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# Determinant of Earnings Quality: IFRS Convergence, Accounting Disclosure and Audit Committee in Indonesia

**Diyah Pujiati**
*Corresponding Author: Accounting Department, Hayam Wuruk Perbanas University, Surabaya, Indonesia. Phone Number: +628156535086, ORCID ID: 0000-0002-4269-1335*

**Supriyati**
*Accounting Department, Hayam Wuruk Perbanas University, Surabaya, Indonesia*

**Riski Aprillia Nita**
*Accounting Department, Hayam Wuruk Perbanas University, Surabaya, Indonesia*

## Abstract

*The quality of earnings indicates the current or future capability of the company to support the decisions made by managing board and other stakeholders. This research have to goal to examine the determinant of earnings quality in Indonesia, including: IFRS convergence, accounting disclosures, and audit committees. Data were acquired from official website in period of 2016-2018 and number of data was 212 observation data. Method of analysis involved regression test and classical assumption test. Result of research showed that the audit committee had a positive effect on earnings quality, while the convergence of IFRS and accounting disclosure cannot affect earnings quality. Research model was tested using control variables, respectively leverage, liquidity and company size. The test found that leverage is the only control variable that affects earnings quality. Information in financial statements is not the most important information to investors. Audit committee and creditor contribution play more important role in decisions regarding earnings quality.*

***Keywords:*** *Earnings quality; IFRS; Accounting disclosure; Audit committee*

***JEL Classifications:*** *G17; G21*

## Introduction

Financial statements represent a meaningful source of information used by stakeholders to understand the actual condition of the firm. Financial statements can be used by potential investors in making investment decisions. Relevant information will help investors in making decisions in rational way. Information that becomes main concern of investors is information about earnings. This information however does not guarantee that earnings of the company is in high quality. Earnings do not directly show the actual economic condition of the company. Therefore, earnings alone may still be doubtful and misleading users of financial statement (Maya, 2015). However, shareholders and other users of financial statements still rely greatly on financial statements for their investment decisions.

Response to earnings publication is always wild. Market may respond earnings information reactively. The degree of this reaction depends on the earnings quality reported by the firm. Low earnings quality can lead investors and other stakeholders to make wrong decisions on investment. One case for this situation is earning information issued by PT. Garuda Indonesia Tbk (GIAA). The managing board of GIAA was considered fraud after presenting financial statements improperly. In 2018, GIAA recorded net earnings for USD 809.85 thousands or equaled to IDR 11.33 billions after suffering frequent losts. Total earnings obtained from other sectors had reached USD 306.88 millions. Problem occured when two commissioners of GIAA refused to validate financial statements due to their objection to verify income that the company might get from the agreement of flight connectivity service between PT. Mahata Aero Teknologi and PT. Citilink Indonesia. This improper presentation of financial statements had reduced public trust to GIAA. Low public trust sent bad signal on business sectors that underlie the company. Share value of the company drastically descended as the consequence of the fraud (m.detik.com, 2019).

Theoretical base used by this research is agency theory introduced by Jensen & Meckling (1976) which explains the existence of a conflict of interest between the principal and the agent. The managing board as an agent is a party mandated by the principal to work in their interests. As the contractor, managing board must be liable to shareholders. According to agency theory, problem of earnings quality can be solved by using earnings quality as a measure in determining the quality of the company's financial information. Good financial information is always preceded by good financial reports. A company is declared qualified when the earnings reported in the financial reporting are the real earnings that show the real performance.

Earnings quality refers to earnings written in financial report which show real performance (Irawati, 2012). Earnings in the best quality are earnings presented as it is. If the reported of earnings is not consistent to the real condition, then earnings quality will be low. Quality of earnings can provide information that can influence investors in investment decision making. However, earnings quality itself is affected by several factors, such as IFRS convergence (Almaharmeh & Masa'deh, 2018; Sutrisno & Djashan, 2017), accounting disclosure (Suryanto, 2016; Febrina & Suaryana, 2011), and audit committee (Darabali & Saitri, 2016; Suryanto, 2016; Silfi, 2016; and Simamora, Tanjung, & Julita, 2014). The imperative for the companies at stock exchange (listed companies) to use IFRS has been one of the most noticeable development of accounting regulations (Daske, Hail, Leuz, & Verdi, 2008). Regulators in those countries expect that the use of IFRS can inspire financial statements comparibility, improve company transparency and increase financial statements quality, which these all will benefit investors. However, there is a debate whether IFRS can increase the accounting information quality (Barth, Landsman, & Lang, 2008; Daske et al., 2008; Karampinis & Hevas, 2010; Alali & Foote, 2012). There is an opinion saying that IFRS can increse accounting information quality through the use of fair value to reflect show the company economical condition. Moreover, the implementation of IFRS can also restrain managerial opportunism (Barth et al., 2008).

The conceptual debate the function of IFRS still continues. Previous empirical studies have different positions concerning the function of IFRS in the enhancement of accounting information quality. For example, Barth et al. (2008) and Alali & Foote (2012) found that financial reporting presented based on IFRS has higher quality than financial reporting processed with prior accounting standards. The studies from Hung & Subramanyam (2007) and Karampinis & Hevas (2010) gave opposite empirical findings. These studies found that accounting information quality is not improving after IFRS adoption. Due to such gap, the IFRS effect on the improvement of accounting information quality becomes the issue of the current research.

The application of IFRS in each country is different. Almost all countries in the world have adopted IFRS, with different levels of compliance. Most of the developed countries have adopted IFRS almost 100% except for the USA while some developing countries have adopted the entire contents of IFRS, some others are by

harmonizing IFRS with the standards that have been applied before. Within the context of Indonesia, IFRS convergence has proceed in three stages since 2008 to 2012. Precisely in 2012, the IFRS has been widely used by companies listed at Indonesia Stock Exchange (IDX). The implementation of IFRS has given positive impact, which among others are inspiring comparability, improving transparency and increasing information quality in financial statements (Kristanto, Tarigan, & Tarigan, 2014). The use of IFRS as global accounting standards has decreased the number of options of accounting methods that the company can use. Sutrisno & Djashan (2017) said that IFRS convergence in Indonesia minimizes the capability of managing board to commit fraud and helps to ensure that information presented in financial statements is in better quality. Studies carried out by Almaharmeh & Masa'deh (2018) and Sutrisno & Djashan (2017) found that IFRS convergence affects earnings quality. Inggrid & Wardhani (2011) discovered that during the high season of demand for converting accounting standards to IFRS, the convergence has been proved as capable to increse company earnings quality.

Accounting disclosure is other factor that influences earnings quality. The effect of accounting disclosure on earnings quality can be found in the capability of the company to implement high-quality accounting standards, which implicates to the reporting of high earnings quality in company financial performance. The goal of accounting disclosure is to provide information that the users of financial reporting find as important and relevant to their decisions. Consistent to the fundamental goal of the accounting, one goal to be achieved is the presentation of adequate information to attain the desired comparison. Study conducted by Febrina & Suaryana (2011) revealed that accounting disclosure affects earnings quality of the company. This finding was confirmed by Inggrid & Wardhani (2011) by saying that high level of accounting disclosure is followed by high level of earnings quality. Conversely, Suryanto (2016) argued that accounting disclosure have no effect on earnings quality.

Other factor affecting earnings quality is audit committee. In this context, audit committee is a created by company to supervise and ensure that the company will present information in high quality (Darabali & Saitri, 2016). Few studies, including Darabali & Saitri (2016), Suryanto (2016), Silfi (2016), and Simamora et al. (2014), found that audit committee affects earnings quality. However, study carried out by Reyhan, Zirman, & Azlina (2014) discovered that audit committee does not affect earnings quality. Background and phenomena related to the topic of the current research have been explained.

Based on several inconsistent findings of previous studies regarding the factors that influence earnings quality, this research is intended to empirically examine the determinant of earnings quality in Indonesia. These factors include IFRS convergence, accounting disclosures, and audit committees.

## Literature Review

### Agency Theory

Jensen & Meckling (1976) to described the working relationship between the principal (owner) and agent (company management) known as agency theory. This relationship creates an agency conflict. Agency conflict is caused by interest gap between principal and agent. Because the agent acts as the party that manages the company, then the agent holds more knowledge about the condition of the company than the owner. Such imbalance position of information triggers a condition called information asymmetry. This condition leads managers to act opportunistically including manipulating financial statements and conducting earnings-oriented accounting practice to maximize their interest. As the consequence, reported earnings information in financial reporting never really shows the real performance of the company, which therefore, can mislead the users of financial statements during decision making process. Interest gap between owner and management produces agency cost, which the type of this cost can include monitoring cost, bonding cost and residual loss (Jensen & Meckling, 1976). Monitoring cost is fees paid by owner to supervise and control management behavior. Bonding cost is cost borne by agent to execute certain mechanism to ensure that the interest of principal will be satisfied. *Residual loss* is cost that indicates the decline of principal welfare due to interest gap between principal and agent. Any efforts to reduce agency conflict are always difficult in the company that has *zero agency cost*. Jensen & Meckling (1976) asserted that owners can limit opportunistic action from the managing board by giving incentives based on managerial performance. Such arrangement may urge the managing board to present financial statements transparently because managerial performance is determined from earnings. The presentation of earnings in financial statements

shall be free from manipulation and misstatements, which by implication, earnings information will have higher quality and be meaningful to the users of financial statements.

**Financial Statements Quality**

Financial statements are the instrument used to understand financial condition and performance level of the company which then this knowledge will be used by financial statements users in making their decisions. Financial statements are also defined as information records made by an entity in an accounting period to describe performance level of the entity. Financial statements are a medium of communication used by managing board to the party external to the company. The quality of this communication depends on the quality of financial statements presented. Financial statements in good quality are only achieved after showing compliance with the rules made by professional accounting organization (accounting standards board) and government. Standards of quality that indicate how good the financial statements is prepared include relevant, understandable, contestable, neutral, punctual and comparable (Rudianto, 2009).

**Earnings Quality**

Information about earnings is needed to assess the change of potential economic resources that can possibly be managed in the future in order to produce cash flow and to controlling the effectiveness of the company in the use of resources. Earnings in high quality are earnings that may still continue in the future (*sustainable earnings*), which can derive from accrual components and cash condition that indicate the real financial performance of the company. Dechow, Ge, & Schrand (2010) explained that (1) earnings quality depends on whether relevant information is existed in decision making process; (2) earnings quality can be estimated from earnings reported in financial reporting which describe of company financial performance; and (3) earnings quality is indicated by the usefulness of financial performance on decision making. According to Sadiah & Priyadi (2015), earnings quality can be grouped based on:1) time lapse of earnings, 2) relationship of earnings and accrual cash; 3) qualitative concept of conceptual framework; and (4) decision for implementation.

**Hipothesis development based on literature findings**

**IFRS Convergence**

International Financial Reporting Standards (IFRS) represent the standards of recording and reporting of accounting items that have been applied internationally and issued by International Accounting Standard Boards (IASB), an international organization established to create accounting regulations that are in high quality, understandable, applicable, and accepted internationally. International Accounting Standards, which are popularly known as IFRS, refer to the standards for making high-quality accounting reporting. The IFRS is also regarded as an accounting frame that comprises elements such as professional assessment on economic standing of the transactions, clear and transparent disclosures concerning the transactions, explanation toward conclusion, and accounting of the transactions.

Financial Accounting Standards Boards of Indonesia Accountant Association (DSAK-IAI) planned to start IFRS convergence in 2009 and complete the program before the year of 2012. The target of the 2012 IFRS convergence was to change the material contents of Statements of Financial Accounting Standards (PSAK) to be adapted to IFRS on January 1 of 2009 and to prevail the standards effectively on January 1 of 2012. The success key of IFRS convergence is the capability of the companies to pass through transition period. During this period, many companies created adhoc team of IFRS convergence with tasks to conduct preliminary preparation and organize resources. Accounting practitioners were involved in the process, such as management accountants, public accountants, academician accountants, and regulators and other professionals, such as appraisers and actuaries. The benefits that the companies may get from IFRS convergence are increasing the quality of financial accounting standards, reducing the cost to comply with financial accounting standards, improving the credibility and usefulness of financial statements, inspiring comparability of financial statements, improving financial transparency, decreasing capital cost by opening opportunity of fund raising activity through capital market, and increasing the efficiency of financial statements preparation.

Financial Accounting Standards (SAK) are a frame in financial reporting procedure aimed to produce uniformity in financial statements presentation. Within Indonesia context, SAK encompasses various



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accounting standards such as IAS, IFRS, ETAP and GAAP. The most popular accounting standard used to prepare financial statements, which has gotten public accountability, is PSAK (*Statements of Financial Accounting Standards*). Indonesia has adopted IFRS in full scale starting from January 1 of 2012. The implementation of IFRS was gradual, which was started by the application of 19 PSAK and 7 ISAK for the companies that adopted IAS or IFRS starting from January 1 of 2012. These companies still underwent the convergence process. The IFRS convergence in Indonesia involved three stages, namely Adoption Stage (2008-2011) in which all IFRS were inserted to PSAK; Final Preparation Stage (2011) in which infrastructures were prepared and completed and the application of IFRS-based PSAK was executed gradually; and Implementation Stage (2012) in which IFRS-based PSAK was implemented gradually and then the implementation was evaluated to find out the comprehensive impact of PSAK.

The application of IFRS can improve the quality of financial disclosure and also minimize earnings management. Some requirements are coming up with the application of IFRS. One requirement is that IFRS emphasizes on principle-based accounting which therefore requires the managing board to develop logical estimations and assessments on financial statements. Other requirement is that IFRS compels the managing board to implement full disclosures on financial statements using fair value approach, either for qualitative or quantitative accounting information. The application of IFRS has put the managing board into difficulty to commit opportunistic behavior that usually culminates at earnings management. Indirect impact of IFRS adoption on the companies includes alleviating earnings management practice, increasing relevance value, and recognizing loss on time or immediately if compared to before IFRS adoption. Managerial opportunism declines with IFRS adoption which therefore information in financial statements is truly free from manipulation. Information that is free from manipulation indicates that this information has high quality, including information about earnings. Few empirical studies showed that IFRS convergence affected earnings quality of public companies (Almaharmeh & Masa'deh, 2018; Sutrisno & Djashan, 2017; Syarif & Pasaribu, 2015; Ismail et al., 2013). Referring to this explanation, first hypothesis is written as following:

H1: IFRS convergence has effect on earnings quality.

**Accounting Disclosure**

The disclosure of information in financial statements is differentiated into two, respectively mandatory disclosures and voluntary disclosures. In the case of voluntary disclosures, the managing board is given free option to deliver accounting information and other information considered relevant to the decision making of financial statements users. The liberation to conduct voluntary disclosures has produced wide variation in voluntary disclosures across the companies.

Accounting disclosure is aimed to provide important and relevant information to the users of financial statements in order to help them to make the best decisions. Good accounting disclosure indicates that the company can provide important and relevant information to the users of financial statements and this information will be used to help them in making decisions. Content Analysis is used to measure accounting disclosure, precisely to estimate how far the company is in disclosing financial statements. The estimation is obtained by ensuring whether accounting information is presented in financial statements (Adhikari & Tondkar, 1992). If information items do not exist in financial statements, the company is given score 0, whereas if the required information items do exist in financial statements, the company is given score 1 (Inggrid & Wardhani, 2011). This scoring index is applied to every information item. Data from content analysis describe how far the responsibility of the company is in presenting the required information in financial statements (Adhikari & Tondkar, 1992).

Good accounting disclosure will show that the company has presented important and relevant information to financial statements users who then use the information in their decision making. The study by Febrina & Suaryana (2011) found that accounting disclosure affects earnings quality. This position is supported by Inggrid & Wardhani (2011) through their finding that high diclosure level is followed by high level of earnings quality. Based on this statement, second hypothesis is formulated as following:

H2: Accounting disclosure has effect on earnings quality.

**Audit Committee**

Audit committee is an organization functioned to help independent commissioner to supervise the preparaton of financial statements and to improve the quality of internal and external audits. Audit committee is founded by and responsible to commissioner board to be helpful to the task and role of commissioner board. The task of audit committee is to inspect any information items in financial statements, especially financial information. Simamora et al. (2014) asserted that audit committee has role and responsibility to oversee the presentation of financial statements by giving emphasis on the compliance with currently applied accounting standards and policies. The presence of audit committee in a company can improve supervision and control processes on the managing board, which also may diminish fraudulent action that can harm internal and external parties of the company. Moreover, audit committee can express its opinion independently, which can alleviate agency conflict between owners and managing board.

In the process, audit committee must have meeting couple of times with the managing board to monitor the process of financial statements preparation (Lestari & Cahyati, 2017). This meeting is held periodically, which is minimally once meeting in three months.. The meeting can only be held if the attendant is more than a half of members of audit committee. Moreover, audit committee is an attribute of the application of good corporate governance, which audit committee is required to be compliance with the principles of independence, transparency, accountability, responsibility, and fairness. Audit committee shall have dependable competence, especially related with accounting and finance, in order to help the committee to detect and prevent any manipulation in financial statements. In accordance with the Regulation of the Audit Committee in Indonesia, minimum number of audit committee membership in a company is three individuals selected from independent commissioner and external party. If the size of audit committee is large enough, then the committee becomes more capable to oversee the presentation of financial statements and to detect any misstatements, which as the result, the presented information will have better quality.

Results given by Aryengki, Satriawan, & Rofika (2016) and Suryanto (2016) showed that audit committee has effect on earnings quality. The existence of audit committee in a company can help commissioner board to improve the quality of financial statements and to make internal and external audits more effective. Audit committee also conducts examination on accounting policies made by the company, which at least is intended to minimize managerial opportunism or to constrain the habit of selecting earnings-oriented policies that often initiates earnings management. If financial statements are not in correspond with the standards, then commissioner board can ask audit committee to reexamine financial statements in order to ensure that managing board will be more careful in preparing financial statements. Large membership size of audit committee can facilitate the committee to supervise audit on financial statements with the prevailed accounting standards. The supervision from audit committee is considered more effective when the size of audit committee is larger. Indeed, more members in audit committee are associated with good performance of audit committee in supervising managerial behavior. If managerial fraud can be restrained, then information presented in financial statements will be in higher quality. With respect to this explanation, third hypothesis is then proposed as following:

H3: Audit committee has effect on earnings quality

## Research and Methodology

Variable observed in this research includes IFRS convergence, accounting disclosure, audit committee, leverage, liquidity, company size, and earnings quality. Research scope was limited to manufacturing companies in Indonesia period 2016-2018. Earnings quality is the reflection of earnings sustainability in the future. This earnings sustainability is estimated by examining the conditions of cash flow and accrual component that represent the actual financial performance of the company. Earnings quality is measured using earnings quality ratio which indicates the relationship between cash flow and net earnings. IFRS convergence is the adjustment of PSAK, which is accounting standards used in Indonesia, to international standards (Saifuddin, 2016). The identification of IFRS convergence is confirmed by seeing the convergent PSAK (post-adjustment) in official site of IAI, precisely www.iaiglobal.or.id. Mandatory disclosures in IFRS convergence are measured using scoring technique. If the item that needs to be disclosed is actually disclosed by the company, then the score is one. Conversely, if the item is not disclosed by the company, then the score is zero. If the item has been disclosed but cannot be used by the company, the measure is marked by n/a (not applicable). Accounting disclosure is the supply of relevant information to the users of financial statements. If accounting disclosure can give relevant information to the company, then the

information may help the company in making the best decisions (Suryanto, 2016). Accounting disclosure is measured with content analysis, which is operated by counting the number of accountability disclosure in financial statements and also by observing whether the needed information is presented in financial statements. Adhikari (1992) added that if information item is not in financial statements, then the score is 0. If information item is in financial statements, then the score is 1. The audit committee is measured by the number of audit committee members in the company.

Control variable used in this research includes leverage, liquidity and firm size. Leverage is the relationship of company debt on capital or assets. The estimation of leverage is done through debt ratio, which is a comparison between total debt and total assets. This ratio shows how far the debt can be covered by the assets. Liquidity is estimated through current ratio. Furthermore, company size is classified with total assets.

### Research Sample

The sample includes manufacturing companies listed at Indonesia Stock Exchange in period 2016-2018. The companies are sorted to be the sample through criteria, namely: a) that the companies have been listed on IDX; b) that the companies have published the complete form of financial statements; and c) that the companies have issued financial statements in rupiah currency unit. Data type was quantitative and the data were acquired from the websites of Indonesia Stock Exchange (IDX) and Indonesia Accountant Association (IAI).

### Data Analysis Technique

Descriptive analysis is aimed to produce description about data through mean value, minimum value, maximum value and standard deviation of each variable. Research model was tested with regression linear analysis. The formula of the test is written in the following equation:

Earnings Quality = $\beta_0 + \beta_1$ IFRS + $\beta_2$ Accounting Disclosure + $\beta_3$ Audit Committee + $\beta_4$ Leverage + $\beta_5$ Liquidity + $\beta_6$ Company Size + $e_i$

Classic assumption test is conducted to know whether regression estimation is free from normality, heteroscedasticity, multicollinearity and autocorrelation symptoms. Model test involves F-test, Adjusted R-square, and t-test, which all are applied to main variable and control variable.

## Findings

### Description of Research Subject

Subject of this research is manufacturing companies listed at Indonesia Stock Exchange (IDX) in period 2016-2018. The following is the table presenting the result of sampling with predetermined criteria.

**Table 1:** Selection of Research Sample in Period 2016-2018

| No. | Sample Criteria | 2016 | 2017 | 2018 | Total |
|---|---|---|---|---|---|
| 1. | Manufacturing companies have listed at Indonesia Stock Exchange | 146 | 146 | 166 | 458 |
| 2. | Manufacturing companies have published financial statements in complete form | (27) | (17) | (10) | (54) |
| 3. | Manufacturing companies have issued financial statements in rupiah currency unit | (28) | (28) | (30) | (86) |
| Sample data | | | | | 324 |
| *Outlier data* | | | | | (156) |
| Final sample data | | | | | 212 |

Initial sample was amounted to 458 data. This sample was then selected using three criteria. After applying the criteria in Table 1, there were 54 samples that did not publish financial statements in complete form and there were 156 data indicated as *outlier*. In the end of sampling process, total sample data were 212 samples. Descriptive analysis was implemented to describe or to indicate the values of *mean*, standard deviation, variance, maximum, and minimum of research variables.



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**Table 2:** Result of Descriptive Analysis

| Variable | Sample | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Earnings Quality | 212 | -.4886 | 2.0640 | .78767 | .60654 |
| IFRS Convergence | 212 | .3409 | .71111 | .55738 | .07869 |
| Accounting Disclosure | 212 | 0.4 | 0.81667 | 0.65888 | 0.06788 |
| Audit Committee | 212 | 0 | 5 | 3.04 | .470 |
| Liquidity | 212 | .02136 | 65.19484 | 2.86604 | 4.89469 |
| Leverage | 212 | .04942 | 54.75415 | .75545 | 3.74838 |
| Company Size | 212 | -.88222 | 1.23402 | .10747 | .22239 |

Earnings Quality is referring to the sustainability of earnings in the future shown by the condition of cash flow and accrual component that represents the real financial performance of the company. Earnings quality is measured using earnings quality ratio modelled by Penman. Mean value of earnings quality is 0.78767 or 78.77%, which signifies that earnings quality of the sample is in good category and capable to produce good earnings in the future. IFRS Convergence is the adjustment of Indonesian accounting standards (PSAK) to international standards. IFRS convergence has been used by many countries as a condition when financial statements are compared to each other. The quality of earnings reported by the companies can be improved through IFRS convergence. Mean value of IFRS convergence is 0.55738 or 55.74%, which points out that the value is close to 1, which indicates that number of companies with IFRS convergence is many. Accounting Disclosure is implemented to deliver relevant information to financial statements users. If the information is relevant, then this information may help the company in making the best decisions. Mean value of accounting disclosure is 0.65888 or 65.89%, which informs that the companies have disclosed relevant information in financial statements. Audit Committee is functioned to assist independent commissioner to oversee the presentation of financial statements and to improve the quality of internal and external audits. The existence of audit committee in a company can improve the supervision and control on the managing board. Fraudulent action that may harm internal and external parties of the company can be minimized through the supervision and control of audit committee. Audit committee is measured through number of members of audit committee in the company. Larger size of audit committee will enable the committee to divide each member for supervising the preparation of financial statements and also for detecting wrong contents in financial statements. This supervision helps the company to produce high-quality information. Mean value of audit committee is 3.04, which describes that three members of audit committee are already in correspond with the requirement of Financial Service Authority and also that audit committee is playing important role in company operational.

Liquidity is the capability of the company to fulfill short-term requirements on time. In this research, liquidity is measured by current ratio, which involves a comparison between current assets and current debts. Mean value of liquidity is 2.86604 or 286.60%, which signifies that liquidity is very high and the companies are capable to produce earnings and provide operational funds. Leverage is an instrument used to measure how far the company relies on creditors for financing the assets. Mean value of leverage is 0.75545 or 75.55%, which is included in high category. This position indicates that the composition of operational funding greatly relies on third party funding (creditors). Company Size is about whether the company is large or small. Mean value of company size is 0.10747 or 10.75%, which informs that assets level of the manufacturing companies is high.

Classical assumption test is aimed to ensure whether regression equation for estimation is already accurate, unbiased, and consistent. Classical assumption test involves few tests for knowing normality, multicollinearity, autocorrelation and heteroscedasticity.



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**Table 3:** Result of Classical Assumption Test

| Test | Result |
|---|---|
| Normality | The value of KS test with probability value of 0.200, residual data normally distributed. |
| Autocorrelation | The run test with probability 0.054 > 0.05, there is no autocorrelation. |
| Multicollinearity | All independent variables have tolerance value ≥ 0.10 and VIF value ≤ 10. Both value inform that there is no multicollinearity. |
| Heteroscedasticity | All independent variables do not have heteroscedasticity because each variable has significance value more than 0.05. |

**Hypothesis Test**

Hypothesis testing in this study using linear regression analysis. The results of hypothesis testing are presented in table 4, F-value is 3.283 with p-value of 0.004 < 0.05, which describes that regression model is fit. Therefore, further interpretation on regression model may proceed. The value of adjusted-R square is 0.061, which explains that the effect level of all independent variables on dependent variable is only 6.1% while the remaining of 93.9% is coming from other variables beyond research model.

**Table 4:** Hypothesis testing results

| Variable | Beta | t-value | p-value |
|---|---|---|---|
| Constant | -0.430 | | |
| IFRS Convergence | 0.116 | 0.221 | 0.825 |
| Accounting Disclosure | 0.599 | 0.938 | 0.349 |
| Audit Committee | 0.268 | 2.981 | 0.003* |
| Leverage | -0.022 | -2.002 | 0.047* |
| Liquidity | -0.003 | -0.308 | 0.758 |
| Company Size | -0.313 | -1.705 | 0.090 |

**IFRS Convergence and Earnings Quality**

IFRS convergence is defined as the adjustment of Statements of Financial Accounting Standards (PSAK), which is used in Indonesia, to international standards. The comparison of the qualities of financial statements across countries is done by using IFRS convergence. This arrangement is intended to improve the quality of earnings reported by the company. Mandatory disclosures required by IFRS can improve clarity and transparency of financial statements. Next, higher level of disclosure can decrease agency problem that is often caused by less transparent reporting. Interestingly, IFRS convergence does not affect earnings quality. Good quality accounting regulations cannot always result good quality accounting information. One among few reasons is low incentive for the preparer of financial statements. Other reason is that earnings quality is not only measured from the level of compliance with accounting standards but also from the process of preparing financial statements. Well prepared financial statements can produce better earnings quality. Therefore, earnings quality not only derives from compliance with IFRS convergence. This position is in line with previous studies, including Kusumaningwedari & Oktorina (2017), Kristanto et al. (2014), and Houqe et al. (2011), which the findings generally showed that IFRS convergence does not effect on quality of earnings. However, other studies did not support this position, such as Almaharmeh & Masa'deh (2018), Sutrisno & Djashan (2017), Syarif & Pasaribu (2015), and Ismail et al. (2013), which the findings generally revealed that IFRS convergence has effect on earnings quality.

**Accounting Disclosure and Earnings Quality**

Accounting disclosure is about standards and practices of disclosure affected by financial sources, legal system, political and economical bondings, economic development level, education level, culture and other effect. Accounting disclosure does not affect earnings quality. The relationship between accounting disclosure and earnings quality is not directly associated with high-quality accounting standards. The companies sometimes fail to produce high earnings quality in their financial statements because of lower financial performance. When the company is able to use accounting standards, then earnings quality is potentially higher. Many companies are considered by investors as failed to provide meaningful information in financial statements. One reason is that many investors do not yet understand the intricacies of the presentation of financial statements. Other reason is that financial statements must clearly show financial condition of the company. Therefore, the preparer will need actual data representing this financial condition.

Good company usually has well-managed financial reporting system. Without financial reporting, the company is difficult not only to analyze the financial condition of the company but also to understand what happens in the company. This position is supported by Suryanto (2016) who found that accounting disclosure cannot affect earnings quality. The refusal to this position comes from Febrina & Suaryana (2011) and Inggrid & Wardhani (2011), which the findings generally pointed out that accounting disclosure has effect on quality of earnings.

### Audit Committee and Earnings Quality

Audit committee is a committee created by commissioner board to help commissioner board to monitor preparation process of financial statements from the managing board in order to increase the credibility of financial reporting. Membership level of audit committee can affect its performance. High membership level in audit committee is associated with better performance. Well-performed audit committee gives assurance to stakeholders that company earnings quality is also good. The audit committee owned by the company is expected to minimize errors in making financial reporting, but it is also helpful for improving the quality of information in financial reporting. In other words, well-performed audit committee will improve the quality of earnings reported by the company. Good corporate governance can be achieved through activities such as creating audit committee in proper membership level, giving reasonable incentives and supervising managers. In this context, the existence of an audit committee in the company can improve the quality of the company's earnings. Larger membership level of audit committee produces stricter supervision on the company during the preparation of financial statements which then will lead to the better earnings quality. The contribution of agency theory in this context reminds any readers that any parties connected to the company shall reduce their self-interest and emphasize on self-control. Audit committee always spends greater attention to the internal control on the company to minimize fraudulent actions that may harm many stakeholders. When stakeholders successfully improve their self-control, then their well-built self-control helps the company to achieve company performance. The size or number of audit committee membership in the company can assure that earnings delivered by the company have greater quality because the supervision on the preparation of financial statements has been more effective. This position is consistent of previous research by Aryengki et al. (2016), Silfi (2016), and Suryanto (2016), which generally indicated that the existence of an audit committee in the company can improve the quality of the company's earnings. The existence of audit committee in corporate governance brings positive impact on the company because the supervision on managing board is better than before audit committee is created. However, the opposer to this position is shown by Reyhan et al. (2014) and Rachmawati & Triatmoko (2007) with their findings generally informing that audit committee cannot affect earnings quality.

### Leverage and Earnings Quality

Leverage is an instrument used to measure the reliance level of the company on creditors to finance corporate assets. High leverage ratio signifies that the company has used debts as capital structure for financing company operationals. If the company assets are not compatible to the liabilities incurred by the company, then this situation has put the company in difficult position. As the consequence, financial condition of the company will be disturbed which impacts on earnings produced by the company. Based on this statement, an increase in the value of the company's leverage will result in a decrease in the value of the company's earnings quality. Debt level of the company also affects earnings quality. High debt level can force the managing board to be more careful in reporting cash flow and earnings. Earnings quality may become lower when the managing board has been more fearful to report the actual condition. The company with high leverage level is in high obligation to fulfill the needs of creditors for high-quality information. Sometimes, additional information is needed to alleviate the doubt of shareholders as well as to ensure that the rights of shareholders as creditors are successfully met. This position is in correspond to the results of previous studies conducted by Warrad (2017), Septiyani et al. (2017), Silfi (2016), Ramadan (2015), Warianto & Rusiti (2014), and Sukmawati et al. (2014), which the findings generally pointed out that leverage has significant effect on earnings quality. But, those findings are opposed by studies carried out by Sadiah & Priyadi (2015), Dira & Astika (2014), and Wulansari (2013), which the findings generally indicated that leverage cannot affect earnings quality.



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### Liquidity and Earnings Quality

Liquidity is the capability of the company to pay its short-term debts with its current assets. In this context, liquidity is presumed as not having significant effect on earnings quality. Current assets usually comprise receivables and reserves that will be used to pay current liabilities. Every company may need different time schedule to manage the assets. This schedule can be in the long term because the company must firstly change receivables and reserves into cash form before using them to pay liabilities. This situation indicates that liquidity cannot ascertain whether the company has good or bad earnings quality. In other words, the high level of company liquidity is not able to improve the quality of earnings. This condition is not compatible with agency theory, which said that *principal*, or shareholders, will be benefited if the company has high liquidity. *Principal* always endeavors to avoid the risk borne by the company due to corporate incapacity to pay debts. When the company fails to pay the debts, financial condition of the company is deeply affected which then decreases earnings quality. This statement has been in conformity with the research by Sadiah & Priyadi (2015) and Dira & Astika (2014), which the findings generally revealed that the high level of company liquidity is not able to improve the quality of earnings. This position is in contrast to the results of studies carried out by Basuki (2018), Ananda & Ningsih (2016), Silfi (2016), Sukmawati et al. (2014), Warianto & Rusiti (2014), and Wulansari, (2013), which the findings generally indicated that liquidity has significant effect on company earnings quality.

### Company Size and Earnings Quality

Company size is a comparison used to ensure whether the company is large or small. Large companies usually have the convenience of obtaining greater funding,and have better financial performance so that they are able to generate higher quality profits than small companies. Most manufacturing companies have large size but investors show greater emphasis on general market of the company rather than total assets. Company size is classified into large, medium and small companies. The influence of the size of the company on the quality of earnings indicates that total assets of the company may affect market response to the company. When company size is large, market response to the company is high, and this situation is producing high earnings quality. When the size of the company is small, then market response to the company is low, which can lead to low earnings quality. These findings correspond to the results of research by Basuki (2018), Septiyani et al. (2017), and Sukmawati et al. (2014), which generally informed that company size does not have effect on earnings quality. This position is the opposite of the results of studies carried out by Ananda & Ningsih (2016), Sadiah & Priyadi (2015), Dira & Astika (2014), and Warianto & Rusiti (2014), which generally showed that the size of the company affects the quality of earnings.

## Conclusion

Audit committee and leverage affect earnings quality. The number of members of the audit committee of a company can be utilized by the company to improve earnings quality. Meanwhile, a decrease in the amount of company leverage can improve the quality of earnings. IFRS convergence, accounting disclosure, liquidity, and firm size have no effect on the quality of company earnings.

The limitation of this research includes: 1) too many data indicated as outlier and that must be removed by researcher, which signifies that data are quite varying and heterogenous; 2) too few information presented in financial statements, which makes researcher difficult to process data regarding accounting disclosure; and 3) the difficulty in identify accounting disclosure and IFRS convergence that may differ from other research. In accord with the conclusions and limitations, several suggestions are given, respectively: 1) this research shall extend research period and enhance sample scope to not only include manufacturing companies in order to obtain more data sample and lesser data variance; and 2) this research must ensure that variables containing many items, such as accounting disclosure and IFRS convergence, are already comparable across the companies before using those variables as research variables.

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