THE ROLE OF EARNING QUALITY IN FINANCIAL PERFORMANCE TO INCREASE FIRM VALUE

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A r t i c l e

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A b s t r a c t

This research aimed to investigate the impact of free cash flow, leverage, and profitability on earnings quality and the impact of earnings quality on firm value. The population used is manufacturing companies listed on the Indonesian Stock Exchange (IDX) from 2017 to 2019. The number of samples is 64 companies each year chosen with purposive sampling method. This research uses documentary data, ie the annual report and financial statements. Path analysis was used to analyze the data and the mediation hypothesis was analyzed by using the Sobel test. The results of this research indicate that free cash flow and leverage have a positive and not significant impact on earnings quality. In contrast, profitability has a negative and significant impact on earnings quality. The results also show that free cash flow, leverage, and profitability have a positive and significant effect on firm value. Conversely, earnings quality has a positive and not significant impact on firm value.

Keywords: Earnings Quality, Firm Value, Free Cash Flow, Leverage, Profitability.

1. INTRODUCTION

Enterprise values are investors' perception of a company, which is often associated with price shares (Ng & Daromes, 2016). Financial performance is the main key that will affect the value of the company because it can describe the company's ability to manage its resources so that they are used efficiently (Riny, 2018). Company value which is assessed based on financial performance makes the company tend to produce high quality profits because information from quality earnings can explain the company's future and can be used by investors to make a decision. (Dewi & Devie, 2017).

Earnings quality can be interpreted as the difference between the net income reported in the income statement and the actual profit, so that it can reflect the real performance of the company (Purnamasari et al, 2016). This difference can be caused by information asymmetry. Information asymmetry results from managers having an advantage over investors and other interested parties in that they have more information about the entity's current and future prospects (Rankin et al, 2012: 140).

In April 2019, PT Garuda Indonesia Tbk (GIAA) has do management profit on reports of its finances in 2018. According to a report on GIAA finance 2018, the company's record profit is clean US $ 809.85 thousand. While in the third quarter of 2018, Garuda Indonesia still experiences a loss of US $ 114.08 million. In Meeting General GIAA Shareholders (GMS) which was held on January 24 2019, Garuda Indonesia's management acknowledged income from Mahata of US$ 239,940,000, of which of US$ 28,000,000 is part of the results obtained from PT Sriwijaya Air. Meanwhile, revenues from contracts with Mahata are unrealized revenues. Based on this phenomenon, it can be seen that the difference between the net profit actually obtained and the net profit recorded in the financial statements will have an impact on the resulting profit information.

Good or bad quality of the company's earnings can be seen through the cash flow report which includes the company's operations, financing and investment activities. Companies with high free cash flow indicate that the company is in a healthy condition because it still has free cash (Widiastari & Yasa, 2018). Free cash flow is the remaining cash owned by the company after the company has financed all investments and working capital for the company's operations (Yogi & Damayanthi, 2016).

In addition to free cash flow, leverage is also a factor that affects the quality of company profits. According to Sutama & Lisa (2018), leverage is the use of debt by companies to carry out company operations. The greater the debt owned by the company will increase the supervision carried out by creditors, so that management flexibility to carry out earnings management decreases (Almadara, 2017).

Profitability is a ratio that shows the company's ability to generate profits at various levels of operation, so this ratio will reflect the overall effectiveness and success of management (Sutama & Lisa, 2018). The better the company's ability to generate profits will be reflected in the profit information provided by the company and have an impact on the quality of company profits (Dewi & Devie, 2017).

Dewi & Devie (2017) stated that basically every company will compete to produce high quality earnings because profit information can be used to explain the future and this information will be used by investors to make a decision. In other words, the higher the quality of earnings will increase the value of the company. Ng & Daromes (2016) stated that earnings quality has no effect on firm value. Researchers define earnings quality as sustainable profits and companies use their cash resources inefficiently so they tend not to be able to maintain their continued earnings in the future.

Based on the phenomena and inconsistencies of previous studies, researchers are interested in examining the effect of free cash flow, leverage, and profitability on earnings quality and its effect on firm value. The difference between this research and previous research is the object under study. This research examines manufacturing companies listed on the IDX during the 2017-2019 period. Researchers chose manufacturing companies because manufacturing companies often have inventory as the largest account and for most manufacturing companies, inventory is very material and complicated to audit so it is vulnerable to manipulation (Arens, et al, 2014: 418).

Based on the background of the problems that have been described, the problems that can be formulated are as follows: (1) Does free cash flow, leverage, and profitability have an effect on earnings quality?; (2) Do earnings quality, free cash flow, leverage, and profitability have an influence on firm value?; and (3) Does earnings quality mediate the effect of free cash flow, leverage, and profitability on firm value?

2. LITERATURE REVIEW

Theory Signal

Spence (1973) illustrates the labor market (job market) and suggests that companies that have superior performance use financial information to send signals to the market. Spence (1973) also stated that the cost of signaling for bad news is higher than for good news and companies with bad news send signals that are not credible. This motivates managers to disclose information in order to reduce information asymmetry in the hope of sending good signals (good news) about the company's performance to the market.

Signal theory addresses the problem of information asymmetry in markets and shows how this asymmetry can be reduced by providing more information (Morris, 1987). Information asymmetry results from managers having an advantage over investors and other interested parties because they have more information about the current and future prospects of the entity (Rankin et al, 2012:140). Information asymmetry causes investors to not know how a company is performing.

Signal theory explains why companies have the urge to provide financial report information to external parties (Purwanto, 2012). This is because the financial performance factor is the main key that will affect the value of the company (Riny, 2018). So, companies need to provide more information, especially company financial information to investors so that they can reduce information asymmetry and can increase investor confidence in company performance.

Firm Value

Firm value is an investor's perception of the company, which is often associated with stock prices (Ng & Daromes, 2016). Firm value is the price that potential buyers (shareholders or investors) are ready to pay if the company is sold (Widiastari and Yasa, 2018). Firm value is an important concept for investors, creditors and stakeholders in determining investments in order to obtain capital gains and anticipate risks that will occur (Riny, 2018). The financial performance factor is the main key that will affect the company's value because it is a factor that talks about how the company manages the company's finances so that it is efficient in its use (Riny, 2018).

Profit Quality

Earnings quality can also be interpreted as the difference between net income reported in the income statement and actual profit, so that it can reflect real company performance (Purnamasari, 2016). Good earnings quality is expected by the company because this earnings information can be used to explain the future and will be used by investors to make a decision (Dewi & Devie, 2017). Paulus (2012) classifies the determination of earnings quality as follows:

1. Based on the time series nature of earnings, earnings quality includes: persistence, predictability (predictability), and variability.
2. Earnings quality is based on the earnings-cash-accrual relationship which can be measured by various measures, namely: the ratio of operating cash to profit, changes in total accruals, estimated abnormal/discretionary accruals (abnormal accruals/DA), and estimated accrual-cash relationships.
3. Earnings quality can be based on a qualitative conceptual framework (Financial Accounting Standards Board, FASB, 1978).
4. Quality of earnings based on implementation decisions.

Free Cash Flow

Free cash flow is the remaining cash owned by the company after the company has financed all investments and working capital for the company's operations (Yogi & Damayanthi, 2016). Free cash flow reflects the company's flexibility in making additional investments, paying off debt, buying treasury shares or adding liquidity (Suartawan & Yasa, 2014). Information regarding free cash flow can be obtained through the statement of cash flows.

Leverage

Leverage is the use of debt by companies to carry out company operations (Sutama & Lisa, 2018). High leverage indicates that the company uses a lot of debt to fund the company's activities. The greater the use of debt in the company, will also increase the risk faced by the company as a result of not being able to fulfill its obligations in the future.

Profitability

Profitability shows the balance of income and the company's ability to generate profits at various levels of operation, so this ratio will reflect the overall effectiveness and success of management (Sutama & Lisa, 2018). High profitability indicates that the company has an efficient ability to generate profits so that it will increase investor confidence in the company. Fatmasari (2016) explains three benefits derived from using profitability ratios, namely:

1. Knowing the level of profit earned by the company in a period.
2. Find out the comparison of the company's profits in the previous year with the current year.
3. Know the development of profits from time to time.

Framework

The following is the form of the framework used:

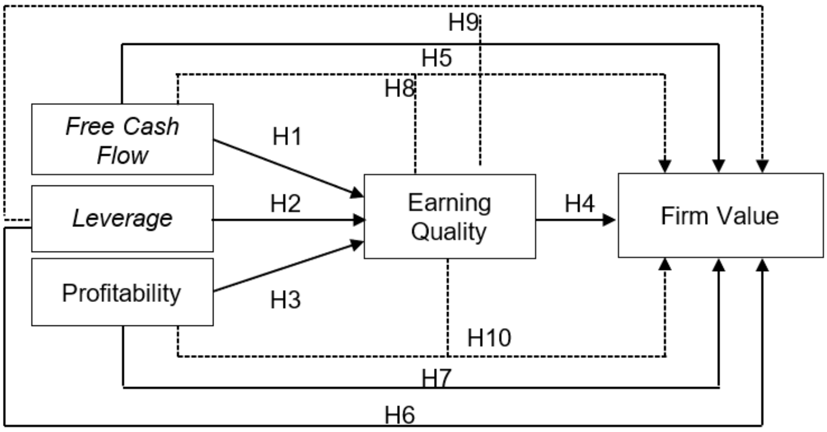

Figure 1 : Framework

Hypothesis

Based on the framework, the formulation of the hypothesis in the study is as follows:

H1: Free cash flow has a significant effect on earnings quality.

H2: Leverage has a significant effect on earnings quality

H3: Profitability has a significant effect on earnings quality

H4: Earnings quality affects firm value

H5: Free cash flow has an effect on firm value

H6: Leverage has an effect on firm value

H7: Profitability has an effect on firm value

H8: Earnings quality mediates the effect of free cash flow on firm value

H9: Earnings quality mediates the effect of leverage on firm value.

H10: Earnings quality mediates the effect of profitability on firm value.

3. RESEARCH METHODS

The data collection method used in this study is the observation method, namely the method of collecting research data through observation techniques and analysis of the contents or message of a document, which in this study analyzes the contents of annual reports and sustainable financial reports of non-financial companies registered in Indonesia Stock Exchange (IDX) for the 2017-2019 period. The population in this study are public companies listed on the Indonesia Stock Exchange (IDX) during the period 2017 – 2019. The data needed is an annual report issued by the company in 2017 – 2019. The sample used in this study was selected using a purposive method. This study uses secondary data from company data listed on the Indonesia Stock Exchange/IDX (Indonesian Stocks Exchange).

3. RESULT AND DISCUSSION

RESULT

The results of research on the role of earnings quality on financial performance can increase firm value which are used in the form of normality tests, multicollinear tests, heteroscedasticity tests and hypothesis tests can be seen below:

Normality Test

Table 1

Normality Test

Struktur Model	*Kolmogorov – Smirnov*	Asymp. Sig. (2-tailed)	Explanation
Substructure 1	1.139	0.149	Normal
Substructure 2	1.174	0.127	Normal

Source: Data Processed, 2020.

Multicollinearity Test

In this study, the multicollinearity test was carried out using the tolerance value and the variance inflation factor (VIF). If the tolerance value is above 0.10 and the value is less than 10, it can be concluded that there are no symptoms of multicollinearity. The results of the multicollinearity test can be seen below:

Table 2.

Multikolinearitas Test

Structure Model	Collinearity Statistics	
	Tolerance	**VIF**
Substructure 1 (Effect of Free Cash Flow, Leverage, and Profitability on Earnings Quality)		
Free Cash Flow	0.883	1.133
Leverage	0.957	1.045
Profitability	0.847	1.180
Substructure 2 (Effect of Free Cash Flow, Leverage, Profitability, and Earning Quality on Firm Value)		
Free Cash Flow	0.867	1.153
Leverage	0.955	1.047
Profitability	0.801	1.248
Earning Quality	0.936	1.069

Source: Data Processed, 2020.

Heteroscedasticity Test

The heteroscedasticity test with scatter plot in this study was assisted by SPSS with the following results:

Tabel 3

Heteroscedasticity Test

Structure Model	t count	Sig.
Substructure 1 ((Effect of Free Cash Flow, Leverage, and Profitability on Earnings Quality)		
Free Cash Flow	1.554	0.122
Leverage	-1.004	0.317
Profitability	-1.611	0.109
Substructure 2 (Effect of Free Cash Flow, Leverage, Profitability, and Earning Quality on Firm Value)		
Free Cash Flow	0.697	0.487
Leverage	-0.457	0.648
Profitability	1.377	0.170
Earning Quality	-0.017	0.986

Source: Data Processed, 2020.

Path Analysis

Hypothesis testing used is the regression model in path analysis to predict the relationship between exogenous and endogenous variables.

Tabel 4

Path Analysis

Structure Model	Coefficient	Sig.	Explanation
Substructure 1			
(Effect of Free cash flow, Leverage, and Profitability in earning quality)			
Free Cash Flow			
Leverage	0,137	0,079	Not Significant
Profitability	0,042	0,557	Not Significant
	-0,252	0,002	Significant
Substructure 2			
(Effect of Free cash flow, Leverage, Profitability, and Earning quality in Firm Value)			
Free Cash Flow			
Leverage	0,265	0,000	Significant
Profitability	0,175	0,001	Significant
Earning quality	0,650	0,000	Significant
	0,038	0,452	Not Significant

Source: Data Processed, 2020.

DISCUSSION

Effect of Free Cash Flow on Earning Quality

The results of testing the effect of free cash flow on earnings quality show a regression coefficient of 0.137 with a significance probability value of 0.079 greater than 0.05 so it can be concluded that free cash flow has a positive and not significant effect on earnings quality. This study measures the quality of earnings using discretionary accruals so that the results show that free cash flow will increase earnings information that contains discretion and reduce the quality of corporate earnings but does not have a strong effect so that the free cash flow hypothesis has a significant effect on earnings quality is rejected.

Free cash flow can indicate management is not optimally utilizing the available cash appropriately, or using it for investments that benefit themselves (Kodriyah & Fitri, 2017). To cover this, management performs earnings management measures that can increase the difference between actual earnings and reported earnings. Meanwhile, quality earnings are earnings figures that do not contain earnings management by management (Wahyuni & Muslim, 2010). However, some investors also view high free cash flow as an indication of good company performance. This is because positive free cash flow also provides a positive signal for investors, because investors perceive that companies have more cash for dividend distribution (Yogi & Damayanthi, 2016). The existence of these indications causes free cash flow to have no significant effect on earnings quality.

According to signaling theory, one of the reasons companies are required to provide information on their financial reports is because of information asymmetry between management and stakeholders (Rokhlinasari, 2016). Information asymmetry can provide opportunities for management to practice earnings management (Rokhlinasari, 2016). To overcome this asymmetry, the company provides information about free cash flow which also gives a signal that the company is capable of making additional investments. However, not all investors respond to information about free cash flow as a good signal because free cash flow also shows that management does not optimally utilize available cash (Kodriyah and Fitri, 2017). Thus, free cash flow does not significantly improve earnings quality as measured by discretionary accruals.

The results of this study are supported by the results of research by Kodriyah & Fitri (2017) which states that free cash flow has a positive effect on earnings management. When earnings management practices increase, the greater the difference between actual profit and reported profit so that the quality of the company's earnings will decrease. This is because profit can be said to be qualified if actual profit is the same as reported profit. The results of this study are not supported by the research of Yogi & Damayanthi (2016) which states that free cash flow reduces earnings management actions.

Effect of Leverage on Earnings Quality

The results of this study indicate that the influence of the leverage variable on earnings quality shows a regression coefficient value of 0.042 with a significance probability value of 0.557 greater than 0.05 so it can be concluded that leverage has a positive and not significant effect on earnings quality. This study measures the quality of earnings with discretionary accruals so that the results show that corporate leverage will increase earnings information that contains discretion and reduce the quality of corporate earnings but does not have a strong influence so that the leverage hypothesis has a significant effect, the effect on earnings quality is rejected.

Leverage shows that a company will have a risk in the future because it is unable to pay off existing debt. This will encourage management to produce earnings information that contains discretion which actually reduces the quality of these earnings. However, there are indications that creditors as parties who are harmed by the risk of default will increase their supervision of the company, thereby reducing management's flexibility in carrying out earnings management actions (Almadara, 2017). The existence of these indications resulted in leverage not having a significant effect on increasing the quality of earnings as measured by discretionary accruals. Signal theory explains why companies have the urge to provide financial report information to external parties (Purwanto, 2012). Managers are motivated to disclose information in hopes of sending a good signal about company performance. For this reason, companies with leverage will try to attract investors through earnings management actions in the hope of providing a good signal to investors. However, these earnings management actions can increase the difference between actual earnings and reported earnings.

The results of this study are supported by the results of research by Mahawyahrti & Budiasih (2016) which states that leverage has a positive effect on earnings management actions. Increasing earnings management actions will increase earnings information that contains discretion where this information will reduce earnings quality. This is because profit can be said to be of high quality if the actual profit is the same as the reported profit. In contrast, the results of the research by Widianingrum & Sunarto (2018) state that leverage has no effect on earnings management.

Effect of Profitability on Earnings Quality

The results of testing the influence of the profitability variable on earnings quality show a regression coefficient value of -0.252 with a significance probability value of 0.002 less than 0.05 so it can be concluded that profitability has a negative and significant effect on earnings quality. This study measures the quality of earnings using discretionary accruals so that the results show that the profitability of a company tends to reduce earnings information that contains discretion and increases the quality of corporate earnings so that the profitability hypothesis has a significant effect on the quality of earnings received.

Profitability is a ratio that shows a company's ability to generate profits so that it becomes one of the important information for investors. The better the company's ability to generate profits will be reflected in the profit information provided by the company and have an impact on the quality of company profits (Dewi & Devie, 2017). This is because the company is able to generate profits without using discretion. Companies that are free from earnings information that contains discretion will improve the quality of company profits.

According to signaling theory, one of the reasons companies are forced to provide information on their financial reports is because of information asymmetry (Rokhlinasari, 2016). One of the financial information shared by the company is information about the company's profitability. This information is provided with the hope of providing a good signal to investors.

The results of this study are supported by the results of Fatmasari's research (2016) which states that profitability has no effect on increasing earnings management practices. In other words, profitability will increase the quality of company earnings because it is free from earnings management actions that can increase the difference between actual profit and reported profit. Meanwhile, the results of this study are not supported by the results of research by Soly & Wijaya (2017) which states that high company profitability can increase company discretionary accruals so that the quality of company profits decreases.

Effect of Profit Quality on Firm Value

The results of testing the effect of the earnings quality variable on firm value show a regression coefficient value of 0.038 with a significance probability value of 0.452 greater than 0.05 so it can be concluded that earnings quality has a positive and insignificant effect on firm value. This shows that earnings quality as measured by discretionary accruals will increase firm value but does not have a strong influence so that the hypothesis of earnings quality having a significant effect on firm value is rejected.

Quality earnings are information that can be used to explain the future, and this information will be used by investors to make decisions (Dewi & Devie, 2017). In other words, an increase in the quality of earnings can indicate a good company's financial performance. Good company financial performance will increase investor interest in the company. This will have an impact on the value of the company in the eyes of investors.

However, in improving its financial performance, management can take various ways, including by using earnings information that contains discretion.

However, profit information that does not interfere with cash flow consistency will make investors react positively to the company's financial performance (Susanto & Christiawan, 2016). In addition, there is a possibility that investors fail to find earnings information that contains discretion so that investors will assume that the profits generated are of high quality and will have an impact on increasing the value of the company. However, there are still investors who do not believe in the authenticity of the profits stated in the reports and believe that managers as managers of the company can take actions that can increase the difference between actual profits and those stated in the financial statements. The existence of this possibility makes earnings quality not significantly affect the increase in firm value.

The results obtained are also in line with the signal theory. Profit information due to earnings management actions carried out by increasing profits that do not interfere with cash flow consistency is a positive signal that is reacted by the market as good news (Lesmana & Sukartha, 2017). This will have an impact on increasing investor interest in the company so that the value of the company also increases.

The results of this study are supported by the results of Fahmi & Prayoga's research (2018) which states that there is no effect of earnings management on firm value. The results of this study are in line with the results of research by Purnamasari, et al, (2016) which states that earnings quality has no significant effect on firm value. This is because there is a different response from each investor to the profit information provided by the company.

Effect of Free Cash Flow on Firm Value

The results of this study indicate that the effect of the free cash flow variable on firm value shows a regression coefficient value of 0.265 with a significance probability value of 0.000 which is less than 0.05 so that it can be concluded that free cash flow has a positive and significant effect. influence on firm value. This shows that free cash flow will increase firm value so that the hypothesis of free cash flow has a significant effect on firm value is accepted.

Free cash flow is the remaining cash owned by the company after the company has financed all investments and working capital for the company's operational activities so that high free cash flow indicates that the company is in good health. This is because high free cash flow will increase investor confidence that the company is able to make additional investments that can provide benefits. Therefore, free cash flow will increase investor interest in the company and will have an impact on increasing the value of the company.

Signal theory explains that managers are motivated to disclose information in hopes of sending good signals about company performance. Information about free cash flow can indicate a company is in good health (Widiastari & Yasa, 2018). In other words, free cash flow can provide a positive signal to investors so that the results of this study are in line with signal theory.

This research is consistent and in line with the results of research from Suartawan & Yasa (2014). The results of the study state that free cash flow has a positive and significant effect on firm value. Meanwhile, this research is not in line with the results of research by Widiastari & Yasa (2018), which states that free cash flow has no significant effect on firm value.

Effect of Leverage on Firm Value

The results of this study indicate that the influence of the leverage variable on firm value shows a regression coefficient value of 0.175 with a significance probability value of 0.001 which is less than 0.05 so it can be concluded that leverage has a positive and significant effect on firm value. This shows that leverage will increase firm value so that the leverage hypothesis has a significant effect on firm value is accepted.

Leverage is the use of debt by companies to carry out company operations (Sutama & Lisa, 2018). High company leverage can be used to obtain higher profits by using capital from debt. So that the company can run its business optimally and even though there is an increase in interest expenses. Loans made by companies can make companies obtain greater income so that company profits will increase. Increasing company profits will increase the value of the company in the eyes of investors.

Signal theory explains that managers are motivated to disclose information in hopes of sending good signals about company performance. However, information regarding high leverage indicates a high risk of default in the future. As a result, this information will affect the value of the company. To overcome this, management is motivated to make the most of its loans to generate profits and increase the value of the company.

This research is consistent and in line with the results of the research by Sutama & Lisa (2018) and Linawaty & Ekadjaja (2017). These studies state that leverage has a positive and significant effect on firm value. Meanwhile, this study is not in line with the results of Hasibuan's research, et al, (2016) which states that leverage has a negative and significant effect on firm value.

Effect of Profitability on Firm Value

The results of this study indicate that the effect of the profitability variable on firm value shows a regression coefficient value of 0.650 with a significance probability value of 0.000 which is less than 0.05 so it can be concluded that profitability has a positive and significant effect on firm value. This shows that the higher the level of profitability of a company, it will increase the value of the company so that the profitability hypothesis has a significant effect on firm value is accepted.

Profitability shows the company's ability to generate profits (Sutama & Lisa, 2018). High profitability indicates that the company has an efficient ability to generate profits so that it will increase investor confidence in the company. Increased investor confidence will increase investor interest to invest in the company. In addition, high profitability is a sign that investors will get a high return. This makes companies with high profitability favored by investors.

Signal theory states that the greater the company's profits, the firm's value will increase (Widiastri & Yasa, 2018). High profitability indicates high company profits. So the higher the company's profitability, the higher the company's value in the eyes of investors.

This research is consistent and in line with the results of research from Hasibuan, et al, (2016) which states that profitability has a positive and significant effect on firm value. Meanwhile, this research is not in line with the results of Putri's research (2017). This study states that profitability has no significant effect on firm value.

The Mediation Role of Earning Quality on the Effect of Free Cash Flow on Firm Value

The Sobel test p value is 0.546 based on the Sobel test p value which is greater than 0.05, it can be concluded that earnings quality does not play a role in mediating free cash flow on firm value so that the earnings quality hypothesis mediates the effect of free cash flow on firm value is rejected. This shows that the existence of earnings quality to mediate the effect of free cash flow on firm value will not affect the effect of free cash flow on firm value.

Firm value can be assessed based on financial performance. The company's financial performance can be seen through free cash flow which also gives a positive signal to investors, because investors assess the company to have good performance and have more cash for dividend distribution (Yogi & Damayanthi, 2016). Then the effect of free cash flow can directly increase the value of the company. While the earnings quality variable as a mediator does not have a strong effect. This is because high free cash flow can also indicate management is not optimally utilizing the available cash appropriately (Kodriyah & Fitri, 2017).

To cover this, management is motivated to produce earnings information that contains discretion which will actually have an impact on decreasing the quality of earnings. However, profit information that does not interfere with cash flow consistency will make investors react positively to the company's financial performance (Susanto & Christiawan, 2016). In addition, investors may also fail to find earnings information that contains this discretion and assume that cash has been used optimally by management. Therefore, whether there is earnings quality as measured by discretionary accruals, free cash flow will still increase firm value.

Signal theory addresses the problem of information asymmetry resulting from managers having an information advantage over investors and other interested parties because they have more information about the current and future prospects of the entity (Rankin, et al, 2012:140). Information asymmetry can provide opportunities for earnings management actions. One of the causes of earnings management is management's failure to process cash flow which results in high free cash flow. This earnings management action can increase the difference between actual earnings and reported earnings. However, investors fail to find these actions so that investors still think the company has quality earnings.

The results of this study are supported by the results of research by Kodriyah & Fitri (2017) which states that high free cash flow will increase earnings management actions. The results of this study are also supported by the results of Fahmi & Prayoga's research (2018) which states that there is no effect of earnings management on firm value. In addition, the results of this study are also supported by the results of research by Suartawan & Yasa (2014) which states that free cash flow has a positive effect on firm value.

The Mediation Role of Earning Quality on the Effect of Leverage on Firm Value

The Sobel test p value is 0.617 based on the Sobel test p value which is greater than 0.05, it can be concluded that earnings quality does not play a role in mediating leverage on firm value so that the earnings quality hypothesis mediating the effect of leverage on firm value is rejected by the company. This is because the quality of earnings to mediate the effect of leverage on firm value does not affect the effect of leverage on firm value.

Sutama & Lisa (2018) state that leverage is the use of debt by companies to carry out company operations. Company leverage can be utilized to obtain higher profits by using sources of funds in business development originating from debt so that the company can run its business optimally and increase the company's value in the eyes of investors. On the other hand, leverage indicates the risk of default that will occur in the future. To cover the risk of default, management is motivated to produce earnings information that contains discretion. This action will reduce the quality of the profit generated. However, profit information that does not interfere with cash flow consistency will make investors react positively to the company's financial performance (Susanto & Christiawan, 2016). In addition, there is a possibility that investors will fail to find earnings information that contains discretion and assume that companies can use debt properly. As a result, investors assume that companies have quality earnings and have an impact on increasing firm value so that with earnings quality as measured by discretionary accruals, fixed leverage will increase firm value.

Signal theory explains that managers are motivated to disclose information in hopes of sending good signals about company performance. For this reason, companies that have leverage will try to improve the quality of their earnings in the hope that investors will assume that the company has succeeded in managing the company's debt to become an advantage for the company. Positive signals captured by investors can affect investor interest in the company so that it will have an impact on company value. This research is supported by the research results of Linawaty & Ekadjaja (2017) which state that leverage can increase firm value. The results of this study are also supported by the research of Widayanti et al, (2014) which states that leverage has a negative effect on earnings quality. This can happen because leverage increases earnings management actions which can reduce earnings quality. The results of this study are also supported by the results of Fahmi & Prayoga's (2018) research which states that there is no effect of earnings management on firm value.

The Mediation Role of Earning Quality on the Effect of Profitability on Firm Value

The p-value of the Sobel test is 0.462 based on the Sobel-test p-value which is greater than 0.05, so it can be concluded that earnings quality does not play a role in mediating profitability on firm value so that the hypothesis of earnings quality mediating the influence of profitability on firm value is rejected by the company. This is because the quality of earnings as measured by discretionary accruals will actually weaken the effect of profitability on firm value.

Profitability is a ratio that shows a company's ability to generate profits (Sutama & Lisa, 2018). Thus high profitability will increase investor interest in the company and will increase the value of the company. High profitability reflects good company performance. With good performance, companies do not need to generate earnings information that contains discretion.

For investors, profitability shows that the company is able to generate profits. The company's profit is a sign of the company's return on investment in the future. This makes investors do not pay attention to the quality of the profits generated. However, there are some investors who also pay attention to earnings quality as an important factor in assessing a company. Quality earnings are profit information that can be used to explain the future, and this information will be used by investors to make decisions (Dewi & Devie, 2017). Thus there are two sides of investors, namely investors who take big risks to get large returns, and investors who take small risks in investing. This is what makes earnings quality unable to mediate the effect of profitability on value.

Signal theory states that the greater the profit, the firm value will increase (Widiastri & Yasa, 2018). By using signal theory, the company's profitability has succeeded in becoming a positive signal for investors. However, high profitability accompanied by good earnings quality cannot yet be a strong signal for investors to increase their valuation of the company. This is because not all investors pay attention to the quality of the company's earnings as an important factor in assessing the company, especially for investors who like to take big risks to get big profits.

The results of this study are supported by the results of Fatmasari's research (2016) which states that profitability has no effect on increasing earnings management practices. The results of this study are supported by the results of Fahmi & Prayoga's research (2018) which states that there is no effect of earnings management on firm value. The results of this study are also supported by the results of Hasibuan's research, et al., (2016) which states that profitability has a positive and significant effect on firm value.

5. CONCLUSION

Based on testing and data analysis, free cash flow tends to reduce the quality of earnings as measured by discretionary accruals, due to an increase in earnings information that contains discretion but is not significant. Second, leverage tends to reduce earnings quality as measured by discretionary accruals, due to an increase in earnings information that contains discretion but is not significant. Third, profitability tends to reduce earnings information that contains discretion thereby increasing earnings quality as measured by discretionary accruals. Fourth, earnings quality as measured by discretionary accruals tends to increase firm value but earnings quality does not significantly increase firm value. Fifth, free cash flow tends to increase firm value. Sixth, leverage tends to increase firm value. Seventh, profitability tends to increase firm value. Eighth, earnings quality plays no role in mediating the effect of free cash flow on firm value. The nine earnings qualities do not play a role in mediating the effect of leverage on firm value. Ten, earnings quality cannot mediate the effect of profitability on firm value.

Theoretically, the results of this study can be used as a reference for further research and it can be seen that in assessing companies, investors tend to ignore the quality of their earnings and focus more on free cash flow, leverage, and profitability. For investors, the results of this study provide practical implications in the form of an illustration for assessing a company through free cash flow, leverage, and company profitability and can be used as material for consideration in making investment decisions.

This study has limitations that can be used as directions for further research, namely: (1) The year of observation used in this study was relatively short, namely only 3 years from the 2017-2019 period. (2) The earnings quality variable is proxied by using discretionary accruals, where this measurement tool is very commonly used to proxy for earnings management.

6. BIBLIOGRAPHY

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