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Factors that affect earnings quality in manufacturing companies listed on IDX period 2012-2016

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ABSTRACT

The manufacturing company's profit information is useful for the right decision-making. This study aimed to determine the effect of leverage, liquidity, audit firm reputation, conservatism, and investment opportunity set (IOS), independent commissioner and institutional ownership on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016. Return on asset (ROA) was used as a control variable. The sample was taken using a purposive sampling technique, of 100 manufacturing companies. The data were analyzed using a multiple linear regression analysis. The results showed that leverage, liquidity, conservatism, independent commissioner and institutional ownership have no effect on earnings quality either using control variable or without using control variable. Investment opportunity set (IOS) has an effect on earnings quality when tested without using control variable, but has no effect when tested using control variable. Audit firm reputation has an effect on earnings quality when tested either using control variable or without using control variable.

ABSTRAK

Informasi laba perusahaan manufaktur berguna untuk pengambilan keputusan yang tepat. Penelitian ini bertujuan untuk mengetahui pengaruh leverage, likuiditas, reputasi firma audit, konservatisme, dan investment Opportunity set (IOS), komisaris independen dan kepemilikan institusional terhadap kualitas laba di perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (BEI) periode 2012-2016 . Return on asset (ROA) digunakan sebagai variabel kontrol. Sampel diambil menggunakan teknik purposive sampling, dari 100 perusahaan manufaktur. Data dianalisis menggunakan analisis regresi linier berganda. Hasil penelitian menunjukkan bahwa leverage, likuiditas, konservatisme, komisaris independen dan kepemilikan institusional tidak berpengaruh terhadap kualitas laba baik menggunakan variabel kontrol atau tanpa menggunakan variabel kontrol. Investment Opportunity Set (IOS) berpengaruh pada kualitas laba ketika diuji tanpa menggunakan variabel kontrol, tetapi tidak berpengaruh ketika diuji menggunakan variabel kontrol. Reputasi perusahaan audit berpengaruh pada kualitas laba ketika diuji baik menggunakan variabel kontrol atau tanpa menggunakan variabel kontrol

1. INTRODUCTION

The Indonesia Central Securities Depository (KSEI) noted that the number of Indonesian Capital Market investors has exceeded one million. Based on KSEI data as of Wednesday, June 7, 2017, Single Investor Identification (SID) has reached 1,000,289. This number was a drastic increase since 2012. The high number of investors in Indonesia indicates that the interest of domestic and foreign investors to invest in Indonesia is also increasing. Therefore, the higher the investor's interest, the higher the level of need for information about the company as a place to invest.

The important factor needed by investors in the capital market is financial information for economic decision making. Financial statement is one of the tools used by management to show company performance. Through financial statement, the prospective investors and stakeholders can see the company's condition (Shanie and Linda, 2014).

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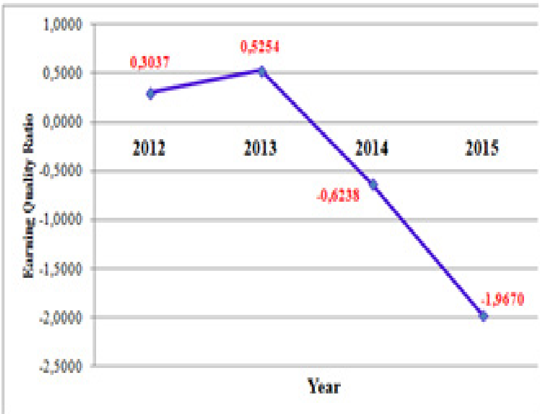
SFAC No. 8 in the FASB states that the purpose of financial statements is to make decisions for potential investors, lenders, and other creditors to provide resources for the company (FASB, 2010). One item that is considered is company profits. Profit, as part of a financial report, that does not present the actual conditions of the company can be of doubtful quality (Shanie and Linda, 2014).

Based on the preliminary data collected by the researcher, it shows that there is a decrease in the quality of earnings in manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2012 to 2015. The data used is in the form of company financial statement information. The data was taken from 144 manufacturing companies in 2012-2015. However, there were 29 companies that did not present complete financial statements. So there were only 115 companies used as the research data. Information on earnings quality is calculated using earnings quality ratio: operating cash flow divided by earnings before interest and tax (EBIT). The results obtained are as follows:



Source: www.idx.id.co processed

Figure 1
Graph of Decreasing Earnings Quality

From 2012 to 2013, the earnings quality ratio increased from 0.3037 to 0.5254. However, from 2013 to 2015, the earnings quality ratio continued to decline to -0.6238 in 2014 and -1.9670 in 2015. The earnings quality ratio shows a comparison between cash flows and net income. The higher the ratio, the higher the quality of earnings because the greater the portion of operating profit which is realized in the form of cash (Vatanparast et al., 2014).

The high interest of investors to invest makes it important for investors to get quality earnings information. In addition, the company must also provide quality financial information so that investors can make the right decisions. The phenomenon of decreasing earnings quality in manufacturing companies in Indonesia and the inconsistent results of previous studies encourage researcher to examine further about the factors that influence earnings quality.

2. THEORETICAL FRAMEWORK AND HYPOTHESIS

Earnings Quality

According to Wahlen, *et al*. (2015: 422), earnings quality is a profit that can be used to make accurate assessments of company's current performance and as a basis for predicting future performance. In addition, earnings quality is the profits that are presented based on a balance sheet that allows accurate assessment of key risks, such as liquidity, financial flexibility and solvency. Thus, earnings quality can be used for assessment of the company's performance because it reflects accurate assessment showing the company's financial condition.

Earnings quality is a multidimensional concept that creates different understanding from various points of view. Besides that, earnings quality can also reflect actual company performance. In this case, a company can be said to be of high quality if they shows quality information and have little or no perceived noise. According to Givoly and Hayn (2000), perceived noise in accounting earnings is caused by transitory events or the application of accrual concepts in accounting. So, perceived noise covers the manipulation of accrual accounts by adhering to a standard that can reduce or raise accrual accounts so that it can affect the reporting of corporate profits.

According to Darsono and Ashari (2010: 73), one characteristic that determines the quality of earnings is the relationship between accounting earnings and cash flows. The higher the relationship or the lower the difference between cash flows and company profits, the higher the quality of earnings. This is because the more income and cost transactions, that are cash basis and not accruals, the more objective is the recognition of income and costs in the profit and loss statement. Therefore, high quality of earnings can be realized into cash.

The Effect of Leverage on Earnings Quality

According to Brigham and Houston (2010: 140), leverage is a ratio that measures the extent to which a company uses funding through debt (financial leverage). According to Shanie and Linda (2014), if a company has a high level of leverage, it means that the company is highly dependent on external loans to finance its assets. Conversely, if a company has a low level of leverage, it means that the company uses its own capital to finance its assets. This ratio shows the company's ability to fulfill all its financial obligations if the company is being liquidated. Debt is needed by the company to increase the value of the company by increasing operating activities and business expansion. If the company only uses capital from shareholders, the company will certainly have difficulties. However, the high amount of debt will also increase financial risk in terms of company liquidity. In addition, investors will not be interested in investing because investors think that the company will prioritize payment of debt and loan interest rather than paying dividends.

If leverage is high, it will encourage management to do various ways to keep getting investors. One of them is not reporting the true financial condition of the company. The existence of financial statements that are not presented in accordance with the real conditions of the company will affect the profit items, that is, a decrease in the quality of earnings. This is because the earnings included in items of financial statements are not presented based on actual conditions. Conversely, if leverage is low, the company has little debt and shows that the condition of the company is getting better. This encourages the company to present real financial information to show that the company is in good condition. That is why, it can be concluded that the higher the leverage ratio, the lower the earnings quality, and the lower the leverage, the higher the earnings quality.

The results of the studies conducted by Shanie and Linda (2014), Ramadan (2015), Latif et al (2017), Mehrani et al (2017), Salehi and Bahrami (2017) and Belgacem and Omri (2015) show that leverage has an effect on earnings quality. Based on the theoretical basis and the results of previous studies, the hypothesis can be stated as follows:

H1: *Leverage has a negative effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016.*

The Effect of Liquidity on Earnings Quality

Liquidity, according to Wahlen, et al. (2015: 355), is the ability of other assets of the company to be converted into cash to meet its short-term debt that has matured. The current liquidity ratio shows the amount of current assets available to pay off obligations that are due. A small ratio indicates that the company's current assets are not enough to pay its short-term liabilities. If the company's liquidity is high, this indicates that the company is able to pay its short-term expenses or obligations before maturity. Thus, high liquidity shows good company performance because the company is able to pay its short-term debt using its current assets without using funds from outside or loans. While low liquidity shows poor company performance, because the current assets owned by the company are not enough to pay its short-term liabilities.

A high liquidity ratio can encourage managers to present real financial information to show that the company's performance is good. Financial reporting, which is based on the actual conditions, makes the earnings, as a component in the financial report, more qualified. Vice versa, if liquidity is low, the quality of earnings will also decrease because managers tend to report financial information not in accordance with the actual conditions with the aim to attract investors and users of the financial statements.

The results of studies conducted by Shannie and Linda (2014) and Yoga and Tresno (2014) show that liquidity has an effect on earnings quality. Based on the theoretical basis and the results of previous studies, the second hypothesis can be stated as follows:

H2: *Liquidity has a positive effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016*

The Effect of Audit Firm Reputation on Earnings Quality

Audit Firm is a business entity that has obtained a license from the Minister as a place for Public Accountants to provide services (Minister of Finance Regulation (PMK) Number: 17/ PMK.01/ 2008). Audit Firm reputation is an arrangement that reflects the quality of services provided for examining financial statements (Marisatusholekha and Budiono, 2014). Companies that use audit services from highly reputed Audit Firm will try to present accountable and transparent financial reports and do not carry out accounting practices. This is because every company wants good audit results and unqualified opinion. In addition, the audit results from the highly reputable Audit Firm are also more trusted by the users of financial statements.

If the auditor finds an indication of fraud or reporting that is not in accordance with the actual conditions, he knows that it will affect the results of the audit. This will encourage management to improve the performance and value of the company and try to present financial statements that are in accordance with the actual conditions so that the company will get good audit results and the users of the financial statements will increasingly trust the financial statements presented by the company. Therefore, if the company uses a highly reputable Audit Frm, they will present the actual financial statements that cause profits to be of higher quality, and vice versa. The results of research conducted by Bolmiri et al (2016) show that audit quality (with the proxy of Audit Firm reputation) has an effect on earnings quality. Based on the theoretical basis and the results of previous studies, the third hypothesis can be stated as follows:

H3: *Audit Firm reputation has a positive effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016.*

The Effect of Conservatism on Earnings Quality

According to Wahlen, et al. (2015: 416), conservatism is the response of an accountant and manager when faced with conditions of uncertainty in measuring the economic impact of a transaction both in cost and income. Whereas according to Watts (2003), conservatism is the principle of prudence in financial reporting. This means that companies are in no hurry to recognize and measure assets and profits and immediately recognize losses and debts that might occur. In the principle of conservatism, recognition of income and expenses is accepted if it has actually happened so that the recognized revenues and expenses will reflect the actual condition of the company and not use an accrual basis. Therefore, in this study, the researchers hypothesize that there is an influence between conservatism and earnings quality. The more conservative the company is in recognizing the expenses and revenues, the more qualified the earnings presented because the recognition of expenses and revenues is what actually happened. Vice versa, if the company is not conservative in recognizing expenses and revenues, the earnings presented will be of low quality because the company recognizes expenses and revenues not based on actual revenues and expenses that have occurred, or on an accrual basis. Thje results of studies conducted by Putu and Dewa (2014), Ramadan (2015), and Vatanparast, et al (2014) show that there is a significant influence between conservatism and earnings quality. Based on the theoretical basis and the results of previous studies, the hypothesis in this study is:

H4: *Conservatism has a positive effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016.*

The Effect of Investment Opportunity on Earnings Quality

The term investment opportunity set (IOS) was first introduced by Myers (1977). According to him, a company is a combination of the value of asset in place with investment choices in the future. However, according to Jogiyanto (2013: 58), investment opportunity is the breadth of opportunity or investment opportunity for a company. For companies, investment opportunities are opportunities to develop. However, companies often cannot take advantage of and implement these opportunities in the future.

For example, when a company has a high investment opportunity set (IOS), the company management will present this condition to the users of financial statements and to attract investors. The IOS ratio shows the stability of the company's profits and the opportunity for investment in the future. So, if the company has a high IOS, the reported profit is the profit that matches the actual conditions to show that the company has the opportunity to grow in the future and the resulting profit can reflect the company stock price. Conversely, if the IOS value is low, the company will not report the actual conditions because it will show that the company does not have alternative investments in the future. So, high IOS will affect management to present high-quality earnings, while low IOS will encourage management to present low-quality earnings.

The results of previous studies by

Chusnulia (2014) and Rizki (2012) show that investment opportunity set (IOS) has a positive effect on earnings quality. Based on the theoretical basis and the results of previous studies, the fifth hypothesis can be stated as follows:

H5: *Investment opportunity set has a positive effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (BEI) period 2012-2016.*

The Effect of Independent Commissioners on Earnings Quality

Independent Commissioners are members of the board of commissioners who are from outside the company and do not have a relationship with the company or are not affiliated with directors, controlling shareholders, other members of board of commissioners and are not involved in business relationships or other relationships that can affect their independence (Monks and Minow, 2011 : 257). In this case, Vafeas (2000) argues that independent commissioners can improve the quality of earnings by limiting the level of earnings management through a monitoring function of financial reporting by the company. In addition, the monitoring function is influenced by the number of independent commissioners. It can be concluded that the greater the number of independent commissioners, the more stringent supervision of management performance. For that reason, it encourages the management to pay more attention to the components in the financial statements presented, one of them is quality earnings, the earnings that reflect the true condition of the company. The greater the number of independent commissioners in the company, the higher the earnings quality presented. Conversely, the smaller the number of independent commissioners in the company, the lower the earnings quality presented because of lack of supervision that causes management to act opportunistically. The results of studies conducted by Putu & Putu (2016), Amanita, et al (2013) and Siagian and Tresnaningsih (2011) show that independent commissioners influence the earnings quality. Based on the theoretical basis and the results of previous studies, the sixth hypothesis can be stated as follows:

H6: *Independent Commissioners have a positive effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016.*

The Effect of Institutional Ownership on Earnings Quality

Institutional ownership is the ownership of company shares by parties outside the company such as institutions or companies owned by non-bank financial institutions such as insurance companies, investment companies, mutual fund companies, leasing companies, pension funds companies, etc. (Horne and Wachowicz, 2008 : 485). Institutional ownership can reduce agency problems and will have a positive impact on the company. With the presence of supervision from outside parties, it can be ascertained that financial statements can be used for all stakeholders and no party is harmed.

The supervision of the institutional owner, management can also show good corporate performance and present actual financial statements to improve the earnings quality presented to institutional owners and investors. The greater the proportion of shares owned by outside parties, the higher the earnings quality presented by management. Conversely, the fewer the shares owned by outside parties, the lower the supervision of management performance and thus encouraging management to present low-quality of earnings. The results of previous studies conducted by Nela and Anissa (2014), Putu and Putu (2016) and Mehrani (2017) show that institutional ownership affects the earnings quality. Based on the theoretical basis and the results of previous studies, the seventh hypothesis can be stated as follows:

H7: *Institutional ownership has a positive effect on earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX) period 2012-2016.*

3. RESEARCH METHOD

Sample Classification

The study used a population from all manufacturing companies listed on the Indonesia Stock Exchange period 2012-2016, consisting of 156 manufacturing companies. They were selected based on certain criteria or using a purposive sampling. The number of sample companies that meet the criteria is as many as 100 companies. The research period is 5 years with the number of 500 data. Outlier data was 136 data so that the number of data used in this study was 364 data.

Research Data

The type of data used in this study is secondary data taken from manufacturing companies listed on the Indonesia Stock Exchange (IDX). The data used are annual financial statement data for the period 2012 - 2016. Financial data are obtained from pure financial reports that have been processed such as those found in the Indonesia Capital Market Directory (ICMD), www.sahamok.com and the official website of the Indonesia Stock Exchange (www.idx.co.id).

Research Variable

The study used dependent variable of earnings quality (Y), while the independent variables are leverage (X1), liquidity (X2), Audit Firm reputation (X3), conservatism (X4), investment opportunity set (X5), independent commissioners (X6) and institutional ownership (X7). In addition, this study also used control variable, return on assets (ROA).

Operational Definition of the Variables

Earnings Quality (Y)

Darsono and Ashari (2010: 73) argue that high quality earnings can be realized into cash. Cash in the company can be seen through the company's cash flow statement. The earning quality ratio shows the relationship between cash flow and net income. Therefore, the higher the ratio, the higher the earnings quality because the greater the operating profit portion is realized in cash and not on an accrual basis.

$$\textit{Earnings Quality} = \frac{\textit{Cash Flow from Operating Activity}}{\textit{EBIT}}$$

Leverage (X1)

Leverage is used to explain the company's ability to use assets and sources of funds to increase the returns to the owners. The high company leverage indicates that the company uses more debt in its capital structure. Leverage is measured using Debt to Equity Ratio (DER) which compares the total liabilities with total equity of a company for a certain period (Shanie and Linda, 2014).

DER= Total Liability/Total Equaity

The ratio value is greater than one which indicates that the application of conservative accounting. This is based on the idea that the market to book value that is more than one indicates that the company recognizes that the book value of the company is smaller than the market value of the company. The formula used is as follows:

Liquidity (X2)

Liquidity is a financial ratio that measures a company's ability to settle its debt obligations in the short term. The liquidity ratio looks at the company's current assets against current debt / liabilities (Mamduh and Abdul) (Luciana and Vieka, 2007). This variable is measured by Current Ratio.

$$\textit{Current Ratio} = \frac{\textit{Current Asset}}{\textit{Current Liability}}$$

Audit Firm Reputation (X3)

Audit Firm reputation is measured using Audit Firm ratings based on the number of clients. The selection refers to the Audit Firms registered in BAPEPAM assuming that the reputable Audit Firms are those listed on the capital market (Luciana, 2004). Audit Firm reputation was measured by rating them where the number of Audit firms is divided into three categories. Category 3 shows a highly-reputed Audit Firm because it has the highest number of clients. Category 2 shows a medium-reputed Audit Firm with a moderate number of clients. Category 1 shows the low reputable Audit Firm with the least number of clients.

Conservatism (X4)

Based on the research by Givoly & Hayn (2000), conservatism is measured using a market to book ratio. This ratio is a comparison between the equity market value and the equity book.

$$M/B = \frac{\textit{Market Value of Common Equity}}{\textit{Book Value of Common Equity}}$$

Investment Opportunity Set (X5)

The investment opportunity set (IOS) shows the company's opportunity to grow in the future. The use of the E/P ratio in the IOS proxy is due to this ratio that can show an indicator of future earnings flows, allowing the company to grow in the future. Investment Opportunity Set is measured using the following formula:

$$E/P = \frac{\text{Earnings per share}}{\text{The closing price per share}}$$

Independent Commissioners (X6)

Independent commissioners in the company are measured by the ratio of independent commissioners, which is the proportion of the number of independent commissioners compared to the board of commissioners. A large ratio shows that the proportion of independent commissioners is increasing. Based on the decision of the directors of PT Jakarta Stock Exchange No. Kep-305 / BEJ / 07-2004, the number of independent commissioners that must be owned by public companies is at least 30% of the total members of the board of commissioners. The following is the formula used to measure the number of independent commissioners:

$$\text{Independent Commissioner} = \frac{\text{Number of Independent Commissioners}}{\text{Total Members of The Board of Commissioners}} \times 100$$

Institutional Ownership (X7)

Institutional ownership is the proportion of shares held by institutions or companies owned by non-bank financial institutions such as insurance companies, investment companies, mutual fund companies, leasing companies, pension funds companies, etc. The institutional ownership can be calculated using the following formula:

$$\text{Institutional Ownership} = \frac{\text{Number of Shares Owned by Institution}}{\text{Total outstanding shares}} \times 100$$

Analysis Instruments

Multiple linear regression analysis is used to test the influence of the independent variables on the dependent variable in this study. The following is the regression equation model:

EQ = α + β1 LEV + β2CR + β3AFR + β4Cit + β5EP + β6COM + β7INST + e

Note:
α: Constant regression coefficient
β1-7: Regression Coefficient of Variable X1,2,3,4,5,6,7
EQ: Earning Quality
LEV: Debt to Equity Ratio to measure leverage
CR: Current Ratio to measure Liabilities
AFR: Audit Firm Reputation
Cit: Conservatism
EP: Investment opportunity set
COM: Proportion of Independent Commissioners
INST: Institutional Ownership

Return on Asset (Control Variable)

Return on assets illustrates how much the company's effectiveness is to generate profits by utilizing assets owned (Shanie & Linda, 2014). Return on assets is one form of profitability ratios to measure a company's ability to generate profits using total assets that exist and after capital costs are excluded from the analysis. According to Lukman (2011: 63), return on assets is calculated from net income divided by total assets.

$$\text{Return on Asset} = \frac{\text{Net Income}}{\text{Total Asset}}$$

4. DATA ANALYSIS AND DISCUSSION

Descriptive Analysis

Descriptive analysis is used to provide an overview of the variables used in the study (Imam, 2013: 19).

The results of the descriptive analysis in Table 1 show that earnings quality, leverage, liquidity, Audit Firm reputation, conservatism, investment opportunity sets, independent commissioners and institutional ownership have diverse data, because there are several variables that have high standard deviations. Besides, they are much different from the average number, that is, the variable of leverage and the variable of conservatism. But overall, when viewed from the standard deviation, it shows that the data have a good distribution because the standard deviation number is not much different from the average.

Regression Analysis

Regression analysis is used to find out the effect of the independent variables on the dependent variable. The regression model in this study has met the classical assumption test or there is no problem with classical assumptions, including normality, autocorrelation, heteroscedasticity and multicollinearity, so that multiple regression tests could be done further.

EQ = 0.263316 + 0.000374(LEV) – 0.014225(CR) + 0.148011(AFR) + 0.000074(Cit) + 0.281858(EP) + 0.299930(COM) + 0.032417(INST) + e

EQ = 0.284049 – 0.000080(LEV) – 0.023607(CR) + 0.116194(AFR) – 0.000109(Cit) + 0.146498(EP) + 0.315879(COM) – 0.016327(INST) + 1.356419(ROA) + e

Table 1
Results of Descriptive Analysis

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Earnings Quality	364	-1.67	1.95	0.6171	0.63318
Leverage	364	-225.04	23.24	0.3818	12.1748
Liquidity	364	0.01	15.16	2.5678	2.27086
Accounting Firm Reputation	364	1.00	3.00	1.5797	0.80407
Conservatism	364	0.08	3880.00	76.9775	363.12621
Investment Opportunity Set	364	-2.58	2.36	0.0398	0.34532
Independent Commissioner	364	0.00	1.00	0.3906	0.12880
Institutional Ownership	364	0.00	0.9896	0.68870	0.2141

Source: Data processed

Table 2
Results of Multiple Linear Regression Analysis without Control Variable

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.263316	0.169		1.558	0.120
LEV	0.000374	0.003	0.007	0.140	0.889
CR	-0.014225	0.015	-0.051	-0.973	0.331
AFR	0.148011	0.041	0.188	3.645	0.000
Cit	0.000074	0.000	0.042	0.764	0.445
EP	0.281858	0.095	0.154	2.966	0.003
COM	0.299930	0.272	0.061	1.102	0.271
INST	0.032417	0.154	0.011	0.211	0.833

Source: Data processed

Results of t Statistical Test

The first hypothesis test was done to see the effect of leverage on earnings quality without using control variable. Based on Table 2, the t-value of the variable of leverage is 0.140, with the significance level of 0.889 which is greater than 0.05, or 0.889> 0.05. The leverage has no significant influence on earnings quality. Therefore, H1 is rejected. Based on Table 3, when using control variable, the t value of the leverage variable is -0.030, with the significance level of 0.976 which greater than 0.05, or 0.976> 0.05. So, leverage has no significant influence on earnings quality. Therefore, H1 is rejected. It can be concluded that the presence of control variable does not affect the influence of leverage on earning quality, because the results of the t test using control variable and without using control variables show the same results.

The second hypothesis test is conducted to find out the effect of liquidity on earnings quality without using control variable. Based on Table 2, the t value os the liquidity variable is -0,973, with the significance level of 0.331 which is greater than 0.05, or 0.331> 0.05. So, liquidity has no significant effect on earnings quality. Therefore, H2 is rejected. Based on Table 3, when using control variable, the t value of the liquidity variable is -1.604, with the significance level of 0.110 which is greater than 0.05, or 0.110 > 0.05. So, liquidity has no significant effect on earnings quality. Therefore, H2 is rejected. It can be concluded that the presence of control variables does not affect the influence of liquidity on earnings quality, because the results of the t test using control variable and without using control variable show the same results.

The third hypothesis test is conducted to find out the effect of Audit Firm reputation on earnings quality without using control variable. Based on Table 2, the t value of the Audit Firm reputation variable is 3.645, with the significance level of .,000 which is smaller than 0.05, or 0,000 < 0.05. So, Audit Firm reputation has a significant positive effect on earnings quality. Therefore, H3 is accepted. Based on Table 3, when using control variable, the t value of t of the Audit Firm reputation variable is 2.816, with the significance level of 0.005 which is smaller than 0.05, or 0.005 < 0.05. That's why, Aucit Firm reputation has a

Tabel 3
The Results of Multiple Linear Regression with Control Variable

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.284049	0.167		1.702	0.090
LEV	-0.000080	0.003	-0.002	-0.030	0.976
CR	-0.23607	0.015	-0.085	-1.604	0.110
AFR	0.116194	0.041	0.148	2.816	0.005
Cit	-0.000109	0.000	-0.063	-0.986	0.325
EP	0.146498	0.103	0.080	1.426	0.155
COM	0.315879	0.269	0.064	1.175	0.241
INST	-0.016327	0.152	-0.006	-0.107	0.915
ROA	1.356419	0.420	0.215	3.233	0.001

Source: Data processed

significant positive effect on earnings quality. Therefore, H3 is accepted. It can be concluded that Audit Firm reputation has a significant effect on earnings quality because the results of the t test using control variable and without using control variable show the same results, that is, positive influence.

The fourth hypothesis test is conducted to find out the effect of conservatism on earnings quality without using control variable. Based on Table 2, the t value of the conservatism variable is 0.764, with the significance level of 0.445 which is greater than 0.05, or 0.445 > 0.05. So, conservatism has no significant influence on earnings quality. Therefore, H4 is rejected. Based on Table 3, when using control variable, the t value of the conservatism variable is -0,986, with the significance level of 0.325 which is greater than 0.05, or 0.325 > 0.05. So, conservatism has no significant influence on earnings quality. Therefore, H4 is rejected. It can be concluded that the presence of control variables does not affect the influence of conservatism on earnings quality, because the results of the t test using control variable and without using control variables show the same results.

The fifth hypothesis test is conducted to find out the effect of investment opportunity set on earnings quality without using control variable. Based on Table 2, the t value of the investment opportunity set variable is 2.966, with the significance level of 0.003 which is smaller than 0.05, or 0.003 < 0.05. So, investment opportunity set has a significant positive effect on earnings quality. Therefore, H5 is accepted. Based on Table 3, when using control variable, the t value of the investment opportunity set variable is 1.426, with the significance level of 0.155 which is greater than 0.05, or 0.155 > 0.05. So, investment opportunity set has no significant influence on earnings quality. Therefore, H5 is rejected. It can be concluded that the existence of a control variable weakens the effect of investment opportunity set on earnings quality, because after a t test using the control variable, the investment opportunity set has no effect on earnings quality.

The sixth hypothesis test is conducted to find out the effect of independent commissioners on earnings quality without using control variable. Based on Table 2, the t value of the independent commissioner variable is 1.102, with the significance level of 0.271 which is greater than 0.05, or 0.271 > 0.05. So, conservatism has no significant influence on earnings quality. Therefore, H6 is rejected. Based on Table 3, when using control variable, the t-value of the independent commissioner variable is 1.175, with the significance level of 0.241 which is greater than 0.05, or 0.241 > 0.05. So, independent commissioner has no significant influence on earnings quality. Therefore, H6 is rejected. It can be concluded that the presence of control variable does not affect the influence of independent commissioners on earnings quality.

The seventh hypothesis test is conducted to find out the effect of institutional ownership on earnings quality without using control variables. Based on Table 2, the t value of the institutional ownership variable is 0.211, with the significance level of 0.833 which is greater than 0.05, or 0.833 > 0.05. So, institutional ownership has no significant effect on earnings quality. Therefore, H7 is rejected. Based on Table 3, when using control variable, the t value of the institutional ownership variable is -0.107, with the significance level of 0.915 which is greater than 0.05, or 0.915 > 0.05. So, institutional ownership has no significant effect on earnings quality. Therefore, H7 is rejected. It can be concluded that the existence of control variable does not affect the influence of institutional ownership on earnings quality, because the results of the t test using control variable and without using control variable show the same results.

Discussion

The Effect of Leverage on Earnings Quality

The leverage ratio of PT Hanjaya Mandala Sampoerna Tbk (HMSP) in 2014 was 1.1026, while the leverage ratio of PT. Bentoel International Investama Tbk (RMBA) in 2012 was 2.6049. Yet, in the same year, the two companies had almost the same earnings quality ratios, 0.8094 (HMSP) and 0.8033 (RMBA). Similar things also happened to Gajah Tunggal Tbk (GJTL) in 2012 and Arwana Citra Mulia Tbk (ARNA) in 2015, where the earnings quality ratios were the same (1.171), but the leverage ratios were far different, 1.3492 and 0.5991. This showed that the source of funds used by the companies did not affect the amount of profit and operating cash flow used, because the high leverage of a company was caused by the small amount of capital owned so that it would not be enough for the company to carry out operational activities. Therefore, companies had to make loans from third parties that ultimately caused leverage to be high. The high and low earnings quality ratio with the proxy of operating cash flow divided by company's EBIT was not influenced by the source of funds used by the company but rather by the company's performance to generate profits from operating activities or EBIT and the high operating cash flow was caused by the low transaction recognition in accrual.

Besides based on these data, the researchers also argue that this happens because when a company has high debt that causes high leverage, the company will be increasingly dynamic. This means that the management will be more motivated to improve its performance so that the company can pay its debts. The positive impact is that the company will be more developed. So, leverage has no effect on earnings quality.

The results of this study support the results of research conducted by Rizki (2012), Chusnulia, et al (2014), Marisatussholekha and Eddy (2014), Kadek and Ida (2014) that leverage has no effect on earnings quality.

The Effect of Liquidity on Earnings Quality

The high and low level of company liquidity does not affect the quality of earnings presented by management within the company because when liquidity is low, it indicates the inability of the company to pay its short-term obligations. PT. Indocement Tunggal Prakasa Tbk (INTP) in 2012 had a minimum liquidity ratio of 0.01. The very low ratio was caused by very high short-term liabilities.

In order to pay for the short-term obligations, the company had to do various ways, such as withdrawing its assets by selling inventory, collecting receivables and selling securities. The company focused more on choosing various alternatives that had to be done to overcome the liquidity problem. So that the presence of liquidity problems did not encourage management to report low earnings quality of earnings or the earnings that did not reflect the real condition of the company but instead focused more on resolving these liquidity problems and maintaining liquidity problems in the future.

The results of this study support the results of research conducted by Amanita (2013) and Kadek and Ida (2014) that liquidity has no effect on earnings quality.

The Effect of Audit Firm Reputation on Earnings Quality

Marisatusholekha and Eddy (2014) state that with the superior expertise possessed, qualified auditors can detect earnings management. Companies that use audit services from highly reputable Audit Firm will try to present accountable and transparent financial reports and will not carry out accounting practices. This is because every company wants good audit results or unqualified opinion. In addition, the audit results from highly reputable Audit Firm are also more trusted by users of financial statements. If in the audit, the auditor finds an indication of fraud or reporting that is not in accordance with the actual conditions, it will affect the results of the audit.

The condition above will encourage management to try to present financial statements that comply with applicable standards so that profits are presented in accordance with the actual conditions, so that the company will get good audit results and the users of financial statements increasingly trust the financial statements presented by the company. So, if the company uses a highly reputable Audit Firm, the company will present the financial statements in accordance with the actual financial condition, thus resulting in earnings quality to be high. The results of this study support the results of research conducted by Bolmiri et al (2016) that Audit Firm reputation has an effect on ernings quality.

The Effect of Conservatism on Earnings Quality

The minimum conservatism ratio PT. Apac Citra Centertex Tbk (MYTX) in 2015 was 0.08 with a profit quality ratio of 0.3201, while the maximum conservatism ratio of PT. Unilever Indonesia Tbk (UNVR) in 2016 was 3880 with a profit quality ratio of 0.7798. The conservatism ratios differed greatly because it was the lowest and highest number, but the change in the earnings quality ratio was very small. Thus, it can be concluded that the size of conservatism does not affect the quality of earnings. Another factor that makes conservatism unable to affect the quality of earnings is that the company only applies conservatism when in a state of doubt. In such a condition, the management must wisely recognize the burden or loss that occurs and immediately compared to recognition of income. The treatment is carried out by management solely in order to guard against uncertain conditions and still be hesitant. So, the motivation of management to implement conservatism is not to improve the earnings quality of reported, but to overcome the uncertain conditions. The results of this study contradict the results of research conducted by Putu and Dewa (2014), Ramadan (2015), and Vatanparast, et al (2014) that there is a significant influence between conservatism and earnings quality.

The Effect of Investment Opportunity on Earnings Quality

Based on the first analysis in Table 2, or without the control variable, it can be concluded that investment opportunity set (IOS) has a positive effect on earnings quality. The point is that the greater the chance of the company to grow in the future, the higher the earnings quality presented by the company. This is because with the high investment opportunity set, management will present these conditions to users of financial statements and to attract investors. The IOS ratio shows the stability of the company's profits and the opportunity for investment in the future, so that if the company has a high IOS, the reported profit is the profit that matches the actual conditions with the aim to show that the company has the opportunity to grow in the future. In addition, the resulting profit can reflect the price company stock. Conversely, if the IOS ratio is low, the company will not report the actual conditions because it will show that the company does not have alternative investments in the future. Thus, high IOS ratio will affect management to present high-quality earnings, while low IOS will encourage management to present low-quality earnings.

The results of this study are consistent with the results of research conducted by Chusnulia (2014) and Rizki (2012) that investment opportunity sets have a positive effect on earnings quality. The analysis in Table 3, with the control variable, shows that the investment opportunity set does not affect the quality of earnings. This is because the opportunity to grow is done by the company by utilizing existing alternatives to show that the company has the opportunity to grow in the future. So, for the company, the opportunity to grow in the future is not done by reporting company profits according to actual conditions. This is contrary to the signaling theory which shows that the company will signal to outside parties regarding the actual conditions to attract investors. The results of the study using control variable are consistent with the results of research conducted by Erikson, et al (2014) and Putu and Putu (2016) that investment opportunity set has no effect on earnings quality.

The Effect of Independent commissioners on Earnings Quality

The variable of independent commissioners does not influence the quality of earnings because the existence of independent commissioner is used by the company to meet regulations only and is not used to enforce good corporate governance (GCG) within the company to conduct supervision. Therefore, the existence of independent commissioners within the company is not used to properly monitor the actions taken by management. This may cause management to be able to do various ways to report company profits to show that the management performance is good. Therefore, the actions taken by management related to the reporting of financial statements and company profits are not influenced by the presence of independent commissioners. The results of this study are consistent with the results of research conducted by Erikson, et al (2014) and Marisatusholekha and Eddy (2014) that the variable of independent commissioners has no effect on earnings quality.

The Effect of Institutional Ownership on Earnings Quality

Institutional ownership has no effect on earnings quality because the institutional parties that own the company's shares have no power to influence what management reports in the financial statements. This shows that the existence of investors from institutions is not able to improve the quality of earnings of companies, especially manufacturing companies used as the samples in this study. The results of this study support the results of research conducted by Erikson, et al (2014) and Amanita, et al (2013) that institutional ownership has no effect on earnings quality.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

Conclusion

This research was done to examine the factors that influence the quality of earnings in manufacturing companies listed on the Indonesia Stock Exchange period 2012-2016. It used 100 companies with 364 data as the sample. Some conclusions can be drawn as follows: 1) leverage has no effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 either using control variable or not using control variable; 2) liquidity has no effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 either using control variable or not using control variable; 3) Audit Firm reputation has a positive effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 either using control variable or not using control variable; 4) conservatism has no effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 either using control variable or not using control variable; 5) investment opportunity set (IOS) has a positive effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 when tested without using control variable, but investment opportunity set (IOS) has no effect on earnings quality when tested using control variable; 6) independent commissioner has no effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 either using control variable or not using control variable; 7) institutional ownership has no effect on earnings quality in manufacturing companies listed on IDX period 2012-2016 either using control variable or not using control variable.

Suggestion

In this study, the proxy used to measure earnings quality is earnings quality ratio which is calculated using a comparison between operating cash flows divided by EBIT. It is recommended that further research use other proxies to measure earnings quality more accurately, such as earnings reponse coefficient and discretionary accruals. In addition, the measurement of earnings quality should also consider the existence of IFRS mandatory which requires actual earnings disclosure.

Based on the initial sample data, when a normality test is performed, it shows that the data are not normal. This is because the research data used contain data crossection. The data collect data that represent various sizes (small, medium and large). It is recommended that further research test the data after grouping by size, so that there is no need to do outliers. Thus the data used are even more and the results are more accurate.

The observation period used in this study was only 5 years. Therefore, it is recommended that further researchers lengthen the observation period so that the results of the study are more optimal. This is expected to be able to find out the changes in the average of the independent variables and the dependent variable in the longer term, so that it can be concluded the influence of changes that occur consistently over a longer period of time.

It is also recommended that further researchers use other independent variables that can affect earnings quality such as the level of education and the gender of the parties who compile the company's financial statements. It can be seen that the value of Adjusted R Square in this study has a small value which indicates that the influence of independent variables on the dependent variable is weak or not significant.

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