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Examining the Impact of Capital Structure on Earnings Quality in Food and Beverage Companies Listed on the Jordanian Stock Exchange

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ABSTRACT

Quality earnings are useful to users because they assist users in decision-making and resource allocation. The current study objected to determine the impact of capital structure on earnings quality of the Food and Beverages companies listed at Amman Stock Exchange (ASE). The researcher recognized that the capital structure of companies is made of equity or debt. Accordingly, two variables were selected for examination, namely: financial leverage and equity, in the presence of five control variables: company size, return on assets, current ratio, return on equity, and growth in sales. The analysis was conducted using a regression model on a sample of 13 Food and Beverages companies listed at ASE from 2011-2015, resulting in 65 firms/year observations. The results suggested that the financial leverage of the Food and Beverages companies had a statistically significant direct impact on the earnings quality. The researcher concluded that the capital structure of Food and Beverages enterprises listed at ASE has an impact on earnings quality.

Keywords: Earnings quality, earnings management, Jordan, capital structure, debt, equity.

1. BACKGROUND INFORMATION

Stock exchange agents and financial analysts developed earning quality theory. They affirmed that the reported profit might not show the profitability as one would imagine. The analysts suggested that one should consider the earning quality of the reported amounts in determining the profitability. According to Bodie, Kane and Marcus (2002), earnings quality is simply the continuation of the current level of earnings in the future periods (Lin & Lee, 2016). Several researchers have examined and identified factors that have an impact on earnings quality. For instance, Lee, Lev and Yeo (2007) found out that shareholder structure

might affect the earnings management (Alaryan, 2015). They asserted that earnings management practices decrease in organizations with a large number of independent members of the Board of Directors. Other factors that affect quality earnings include the ratio of concentration and different accounting standards (Lin & Lee, 2016). In the current study, the researcher objected to determine the impact of capital structure on earnings quality in Food and Beverages companies listed at the Amman Stock Exchange (ASE).

Clearly, the important aspect of financial statements is to reflect the underlying position of the firm and aid users in making decisions. Earning quality relates to this critical role of accounting. The term "quality earnings" is defined in the context of specific decision models. If the values in the financial statements are of low quality, the values might not be useful in decision-making. In such a case, the financial statements are not seen to fulfill their critical role (Alam & Liu, 2008). Therefore, a financial accounting research study should objectively determine the quality of accounting of firms. Earnings quality means that the value of each share does not solely depend on the profit realized by each share in the current year. Indeed, the value depends on the expectations of the profitability of the company in the future years. It also depends on the assurance coefficient associated with the future profitability.

The capital structure of companies is made of equity or debt (Lin & Lee, 2016). The use of debt in the capital structure of organizations varies from one country to another, industry to another, and firm to another firm within the same industry. The use of debt in the capital structure of a company depends on the funding needs of a firm as well as the desire and ability of stockholders to provide funds to a company. The current analysis investigated the relationship between capital the structure of companies and earnings management practices. Moreover, the consequences of earnings management could have adverse effects on debt providers. Some researchers investigated the relationship between capital structure and the performance of 167 Jordanian companies (Ghosh & Moon, 2010). The research utilized data of the firms ranging from 1989 to 2003. The researchers discovered a meaningful relationship between the ratio of short-term liabilities and the assets, the ratio of total liabilities and owners' equity, and the ratio of total liabilities and total assets.

Abbadi, Hijazi and Al-Rahahleh (2016) examined the effect of the quality of corporate governance on earnings management of Food and Beverage and service companies listed on ASE in the period between 2009 and 2013. The researchers controlled the effect of financial leverage, sales growth, and return on assets, and firm size to measure the effect of corporate governance by measuring the discretionary accruals. The findings of the study indicated that the level of earnings management is adversely affected by the quality of corporate governance. Additionally, the researchers noted that most companies with high return on assets do not use discretionary accruals. Again, the researchers revealed that most companies with high leverage are motivated to use discretionary accruals and restate their financial statements. Therefore, the companies might have tried to show a margin of safety to creditors to avoid debt covenant violation.

Researchers have investigated the relationship between capital structure and earning quality. Indeed, capital structure and earnings quality are essential aspects of the components of finance and accountancy. Studying the two subjects helps investors to make informed decisions on their investment. Alaryan (2015) argued that companies with higher private ownership equity are likely to engage in earnings management. Alaryan utilized the financial listed firms at ASE. The analysis revealed a positive relationship between family ownership, institutional ownership, foreign ownership and earnings quality. Also, Cascino, Pugliese,

Mussolino, and Sansone, (2010) asserted that family firms convey financial of higher quality unlike their non-family peers.

2. IMPORTANCE OF THE STUDY

The current research is essential because quality earnings will be more useful to users and will assist them in decision-making regarding resource allocation. The firms, regulators, standard setters, and investors should aim at continuously improving earnings quality. Specifically, some firms in the current market reveal more profits than the actual (Barton & Simko, 2002). The management of most firms motivates executives to manage earnings. The management offers financial rewards to executives to report more profit. The current paper seeks to add knowledge on the impact of financial leverage on earnings management practices. Currently, the environment of earnings quality in the Jordanian Stock Exchange has not been adequately investigated.

3. OBJECTIVES OF THE STUDY

The study was conducted with the following objectives:

- Add more literature to the subject of earnings quality, including incentives, results, and the model that can be used investigate the subject matter.
- Determine whether the financial leverage of Food and Beverages companies listed in ASE affects earnings quality.
- Determine whether the equity ratio of Food and Beverages companies listed in ASE affects earnings quality.

4. DEFINITION OF TERMS

Earnings Quality

The term "earnings quality" has varying definitions because the users of the information use it in a variety of decisions. However, researchers agree that persistent earnings that are closer to cash have higher quality. Additionally, earnings that are closer to real profits are of high quality. Also, earnings quality has been defined as the persistence of the current level of earnings in the future (Li & Hwang, 2011). Other researchers have agreed that earnings constancy and management determine earnings quality. Again, earnings quality could be defined as the ability of accounting earnings to reflect economic activities.

Earnings Management

According to Lee, Lev, & Yeo (2007), "earnings management" is defined as simply a targeted approach in financial reporting to attain some personal interests. Executives might try to manipulate price and earnings reporting to impress users who value reported earnings. Several motives drive management to manipulate earnings. First, executives might practice earnings management to encourage investors to acquire the stocks of the company and increasing the market value. Secondly, accrual accounting offers options for determining earnings at various periods since accruals are used to manipulate corporate earnings (Ewert, 2011). The management practices used to determine them determines the quality of earnings. Executives

can adjust the reported earnings by adopting certain accounting policies as well as accruals management. The earnings of a company might differ with the actual corporate performance when estimates are used in financial statements.

Capital Structure

The "capital structure" of companies is defined as the equity or debt. The use of debt in the capital structure of organizations varies from one country to another, industry to another, and firm to another firm within the same industry (Alaryan, 2015). The use of debt in the capital structure of a company depends on the funding needs of a firm as well as the desire and ability of stockholders to provide funds to a company (Ghosh & Moon, 2010). The current analysis expressed capital structure as debt and equity.

5. RESEARCH QUESTIONS

The current research study objected to answer the following questions:

1. Do the Food and Beverage companies listed in ASE engage in quality management practices?
2. Does the debt ratio of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?
3. Does the equity ratio of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?
4. Does the size of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?
5. Does the return on assets of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?
6. Does the current ratio of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?
7. Does the return on equity of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?
8. Does the growth in sale of Food and Beverage companies listed in ASE have an impact on the earnings quality of the companies?

6. HYPOTHESES

The current research study objected to achieve the objectives of the study by testing the following hypotheses:

$H_0$1: There is no significant impact of the debt ratio of the Food and Beverage companies listed in ASE on earnings quality.

$H_0$2: There is no significant impact of the equity ratio of the Food and Beverage companies listed in ASE on earnings quality.

$H_0$3: There is no significant impact of the SIZ of the Food and Beverage companies listed in ASE on earnings quality.

$H_0$4: There is no significant impact of the return on assets of the Food and Beverage companies listed in ASE on earnings quality.

$H_0$5: There is no significant impact of the current ratio of the Food and Beverage companies listed in ASE on earnings quality.

$H_0$6: There is no significant impact of the return on equity of the Food and Beverage companies listed in ASE on earnings quality.

$H_0$7: There is no significant impact of the growth in sale of the Food and Beverage companies listed in ASE on earnings quality.

7. LITERATURE REVIEW

According to Dechow and Schrand (2010), higher quality earnings offer more information about the aspects of the financial performance of a company, which are relevant to specific decisions made by specific decision-makers. This definition embraces the notion that high-quality financial reports represent the fundamental earnings of a company that is relevant to the users of financial reporting (Ewert & Wagenhofer, 2013). The users of financial statements require the statement to reflect the underlying position of the organization to guide them while making decisions. Therefore, low-quality financial statements are less useful. The current analysis did not aim to provide an exhaustive overview of the literature on the capital structure or earnings quality. Rather, the review inspires thoughts about earnings quality and how the capital structure might affect quality earnings.

Researchers have presented several viewpoints regarding the quality of accounting. However, most researchers, including Abdelghany (2005) and Ball and Shivakumar (2005), agreed that the decision usefulness is an indicator of high-quality earnings (Ewert & Wagenhofer, 2013). The latter affirmed that decisional usefulness is an essential characteristic of quality earnings since it is empirically tractable and captures the attention of standard setters. Financial reporting must meet certain conditions to become decision-useful. First, the financial reporting must represent a true and fair position of the company. Secondly, the financial statements ought to be precise, transparent, and comparable.

Deshow and Schrand (2004) outlined conditions for the decision usefulness of high-quality earnings (as cited in Li & Hwang, 2011). First, they argued that the reported earnings should present the current performance of a company. Secondly, they explained that the financial reporting must indicate the future operating performance of a company. Thirdly, they noted that the high-quality earnings should annuitize the intrinsic value of a firm. Some researchers asserted that financial reporting is the main valuation model. Hence, they argued that persistence and sustainability are the most vital attribute of high-quality earnings. For instance, Penman and Zhang (2002) argued that quality earnings are sustainable indicators of future earnings (Ewert & Wagenhofer, 2013). Visvanathan (2006) argued the thought of persistence being a quality indicator (as cited in Ghosh & Moon, 2010). He argued that earnings which are closer to cash flows are of high quality since they contain small amounts of accruals.

Basu (1997) argued that conservatism is an indicator of accounting quality (as cited in Ewert &

Wagenhofer, 2013). This argument suggests that caution should be exercised when estimating liabilities and expenses, assets and income, to avoid overstating or understating the latter. Researchers have pointed out that high-quality earnings exhibit fewer earnings management practices (Tiscini & Donato, 2012). Hence, quality might mean the absence of bias and manipulation. Guay, Kothari, and Watts (1996) also argued that managerial opportunism reduces accounting quality (as cited in Ewert, 2011). However, Deschow and Schrand (2004) suggested that the nature of business could affect the quality of earnings (as cited in Ding, Liu, & Wu, 2016). For this reason, a business might have low-quality earnings even if it does not practice earnings management. Examples of such firms are those that operate in very volatile environments. Thus, the underlying business model of a company and opportunistic management has an impact on the quality of earnings.

The characteristics of a firm determine earnings quality. First, the performance of a company affects earnings quality since some firms that perform poorly engage in tactics to boost their earnings. As a result, the accounting tactics lower the earnings quality. According to Doyle, Ge and McVay (2007), weak performance lowers the incentives to introduce earnings management practices (as cited in Hohenfels, 2016). In addition, higher leverage suggests that an organization is closer to a debt covenant restriction. Therefore, managers in highly levered companies might take actions to boost income or even manipulate the financial records to avoid violating a covenant. Such practices reduce the quality of earnings that could be used to make other decisions. Researchers have provided enough evidence that associates debt levels with certain measures of earning quality. DeAngelo, DeAngelo and Skinner (1994), did not find any substantial difference between accruals of companies with and without requisite contracts (as cited in Alam & Liu, 2008) Consequently, higher leverage is mostly associated with lower quality earnings.

Auditors determine earnings quality since they play a role in mitigating both intentional and unintentional misstatements. The ability of auditors to mitigate misstatements is the function of the ability of auditors to mitigate misstatements and to report or adjust it. Researchers predict that auditors determine earnings quality depending on the incentives to report and correct errors, the effort, and effectiveness of the auditors. Therefore, factors that determine the ability to influence earnings quality include reputation costs, independence of the auditor, and litigation risk. The basic premise is that auditors mitigate misstatements. However, the effectiveness, efforts, and incentives are observable (Hohenfels, 2016). Also, there is the lack of data to create proxies for the constructs. An example of a direct empirical proxy for effort and effectiveness include industrial expert of the auditor and hours spent auditing. Additionally, studies have indicated that the relationship between auditing fees and earnings quality depends on sample firms, the specific measure of accruals quality, and type of fees (Li & Hwang, 2011).

Ghosh and Moon (2010) investigated the relationship between financing debt and earnings quality. The researchers discovered a positive relationship between debt and the earnings quality in most firms. The study affirmed that creditors do not have an effective oversight of the financial reporting in cases where companies have high debt levels. The reason for this is that managers avoid the cost of debts contracts instead of reporting high-quality earnings (Alam & Liu, 2008). Similarly, other researchers investigated the relationship between capital assets investment and earnings quality (Alam & Liu, 2008). The findings indicated that firms with lower quality earnings exhibit lower return of assets and assign fewer resources to capital assets.

Indeed, it is important to use earnings quality in decision-making. Also, it is essential to consider cash flow. Managers decide whether to distribute cash holding to shareholders or dedicate it to internal expenditures of the firm. Holding much cash holding is a sign of inefficient resource allocation of resources despite the fact that cash holding is an important asset in a company (Alaryan, 2015). The reason for this is that is that holding much cash can impose costs on an organization including supervision-based agency cost and capital opportunity cost. Low earnings quality leads to both internal and external uncertainties, which might make a company to hold too much cash holding. At the same time, low-quality earnings might increase information asymmetry between executives and shareholders which reduces the stock value. Researchers have discovered a positive relationship between cash holding and information asymmetry. Lower quality earnings lead to higher information asymmetry. Much cash holding leads to higher agency costs. Therefore, a company can encounter problems when it holds much cash.

Barton, and Simko (2002) investigated the relationship between earnings quality and cash holdings in companies listed on the New York Stock Market (Barton &Simko, 2002). The research found out that companies with low earnings quality had increased asymmetrical information between internal and external shareholders of the company. The researchers found that low earnings quality hurt the cash assets value and have a positive effect on cash holding. The negative effect of the low earnings quality neutralized the positive effect of increasing cash holding in the value of the company (Li & Hwang, 2011). Another research study conducted by Kashanipour and Naghinejad (2009) did not find a significant impact of cash flows on cash holdings.

A primary concern in corporate finance is how organizations make decisions regarding their capital structure. According to the trade-off theory, the optimal leverage of a firm should be chosen from a trade-off between the benefits as well as the costs of the debt. The benefits include tax savings and reduced cost between the managers and shareholders (Hohenfels, 2016). On the other hand, the costs include financial distress costs and agency conflicts between shareholders and debt holders. Additionally, the pecking order theory suggests that a company should implement a financing hierarchy that minimizes negative selection costs incurred in security issuance (Baber, Kang, and Li, 2011). Recent studies on capital structure have used the characteristics of organizations and industries to explain the variation of financial leverage. However, most of the studies fail to acknowledge earnings management, although it is an essential proxy for information quality that companies present to the insiders and outsiders.

8. METHODOLOGY

The current study was conduced using descriptive and regression analyses to examine the relationship between variables based on the research objective.

Study Population

The regression model analysis was applied on a sample of 13 Food and Beverage companies listed at ASE during 2011-2015 resulting in 65 firms/year observations.

Dependent Variable

The dependent variable is earnings quality of Food and Beverage firms, which is expressed as the ratio of the cash flow from operating activities divided by EBIT

$$EQ = CFO/EBIT$$

EQ: Earnings quality

CFO: Cash flow from operating activities

EPIT: Earnings before interest & tax

Independent Variable

The independent variable is capital structure. The researcher evaluated the effect of the dependent variable (earning quality) on the independent variable (capital structure). Capital structure will be expressed in terms of debt ratio and equity ratio. Debt ratio examines the impact of equity on earnings quality.

$$\text{Debt Ratio} = \text{Total Liabilities}/\text{Total Assets}$$

Equity ratio is the total equity of a company divided by the total assets. According to literature, the equity ratio measures the amount assets that are financed by the investments of the business owner.

$$\text{Equity Ratio} = \text{Equity}/\text{Total Assets}$$

Control Variables

Other factors can affect the quality of earnings apart from the independent variable. Failure to consider these factors would lead to a wrong conclusion. The control variables used in the current study include return on assets, company size represented by total assets, current ratio, growth in sales, and return on equity.

Estimation of the Regression Model

Earnings quality can be considered as a function of debt and equity in the presence of control variables. The control variables are return on assets, company size represented by total assets, current ratio, growth in sales, and return on equity.

Estimation regression model that will be used to realize the objectives of the current research and test its hypotheses in the presence of the control valuables can be reformulated mathematically as follows:

$$EQ = \beta_0 + \beta_1 \times X_1 + \beta_2 \times X_2 + \beta_3 \times X_3 + \beta_4 \times X_4 + \beta_5 \times X_5 + \beta_6 \times X_6 + \beta_7 \times X_7 + \ell$$

The mathematical representation is further explained by the following:

- EQ = Dependent variable: quality earnings expressed in a way that are unusual accrued
- X1 = Independent variable: the capital structure expressed by total liabilities to total assets
- X2 = Independent variable: the capital structure expressed by equity to total assets
- X3 = Controlled variable: the company expressed by the total assets
- X4 = Controlled variable: return on assets
- X5 = Controlled variable: current ratio
- X6 = Controlled variable: ROE (Return on equity)

- X7 = Controlled variable: growth in sales expressed by the increase or decrease in the sales of the company between related periods

9. ANALYSIS AND INTERPRETATION

Descriptive Analysis

Table 1
Variables of the Jordanian Food and Beverage companies

	EQ	*Debt*	*Equity Ratio*	*SIZE*	*ROA*	*CR*	*ROE*	*GIS*
Mean	1.0705	37.3455	59.3116	43957394.4715	2.2190	3.3515	–534.3426	–0.0207
Median	0.99	27.11	69.49	12562959	4.25	1.79	4.47	0
Mode	0.46	0	0	0	1.76	1.15	0	0
Standard Deviation	4.7240	36.981	38.0618	75394640.9692	9.3198	4.0089	4284.5033	0.3288
Count	65	65	65	65	65	65	65	65
Confidence Level (95.0%)	1.1706	9.1630	9.4313	18681877.108	2.3093	0.9934	1061.6479	0.0815

The descriptive analysis shows variables of the Jordanian Food and Beverage companies within the selected study sample. The variables include dependent variable (EQ), independent variables, debt ratio and equity ratio, and control variables, including return on assets, company size represented by total assets, current ratio, growth in sales, and return on equity. Table 1 above shows that the value of the earnings quality was 1.0705 in average. Based on this information, it was concluded that the disclosed earnings of the Food and Beverage companies listed at ASE were of high quality. The analysis (as shown in Table 1) shows that proxy for the debt ratio of the companies was 37.346 and a standard deviation of 36.98.

Regression Analysis

Table 2
Results of the ANOVA

	Coefficients	*Standard Error*	*t-Stat*	*p-value*
Intercept	0.067687807	3.411079073	0.019844	0.984238
Debt	0.000556857	0.036908751	0.015087	0.988015
Equity	0.003877996	0.038381789	0.101037	0.919875
SIZ	3.94054E-09	8.43337E-09	0.467256	0.642098
ROA	-0.03407398	0.110030115	-0.30968	0.757935
C R	0.208970121	0.185067516	1.129156	0.263562
ROE	5.23412E-05	0.000190696	0.274474	0.784712
GIS	0.868556235	2.131208915	0.407542	0.685137

The regression analysis (Table 2) shows the existence of direct impact of debt on earnings quality where the regression coefficient and *t*-value of the debt ratio were (0.00056, 0.015) respectively. It, therefore, means that there was a significant impact at the confidence level of 95%. Accordingly, the researcher rejected the first hypothesis, which stated that, *There is no significant impact of the debt of the Food and Beverage companies listed in ASE on earnings quality*.

As for the equity ratio of the firm, the results (as shown in Table 2) indicate that there exists a statistically significant direct impact of the equity ratio of a company on earnings where regression coefficient and t-value of the equity ratio were (0.0038, 0.1010) respectively. Accordingly, the researcher rejected the second hypothesis, which stated that, *There is no significant impact of the equity of the Food and Beverage companies listed in ASE on earnings quality.*

The regression analysis (Table 2) shows the existence of direct impact of size of firms on earnings quality where the regression coefficient and t-value of the Size of the firms were (3.94E-09, 0.47) respectively. It, therefore, means that there was a significant impact at the confidence level of 95%. Accordingly, the researcher rejected the third hypothesis, which stated that, *There is no significant impact of the size of the Food and Beverage companies listed in ASE on earnings quality.*

As for the return on assets of the firm, the results (as shown in Table 2) indicate that there exists a statistically significant direct impact of the return on assets of a company on earnings where regression coefficient and *t*-value of the return on assets were (–0.034, -0.31) respectively. Accordingly, the researcher rejected the fourth hypothesis, which stated that, *There is no significant impact of the return on assets of the Food and Beverage companies listed in ASE on earnings quality.*

The regression analysis (Table 2) does not show the existence of direct impact of current ratio of firms on earnings quality where the regression coefficient and t-value of the current ratio were (0.21, 1.13) respectively. It, therefore, means that there was no significant impact at the confidence level of 95%. Accordingly, the researched failed to reject the fifth hypothesis, which stated that, *There is no significant impact of the current ratio of the Food and Beverage companies listed in ASE on earnings quality.*

As for the return on equity of the firm, the results (as shown in Table 2) indicate that there exists a statistically significant direct impact of the return on equity of a company on earnings where regression coefficient and *t*-value of the return on equity were (5.23E-0.5, 0.27) respectively. Accordingly, the researcher rejected the sixth hypothesis, which stated that, *There is no significant impact of the return on equity of the Food and Beverage companies listed in ASE on earnings quality.*

The regression analysis (Table 2) shows the existence of direct impact growth in sales of firms on earnings quality where the regression coefficient and t-value of the growth in sales were (0.87, 0.41) respectively. It, therefore, means that there was a significant impact at the confidence level of 95%. Accordingly, the researcher rejected the seventh hypothesis which stated that, *There is no significant impact of the growth in sales of the Food and Beverage companies listed in ASE on earnings quality.*

The equation of the study was:

$$EQ = \beta_0 + \beta_1 \times X_1 + \beta_2 \times X_2 + \beta_3 \times X_3 + \beta_4 \times X_4 + \beta_5 \times X_5 + \beta_6 \times X_6 + \beta_7 \times X_7 + e$$

The regression analysis shows the variation of Earnings quality as a result of the independent variables. The analysis also considers the effect of the controlled variables on EQ.

10. DISCUSSION

The current study objected to determine the impact of capital structure on earnings quality in Food and Beverage companies listed at ASE. Accordingly, two variables were selected: debt and equity, in the presence of five control variables: company size, return on assets, current ratio, return on equity, and growth in

sales. The analysis applied regression model on a sample of 13 Food and Beverage companies listed at ASE during 2011-2015 resulting in 65 firms/year observations. The mean of the earnings quality was 1.0705 (as shown in Table 1). Therefore, the disclosed earnings of the Food and Beverage companies listed at ASE were of high quality. High-quality earnings exhibit fewer earnings management practices (Ding et. al., 2016). Hence, it implies that quality might mean the absence of bias and manipulation.

The results indicated that there exists a statistically significant direct impact of debt and equity ratio of the Food and Beverage companies listed at ASE on earnings. According to Table 2, the regression coefficient and *t*-value of the debt ratio were (0.0056, 0.015); while the regression coefficient and *t*-value of the equity ratio were (0.0038, 0.1010). The current research achieved its research objectives. First, the research discovered that the Food and Beverage companies listed at ASE had high-quality. Researchers agree that the decision usefulness is an indicator of high-quality earnings. Consequently, the earnings of the Food and Beverage companies listed at ASE are decision-useful since they are of high quality

The debt ratio represented the financial leverage. The results of this are consistent with the findings of research conducted to investigate the relationship between capital structure and the performance of 167 Jordanian companies (Ghosh & Moon, 2010). The research utilized data of the firms ranging from 1989 to 2003. The researchers discovered a meaningful relationship between the ratio of short-term liabilities and the assets, the ratio of total liabilities and owners' equity, and the ratio of total liabilities and total assets.

11. RECOMMENDATIONS

The current analysis found out that the disclosed earnings of the Food and Beverage companies listed at ASE were of high quality. Investors should recalculate the income statements for companies, creating a defensive income statement as well as an enterprising statement. In this way, the evaluation compensates the defects in the traditional income statement. For instance, the retained earnings that a company reinvests back in the business are not calculated as an expense. If a business achieves profit on the defensive income statement and the enterprising statement, then the company has authentic earnings power.

12. CONCLUSION

The capital structure of companies is made of equity or debt. The current analysis considered earnings quality as a function of debt ratio and equity ratio in the presence of control variables which are: return on assets, company size represented by total assets, current ratio, growth in sales, and return on equity. The results of the study indicate that the capital structure of Food and Beverage companies listed at ASE has an impact on earnings quality.

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