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Drivers of Earnings Quality: An Analysis of Managerial Ability and Earnings Management in Indonesia

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Abstract. This study investigates the influence of managerial ability and earnings management on earnings quality in Indonesian manufacturing firms. Analysis was conducted on 272 firms from 2017-2021 using regression modeling. Results show managerial ability and earnings management positively influence earnings quality. Further, earnings management mediates the relationship between managerial ability and earnings quality. The findings underline earnings management as an important strategy for managers in emerging markets like Indonesia to maintain strong and consistent earnings quality for stakeholders.

Keywords: managerial ability, earnings management, earnings quality, upper echelons theory

1. Introduction

Research on earnings quality in Indonesia includes an in-depth analysis of the factors that influence the extent to which financial statements reflect the company's actual performance. Some of the main aspects of research involve the impact of earnings management policies, accounting practices, corporate governance, and environmental issues on the quality of financial information (Mahrani & Soewarno, 2018). This research may evaluate earnings management policies implemented by companies in Indonesia, both aggressive and conservative, and their impact on the reliability of financial information. In addition, aspects of accounting practices, such as asset valuation methods, revenue recognition, and other accounting policies, can be the focus of research to understand how these practices affect earnings quality.

Earnings is the most important output from financial report results, and earnings quality are able to reflect the company's performance. On the other hand, research into earnings quality has seen continuous growth (SeTin and Murwaningsari, 2018). Earnings quality are both sustainable and predictive of future outcomes (Dichev et al., 2016). Earnings quality stands as a vital characteristic within financial reports, profoundly influencing the efficient allocation of a company's resources (Elbolok et al., 2022). The information contained in earnings reports serves as a primary indicator for investors and other stakeholders when making critical decisions. Companies with strong earnings quality reflect robust operational performance (Demerjian et al., 2013).

A company's capacity to generate earnings hinges on its management's ability in executing operational activities and effectively stewarding the company's resources. Managerial ability to devise efficient business processes based on the information they have is the key to a company's success (Baik et al., 2018 ; Ahmed et al., 2023). Managerial ability have an important role in making financial reports (García-Meca and García-Sánchez, 2018). Several studies corroborate this assertion. For example, Demerjian et al., (2013) expound upon how managerial ability significantly impacts the quality of assessments and estimates, thereby shaping a company's earnings. Hapsoro and Shufia (2018) posit that managerial ability reinforces earnings persistence within the Indonesian and Malaysian contexts. Furthermore, Demerjian et al., (2020) have discovered that managers possessing high ability levels are more prone to engage in deliberate earnings management to enhance a company's future operational performance. Hwang (2018) found that managerial ability influences the quality of company earnings before and after the IPO.

Earnings management is a widely practiced financial phenomenon employed by managers to oversee a company's operations. Managerial ability and concentrated ownership are phenomena observed in growing economies, such as Indonesia (Enomoto et al., 2015). Earnings management practices adopted by companies constitute one of the strategies used by managers to oversee a company's operations (Meini and Siregar, 2014). Earnings management leverages the flexibility within financial reports to provide more accurate information to stakeholders (Beyer et al., 2019). This strategy is employed to stabilize a company's profits, ensuring consistency for investors (Potharla, 2022). High-quality earnings are those that exhibit persistence (V. Li, 2019).

The quality of a company's earnings is primarily determined by internal factors, particularly the capabilities of the company's managers. However, empirical evidence still yields inconsistent results regarding the role of managerial capabilities in shaping the quality of a company's earnings. This fact encourages researchers to add earnings management as a mediating variable. Earnings management is a form of strategy carried out by managers to form higher quality company earnings (Baskaran et al., 2020). This research builds upon the study by Hakim et al. (2022), which elucidates that managerial capabilities have an impact on earnings management policies employed by manufacturing sector companies in Indonesia.

2. Theoretical Literature Review

2.1 Upper echelons theory

The Upper Echelons Theory, as put forth by Hambrick & Mason (1984), posits that fundamentally, an organization is a manifestation of the conduct exhibited by its top-tier management. A manager occupying the uppermost echelon plays a strategic role as the decision-maker within the organization. Those at the helm bear the responsibility for the entirety of the organization's activities, oversee every facet of managerial actions, determine the operational procedures, and their personal characteristics exert an influence on the outcomes of the organization. A manager's pivotal role lies in formulating the organization's strategy and allocating resources. The Upper Echelons Theory serves as a framework for elucidating that an organizational leader is shaped by individual knowledge, beliefs, and characteristics.

The Upper Echelons Theory posits that the value-based and cognitive-based aspects of a top-tier manager are manifest in the organization's performance, strategic choices, and overall effectiveness (Hambrick & Mason, 1984). A manager's background characteristics emerge from their values, cognitive processes, work experience, educational attainment, functional track record, and socio-economic status. These background traits also serve as indicators of a manager's ability to address issues and make informed decisions within the company.

2.2 Managerial ability

Managerial ability, in this context, refers to a manager's proficiency in efficiently deploying a company's resources to generate robust revenue streams (Demerjian et al., 2020). Competent managers possess a deep understanding of the company's operations, enabling them to make well-informed decisions, particularly in the realm of accounting policies (Setiawati et al., 2022). They navigate the company's unique landscape effectively, leveraging available resources. Managerial ability is a pivotal factor in achieving operational efficiency (Li, 2015). Specifically, in this study, managerial ability pertains to financial management ability, evaluating a company's financial acumen relative to others in the same industry.

The Upper Echelons Theory, as articulated by Hambrick & Mason (1984) , posits that fundamentally, an organization mirrors the behaviors exhibited by its top-tier management. Managers, playing a pivotal role in the financial reporting process, harness their influence through operational decisions to exert an impact on a company's profitability (Ahmed et al., 2023). (Demerjian et al., 2020) contend that managerial prowess has a favourable effect on the quality of a company's earnings. Hairston et al (2019) have discerned a constructive association between managerial ability and three metrics of earnings quality. SeTin & Murwaningsari (2018) have underscored the pivotal role of managerial ability in augmenting a company's profits. Hapsoro & Shufia (2018) have expounded that heightened managerial aptitude enhances a company's earnings quality. Our inaugural hypothesis reads as follows:

H1 : Managerial ability exerts an influence on earnings quality.

2.3 Earnings Management

Earnings management, as a phenomenon, encompasses managerial decisions regarding accounting policies aimed at influencing profits to achieve specific, targeted earnings (Scott, 2015). Baskaran et al., (2020) elucidate that earnings management is a widely employed practice for the manipulation of reported corporate earnings. Hakim et al (2022) and Elbolok et al (2022) elucidate that companies adopting IFRS engage in earnings management to oversee corporate profits. Management exercises judgment in crafting financial statements in collaboration with owners to modify financial disclosures (Arianpoor & Farzaneh, 2023).

The upper echelons theory is employed to expound that managerial ability is influenced by knowledge, beliefs, and personal attributes. Managerial proficiency in resource management within a company is expected to yield high-quality corporate earnings. Managers endowed with high ability will opt for strategies aligned with the company's resources. Earnings management represents one of the strategic choices employed by managers to oversee the company's income. Earnings management is utilised to maximise a company's resources to attain the ultimate outcome of consistent earnings (Ulfah et al., 2022). Jeong & Choi (2019) revealed that earnings management policies have a detrimental effect on earnings persistence. Li (2019) corroborated these findings, indicating that a company's earnings management policies impact future earnings. Our second hypothesis is as follows:

H2 : Earnings management affects earnings quality

The upper echelons theory elucidates that fundamentally, an organisation is a reflection of the behaviours generated by top management. A manager at the highest level plays a strategic role as the decision-maker in resource management within the organisation. The characteristics possessed by managers will exert influence on the outcomes of the company. The upper echelons theory is employed to clarify that a manager's ability is influenced by individual knowledge, beliefs, and characteristics. A manager's ability determines the choice of strategies to be implemented in running the company.

The proficiency of a manager in resource management within a company is anticipated to contribute to high-quality corporate earnings and systematically provide dependable insights for predicting future earnings. Managers with superior abilities tend to make more accurate predictions compared to their less adept counterparts. Such capable managers can effectively and efficiently organize, coordinate, and mobilize a company's resources to attain the established objectives. The quality of earnings represents a pivotal aspect of financial reports that significantly influences the efficiency of a company's resource allocation (Mahrani & Soewarno, 2018). Managers with heightened capabilities are more inclined to select strategies that are in harmony with the company's available resources. The strategic choice of accounting methods used to oversee corporate earnings is a deliberate managerial approach.

Earnings management is a strategy employed by managers to oversee a company's income. Earnings management aims to maximize the resources a company possesses to achieve the ultimate outcome of consistent earnings (Wahyono et al., 2019). Managers, as key figures in the financial reporting process, utilize their influence through operational decisions to impact a company's earnings. This aligns with the upper echelons theory, which reveals that managers differ in their selection of corporate strategies during complex situations. Our third hypothesis is as follows:

H3 : Earnings management mediates the relationship between managerial capability and earnings quality

High managerial ability can make a positive contribution to earnings quality. Skilled managers may be more likely to manage company operations efficiently, reduce levels of uncertainty, and provide more accurate and reliable financial information. Managers who have good managerial skills tend to use earnings management policies wisely. They can be more careful in choosing earnings management strategies, and ensure that these steps do not harm the quality of the company's financial information. Overall, aggressive or manipulative earnings management policies can harm earnings quality. If earnings management practices are not transparent or conflict with conservative accounting principles, this can have a negative impact on earnings quality. In practice, critically highlighting the implementation of earnings management policies, the extent of the role of managerial abilities in their success, and their impact on the quality of financial information conveyed to stakeholders is very important. Managerial intelligence and honesty can play a major role in maintaining optimal profit quality.

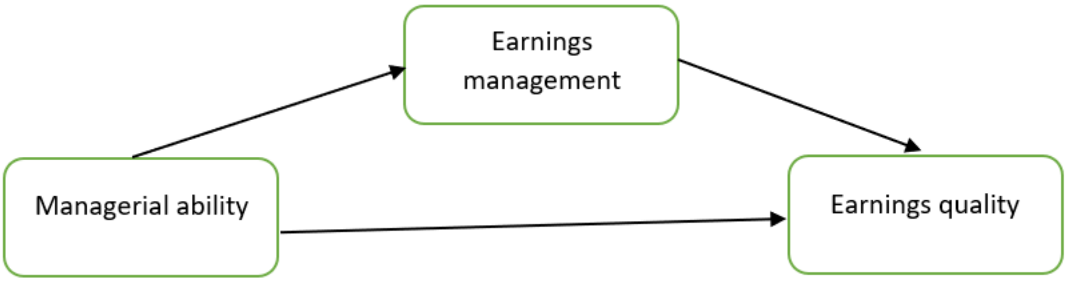

Figure 1. Research Model

3. Research Methodology

3.1 Data

The research population encompasses manufacturing companies that were listed on the Indonesia Stock Exchange during the period spanning from 2017 to 2021. Researchers used research years between 2017 to 2021 because in that year companies in Indonesia experienced the impact of COVID-19 so many companies used earnings management policies. The research sample was meticulously selected through purposive sampling, adhering to the following criteria:

1. The chosen sample comprises companies within the manufacturing sector that are officially listed on the Indonesia Stock Exchange.
2. These companies belong to the manufacturing sector and were listed between the years 2017 and 2021.
3. Furthermore, these manufacturing sector companies must have published comprehensive financial reports, making their data readily available for the measurement of the research variables.

Table 1 explains the criteria for purposive research sampling

No	Criteria	Total
1	Manufacturing companies listed on the Indonesia Stock Exchange from 2017 – 2021	882
2	Companies that present incomplete financial statements during the observation period	(580)
3	Companies delisted during the observation period	(30)
	Total sample for research year 2017 - 2021	**272**

3.2 Measurement of Research Variables

Table 2 illustrates the operationalization of the variables employed in this study.

Table 2. Operationalization of Variables

Variable	Source	Measurement
Earnings Quality	Penman (2010)	P0 = β0 + β1P0t-1 + e P0 : Company's net profit in year t β1 : Profit persistence regression coefficient e : Residual error P0t-1 : Company's net profit in year t-1 The measurement of profit persistence is proxied by the regression coefficient value between the current period's operating profit and the previous period's operating profit, which is then multiplied by the natural logarithm of last year's

		operating profit. Operating profit is used as a measure of high persistence because operating profit is income that comes from the company's main activities.
Earnings Management	(Dechow *et al.*, 1995)	Calculate Total Accrual for company i using the formula: $\mathbf{TAC_{it} = Ni_{it} - CFO_{it}}$ TACit : Total accrual of company i in period t. Niit: Comprehensive net profit of company i in period t. CFOit: Cash flow from operating assets of company i in period t The total accrual value (TAC) is estimated using a multiple linear regression equation based on Ordinary Least Squere (OLS) as follows: $\mathbf{TAC_{it}/A_{it-1} = \beta_1(1/A_{it-1}) + \beta_2(\Delta Revt_t/A_{it-1}) + \beta_3(PPE_t/A_{it-1})}$ Calculating Non-Discretionary Accrual (NDA) Using the regression coefficient above, the non-discretionary accrual (NDA) value can be calculated using the formula: $\mathbf{NDAit = \beta_1(1/A_{it-1}) + \beta 2(\Delta Revt_t/Ait\text{-}1\text{-}\Delta Rect_t/A_{it-1}) + \beta_3(PPE_t/A_{it-1})}$ ΔRevt : Company i's income in period t minus income in period t-1. ΔRect : Company i's receivables in period t minus receivables in period t-1. PPE: Value of company I's fixed assets in period t. B1β2β3 : Parameters obtained from the regression equation. Calculating Discretionary Accrual (DA) Discretionary accrual (DA) can be calculated by the difference between total accrual (TA) and the non-discretionary accrual (NDA) value, as follows: **DAit = TACit/Ait – NDAit** DAit: Company i's discretionary accruals in the t-th period NDAit: Non-discretionary accruals of company i in period t TACit: Total accruals of company i in period t Ait-1: Total assets of company i in period t-1
Managerial Ability	Demerjian *et al* (2013)	$\max\theta = \frac{Sales}{Asset +\ Labor + DSI + DSO + Goodwill + Other\ Intangible\ Assets}$ Sales : Total Sales Assets : Total Assets Labor : Number of Workers DCI : Days COGS In Inventory, inventory turnover in a day DSO : Days Sales Outstanding, estimated average number of days to collect receivables Goodwill : The value of goodwill Other intangible assets : Intangible assets other than goodwill on the balance sheet The efficiency measure θ can take values between zero and one. This measurement considers managerial ability in year t-1 and beyond, namely the period before year t, when earnings quality is measured. A successful company is a company that is able to generate sales at the lowest cost. The greater the Maxy value, the better the manager's ability to manage input to produce output.
Company Size	(Solikhah *et al.*, 2022)	$\text{Company Size} = \text{Ln(Total Assets)}$
Operating Cash Flow	(Hui *et al.*, 2016)	The measurement of operating cash flow size employs a dummy variable, wherein a value of 1 indicates positive operating cash flow, while a value of 0 signifies negative cash flow

3.3 Research Model

The regression model in this research can be formulated as follows:

$$ML = \alpha + \beta 1KM + \varepsilon \quad (1)$$

$$KL = \alpha + \beta 1KM + \beta 2ML + \beta 3UP + \beta 4CFO + \varepsilon \quad (2)$$

where ML = Earnings Management; KM = Managerial Ability; QL = Earnings Quality; UP = Company Size; CFO = Operating Cash Flow.

4. Empirical Results

Table 3 provides an overview of the statistical data in this research. The mean, maximum, and minimum values for each research indicator exhibit variations. The highest value among these indicators is company size, standing at 34.422, whereas the lowest value pertains to earnings quality, which is at -1.636. Company size also boasts the highest standard deviation at 1.750, while earnings management through accruals has the lowest standard deviation at 0.173.

Table 3. Statistical Data Description

	Managerial Ability	Accrual Earnings Management	Earnings Quality	Company Size	CFO
N	272	272	272	272	272
Mean	0.3550684	-0.0379312	0.0681706	28.3674872	85
Std. Deviation	0.27240182	0.17307939	0.66275406	1.75047255	355
Minimum	0.0000	-0.69036	-1.63618	21.32253	0
Maximum	1.0000	0.58894	2.57410	34.42229	1

Table 4. Correlation Analysis

	Managerial Ability	Accrual Earnings Management	Company Size	CFO
Managerial Ability	1.000	-0.322	-0.524	-0.086
Accrual Earnings Management	-0.322	1.000	0.070	0.028
Company Size	-0.524	0.070	1.000	-0.116
CFO	-0.086	0.028	-0.116	1.000

The relationships among the research variables, as indicated in the paired correlation analysis presented in Table 4, exhibit relatively modest strength, with correlation coefficients measuring below 40%.

Table 5. Multicollinearity Test

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Managerial Ability	.625	1.600
	Accrual Earnings Management	.883	1.133
	Company Size	.689	1.452
	CFO	.957	1.045

Table 6. Heteroscedasticity

			Managerial Ability	Accrual Earnings Management	Company Size	CFO	Unstandardized Residual
Spearman's rho	Managerial Ability	Correlation Coefficient	1.000	.273**	.437**	.178**	.033
		Sig. (2-tailed)	.	.000	.000	.003	.583
		N	272	272	272	272	272
	Accrual Earnings Management	Correlation Coefficient	.273**	1.000	.060	-.069	-.048
		Sig. (2-tailed)	.000	.	.320	.256	.428
		N	272	272	272	272	272
	Company Size	Correlation Coefficient	.437**	.060	1.000	.183**	.001
		Sig. (2-tailed)	.000	.320	.	.002	.982
		N	272	272	272	272	272
	CFO	Correlation Coefficient	.178**	-.069	.183**	1.000	-.009
		Sig. (2-tailed)	.003	.256	.002	.	.888
		N	272	272	272	272	272
	Unstandardized Residual	Correlation Coefficient	.033	-.048	.001	-.009	1.000
		Sig. (2-tailed)	.583	.428	.982	.888	.
		N	272	272	272	272	272

**. Correlation is significant at the 0.01 level (2-tailed).

Table 5 presents the multicollinearity test, where each research variable has a tolerance value > 0.10 and a VIF value < 10 so that there is no correlation. Table 6 explains the heteroscedasticity test using Spearman's rho. The sig value of each research variable has a value > 0.05. The results show that heteroscedasticity does not occur in the regression model.

Table 7. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.468[a]	.219	.207	.59011	1.975

a. Predictors: (Constant), CFO, Earnings Management, Size, Managerial Ability

b. Dependent Variable: Earnings Quality

Table 8. ANOVA Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	26.056	4	6.514	18.706	.000[b]
	Residual	92.979	267	.348		
	Total	119.035	271			

a. Dependent Variable: Earnings Quality
b. Predictors: (Constant), CFO, Earnings Management, Size, Managerial Ability

Table 7 presents the coefficient of determination (R2) at 0.207. This indicates that managerial ability, earnings management, company size, and CFO collectively account for 20.7% of the influence on earnings quality. Table 8 further demonstrates the adequacy of the research model's equation, with an F value of 18.706.

Table 9. Hypothesis Testing

Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	-.113	.016		-6.959	.000		
	Managerial Ability	.213	.036	.335	5.833	.000	1.000	1.000

Dependent Variable: Earnings Management

Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	-.123	.065		-1.899	.059		
	Managerial Ability	.537	.144	.221	3.722	.000	1.000	1.000

Dependent Variable: Earnings Management

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-.482	.666		-.723	.470		
	Managerial Ability	.095	.166	.039	.572	.568	.625	1.600
	Earnings Management	1.647	.220	.430	7.470	.000	.883	1.133
	Company Size	.015	.025	.040	.610	.542	.689	1.452
	CFO	.177	.103	.095	1.717	.087	.957	1.045

Dependent Variable: Earnings Quality

Table 9 presents the results of the examination concerning the influence of managerial ability and earnings management on the quality of earnings. According to the t-test, it is evident that managerial ability exerts a positive and statistically significant impact on earnings quality. The significance level is recorded at 0.000, which is less than the conventional threshold of 0.05, thereby confirming the acceptance of hypothesis 1. These empirical findings align with the first hypothesis of the study, which posits that managerial ability significantly contributes to earnings quality.

Similarly, the t-test indicates that earnings management also exerts a positive and statistically significant effect on earnings quality. The significance level is 0.000, once again surpassing the 0.05 threshold, thus confirming the acceptance of hypothesis 2. This empirical evidence aligns with the second hypothesis of the study, which suggests that earnings management significantly influences earnings quality.

Table 10. Mediation Analysis

Variable	Coeff	Std Error	Sig
Managerial Ability => Earnings Management	0.213	0.036	0.000
Earnings Management => Earnings Quality	1.647	0.220	0.000

The hypothesis testing for mediation in this research employs the Sobel test. This test is utilised to assess the strength of the indirect impact of the independent variable (X) on the dependent variable (Y) through the intermediary variable (M). The indirect influence of X on Y via M is determined by multiplying the path from X to M (denoted as 'a') by the path from M to Y (referred to as 'b'), which is represented as 'ab'. Therefore, the coefficient 'ab' is calculated as the difference between 'c' and 'c', where 'c' signifies the effect of X on Y without controlling for M, while 'c'' stands for the coefficient representing the effect of X on Y after accounting for M. The standard errors of the coefficients 'a' and 'b' are denoted as ' sa ' and ' sb ', respectively. The standard error of the indirect effect, represented as ' sab ', is calculated using the following formula:

$$\text{Sab} = \sqrt{b^2 Sa^2 + a^2 Sa^2 + Sa^2 Sb^2}$$

In order to ascertain the significance of the indirect impact, it becomes imperative to compute the t-value for the ab coefficient. This computation is conducted employing the following formula:

$$\text{T} = \frac{ab}{Sab}$$

Derived from Table 10, the outcomes of the Sobel test applied to examine Hypothesis 3, which asserts that earnings management serves as a mediator for the impact of managerial ability on earnings quality, are articulated as follows.

$S_{ab} = \sqrt{}\ (1.647)^2 (0.036)^2 + (0.213)^2 (0.220)^2 + (0.036)^2 (0.220)^2$

$S_{ab} = \sqrt{}\ 0.005787 = 0.0761$

$$t = \frac{ab}{Sab} = \frac{0{,}213\ x\ 1{,}647}{0{,}0761} = 4.610$$

Based on the Sobel test calculations outlined earlier, a calculated t-value of 4.610 was obtained, surpassing the critical t-value of 1.96. Consequently, it is deduced that Hypothesis 3 finds support. These empirical results align with the third hypothesis of this study, affirming that earnings management mediates the association between managerial ability and earnings quality.

5. Discussion

The outcomes of Hypothesis 1 testing indicate a significant and positive influence of managerial ability on earnings quality, consistent with the hypothesis proposed. This finding underscores the idea that managers endowed with high levels of ability demonstrate efficient resource management within a company, resulting in enhanced earnings quality. The Upper Echelons Theory elaborates on the values and attributes of top-tier management, which dictate the direction and strategy that ultimately shape a company's outcomes (Hambrick & Mason, 1984). Managerial ability is gauged by the achievement of efficiency in the allocation of a company's resources, aiming for maximum revenue. Higher ability correlates with heightened efficiency, while conversely, lower ability leads to diminished efficiency.

The findings within this study, which demonstrate a positive influence of managerial ability on earnings quality, substantiate the researcher's formulated hypothesis. Managers endowed with relatively elevated levels of ability tend to execute efficient operational strategies, effectively utilizing the company's resources to achieve peak performance, such as increased sales, all while managing associated costs. This is executed with the expectation of augmenting or sustaining the company's profitability. Moreover, managerial efficiency can provide supplementary information within financial reports, which serves as a decision-making tool for financial report users. Furthermore, earnings data within financial reports offers insights into the efficiency levels achieved by managers, underscoring that companies led by highly competent managers significantly contribute to the generation of high-quality earnings outcomes.

The findings of this research are consistent with studies conducted by Demerjian et al., (2013), SeTin and Murwaningsari (2018), Hairston et al., (2019), Hapsoro and Shufia, (2018), and Demerjian et al., (2020). These studies have consistently emphasized that managers with high-level capabilities play a pivotal role in efficiently managing a company's resources, ultimately contributing significantly to the enhancement of the quality of a company's earnings. Wang (2017) also highlights that the presence of managerial ability within a company can effectively reduce instances of financial reporting fraud. These factors collectively enhance a company's appeal to investors, motivating them to invest substantial capital in the company.

The results of hypothesis 2 testing indicate that earnings management exerts a positive influence on the quality of earnings, confirming the formulated hypothesis. This implies that the practice of earnings management by companies does not necessarily constrain the future value of earnings but can be harnessed to achieve the objectives of financial reporting. From the perspective of the upper echelons theory, the development and selection of strategies by management align with their individual experiences and competencies. Competent managers execute company operations with strategic choices that optimize the company's resources to attain the expected outcomes of stakeholders. Earnings management represents one of the strategic options employed by companies within the framework of accounting principles for the reporting process, utilizing it to impact the quality of earnings.

The findings in this study, which demonstrate that earnings management positively influences earnings quality, are in line with the proposed hypothesis. Companies implementing earnings management strategies do not necessarily hold negative perceptions. Managers with experience and proficiency effectively carry out earnings management. They oversee reported company earnings consistently from one period to another, thereby piquing investor interest (Prisadi & Firmansyah, 2023). These research findings align with prior studies by Li (2019), Jeong & Choi (2019), Beyer et al., (2019) and Park (2017), all underscoring the pivotal role of earnings management in enhancing earnings quality.

Hypothesis 3 postulates that earnings management mediates the impact of managerial ability on earnings quality. The findings from the analysis of Hypothesis 3 substantiate the proposition that earnings management serves as an intermediary in the relationship between managerial ability and earnings quality. This outcome aligns harmoniously with the expectations outlined in the hypothesis. The rationale behind this lies in the framework of the upper echelons theory, which posits that the backgrounds of top-level management significantly influence their strategic choices and the subsequent ramifications. The strategic decisions made by a company are, in essence, reflections of the manager's choices, shaped by their individual characteristics and backgrounds. Effective and well-executed strategic decisions are viewed as manifestations of the values and cognitive foundations that exert influence over the organization (Kunto Wijoyo & Firmansyah, 2021). The upper echelons theory underscores the critical importance of scrutinizing the characteristics of corporate leaders, as a company's performance inevitably mirrors the quality of its management.

Earnings management constitutes one of the strategies deployed by corporate management (Alsmady, 2023). Managers craft operational strategies for their companies in accordance with their wealth of experience and managerial acumen. Managers endowed with high levels of ability execute these strategies with precision, harnessing the company's resources to maximum effect and ultimately delivering the desired outcome – profit. Earnings management is strategically employed to align reported earnings with the preferences of stakeholders.

6. Conclusion

The primary objective of this study is to investigate the impact of earnings management strategies in mediating the relationship between managerial ability and earnings quality within manufacturing firms listed on the Indonesia Stock Exchange. The research findings substantiate that proficient managerial ability enhances the quality of earnings generated by these companies. Concurrently, the employed earnings management strategies within these firms have the capacity to mediate the connection between managerial ability and the quality of corporate earnings.

However, it is essential to acknowledge the limitations of this study, which include the utilization of an earnings quality measurement formula reliant on earnings persistence. It is worth noting that certain research outcomes deviate from prior empirical studies, possibly attributed to the unique characteristics, behaviours, and cultural nuances prevalent within the Indonesian industry, setting it apart from other countries. Moreover, the managerial characteristics scrutinized in this research are centred on managerial ability, as the availability of data precludes the exploration of managerial overconfidence aspects.

In addition, research can also consider aspects of corporate governance and their impact on the transparency and integrity of financial reporting. Environmental issues, such as compliance with environmental standards and sustainability impacts, may also be a concern in assessing the quality of earnings of companies in Indonesia. The results of this research are expected to provide in-depth insight into the factors that influence earnings quality at the company and industry level in Indonesia. These findings can contribute to further understanding of accounting practices and earnings management policies in Indonesia, as well as provide a basis for improving corporate governance and financial reporting transparency.

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