

# Managerial Ability and Monitoring Structure as a Mechanism for Improving the Quality of Earnings and the Value of the Firms Listed In Indonesia Stock Exchange

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**Abstract -** The objective of this research is to examine the role of managerial ability and monitoring structures as a mechanism to improve the earnings quality and the value of the firms listed in Indonesia's Stock Exchange locally called Bursa Efek Indonesia (BEI). The sample used in this study was particularly all non-financial companies listed in Indonesia's Stock Exchange. The sample was selected by purposive random sampling method. The number of sample collected was 178 companies. By using path analysis method, the results show that the managerial ability has positive and significant effect on the earnings quality and the value of the firm. Secondly, foreign ownership has no effect on the earnings quality, but it has a negative and significant effect on the value of the firm. Thirdly, the independent audit committee has a negative and significant effect on the earnings quality, but it has no effect on the value of the firm. Fourthly, the audit quality has a positive and significant effect on the earnings quality and the value of the firm. Fifthly, the earnings quality has no effect on the value of the firm. In addition, by using Sobel test, it was found that there was no mediating effects from the earnings quality in mediating the managerial ability and monitoring structures.

**Keywords:** Managerial Ability, Foreign Ownership, Independent Audit Committee, Audit Quality, Earnings Quality, Firm's Value

## I. INTRODUCTION

The stock price of a company can be considered as one indicator in judging the value of the company. The higher is the stock price of a company, the higher will be the value of a company, vice versa. One implication of this indicator is that a company will further lead to have a greater commitment to fulfill its social responsibilities. This study used the concept of value based on stakeholder theory based on a number of dimensions and performance of the company introduced by Harrison and Wicks (2013). Whilst the concept of value in this study refers to the concept of value of equity value advanced by Copeland, Koller and Murrin (1995).

This study was conducted to examine the ability of managers in creating value for the company. Agency theory considers that the management of the company as an agent for stakeholders to maximize the welfare of stakeholders. The management company should have more information about the company's capacity and the overall working environment. For this reason, it is necessary to have a manager who has the ability to manage and design the business processes efficient and is able to make decisions that maximize profits and the value of the company (Libby and Luft, 1993).

This study discusses the concept of supervision in two forms. The first is the surveillance aspect that covers the monitoring activity of the company through equity or ownership mechanism, where shareholders directly contribute to the process control in the form of shareholding companies. In this study, a form of control through the mechanism was particularly in the form of equity ownership by foreigners, whether individuals, legal entities, government and other status abroad (Dan Thi Duc, 2013). The second is in terms of the supervision aspects that cover monitoring activities in the internal and external environment of companies conducted by the high quality of independent audit committee and external auditors in the accounting process and the examination of annual financial statements.

Duc and Thi (2013) states that foreign owners help companies to reduce agency problems and able to increase the value of the company. Foreign ownership becomes valuable when foreign owners play a good role in monitoring the shareholders. Companies that establish an independent audit committee will be able to report profits with less discretionary accruals than companies that do not have an independent audit committee (Klein, 2002; Baxter and Cotter, 2009).

An independent financial audit is a monitoring device that aims to balance the asymmetry of information between managers and companies' stakeholders companies (Herrbach, 2001). Teoh and Wong (1993) also showed that the big Public Accounting Firm (KAP) has great credibility so that the audit results produced tend to be stronger in response to increase the earnings and stock price.

This study focuses on the quality of earnings suggested by Penman (2001) in Abdelghany (2005) who defined that a sustainable earning is the quality of earning of a company. This is due to the fact that sustainable profit is essential as investors focused on future earnings greater relative profits now. Sustainable profit can be said to be qualified as it reflects the company's ability to improve its operating activities to increase revenues in the future.

## II. LITERATURE REVIEW

There have been many studies advanced in the literature in this context. Aier et al., (2005), for example, found a negative relationship between the restatement to the financial expertise of CFO. Specifically, they explained that companies that have a CFO with more work experience as CFO, MBA or CPA were significantly less likely to declare the restatement of earnings. Francis et al., (2008) considered the human dimension of managerial resources is important in explaining the quality of earnings. By using the concept of agency proposed by Fama (1980), it was found that the more famous CEOs tend to have poor earnings quality. These findings are not consistent with the view "efficient contracts" observed by Fama (1980) that the famous CEO will take actions that generate quality earnings.

Furthermore, Demerjian et al., (2012; 2013) proposed a measure of managerial ability based on the efficiency of managers in generating revenue. Managers who are better in understanding the trends of technology and industry are reliable to predict the demand of product as well as able to create higher investment, and can manage their employees more efficient. Demerjian et al., (2013) found that these managers are able to report higher quality earnings and reached the higher value of company. In other words, managers who have a higher quality associated with higher earnings quality. These findings are consistent with the premise that the more capable managers will have a better ability to make an estimate of the accrual, and this shows that companies can increase their corporate value by using managers with higher capabilities.

Douma et al. (2006) highlights the fact that the impact of foreign institutional investors have a positive and significant impact on the performance of the company. In fact, Díaz-Díaz et al., (2008) showed that up to a certain level, foreign ownership will improve innovation performance. This is because foreign shareholders have control over decisions that enable their companies determined the strategic innovation for the company. In addition, Gurbuz and Aybars (2010) showed that foreign ownership will improve the profitability of minority better than domestic ownership. Foreign ownership will enhance the company's financial performance to a certain degree. Wu et al., (2012) and Hyang et al., (2012) showed that foreign ownership and foreign directors showed a better expertise and independent monitoring management. However, Duc and Thi (2013) shows the negative impact of foreign ownership on corporate performance, while the positive impact of foreign ownership on the leverage.

Wild (1996) and Klein (2002) described the positive and significant correlation between the formation of audit committees and the quality of accounting earnings and there is a negative relationship between the independence of audit committees with abnormal accruals. Unlike, Lin et al., (2006) who found that there is a negative and significant relationship between the independence of the audit committee as measured by the percentage of independent directors in the audit committee with the restatement of earnings. Chan and Li (2008) explain that the trend of an increasing number of independent directors continue to grow over the last 20 years, but the definition of "independent" is still much varied. Nevertheless, the independence of the audit committee will increase the value of the company when the board of directors comprising a majority of independent directors.

According to Baxter and Cotter (2009), the establishment of an audit committee reduces earnings management intentionally, but not mistakes on accrual estimation. Pucheta-Martínez and García-Meca (2014) showed that, compared with independent outsiders, institutional director may be more effective in overseeing management because they may have more specific knowledge about the company. In addition, institutional directors have a relatively close relationship with top management, so that they also can reduce the conflict between the board and top management.

Becker et. al. (1998) found that clients of the non-Big Six auditors reported discretionary accruals that increase income relatively more than the discretionary accruals reported by the auditor Big Six clients. Contrary to this, Caneghem (2004) found that inconsistent findings that turns auditor Big Five and non-Big Five not inhibit the practice of earnings management. Other findings also explain that when using alternative proxy for audit quality (which is based on industry expertise auditor), the auditor of Big Five only have a weak relationship with earnings management. Piot and Fetus (2007) also stated that there is no difference in quality between the audit public accounting firm with the big five accounting profit. Francis and Yu (2009) apparently showed that the larger the auditor's office will provide a higher quality audits. In particular, larger offices are more likely to issue a going concern audit report and clients in offices bigger proved to be less aggressive in earnings management behavior.

Gaio and Raposo (2011) show that companies with higher earnings quality will be rated higher in the stock market. Earnings quality is very valuable for companies who need access to capital markets to raise funds. Qian et al., (2012) showed that poor earnings

quality has a negative impact on the value of the company's cash holdings and positive impact on the level of cash reserves. The negative effects of poor earnings quality will neutralize or balance the positive effects of excess cash to the value of the company.

### The Theory of Agency

According to Jensen and Meckling (1976), agency theory based contractual relationship among members in the company, where the principal and agent as the main actors. Principals are the ones that give a mandate to the agent to act on behalf of the principal, while the agent is a party which was given the mandate by the principal to run the company. Thus, the employment contract between principal and agent is an employment contract that explains what should be done manager in running the management of invested funds and profit sharing mechanisms in the form of profits, returns and risks that have been approved by both parties.

Agency theory assumes that each individual is motivated by self-interest that can lead to conflict between principal and agent. Principal party to a contract for the welfare motivated himself with ever-increasing profitability, while the agents are motivated to maximize the economic needs and psychology.

### The Theory of Stakeholders

Stakeholders are groups or individuals who can affect or are affected by the activities of the company to achieve its goals (Freeman, 1984). According to Fontaine et al., (2006), the main group of stakeholders consisting of customers, employees, local communities, suppliers and distributors, and shareholders. Other groups of stakeholder include the media, the general public, business partners, generations to come, the generations (the founder of an organization), academics, competitors, private organizations or activists, and other representatives of stakeholders which can be either the union or trade association, shareholders (creditors and bondholders), governments, regulators and policy makers.

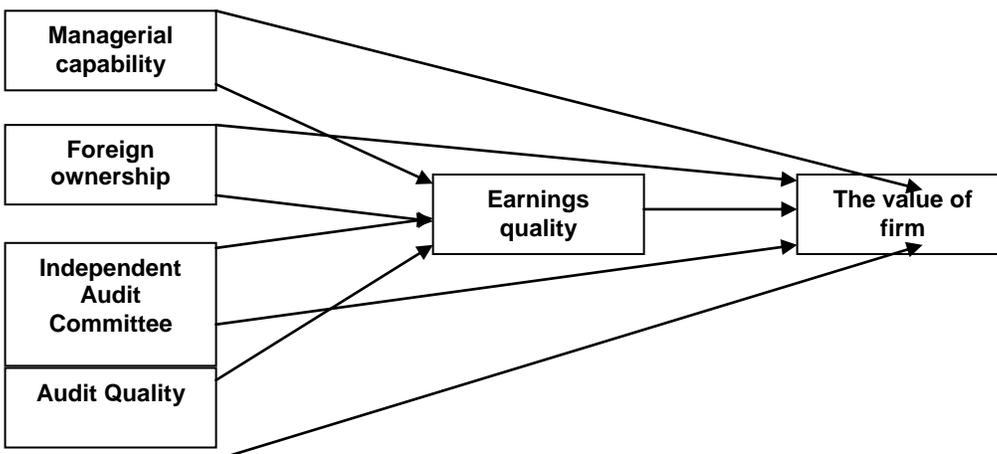
Stakeholder theory focuses on the relationship between organizations with their stakeholders. To maintain and regulate this relationship, it is important to do stakeholder management in that the managers must develop and implement processes that satisfy all or only groups with an interest in an organization (Zsolnai, 2006).

Stakeholder theory emphasizes the importance of a managerial perspective, because managers tend to focus on the things that lead to higher performance based on what is actually measured (Kaplan and Norton, 1992; Sachs and Riihli 2011 in Harrison and Wicks, 2013). In addition to focusing on economic performance, stakeholders measure the broader value of the company at the company.

## III. THEORETICAL FRAMEWORK AND HYPOTHESES

The relationship between variables in this study are based on two main theories, namely the theory of agency and the theory of stakeholders as well as previous studies, and rationalization in order to establish a theoretical model of the framework. Picture 1 exhibits the theoretical Framework of the effect of Managerial Capabilities on the Quality of Earnings and the Value of the firms

Picture 1. The theoretical Framework of the effect of Managerial Capabilities on the Quality of Earnings and the Value of the firms



## **Hypothesis**

### **Managerial Ability, Quality And Value Company Earnings**

The ability of managers to manage the company expected to form judgments and estimates are accurate because more managers know the state of the company, as well as more able to synthesize the information that is reliable to estimate the future that can be used to report higher earnings quality (Libby and Luft 1993). Demerjian et al., (2013) examined the effect of managerial ability of the quality of earnings. Managerial skills mentioned in the study is the managerial capacity in the areas of finance, i.e how efficiently a company in the financial sector relative to other companies in the same industry. The level of relative efficiency of a company is described as a result of the ability of a manager. The study found a positive relationship between managerial ability and the quality of earnings. In other words, the better the ability of a manager in the financial sector, the profit generated will be more qualified.

Further, Bertrand and Schoar (2003) found that the manager has an effect on the choice of the company such as acquisitions or research and development expenses, while Aier et al., (2005) showed that CFOs who have expertise in the field of accounting will do restatement less. This would make a profit stated in the financial statements give a true picture of the company's operations. While Francis et al., (2008) found a strong negative relationship between CEO reputation with the quality of earnings. The better the reputation of the CEO, the profit generated will increasingly not qualified. Based on this brief description above, it was formulated the following hypotheses:

H1: managerial capabilities have a direct influence on the quality of earnings

H2: managerial capabilities have a direct influence on value company

### **Foreign Ownership, Quality And Value Company Earnings**

Jensen and Meckling (1976) asserted that in order to address the agency problem can be made by aligning the ownership structure. In various studies, the ownership structure emerged as an important factor affecting the performance of the company. However, empirical evidence shows mixed results (see, Morck et al., 1988; Margaritis and Psillaki 2010 in and Thi Duc, 2013).

Foreign ownership has plays an important role in the economies of developing countries due to a sharp increase in foreign investment. Duc and Thi (2013) also found foreign owners help companies reduce agency problems and can increase the value of the company. Foreign ownership becomes valuable when foreign owners is the part of the monitoring shareholder because it can function better oversight. Thus, foreign ownership has a strong influence on the quality of corporate profits.

Moreover, Hyang et al., (2012) also confirm that foreign ownership and foreign directors will provide independent monitoring of the management. Management control over foreign investors have relationships with the increase in the value of the company. In line with the above, Alipour (2013) also states that the concentration of ownership is positively related to the ROE. Similarly, Klein et al., (2005) in Pathak et al., (2012) argued that the presence of dispersed ownership will increase expectations of a positive relationship between the size of corporate governance and company performance. Based on this brief description, it is hypothesized as follows.

H3: foreign ownership has a direct influence on the quality of earnings

H4: foreign ownership has a direct influence on the value of the company

### **Independent Audit Committee, Quality And Value Company Earnings**

A good monitoring process will reduce the discretion of accrual and ultimately improve the accuracy of financial statements and then increase confidence in the financial statements (Gaver and Paterson, 2001). Klein (2002) states that the company established an independent audit committee reported profits containing smaller discretionary accruals compared to companies that do not form an independent audit committee.

Carcello and Neal (2003); Felo, Krishnamurthy and SOLIERI (2003) in Chan and Li (2008) found a positive relationship between audit committee independence and quality of financial reporting. The existence of an independent audit committee is essential for the management of the company, especially in maintaining the credibility of the financial statements as well as monitor

the actions of managers. With the monitoring of the performance of the company will increase and will ultimately increase the value of the company.

Piot and Fetus (2007) found a decrease in the normal accrual when an audit committee exists, but the independence of the audit committee does not significantly influence the measurement of the accrual. The results also explain that the audit committee to act as the improved quality of audits within the company but the rules of independence and audit committee assignments in the future must be clearly defined. This brief description lead to the following hypotheses:

H5: an independent audit committee has a direct influence on the quality of earnings

H6: an independent audit committee has a direct influence on value company

### **Quality Audit, Quality and the Value of Earnings**

Becker et al., (1998) showed that a large audit firm will provide a better audit quality. This is based on the consideration that a large audit firm has a team working with the knowledge and technology that is better than the small audit firms. Becker et al., (1998) states that the accrual discretionary will tend to decrease when the auditor comes from large audit firms. Thus, earnings quality will be better because of the financial reporting process complies with the standards that should be applied.

The findings above were confirmed by Herrbach (2001) in that the financial audit by an independent auditor is monitoring tools that aim to balance the asymmetry of information between managers and stakeholders of the company. Nevertheless, it is important to recognize that the audit report is only valuable for users of financial statements if the quality of audits performed really well. Large public accounting firm providing audit services which tend to have a higher quality than the small public accounting firm.

Similarly, Francis and Yu (2009) also states that the auditor larger office will provide higher quality audit. This is because a large auditor's office also has the potential to produce a higher quality audit because they have a larger internal training, networking opportunities and wider. Based on the brief description above, formulated the following hypotheses:

H7: audit quality has a direct influence on the quality of earnings

H8: audit quality has a direct impact on the value of the company

### **Company Earnings Quality and The Value**

The company's main purpose is to increase the company's value. Agency conflict that resulted in the management of opportunistic properties may result in lower earnings quality. The low quality of earnings will result in decisions that one of the users, such as investors and creditors, so that the value of the company will be reduced. Gaio and Raposo (2011) indicates that there is a positive correlation between the quality of earnings and corporate value. This is consistent with the idea that the quality of earnings is very valuable for companies who need access to capital markets to raise funds. While Qian et al., (2012) reported poor earnings quality will worsen asymmetry between the company's internal information with external stakeholders the company resulting decline in the value of the company in the eyes of investors. Based on the brief description above, formulated the following hypotheses:

H9: earnings quality has a direct influence on the value of the company

## **IV. RESEARCH METHODS**

The population in this study are 312 non-financial companies listed in the Indonesian Stock Exchange from 2010 - 2014. This is in line with Pucheta-Martínez and García-Meca (2014) as well as Gaio and Raposo (2011), which focuses on non-financial companies with due consideration to general financial companies are under special supervision of a government authority of the financial sector which limits the company's accounting practices. The sample in this study was determined by using purposive sampling method based on certain criteria. Under the terms of sampling, companies are eligible to be used as samples in this study only 178 companies from years 2010-2014.

In terms of the operational definitions, managerial ability is defined as the ability of the management company that can form accurate judgments and estimates with respect to the company's efficiency, reliable and synthesize information to estimate the future. Measurement variables managerial capacity refers to the study Demerjian et al (2012; 2013) as follows:

$$\text{Firm Efficiency} = \alpha + \beta_1 \ln(\text{Total Assets}) + \beta_2 \text{Market Share} + \beta_3 \text{Free Cash Flow} + \beta_4 \text{In (age)} + \beta_5 \text{Business Segment Concentration} + \beta_6 \text{Foreign Currency Indicator} + \epsilon_i$$

Where :

Total Asset = value of total assets of the company at the end of the fiscal year

Market Share = net profit margin, i.e the percentage of profit on sales

Free Cash Flow Indicator = 1 if the company does not have the value of free cash flow negative and 0 if the company has a value of negative free cash flow

Firm Age = length of companies listed on the stock exchange

Business Segment Concentration = ratio between sales segment with total sales

Foreign Currency Indicator = 1 if the company does not have the foreign currency adjustments at the end of the year and 0 if the company has foreign currency adjustments at the end of the year.

While the Firm Efficiency by Demerjian et al., (2012) will be calculated by the following formula:

$$\text{Max}\theta = \frac{\text{Sales}}{\text{COGS} + \text{SG \& A} + \text{PPE} + \text{Ops Lease} + \text{R \& D} + \text{Goodwill} + \text{Other Intan}}$$

The total efficiency of the company is estimated using an output that is sales revenue and seven input (COGS, SG & A, PPE, Ops Lease, R & D, Goodwill and Other Intan). Total sales revenue is output with consideration of the company's main goal is to generate sales. The most successful companies are those that generate maximum sales at the lowest cost.

Where :

Sales: the total amount of sales

GoGs: the total amount of goods sold

SG & A: the total amount of selling expenses and administration

PPE: the net amount of property, plant and equipment

OpsLease: net operating leasing

R & D: the amount of research and development costs

Goodwill: the amount of goodwill

Other Intan: the amount of other intangible assets

In terms of foreign ownership, this is defined as a proportion of the company's shares are owned by individuals, legal entities, government, as well as the status of its parts abroad (Dan Thi Duc, 2013). The mathematical formula is :

$$\text{Foreign Ownership} = \frac{\text{Shares owned by foreigners}}{\text{Number of shares outstanding}}$$

The estimation of independent audit committee is defined as a committee which monitors the financial reporting process by management to improve the credibility of financial statements. The audit committee is responsible for overseeing the financial reports, overseeing the external audit, and observe the internal control system including the internal audit (Bhutta and Shah, 2014). This can be formulated as:

$$\text{Independent Audit Committee} = \frac{\text{The number of independent audit committee}}{\text{Total number of audit committee}}$$

In terms of quality audit, this study is based on the audit by the public accounting firm (KAP) Big 4 and non-big 4. These measurements will be regressing frequency auditor issued a modified audit opinion on audit quality (Hanwen, 2011) were measured by using logistic regression as follows :

$$\text{MAOit Audit} = \phi_0 + \phi_1 \text{AUDit} + \phi_2 \text{SIZEit} + \phi_3 \text{LEVit} + \phi_4 \text{SIZEit} + \phi_5 \text{INVit} + \phi_6 \text{RECit} + \phi_7 \text{BMit} + \phi_7 \text{ST /PTit} + \phi_8 \text{ROAit} + \phi_9 \text{SOEit} + \phi_{10} \text{OWNERit} + \phi_{11} \text{INDIRit}$$

Where :

MAO = 1 if the company receives a modified opinion and zero otherwise

AUD = 1 if the firm is audited by the big four and zero otherwise

SIZE = the size of the company in the form Ln of total assets  
 LEV = leverage (total debt / total assets)  
 INV = inventory divided by total assets  
 REC = receivables divided by total assets  
 BM = book-to-market ratio (the book value of equity / equity market value)  
 ST / PT = 1 if the company loses two consecutive years and 0 if not  
 ROA = return on assets (profit before taxes / total assets)  
 SOE = government ownership  
 OWNER = presentation monitoring stake  
 INDR = percentage of independent directors to total board

The Quality of earnings in this study refers to the definition made by Penman, 2001 in Abdelghany (2005) where a quality earnings are profits that can reflect the sustainable of earnings in the future. The smaller the ratio between CFO (cash flow from operations) and net income gives an overview profit more qualified. This small ratio indicates more efficient use of cash resources to generate profits provide an overview of company performance better.

$$\text{Quality of Income Ratio} = \frac{\text{Cash Flow From Operations (CFO) (i, t)}}{\text{Net Operating Income (i, t)}}$$

For the value of the company was defined as the ratio of market value to the replacement value of the assets of the company. A higher value greater than one indicates that the company has a good value. The company's value is measured using Tobin's Q in accordance with the study Gaio And Raposo (2011) can be calculated using the following formula:

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

Where :

Q it = the value of the company  
 BVA = book value of total assets  
 MVE = closing market price x number of shares of common stock outstanding  
 BVE = book value of equity

The estimation method used in this context is by using the path analysis with the help of software AMOS (Analysis of Moment Structure).

## V. RESULTS AND DISCUSSION

As mentioned that the population used in this study are all non-financial companies listed on the Indonesian Stock Exchange (BEI) in succession from 2010 to 2014 consisting of 312 companies. However, of this population, the company selected by random sampling method was 178 companies with 890 samples observation. This sample has gone through the process of testing under various assumptions conformance test model (Goodness-of-Fit Model).

Testing was conducted at the time of surgery AMOS runs. There are two tests for normality, the normality of uni-variate and multivariate normality. A data distribution can be considered normal if the value skewness CR or CR kurtosis value is smaller than the critical value table + 1.96 with a 0.05 significance level (p-value 5%). See Table 1 below for the result of univariate and multivariate normality test with AMOS program.

**Table 1**  
**Normality Test Results**

Variable	min	Max	skew	c.r.	kurtosis	c.r.
Managerial ability	0,686	1,059	-0,099	-1,026	0,630	3,274
Foreign ownership	0,000	0,991	0,960	9,985	-0,240	-1,246
Audit Independent Committee	0,000	0,667	0,147	1,530	2,494	12,967
Audit quality	0,000	1,000	0,465	4,837	-1,784	-9,275
Earning Quality	-3,276	4,335	-0,178	-1,856	1,817	9,450

Firm's value	0,172	4,044	1,226	12,747	1,245	6,474
Multivariate					-0,075	-0,098

Source : based on authors calculation (2015)

From Table 1, it can be seen by using Univariate analysis, it can be noted that there are variables that have value CR skewness and kurtosis that are greater than the critical value tables + 1.96. This can be concluded that the distribution of univariate data is not normal at the level of 0.05 significance level (p-value 5%). However, if the test was analyzed by multivariate, note that CR kurtosis of -0.098 is smaller than the critical value tables + 1.96. It can be concluded in multivariate data distribution is normal.

Kline (2011: 60) argues that if the multivariate test result a normal distribution, then the univariate test can be considered normal too. While testing all univariate variables which are non-normal cannot guarantee that multivariate testing is also non-normal. Thus, it can be concluded that the data in this study are normally distributed, as the distribution of multivariate variables are normal. Hence, the assumption of normality in this study have been met.

After testing the suitability of the model (Goodness-of-Fit Model) above, the study then conducted testing against the hypothesis by using a regression model in path analysis to predict the relationship between exogenous and endogenous variables. Based on the results of the analysis of pathways, it was found the standardized path coefficient structural equation this study, as shown in Table 2.

Table 2  
 Estimates of The Standardized path coefficient of structural equation

Variable	Estimate Coeff.	S.E	P	Description
Managerial ability on Earning quality	0,147	0,702	***	Significant
Foreign ownership on the quality of earnings	0,044	0,141	0,248	In significant
Independent audit committee on the quality of earnings	-0,155	0,343	***	Significant
Audit Quality on Earnings quality	0,098	0,083	0,010	Significant
Managerial ability on the firms' value	0,086	0,447	0,020	Significant
Foreign ownership on firms' value	-0,099	0,089	0,007	Significant
Independent audit committee on firms' value	-0,030	0,219	0,413	Insignificant
Audit quality on firms' value	0,338	0,053	***	Significant
Earning quality on firms' value	-0,032	0,025	0,397	Insignificant

Source : calculated by the authors (2015)

### Estimate of the Effects of Mediating variable using Sobel Test

To test the effect of indirect or mediating role of the quality of earnings in relation to the managerial ability of the company's value, the Sobel test is used. The results found that there is no mediating role of the variable quality of earnings in mediating the relationship managerial capabilities to the company's value (see Table 3).

Table 3  
 Estimation of the effect of mediating variable using Sobel Test

Variables	Estimate value	Standard Error	p value of Sobel Test
Effects of managerial ability → Firms value via earning quality	2,711 ; -0,021	0,702 ; 0,025	0,41175606
Effects of foreign ownership ---> Firms' value via earnings quality	0,163 ; -0,021	0,141 ; 0,025	0,49679110
Effects of independent audit committee ---> Firms' value via earnings quality	-1,390 ; -0,021	0,343 ; 0,025	0,41078327

Effects of audit quality ---> Firms' value via Earnings quality	0,215 ; -0,021	0,083 ; 0,025	0,42426851
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Source : Author Estimation (2015)

Based on calculations using Sobel test as shown at Table 3, it can be explained that the indirect effect of managerial ability on the value of the company has a p-value (two-tailed probability) of Sobel test amounted to  $0.411 > 0.05$  alpha. The indirect effect of foreign ownership of the value of the company has a p-value (two-tailed probability) Sobel test amounted to  $0.496 > 0.05$  alpha. The indirect effect of the independent audit committee on the value of the company has a p-value (two-tailed probability) Sobel test amounted to  $0.424 > 0.05$  alpha. The indirect effect of the quality of audits on the company's value has a p-value (two-tailed probability) Sobel test amounted to  $0.410 > 0.05$  alpha. These findings suggest that the variable of the quality of earnings in this study is the type No. Mediation. In other words, the variable of the quality of earnings fail to function as an intervening variable that mediates the effect of managerial capability, foreign ownership, independent audit committees and audit quality on firm value.

**Hypothesis testing**

Hypothesis testing is done by comparing the p-value with a significance level (alpha) of 0.05. If the p-value  $< \alpha 0.05$  then H0 is rejected and H1 accepted. Conversely, if the p-value  $> 0.05$  alpha, H0 is accepted and H1 rejected. The results of path coefficient analysis and Sobel testing are shown at Table 4.

Table4

Results of Hypotheses Testing	
Variable	Results of Hypothesis test
H1: Effects of managerial ability on the quality of earnings	Accepted
H2: Effects of managerial ability on firms' value	Accepted
H3: Effects of foreign ownership on earnings quality	Rejected
H4: Effects of Foreign ownership on the firms' value	Accepted
H5: Effects of independent audit committee on the earning quality	Accepted
H6: Effects of independent audit committee on forms' value	Rejected
H7: Effects of audit quality on earnings quality	Accepted
H8: Effects of audit quality on firms' value	Accepted
H9: Effects of earning quality on firms' value	Rejected

Source: Authors' Estimation (2015)

**Effects of Managerial Abilities on the Quality of Earnings**

As shown at Table 4, the results of testing the hypothesis 1 (H1) indicates that the managerial ability has a positive and significant direct effect on the quality of earnings. The results are consistent with the Libby and Luft (1993) and Demerjian et al., (2013) who found that managerial ability will improve the quality of earnings. This indicates that the better the ability of a manager in the financial sector, the profit generated more qualified. Managerial skills possessed by managers include knowledge and experience of the company's activities. The experience and knowledge generally includes work processes of managers in solving the problem and find ways to increase revenue in the future by using the lowest input. In addition, each manager needs to undertake an evaluation of each of the selected alternative in managing the company input for each effort can provide cash inflows in the future for the company.

The results are also consistent with the concept of agency proposed by Fama (1980), where the need for "efficient contracts" between management and shareholders. According to Fama (1980), the control of large companies can be efficient in the form of economic organization. In a modern company, Fama (1980) stated that there are two functions which are usually connected between employers-management, i.e. the risk that exists naturally and "contract" called the company. Increased competition, making the company should evolve over the device in the organization in order to efficiently monitor the performance of the entire company.

**Effects of Managerial Ability on Firm's Value**

In terms of the effect of managerial ability on the firm's value, the study found that managerial ability has a positive and significant impact on the value of the company. The results are consistent with Bertrand and Schoar (2003) who found that managers

who have better skills in decision making and financial investment will have a permanent effect on corporate governance. While Aier et al., (2005) found that companies that have a CFO with more work experience as CFO, MBA or CPA significantly less likely to declare the restatement of earnings (restatement). Thus, the market confidence in the company is not reduced.

Management as the part of the firm that runs the company's activities need to safeguard the interests of its stakeholders. To maintain and regulate the relationship between management and stakeholders, it takes stakeholder management, where managers with the knowledge, experience and ability to be able to formulate and implement business processes that satisfy all interest groups within an organization. The process that should be undertaken by the manager was in the form of decision-making and business strategy to boost confidence in the company's global market. Each activity carried out by managers should be measured, recorded and reported in the annual financial statements as a form of management accountability to its stakeholders.

The findings are consistent with Freeman (2004), which states that managers and other workers together have an employment contract. However, managers with the knowledge, experience and ability have an obligation to safeguard the welfare of the company by making decisions and business strategies that can benefit the stakeholders. Managers must constantly seek to improve its ability to use any insight and information to create better corporate value. In essence, the perspective of the stakeholders is to create a higher level of prosperity for the stakeholders (stakeholders) in the broad sense.

### **Effects of Foreign Ownership on the Quality of Earnings**

Foreign ownership has no effect on the quality of earnings. Results of this study are inconsistent with Douma et al., (2006), Díaz-Díaz et al., (2008), Gurbuz and Aybars (2010) and Wu et al., (2012) who found that foreign ownership can improve performance and quality of corporate profits. This finding was also inconsistent with the statement Gurbuz and Aybars (2010) which show that foreign ownership minorities have better performance than ownership of the majority of domestic and foreign ownership. Gurbuz and Aybars (2010) show that foreign ownership is worse than the majority domestic ownership. But the results of this study are consistent with the Duc and Thi (2013) study conducted in Vietnam who found that the negative impact of foreign ownership on company performance. This result suggests that the role of foreign ownership controls do not work in companies listed Indonesian Stock Exchange.

In the perspective of Agency Theory, and Thi Duc (2013) explains that foreign ownership can replace debt and help companies perform better control by reducing agency cost of equity by the supervisory manager. However, this can only happen when the foreign shareholders can create an efficient mechanism of control in the company. Thus, foreign ownership in this study had no effect on the quality of corporate profits do not indicate the concentration of foreign ownership, so that the control process cannot function properly.

### **Effects of Foreign Ownership on Corporate Value**

The value of the company shows that foreign ownership has negative direct and significant effect on firm value. The results are inconsistent with Chibber and Majumdar (1999), Djankov and Hoekman (2000), Dhar (1988) in Douma et al., (2006) and Hyang et al., (2012) who found that the management control through foreign investors and board membership tends to reduce the increase in leverage when foreign directors representing the private interests of foreign shareholders. The influence of moderate due to the concentration of foreign ownership has a relationship with the increase in the value of the company.

The results are inconsistent with the stakeholder theory which states that the company's performance should tend to increase when there is a good control in the company. Conglomeration of ownership associated with the family to make a right control of the company in full accordance with the interests of their group. Unfair treatment makes the company does not have the ability to create value together on a number of dimensions for the welfare of all stakeholders at large.

### **Effects of Independent Audit Committee on the Quality of Earnings**

For the Hypothesis 5 (H5), the study showed that independent audit committees have a negative and significant direct effect on the quality of earnings. The results are consistent with the Wild (1996), Pucheta-Martínez and García-Meca (2014) who found a positive and significant relationship between the formation of audit committees and the quality of accounting earnings. Baxter and Cotter (2009) states that the audit committee be composed of independent individuals who do not involved in the day-to-day tasks of management to manage the company and have the experience to carry out the oversight function effectively. One of the main reasons for this independence is to maintain the integrity and objective view in the report, as well as the preparation of recommendations made by the audit committee, as an independent individual tends to be fair and impartial and objective in handling a problem. This indicates that the greater number of independent audit committees will lead to less quality of earnings. However, the existence of an audit committee will hinder the fraud made in the company.

### **Effects of Independent Audit Committee on Corporate Value**

Results of testing the hypothesis 6 (H6) with respect to the value of the company shows that the independent audit committee has no effect on firm value. Results of this study are inconsistent with Chan and Li (2008) who showed that the independence of the audit committee will increase the value of the company when the board of directors comprising a majority of independent directors.

Although the trend of an increasing number of independent audit committees continue to grow over the last 20 years, but the definition of "independent" is still much varied. When companies controlled by families and groups, the independence of the audit committee would be very questionable. Besides the Independent Audit Committee generally consists of individuals who have the duty and other work outside the company and only meet regularly without seeing and directly involved in the activities of the company.

### **Effects of Audit Quality on the Quality of Earnings**

The quality of audit has a positive and significant direct effect on the quality of earnings. The results are consistent with Becker et al., (1998), Francis and Yu (2009) who found that the Big Six auditor has a higher quality audit of the non-Big Six auditor. Large audit firms generally provide audit with higher quality with a higher level of independence compared to small audit firms. This stems from the fact that the major audit firms are less dependent on their clients due to the fact that they have more clients that tend not to be under the pressure of clients and are able to report their audit findings better. The findings are also consistent with DeFond and Jiambalvo (1993) which confirms that the conflict between the auditor-client generally associated with the practice increased revenue and if the external auditor is the public accounting firm of the world, the audit firm is more likely to resist the pressure of managerial and defend his opinion that independent.

### **Effects of the Audit Quality on the Corporate Value**

Also, the study found that quality of audit has a positive and significant direct effect on firm value. This finding is consistent with Francis and Yu (2009) which shows that the larger the auditor's office will provide a higher quality audits. In particular, the larger the firm is more likely to issue a going concern audit report and clients on larger KAP proved to be less aggressive in earnings management behavior so that information reported earnings depict the actual condition of the company.

In the perspective of stakeholder theory, Freeman (1984) and Zsolnai (2006) focuses on the relationship between organizations with their stakeholders. To maintain and regulate the relationship needs to be a process of external scrutiny of the processes within the organization that can bring increased confidence of stakeholders of the organization. Audit process conducted by a large KAP will provide positive expectations to the market that the company has been assessed as appropriate. The market will give a positive reaction in the form of rising stock prices that resulted in increased market value of the company's equity. Thus, the value of the company will be better in the future.

### **Effects of the Earnings Quality on the Corporate Values**

The earnings quality has no effect on firm value. This findings was inconsistent with Sloan (1996), Feng (2011), Gaio and Raposo (2011) who found that companies experiencing an increase in reported income and innovation management to make earnings reported to have high quality, and hence the level of investment in the company will increase. This indicates that the profits from the company tend to be unqualified so it is unable to increase the value of equity of the company. This finding is also consistent with Qian et al., (2012) which states that poor earnings quality will worsen asymmetry between the company's internal information with external stakeholders that resulting the decline in the value of the company in the eyes of investors. Most companies in Indonesia evolved from family ownership, in which the monitoring shareholder is the group of individuals, families and groups of family members. Party who monitoring shareholder have full control of all the information in connection with the company. So that the asymmetry of information that occurs between the agent and the principal in the perspective of agency theory introduced by Jensen and Meckling (1976) has been transformed into the asymmetry of information between the monitoring interest (monitoring shareholder) to the non-monitoring interest (non-monitoring shareholders).

### **Role of Mediating variables in affecting the Earnings Quality on the Firm's Value**

In terms of the role of the mediating factor, the study found that there was no role of mediating variables earnings quality that connects the exogenous variables in this case the managerial capability, foreign ownership, independent audit committees and audit quality by endogenous variables in this case the value of the company. Quality of earnings in this study failed to be a mediating variable. This indicates that investors in the Indonesian market tend to not pay attention to the process of resource usage activity on the company in generating profits. Investors believe more information on the external market in making investment decisions. On the other hand, there are problems associated with investor protection. This problem makes the investor will rely on short-term investment gains rather than on long-term investment. As a result, sustainable profits are not taken into consideration in making investment decisions.

## VI. CONCLUDING REMARKS

This study aimed to examine the direct and indirect effects of managerial ability and control structures in this case foreign ownership, independent audit committees and audit quality on the quality of earnings and corporate value. The study found that (1) managerial ability has a positive and significant direct effect on the quality of earnings; (2) managerial ability has a positive and significant direct effect on firm value; (3) Foreign ownership has no effect on the quality of earnings; (4) Foreign ownership has a direct, negative and significant effect on firm value; (5) an independent audit committee has a direct, negative and significant effect on the quality of earnings. (6) the independent audit committee has no effect on firm value; (7) Quality audits have a positive and significant direct effect on the quality of earnings; (8) Quality audits have a positive and significant direct effect on firm value; (9) The quality of earnings has no effect on firm value; Finally, the results of this study found that there was no role of mediating variables earnings quality that connects the exogenous variables in this case the managerial capability, foreign ownership, independent audit committees and audit quality by endogenous variables in this case the value of the company.

The theoretical implications of this study strengthen the agency theory proposed by Jensen and Meckling (1976), Fama (1980), Eisenhardt (1989), which explains that the need for "efficient contracts" between management and shareholders. The results are also consistent with the concept of stakeholder theory put forward by Freeman (1984), Clarkson (1995), Donaldson and Preston (1995), Freeman (2004), Fointaine et al., (2006), Zsolnai (2006) and Harrison and Wicks (2013), which asserts that the value creation process for companies is generally reflected in the management of the company's operational activities. The practical implications of this research are expected to give due consideration to the company in order to maintain the continuity of their business by using resources efficiently and effectively for the welfare of broad stakeholders.

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