} = \beta_0 + \beta_1 \text{OC}_{it} + \beta_2 \text{SV}_{it} + \beta_3 \text{FS}_{it} + \beta_4 \text{FA}_{it} + \beta_5 \text{L}_{it} + \beta_5 \text{FRQ}_{it} + \varepsilon_{it}$$

Table 5 is available online at: https://docs.google.com/document/d/1KSEZkWquw4GNfSRkOPvi8G6UxxMsMsGM/edit?usp=sharing&ouid=111957436118476234935&rtpof=true&sd=true

*4.4 Interpretation of research findings*

Table 5 shows that the direct test of operating cycle on FV shows a negative effect with a beta-value of −0.002 and a significance value of 0.000; however, there is no direct impact of operating cycle on the quality of financial reporting with a beta-value of −0.546, and a significance value of 0.842. This study supports H1, found an indirect impact negatively of the operating cycle on FV through the quality of financial reporting with a total effect of −0.001 with a significance value of 0.000 so it is significant at the 1% level. This shows that companies that have longer operating cycles generate greater estimation uncertainty and estimation errors, which can result in lower accrual quality and also lower earnings quality due to reduced ability to predict future cash flows. Longer operating cycles cause greater uncertainty, make accruals more dependent (noise) and are less helpful in predicting future cash flows. This result is supported Arachchi *et al.* (2017) and Dechow and Dichev (2002).

The findings in table 5 show that there are in favor of direct impact negatively of SV on FV with a beta-value of −0.000, and a significance value of 0.000 and also a direct impact negatively of SV on FRQ with a beta-value of −1.260 and a significance value of 0.000. Furthermore, this study supports H2, which finds that there is an indirect effect of SV on FV through the quality of financial reporting, with a total effect of −0.000 with a significance value of 0.000; so, it is significant at the 1% level. SV is often a major concern for users of financial statements, especially investors who certainly expect high profits from company activities. SV is the degree of dispersion of sales or the index of dispersion of a company's sales distribution. SV indicates a volatility of the operating environment and greater deviations from approximations and estimates, and corresponds to greater estimation errors and lower accrual quality Dechow and Dichev (2002). If high SV indicates that sales information has a greater estimation error than sales information in the operating environment, then the company's profit is not persistent and cannot be used as a reference for predicting profits in the next period. The fact describes high SV. Yet, research shows that profit is still able to predict cash flow in the future, as the generated profit does not contain too many problems Dechow and Dichev (2002). These results support Nezami *et al.* (2018) and Cohen (2008).

The results in table 5 show that there is a direct impact positively on the FS to the FV with a beta-value of −0.958, and a significance value of 0.000 as well as direct impact positively of the FS to the FRQ with a beta-value of 8,388,561 and a significance value of 0.000. This study is also supported H3 with a total effect of 8,036.241 with a significance value of 0.000. So, it is significant at the 1% level. it means there is an indirect impact positively of the FS to the FV, through FRQ. It can be said that the FS is a static innate factor; it means that the FS can have an impact on the financial report quality as it has the ability to do some diversifications on the business portfolio variations and relatively high politic cost. Companies that have large total assets indicate that the company has reached the maturity stage where in this stage the company's cash flow is positive and is considered to have good prospects in a relatively long period of time, besides that the larger the size of the company, the more transparent and accountable the company will be improve the quality of financial reports. This research supports Rouf (2018) and Arif *et al.* (2016).

The results of this study do not support direct effect positively of FA on the FV with a beta-value of −0.001, and a significance value of 0.142 and a direct effect positively of FA on FRQ with a beta-value of 1.762 and a significance value of 0.610. The results of the H4 test also do not support the indirect effect positively of FA on FV through FRQ with a total effect of −0.002 with a significance value of 0.152. so, it is not significant. Descriptive statistic data show the average of the FA is 31 years. However, there is also a firm that is only 2 years of age. Therefore, this firm does not have too many experiences in running a company's operations. Conversely, a company that has been active in the business world for a long time will have the experience to attract more investors and have the ability to beautify the company's financial

statements. The longer the life of a company in running a business, the more reliable the company will be in compiling financial reports in accordance with the standards that have been applied. Companies that have been operating for a long time have good experience in preparing quality financial reports. Workers who work for a long time have the skills to prepare higher quality financial reports. As a result, this study does not support Rouf (2018) and Arif *et al.* (2016).

Further, findings do not support direct impact negatively on leverage to the FV with a beta-value of −0.041 and a significance value of 0.942 and direct impact of leverage to the FRQ with a beta-value of −3,737.551 and a significance value of 0.188. Besides that, this study of the H5 does not support indirect impact positively of leverage on the FV through FRQ with a total effect of 153.240 with a significance value of 0.256 so it is not significant. In this research, the average leverage is relatively small that is 0.14; hence, it cannot be the main factor that can increase creditor's confidence to loan their money to the company. The amount of company leverage will cause the company to improve the quality of financial statements with the aim of maintaining good performance of investors and auditors. However, not all companies are able to conduct this activity because it really depends on the credibility of the company. The higher the level of leverage of a company, the higher the risk that the company accepts and not all companies are able to face this risk. So, the greater the leverage of a company does not necessarily produce quality financial reports, and a company that has a low level of leverage does not necessarily produce quality financial reports. This research does not support Rouf (2018) and Cohen (2008).

## 5. Conclusion

The quality of financial reporting is related to the overall company's performance. It is reflected in the firm's profit. The first opinion stated that quality profit is reflected on the sustainability of stable net profit. Later, the second opinion claimed that the quality of financial reporting is related to the market's performance in the stock exchange. The stronger relationship between profit and market reward shows high financial report performance. The findings of this research exhibits information on the innate factors from the FRQ. It involves some factors such as dynamic factors (OC and SV) and static factors (FS). These factors are needed to achieve FRQ and is able to provide positive respond to the market. On the other hand, static factors (FA) and institutional risk factors (leverage) are not able to produce high-quality financial reporting. Hence, these factors are not used by investors to make an economic decision.

### *5.1 Implications of research results*

Research implications include theoretical and practical implications. Theoretical implications prove that the valuation of clean surplus theory, which shows the market value of the company, is reflected in the components of the financial statements. This study also uses more than one quality of financial reporting. The practical implication of the research is that the research results are expected to provide information for the company's management to fulfill quality financial reporting, and that the market or investors will respond positively to these conditions. In addition, quality financial reporting information provides benefits for investors and capital market analysts (consisting of investors, brokers and market securities analysts) in determining investment decisions. The Financial Services Authority is also able to improve the implementation of corporate governance practices in Indonesia through reform of the framework supervision of the financial services sector.

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