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The Influence of Institutional Ownership and Audit Quality on Financial Reporting Quality Mediated by Internal Control

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Abstract

The increasing importance of financial transparency in manufacturing firms highlights the need to understand the factors influencing financial reporting quality. This study investigates the effects of institutional ownership and audit quality on financial reporting quality, with internal control as an intervening variable. The research population consists of 50 manufacturing companies listed on the Indonesia Stock Exchange from 2021 to 2024. Purposive sampling was employed to select the sample, and secondary data were collected from the BEI website. Data analysis was conducted using Eviews 12 software. The results reveal that institutional ownership significantly impacts internal control, audit quality also influences internal control, institutional ownership affects financial reporting quality, audit quality does not significantly impact financial reporting quality, internal control positively affects financial reporting quality; institutional ownership does not influence financial reporting quality through internal control, indicating partial mediation; and audit quality does not affect financial reporting quality through internal control, demonstrating complete mediation.

Keywords

Audit Quality, Financial Reporting Quality, Internal Control, Institutional Ownership.

1. Introduction

Financial statements are structured reports based on a company's performance and financial position, serving as a foundation for economic decisions by users. They are essential tools for supporting investment decisions and other business activities. Ambiguous and brief financial statements can adversely affect users' interpretation of a company's financial status. Thus, financial reporting must be qualitative, providing valuable information to investors, lenders, and potential creditors. The primary purpose of financial reporting is to deliver accurate and reliable information that aids consumers in making informed decisions. High-quality financial reporting is particularly vital for small investors, as it often constitutes their sole source of information for investment decisions (Gineitytè, 2020).

The urgency of researching financial reporting quality stems from its necessity in building investor trust in Indonesia's capital market. Rational investors assess investment risks and project expected returns using information from various sources, including financial reports, which are crucial for evaluating a company's fundamental performance. High-quality financial reports, compliant with internationally recognized accounting standards, can attract more significant investment and expand access to global markets (Hussaïni & Faidjarenie, 2022; Akbar & Choiriyah, 2025). However, producing quality financial reports is increasingly challenging in Indonesia due to the lack of regulations mandating financial report preparers to possess accounting expertise.

This study focuses on manufacturing companies, as this sector significantly impacts the national economy, including employment growth. The incorporation of internal control variables as intervening factors in this study provides a novel perspective for examining the effect relationships between institutional ownership and audit quality on financial reporting quality. Effective internal control systems are crucial for the accurate preparation of financial statements, as they enable the timely identification of issues and the implementation of optimal solutions (Puspita & Ariani, 2023). Therefore, the internal control variable is particularly well-suited for evaluating its potential to be an intervening variable.

Although various studies have highlighted the importance of institutional ownership, audit quality, and internal control in improving the Financial Reporting Quality, existing empirical results still show inconsistencies. Several studies have found that institutional ownership and audit quality have a significant effect on internal control and the financial reporting quality (Legina et al., 2022; Nugrahanti et al., 2023), but other studies have shown inconsistent or even insignificant results (Silva et al., 2025; Kartika & Ningsih, 2024). These differences in findings show that there is a research gap, especially in understanding how internal control plays a mediating role in the relationship between institutional ownership, audit quality, and financial reporting quality in the context of companies in Indonesia.

This research contributes to enriching the literature related to the financial reporting quality by presenting empirical evidence on the role of internal control as a mediating variable between institutional ownership and audit quality. Theoretically, this study expands the understanding of corporate governance mechanisms in improving the transparency and accuracy of financial statements. Practically, the results of this study can be a reference for company management and regulators in Indonesia in strengthening supervision and the implementation of internal controls to increase investor confidence and capital market stability. This study aims to examine the effects of institutional ownership and audit quality on financial reporting quality, with internal control as an intervening variable.

2. Literature Review and Hypothesis Development

2.1. The Determinants of Internal Control

Internal control systems are defined as the comprehensive policies and procedures established by management to guide operational activities effectively and efficiently. These systems are essential for ensuring organizational sustainability and compliance with legal requirements (Cobagnolu & Corte, 2021). COSO (2023) describes internal control processes as mechanisms designed to provide reasonable assurance regarding the achievement of operational goals and compliance. Research on the influence of institutional ownership on internal control has been conducted by Legina et al. (2022), whose findings indicate that institutional ownership significantly affects internal control. Similarly, Rostami et al. (2019), also found that institutional ownership has an impact on internal control. Consistent with these previous results, Priantaka and Dewayanto (2019), demonstrated that institutional ownership affects internal control. Additionally, Ismail and Ardiyanto (2017) confirmed that institutional ownership influences internal control.

Several researchers have undertaken research regarding the influence of audit quality on internal control. One such study by Nugrahanti et al. (2023), it revealed that audit quality correlates positively and significantly with internal control. A similar result was found by Abouelghit and Gan (2024), where high audit quality was shown to enhance the effectiveness of internal control. Savitri and Ketut (2023) found that audit quality positively impacts effective internal control.

H1: Institutional ownership has a significant effect on internal control.

H2: Audit quality has a significant effect on internal control.

2.2. The Determinants of Financial Reporting Quality

Financial reports are fundamental to decision-making in capital markets, where accurate and reliable information is critical for investors and regulators. The credibility of financial statements directly impacts investment evaluations, necessitating high-quality earnings reports (Menicucci, 2020). Financial reporting quality is assessed not only by its relevance but also by its faithful representation, which includes completeness, neutrality, and freedom from error (Mbawuni, 2019). The International Financial Reporting Standards (IFRS) set stringent requirements to ensure financial reporting quality, mandating that auditors verify the accuracy of financial statements (Mokrzycka, 2022). The broader goal of financial reporting is to furnish useful information to equity investors, creditors, and other stakeholders for informed decision-making regarding resource allocations (Kieso et al., 2020).

Studies on the relationship between institutional ownership and financial reporting quality have also been conducted. Hoesada and Pradika (2019) established that institutional ownership influences the integrity of financial information reporting. Ali et al. (2024) indicated that companies with higher institutional ownership tend to report higher-quality financial statements. This view was supported by Davis and García (2023), who found that institutional ownership positively affects financial reporting quality. It also demonstrated that institutional ownership can lead to improvements in financial reporting quality. Al-Qadasi et al. (2022) confirmed a positive relationship between institutional ownership and financial reporting quality, a finding echoed by Trinh et al. (2022).

Research on the relationship between audit quality and financial reporting quality has been previously documented. Alhazmi et al. (2024) reported a negative and insignificant relationship between being audited by a big four firm and financial reporting quality. Silva et al. (2025) concluded that companies audited by Big Four firms do not significantly affect financial reporting quality and often exhibit lower quality.

Research on the impact of internal control on financial reporting quality has also been previously conducted. Setiyawati and Mappanyuki (2019) found that the effectiveness of internal control systems influences financial reporting quality. Pham et al. (2023), stated that internal control significantly impacts financial reporting quality.

H3: Institutional ownership has a significant effect on financial reporting quality.

H4: Audit quality has a significant effect on financial reporting quality.

H5: Internal control has a significant effect on financial reporting quality.

2.3. Internal Control as Mediating Variable

Institutional ownership plays a crucial role in shaping corporate governance, as institutional investors can strengthen oversight and long-term value creation, yet sometimes limit the influence of individual shareholders due to differing objectives (Gompers & Metrick, 2022; Grgic & Johansson, 2017). At the same time, audit quality remains a critical element of corporate accountability, influenced by firm culture, auditor competence, and process effectiveness (Johnstone et al., 2019). Ensuring independence and objectivity is essential, as credible audits not only enhance financial reporting reliability but also complement strong governance mechanisms (King, 2023; Savitra & Ketut, 2023).

Research examining the relationship between institutional ownership and financial reporting quality, with internal control as an intervening variable, has been conducted by Wulandari et al. (2025). Their findings indicate that institutional ownership does not significantly influence financial reporting quality with internal control as an intervening variable. Conversely, Qodri et al. (2024) Demonstrated a significant influence of institutional ownership on internal control. Additionally, research by Haryanto and Hidayah (2023) confirmed that internal control positively and significantly impacts financial reporting quality.

Research examining the effect of audit quality on internal control has been conducted by Rais (2023), who found that audit quality impacts internal control. However, Satria and Setiawan (2020) stated that audit quality does not affect the effectiveness of internal control. Regarding the impact of internal control on financial reporting quality, Hidayah (2019) indicated that the implementation of internal control affects financial reporting quality. Conversely, Kartika and Ningsih (2024), found that the internal control system does not significantly affect financial reporting quality.

H6: Institutional ownership has a significant effect on financial reporting quality through internal control.

H7: Audit quality has a significant effect on financial reporting quality through internal control.

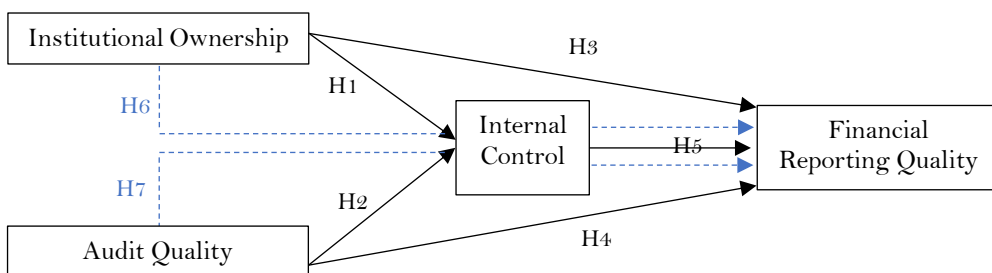


Figure 1. Research Framework

Figure 1 shows that this study develops a framework to examine how institutional ownership and audit quality influence financial reporting quality, both

directly and indirectly through internal control. Institutional ownership (H1, H3) and audit quality (H2, H4) are expected to strengthen governance practices by enhancing internal control mechanisms, which in turn improve the reliability of financial reports (H5). Furthermore, internal control is positioned as a mediating variable, reflecting its role in channeling the effects of institutional ownership (H6) and audit quality (H7) toward better financial reporting outcomes.

The research as follows that (a) examine the direct effect of the independent variable on the dependent variable in the model with the mediating variable, (b) assess the effect of the independent variable on the mediating variable, (c) evaluate the effect of the mediating variable on the dependent variable with the independent variable included, and (d) check the effect of the independent variable on the dependent variable in the model without the mediating variable (Ngatno, 2019). When paths (b) and (c) are significant while path (a) is not, the mediating variable (Z) is considered a complete mediator. If paths (b) and (c) are significant and path (a) is also significant, but the coefficient of (a) is smaller than that of (d), then Z functions as a partial mediator. However, if paths (b) and (c) are significant and path (a) is also significant with a coefficient nearly equal to (d), Z cannot be considered a mediating variable. If either (b) or (c), or both, are not significant, then it is not considered a mediating variable.

3. Methods

This study design to examine the relationships between institutional ownership, audit quality, and financial reporting quality, with internal control as an intervening variable. The population consists of 50 manufacturing firms listed on the Indonesia Stock Exchange from 2021 to 2024. Purposive sampling was used to select the sample, including only firms with complete audited financial reports and excluding 13 delisted firms, resulting in 37 firms and 148 observations (37 firms x 4 years). Secondary data were collected from financial reports available on the BEI website. To ensure data validity, firms with incomplete or non-compliant financial data were excluded. Data analysis was conducted using EViews 12 software, employing path analysis to estimate direct and indirect effects, with the Sobel test used to verify the significance of mediation.

Financial reporting quality is measured as the ratio of operating cash flow to net income, following Menicucci (2020), as this metric reflects earnings quality relevant to investor decision-making. Institutional ownership (IO) is measured as the proportion of shares held by institutions (e.g., banks, insurance companies, or pension funds) relative to total outstanding shares, sourced from annual reports. Audit quality (AQ) is measured as a dummy variable, with a value of 1 for firms audited by Big Four firms and 0 for non-Big Four firms, due to the Big Four's recognized standards of independence and expertise. Internal control (IC) is measured using an internal control disclosure index, calculated as the number of disclosed control items (e.g., monitoring policies, segregation of duties, and compliance procedures based on the COSO framework) relative to the maximum possible score, following Wardhani (2021). Data for IC are derived from annual reports and related disclosures. The analysis comprises two substructural models:

$$\text{Model 1: IC} = \alpha + \beta \text{IO} + \beta \text{AQ} + \varepsilon$$

$$\text{Model 2: FRQ} = \alpha + \beta \text{IO} + \beta \text{AQ} + \beta \text{IC} + \varepsilon$$

Where:

FRQ	=	Financial Reporting Quality
α	=	Constant
β	=	Regression Coefficient
IO	=	Institutional Ownership

AQ = Audit Quality
 IC = Internal Control
 ε = Error term.

Model 1 tests the effect of IO and AQ on IC, and Model 2 examines the effect of IO, AQ, and IC on FRQ. To enhance result reliability, sensitivity tests included control variables such as firm size (based on total assets) and leverage. Limitations of secondary data, such as potential variations in disclosure quality across firms, were acknowledged, and missing data were handled by excluding incomplete observations. This approach ensures consistent and replicable findings.

4. Result

The results section presents the findings of the study, detailing the statistical analyses conducted to test the hypotheses regarding the relationships between institutional ownership, audit quality, internal control, and financial reporting quality among manufacturing firms listed on the Indonesia Stock Exchange from 2021 to 2024. Descriptive statistics, model fit tests, classical assumption tests, and hypothesis testing outcomes are reported to provide a comprehensive understanding of the data and the robustness of the findings. These results are structured to address each hypothesis systematically, supported by path analysis and the Sobel test, ensuring clarity in interpreting direct and indirect effects.

Table 1. Descriptive Statistics of the Variables

Variable	Minimum	Maximum	Mean
Financial Reporting Quality (FRQ)	-156.50	75.380	0.5236
Internal Control (IC)	0.0000	0.9300	0.6518
Institutional Ownership (IO)	0.3200	0.9716	0.7297

Table 1 describes the characteristics of the variables employed in the study. Financial reporting quality ranges from a minimum of -156.50 to a maximum of 75.38, with a mean of 0.5236. According to Lessambo (2018), if the ratio exceeds 1, it indicates good earnings quality, while a ratio below 1 signals potential concerns. This suggests that the earnings quality variable is poor, as the mean of 0.5236 is below 1. Internal control ranges from 0.0000 to 0.9300, with a mean of 0.6518. Wardhani (2021) states that a ratio of 1 indicates good transparency in internal control disclosures. Therefore, the average mean of 0.6518 indicates that internal control disclosures among the 50 companies from 2021 to 2024 are inadequate. Lastly, institutional ownership (IO) has a minimum of 0.3200, a maximum of 0.9716, and a mean of 0.7297. According to Armitage et al. (2022), good institutional ownership is estimated to be around 20% or more. Thus, the average mean of 0.7297, or 72.97%, indicates that institutional ownership is satisfactory.

Audit quality (AQ) is measured using a dummy variable, where 1 represents firms audited by Big Four audit firms and 0 represents those audited by non-Big Four firms. The analysis reveals that the majority of the 50 manufacturing firms from 2021 to 2024 were audited by non-Big Four public accounting firms, indicating a preference for non-Big Four auditors in this sample. This section tests which model (fixed effect, common effect or random effect) is more suitable for estimating panel data in substructural models 1 and 2.

Based on Table 2, the test results indicate that the most suitable research model for Substructural 1 (the effect model of IO and AQ on IC) is the Random Effect Model. Meanwhile, the test results also indicate that the most suitable research model for Substructural 2 (the effect model of IO, AQ, and IC on FRQ) is the Common Effect Model.

Table 2. Results of the Model Fit Test for Substructural 1

Model	Model Fit Test	Prob.	Measurement	Conclusion
Substructural 1	Chow test	0.000	< 0.05	FEM
	Hausman test	0.315	> 0.05	REM
	Lagrange Multiple test	0.000 0	< 0.05	REM
Substructural 2	Chow test	0.310	> 0.05	CEM
	Hausman test	0.855	> 0.05	REM
	Lagrange Multiple test	0.639 3	> 0.05	CEM

Based on Table 3, the correlation coefficients are: IO and IC (-0.2837), AQ and IC (0.2843), and AQ and IO (0.0152). According to Mardiatmoko (2020), a coefficient lower than 0.85 indicates no multicollinearity. Thus, these variables are free from multicollinearity.

Table 3. Multicollinearity Test Result

Variable	IC	IO	AQ
Internal Control (IC)	1.0000	-0.2837	0.2843
Institutional Ownership (IO)	-0.2837	1.0000	0.0152
Audit Quality (AQ)	0.2843	0.0152	1.0000

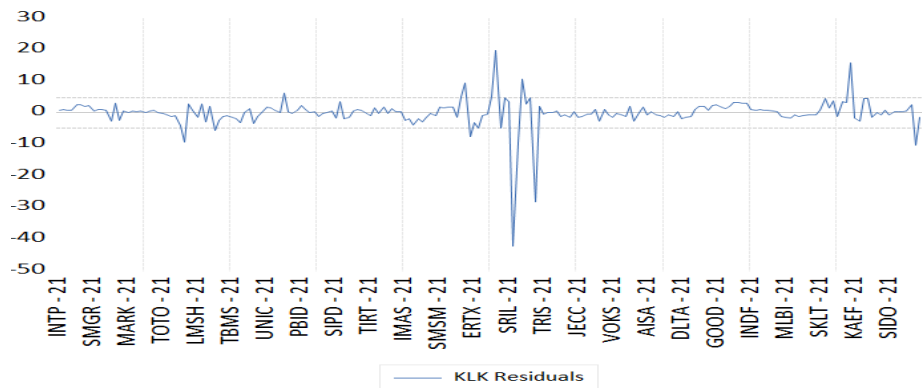


Figure 2. Heteroscedasticity Test Result

Figure 2 shows that to detect heteroscedasticity, we examine the residuals graph. If the residuals do not exceed the limits of 500 and -500, the variance is constant, indicating no heteroskedasticity (Napitupulu et al., 2021). The results show that the residuals remain within these bounds, confirming the absence of heteroskedasticity. A hypothesis test is a statistical procedure used to determine whether there is enough evidence in a sample dataset to support or reject a claim (hypothesis) about a specific population.

Table 4 shows that the results indicate that institutional ownership has a t-statistic of 2.2273, exceeding the t-table value of 1.9720, thus supporting H1 and confirming that institutional ownership affects internal control. Similarly, audit quality has a t-statistic of 2.3065, also greater than 1.9720, leading to the acceptance of H2 and demonstrating that audit quality impacts internal control.

Table 4. Substructural 1 and 2 t-Test Result

Model	Variable	Coefficient	Std.	t-	Prob.
Substructural 1	C	-0.2648	0.0269	-9.8254	0.0000
	IO	-0.2332	0.1047	-2.2273	0.0271
	AQ	0.0656	0.0284	2.3065	0.0221
Substructural 2	C	0.2922	0.9619	0.3038	0.7615
	IO	8.3664	2.7658	3.0249	0.0028
	AQ	1.0413	0.7129	1.4605	0.1457

Table 4 shows that the results indicate that the institutional ownership has a t-statistic of 3.0249, exceeding the t-table value of 1.9720, thus supporting H3 and confirming that institutional ownership affects financial reporting quality. Audit quality has a t-statistic of 1.4605, below 1.9720, meaning H4 is rejected and demonstrating that audit quality does not impact financial reporting quality. Internal control is -2.0615 greater than 1.9720, leading to the acceptance of H5 and proving that internal control impacts financial reporting quality.

Path analysis can be seen as an extension of multiple regression analysis. It tests the influence of intervening or mediating variables, allowing for a comparison between direct and indirect effects. This helps determine whether a mediating variable strengthens or weakens the impact of the independent variable on the dependent variable.

Model 1:

$$IC = -0.2648 - 0.2332 * IO + 0.0656 * AQ$$

The regression results indicate that the constant value is -0.2648, suggesting that in the absence of institutional ownership and audit quality, internal control tends to decrease by 26.48%. The coefficient for IO is -0.2332, meaning that a 1% increase in institutional ownership, while holding other variables constant, is associated with a 23.32% decrease in IC. Conversely, the coefficient for AQ is 0.0656, indicating that a 1% increase in audit quality leads to a 6.56% improvement in IC, assuming other variables remain unchanged.

Model 2:

$$FRQ = 0.2922 - 5.3038 * IO + 8.3664 * AQ + 1.0413 * IC$$

The regression results show that the constant value is 0.2922, meaning that in the absence of institutional ownership, audit quality, and internal control, financial reporting quality increases by 29.22%. The coefficient for IO is 8.3664, indicating that a 1% increase in institutional ownership, ceteris paribus, leads to an 836% increase in FRQ. Similarly, the coefficient for AQ is 1.0413, suggesting that a 1% increase in audit quality results in a 104% improvement in FRQ. In contrast, the coefficient for IC is -5.3038, which implies that a 1% increase in internal control reduces FRQ by 530%, assuming other variables remain constant.

In addition to the causal step approach, hypothesis testing for intervening will also be conducted using the procedure developed by Sobel in 1982, known as the Sobel Test with the following formula:

$$S_e ab = \sqrt{b^2 Sa^2 + a^2 Sb^2} \rightarrow t = \frac{ab}{S_e ab}$$

Using the causal step approach, the analysis reveals that institutional ownership (IO) has a significant positive effect on financial reporting quality, with a coefficient of 8.3664 and a t-statistic of 3.0249, exceeding the t-table value of 1.9720.

Furthermore, IO significantly influences internal control with a coefficient of -0.2332 and a t-statistic of -2.2273 , also greater than the critical value. Finally, IC shows a significant negative effect on FRQ, indicated by a coefficient of -5.3038 and a t-statistic of -2.0615 , which is higher than the t-table threshold.

Table 5. Effect of Variable X1

Variable	Coefficient	Std. Error	t-statistic	Prob.
Constant	2.0945	0.5321	3.9358	0.0001
IO	10.115	2.6577	3.8059	0.0002

Based on Table 5, if IO has an effect on IC and IC has a significant influence on FRQ, where the coefficient of IO's influence on FRQ (coefficient = 8.3664) is smaller than the direct influence coefficient of IO on FRQ without a mediation variable (coefficient = 10.115), then it can be concluded that Internal Control is a partial mediation variable. To test the significance of indirect effects, the Sobel test is calculated as follows:

$$S_{eab} = \sqrt{(-5.3038^2 \times 0.1047^2) + (-0.2332^2 \times 2.5727^2)}$$

$$S_{eab} = 0.8176 \rightarrow t = \frac{ab}{S_{eab}} \rightarrow t = \frac{-0.2332 \times -5.3038}{0.8176} \rightarrow t = 1.5129$$

T-statistic is $1.5129 < t$ table 1.9720 , which means H6 is rejected; institutional ownership does not affect financial reporting quality through internal control.

Applying the causal step approach, the results show that audit quality does not have a direct significant effect on financial reporting quality, as indicated by a coefficient of 1.0413 with a t-statistic of 1.4605 , which is below the t-table value of 1.9720 . However, audit quality significantly affects internal control, with a coefficient of 0.0656 and a t-statistic of 2.3065 , exceeding the critical threshold. In turn, IC significantly influences FRQ, with a coefficient of -5.3038 and a t-statistic of -2.0615 , which is greater than the t-table value. Since paths (b) and (c) are significant while path (a) is not, it can be concluded that internal control serves as a complete mediating variable in the relationship between audit quality and financial report quality. To test the significance of the indirect effect, the Sobel test is calculated as follows:

$$S_{eab} = \sqrt{(-5.3038^2 \times 0.0284^2) + (0.0656^2 \times 2.5727^2)}$$

$$S_{eab} = 0.2264 \rightarrow t = \frac{ab}{S_{eab}} \rightarrow t = \frac{0.0656 \times -5.3038}{0.2264} \rightarrow t = -1.5373$$

The t-statistic is $-1.5373 < t$ table 1.9720 , which means H7 is rejected; audit quality does not affect financial report quality through internal control.

Table 6. F-Test and R Square Result

Test	Measurement	Substructural 1	Substructural 2
F-Test	F-statistic	5.0782	6.5775
	Prob. (F-statistic)	0.0070	0.0002
R-Square	R-squared	0.0490	0.0914
	Adjusted R-squared	0.0393	0.0775

Table 6 shows that for substructural 1, the calculated F-statistic is 5.0782 , which is greater than the table value of 2.2445 . Therefore, it can be concluded that both institutional ownership and audit quality collectively affect internal control.

Meanwhile, for Substructural 2, that F-statistic is 6.5775, which is greater than the table value of 2.2445. Therefore, it can be concluded that institutional ownership, audit quality, and internal control collectively affect financial reporting quality.

Based on Table 6, for Substructural 1, the R-Squared value is 0.0490, or 4.9%, indicating that model Substructural 1 can explain 4.9% of internal control, while the remaining 95.1% is attributed to other variables not included in this model. Meanwhile, for Substructural 2, the R-Squared value is 0.0914, or 9.14%, indicating that model Substructural 2 can explain 9.14% of financial reporting quality, while the remaining 90.86% is attributed to other variables not included in the model.

5. Discussion

Based on the testing results, institutional ownership significantly influences internal control of manufacturing firms listed on the Indonesia Stock Exchange. The findings align with previous research by Ismail and Ardiyanto (2017), Rostami et al. (2019), Priantaka and Dewayanto (2019), and Legina et al. (2022) confirm that institutional ownership impacts internal control. In a modern context, institutional owners serve as effective monitors, ensuring managers fulfill their obligations and act in the company's long-term interests, thereby mitigating risks of non-compliance and unethical behavior.

Audit quality has a significant positive effect on internal control in Indonesian manufacturing firms. High-quality audits improve the reliability of financial reports, detect non-compliance, and safeguard owners' interests, thereby strengthening financial reporting outcomes (Judijanto et al., 2024). This finding is consistent with Nugrahanti et al. (2023), Abouelghit and Gan (2024), and Savitri and Ketut (2023), all of whom confirm that strong audit quality enhances the effectiveness of internal controls. By providing independent assessments, auditors help ensure managerial accountability, fostering transparency and trust between owners and management.

Institutional ownership also shows a significant positive influence on financial reporting quality. Institutional investors, driven by long-term interests, enforce stricter oversight and promote transparency, reducing the risk of manipulative practices. These findings are in line with Hoesada and Pradika (2019), Ali et al. (2024), Davis and García (2023), Kong et al. (2024), Al-Qadasi et al. (2022), and Trinh et al. (2022), who all highlight the role of institutional owners in improving report quality. Their supervisory role not only ensures the integrity of financial information but also builds investor trust and supports sustainable investment growth.

Audit quality does not significantly affect financial reporting quality. Even though big four auditors are known for their independence and expertise, their role is limited to reviewing financial statements after preparation, leaving room for prior managerial manipulation. This aligns with Alhazmi et al. (2024) and Silva et al. (2025), who reported a negative and insignificant relationship between Big 4 audits and reporting quality.

By contrast, internal control has a significant positive effect on financial reporting quality in Indonesian manufacturing firms. Effective controls through policies, monitoring, and preventive mechanisms reduce errors and fraud, thereby strengthening investor confidence (Hussaini & Fadjaranie, 2022). These findings are consistent with Setiyawati and Mappanyuki (2019) and Pham et al. (2023), confirming that internal control fosters accountability and ensures more reliable financial statements.

Institutional ownership does not significantly influence financial reporting quality through internal control, with IC acting only as a partial mediator. While institutional shareholders may enhance transparency, their impact is insufficient to directly improve reporting quality without robust internal controls. This contrasts with Qodri et al. (2024), who found institutional ownership significantly affects

internal control, but aligns with Wulandari et al. (2025), who showed no direct effect on financial report quality when IC is included. Consistent with Haryanto and Hidayah (2023), IC itself has a positive effect on reporting quality, highlighting that reliable financial statements rely more on internal control than on institutional oversight.

Audit quality also shows no direct effect on financial reporting quality, with IC acting as a full mediator. Although strong audits can support IC effectiveness, weak controls limit their ability to improve report quality. This result differs from Rais (2023), who found that audit quality affects IC, but aligns with Satria and Setiawan (2020), who reported no such effect. Evidence on IC's influence is also mixed: Hidayah (2019) found a significant effect on reporting quality, while Kartika and Ningsih (2024) reported otherwise. The present study supports the view that high-quality audits only enhance reporting reliability when reinforced by effective internal controls, confirming IC's role as a key mediating mechanism.

6. Conclusion

This study investigates the relationships between institutional ownership and audit quality on financial reporting quality with internal control as an intervening variable among manufacturing firms listed on the Indonesia Stock Exchange. The findings reveal that institutional ownership significantly influences internal control by promoting transparency and accountability among managers. Similarly, audit quality positively impacts internal control, reinforcing its effectiveness in financial reporting. However, the study found that audit quality does not significantly influence financial reporting quality, a result that contradicts prior research and suggests that internal factors like organizational culture may play a more critical role. The research also indicates that while institutional ownership enhances financial reporting quality, it does not do so through internal control, suggesting a partial mediating role. In contrast, internal control acts as a complete mediator in the relationship between audit quality and financial reporting quality, highlighting the necessity of robust internal controls for ensuring accurate financial statements.

These findings suggest that firms should prioritize strengthening internal control systems and fostering greater institutional ownership to enhance financial reporting quality. Additionally, auditors should focus on improving their recommendations and ensuring compliance by management to optimize internal control effectiveness. The study is limited by its focus on manufacturing firms in Indonesia, which may not be generalizable to other sectors or countries. Additionally, the reliance on quantitative measures may overlook qualitative factors that influence internal controls and financial reporting. Future research could explore the role of organizational culture and management ethics in the relationship between audit quality and financial reporting. Additionally, investigating the impact of external factors, such as regulatory changes, on these relationships could also yield valuable insights.

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Data Disclosure Statement

The data that support the findings of this study are available from the corresponding author upon reasonable request.



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